2025 Annual Federal Tax Refresher

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Introduction to the Course

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

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

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

Course Learning Objectives

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

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

Domain 1 – New Tax Law/Recent Updates

Introduction

Federal tax law requires that various limits be adhered to in the preparation of tax returns, and such limits may change from year to year based on an inflation adjustment or on other factors. Included in those changes for 2025 are changes to standard mileage rates, standard deductions and various other limits. These and additional changes brought about by recent legislation may affect taxpayers' income tax liability. Domain 1 will examine these changes for 2025 and will offer some context within which they apply.

Domain 1 Learning Objectives

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

- Identify the inflation and cost of living adjustments to various federal limits;
- Recognize the applicable optional standard mileage rates;
- Describe the Third Party Network Transaction reporting requirements;
- Identify the salient features of the Direct File Pilot Program;
- Recognize the SECURE 2.0 Act provisions affecting -
    - Catch-up contribution rules, and
    - Increased age of onset blindness or disability for qualified Achieving a Better Life Experience Act (ABLE) programs effective for tax years beginning after 12/31/2025.

1.1 Annual Inflation Adjustments

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

- Certain expenses of elementary and secondary school teachers;
- Income limitation for a qualifying relative;
- Interest on education loans;
- Foreign earned income exclusion;
- Unified credit against estate tax; and
- Annual exclusion for gifts.

1.1.1 Education Expenses of Elementary and Secondary School Teachers

Education expenses of elementary and secondary teachers may be tax deductible. Deductible expenses, not exceeding the applicable limit, paid or incurred by an eligible educator include expenses in connection with:

- Books;
- Supplies (other than nonathletic supplies for courses in health or physical education);
- Computer equipment, including -
    - related software,
    - services and
    - other equipment; and
- Supplementary materials.

For 2025, the deduction for qualified education expenses used in the classroom of elementary and secondary school teachers allowed under Internal Revenue Code §162 (Trade or Business Expenses) is limited to $300.

1.1.2 Income Limitation for a Qualifying Relative

A qualifying relative, for tax purposes, is an individual who:

- Bears a relationship to the taxpayer including -
  - A child or descendant of a child
  - A brother, sister, stepbrother, or stepsister
  - The father or mother, or an ancestor of either
  - A stepfather or stepmother
  - A son or daughter of a brother or sister of the taxpayer
  - A brother or sister of the father or mother of the taxpayer
  - A son-in-law, father-in-law, mother-in-law, brother-in-law or sister-in-law
  - An individual (other than spouse) who has the same principal place of residence as the taxpayer and is a member of the taxpayer's household;
- Has gross income is below the exemption amount;
- Receives more than one-half of his or her support from the taxpayer; and
- Is not a qualifying child of the taxpayer or any other taxpayer for the taxable year.

For taxable years beginning in 2025, the gross income limitation for a qualifying relative is $5,200.

1.1.3. Interest on Education Loans

Student loan interest is, for purposes of the deduction of interest paid on education loans, interest paid by a taxpayer during the year on a qualified student loan. It includes both required interest payments and voluntary interest payments.

If the taxpayer paid $600 or more of interest on a qualified student loan during the year, the taxpayer will receive a Form 1098-E, *Student Loan Interest Statement*, from the entity to which the taxpayer paid the student loan interest.

1.1.3.1 Amounts Included as Interest

The amounts considered interest, for purposes of the student loan interest deduction, include simple interest on the loan and—provided all other applicable requirements are met—the following items:

- Loan origination fee, i.e. the one-time fee charged by the lender when the loan is made. If loan origination fees are not included in the amount reported on the taxpayer's Form 1098–E, *Student Loan Interest Statement*, the taxpayer can use any reasonable method to allocate the loan origination fees over the term of the loan;
- Capitalized interest, i.e. unpaid interest added by the lender to the outstanding principal balance;
- Interest on revolving lines of credit if the borrower uses the line of credit *only* to pay qualified education expenses;
- Interest on refinanced student loans. However, if the taxpayer refinances a qualified student loan for more than the original loan amount and uses the additional amount for any purpose other than qualified education expenses, the taxpayer *cannot deduct any interest* paid on the refinanced loan; and
- Voluntary interest payments, i.e. payments made on a qualified student loan during a period when interest payments are not required.

1.1.3.2 Student Loan Interest Deduction

Although interest, other than mortgage interest or margin interest, is not generally tax-deductible, a special deduction is allowed for interest payments made on a student loan used solely to pay higher education expenses. The maximum student loan interest tax deduction is $2,500 but is subject to certain limitations. The deduction for student loan interest is taken as an adjustment to income.

Because of that, a taxpayer may claim the student loan interest deduction even if he or she does not itemize deductions.

The following is an overview of the student loan interest deduction:

Maximum benefit	Tax deduction of up to $2,500
Qualifying loan	Taxpayer's student loan: • Must have been taken out solely to pay qualified education expenses; and • Cannot be from a related person or a qualified employer plan
Qualifying student	The student must be: • The taxpayer, the taxpayer's spouse, or the taxpayer's dependent; and • Enrolled at least half-time in a degree program
Deduction time limit	A taxpayer can deduct interest paid during the remaining period of his or her student loan
Income limitation and phaseout	Tax deduction phase out begins for taxpayers with modified adjusted gross income in excess of $85,000 ($170,000 for joint returns) and is completely phased out for taxpayers with modified adjusted gross income of $100,000 or more ($200,000 or more for joint returns).
§529 Plan Limitation	The deduction otherwise allowable is reduced (but not below zero) by so much of the distributions treated as a qualified higher education expense under section 529(c)(9) with respect to loans of the taxpayer as would be includible in gross income under section 529(c)(3)(A) for such taxable year but for such treatment.

1.1.4. Foreign Earned Income Exclusion

Because the United States taxes its citizens and residents on their worldwide income, a taxpayer's foreign earned income is includible and could, therefore, result in its being taxed doubly. Although Social security and Medicare taxes may apply to wages paid to an employee regardless of where the services are performed, citizens and residents living and working outside the U.S. may be entitled to a foreign earned income exclusion that reduces their income subject to federal income tax.

Foreign earned income is the earned income a qualified individual receives from sources within a foreign country for services performed during the taxable year. The term "qualified individual," for purposes of the Foreign Earned Income Exclusion, means an individual whose tax home is in a foreign country and who is:

- A citizen of the United States who has been a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year,
- A citizen or resident of the United States who, during any period of 12 consecutive months, is present in a foreign country or countries during at least 330 full days in such period, or
- A U.S. resident alien who is a citizen or national of a country with which the United States has an income tax treaty in effect and who is a bona fide resident of a foreign country or countries for an uninterrupted period that includes an entire tax year

Qualifying U.S. citizens and resident aliens working abroad benefit by avoiding double taxation on specified amounts of foreign earned income. The maximum foreign earned income exclusion amount is the lesser of the foreign income earned or the foreign earned income exclusion amount. For taxable years beginning in 2025, the foreign earned income exclusion amount is $130,000.

1.1.4.1. Earnings Excluded in Foreign Earned Income

The foreign earned income for a qualified individual excludes amounts—

- Received as a pension or annuity,
- Paid by the United States or an agency thereof to an employee of the United States or an agency thereof,

- Included in gross income by reason of:
  - Taxability of beneficiary of nonexempt trust, or
  - Relating to taxability of beneficiary under a nonqualified annuity, or
- Received after the close of the taxable year following the taxable year in which the services to which the amounts are attributable are performed.

1.1.4.2. Limitation on Foreign Earned Income

In cases involving a qualifying taxpayer who has earned income in any year from working in a foreign country and also from working in the United States, the taxpayer's foreign earned income that may be excluded can be determined by dividing the workdays he or she worked in the foreign country by the number of workdays in the year. The result is then applied to the taxpayer's total earned income.

For example, suppose Sally, a qualified taxpayer, has a 2025 income of $120,000, partly from work in a foreign country and partly from work done in the United States. Sally works a five-day week and has a four-week annual vacation. In addition to her work in the foreign country, she worked six weeks in the United States.

To calculate the part of Sally's $120,000 income that is eligible for exclusion, we need to begin by determining the percentage of the year she worked in the foreign country and then apply that percentage to her salary. To do that, you will need to divide the number of workdays spent working in the foreign country by the total number of workdays in the year. Since the year has 52 weeks and four of those weeks are vacation weeks, 48 weeks—240 days, in other words—are spent at work each year (48 x 5 = 240). Since Sally worked six weeks (30 days) in the United States during the year, she worked 210 days in the foreign country (240 – 30 = 210). The percentage of time Sally worked in a foreign country is determined by dividing 210, the days she worked in the foreign country, by 240, i.e., the number of workdays in the year. The result is 87.5% (210 ÷ 240 = .875). By multiplying Sally's $120,000 income by 87.5%, we can see that her foreign income is $105,000 ($120,000 x .875 = $105,000).

If both spouses work abroad and each meets either the bona fide residence test or the physical presence test, they can each choose the foreign earned income exclusion. They both don't need to meet the same test. Together, they can exclude as much as $260,000 in 2025.

1.1.5. Unified Credit Against Estate Tax

The unified credit against the federal estate tax applicable to taxpayers dying in 2025 provides for an exclusion of up to $13.99 million, reduced by the aggregate amount of taxable gifts made during the decedent's lifetime. The unified credit for decedents dying in 2025 is $5,541,800.

1.1.6. Annual Exclusion for Gifts

A gift is considered to be any transfer to an individual, either directly or indirectly, where full consideration (measured in money or money's worth) is not received in return. The general rule is that any gift is a taxable gift. However, there are many exceptions to this rule. Generally, the following gifts are not taxable gifts:

1. Gifts valued at not more than the annual gift tax exclusion;
2. Tuition or medical expenses paid by the taxpayer for another;
3. Gifts to a spouse who is a U.S. citizen; and
4. Gifts to a political organization.

Gift tax rates and estate tax rates are the same. Therefore, a gift in excess of the annual gift tax exclusion will generally incur gift tax liability that may be paid by the donor at the time of the gift or will otherwise reduce the unified credit applicable upon the taxpayer-donor's death. The annual gift tax exclusion amount in 2025 is $19,000, which means that a taxpayer may give assets away equal to $19,000 to any donee without incurring gift taxes. In addition, if a spouse joins in the gift (a split gift), the annual gift tax exclusion is doubled.

For example, if a married couple provide annual gifts to their five children and ten grandchildren—or to any 15 individuals—they could effectively reduce their combined estate by $570,000 (and the gain on the amount given away) each year avoiding taxation on the gifts($38,000 × 15 = $570,000). Charitable gifts do not incur gift taxes, regardless of the amount of the gift.

The annual gift tax exclusion for gifts to non-U.S. citizen spouses in 2025 increased to $190,000 from $185,000 in 2024.

Note: Gifts made to a U.S. citizen spouse are not taxable in any amount whether made during the spouse's lifetime or at death.

1.1.7 Education Savings Bond Program

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

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

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

The income phase out range for the interest exclusion for taxpayers who pay qualified higher education expenses in 2025 begins at MAGI above $149,250 for married filing jointly and $99,500 for all other filing statuses. The exclusion is fully phased out at $179,250 and above MAGI for married filing jointly and $114,500 or more for all other filing statuses.

The applicable 2025 dollar amounts with which taxpayers' MAGI are compared are as follows:

Taxpayer's Filing Status	**2025 Applicable Dollar Amount**	**Phase-Out Income Range**	**Completely Phased-Out**
Single, qualifying surviving spouse or Head of Household (HOH)	$99,500	$99,500 - $114,500	$114,500
Married filing jointly	$149,250	$149,250 - $179,250	$179,250

1.1.8 Qualified Long-Term Care Insurance Premiums and Benefits

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

Those limits generally change yearly. The amount of any long term care insurance premium that may be included in medical care expenses is limited by certain dollar maximums that are indexed for inflation and which change as the insured's attained age changes. The dollar limitations applicable to tax-qualified long term care premiums in 2025 are as follows:

Attained Age Before Close of Tax Year	2025 Limitation on Premium*
40 or younger	$480
41 to 50	$900
51 to 60	$1,800
61 to 70	$4,810
Older than 70	$6,020

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

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

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

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

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

The applicable *per diem* limitation for 2025 is $420. The *per diem* limitation amount is adjusted each year, as needed, to reflect inflation. (Note: Periodic payments under a life insurance contract received on behalf of a chronically-ill insured are likewise tax-exempt, subject to the limits applicable to qualified long-term care insurance benefits.)

1.1.10 Adoption Credit Benefit and Phase-Out

In 2025, the maximum adoption credit is $17,280 per child. Similarly, the maximum amount of employer-provided adoption assistance that a taxpayer may exclude from gross income in 2025 is $17,280 per child. The amount of the adoption credit or excludable assistance, however, is phased out for taxpayers whose 2025 modified adjusted gross income (MAGI) exceeds $259,190 (the "applicable amount") and is eliminated for taxpayers whose MAGI is $299,190 or more.

1.1.11 Alternative Minimum Tax (AMT) Exemption for Child Subject to Kiddie Tax

The exemption amount applicable to a child for whom the "kiddie tax" applies, for the purposes of the alternative minimum tax, may not exceed the sum of the child's earned income for the taxable year plus $9,550 for 2025.

1.1.12 Capital Gains and Losses – Changes for 2025

High-income taxpayers are subject to higher capital gain and qualified dividend tax rates, and these rates generally are adjusted annually. For tax years beginning in 2025, the long-term capital gain and qualified dividend tax rate is as follows:

- The 0% rate applies to –
    - Single filers and married filers filing separately with income up to $48,350,
    - Head of household filers with income up to $64,750,
    - Joint filers with income up to $96,700,
    - Trusts and estates with income up to $3,250;

- The 15% rate applies to –
    - Single filers with income between $48,350 and $533,400,
    - Married filers filing separately with income between $48,350 and $300,000,
    - Head of household filers with income between $64,750 and $566,700,
    - Joint filers with income between $96,700 and $600,050,
    - Trusts and estates with income between $3,250 and $15,900; and
- The 20% rate applies to –
    - Single filers with income exceeding $533,400,
    - Married filers filing separately with income exceeding $300,000,
    - Head of household filers with income exceeding $566,700,
    - Joint filers with income exceeding $600,050,
    - Trusts and estates with income exceeding $15,900.

1.1.13 Average Annual Wage Limitation – Small Employer Health Premium

A small employer's health insurance premium credit is also reduced if the employer paid average annual wages in 2025 of more than $33,300 and is eliminated if the employer paid average annual wages of $66,600. For purposes of the health insurance premium credit, the term "wages" means wages subject to Social Security and Medicare tax withholding determined without considering any wage base limit. For purposes of this limitation, wages paid to a seasonal employee who worked 120 or fewer days during the tax year should not be included.

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

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

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

1.1.14 Threshold for Excessive Business Loss

Businesses other than corporations may deduct business losses not exceeding $313,000 ($626,000 for joint returns) in 2025.

1.1.15 Social Security Limits

Social Security taxes are comprised of two components: OASDI (old age, survivors and disability income) and HI (health insurance) taxes. OASDI is a tax imposed on a worker's wages up to the applicable Social Security taxable earnings limit. That limit is $176,100 in 2025 and generally increases annually. The employee tax rate for the OASDI part of Social Security is 6.2%.

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

1.2 Standard Mileage Rates

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

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

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

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

1.2.1 Business Use of a Taxpayer's Personal Vehicle

The 2025 standard mileage rate applicable to ***eligible*** business use of a vehicle is 70¢ per mile, up from 67¢ in 2024. In order for such expenses to be deductible, they must have been:

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

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

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

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

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

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

1.2.2 Personal Vehicle Use for Charitable Purposes

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

A related issue involves a taxpayer's travel expenses incurred in providing services to a charity. Thus, in addition, a taxpayer may generally claim a charitable contribution deduction for travel expenses necessarily incurred while away from home performing services for a charitable organization. In order to claim a charitable deduction for such travel expenses, however, certain criteria must be met. Pursuant to federal regulations, in order to take a charitable contribution deduction for such travel expenses:

- There must be no significant element of personal pleasure, recreation, or vacation in the travel; and

- The taxpayer must be on duty in a genuine and substantial sense throughout the trip. (A taxpayer having only nominal duties in connection with the trip or who has no duties for a significant part of it would not be permitted to deduct the travel expenses.)

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

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

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

A taxpayer who uses a personal vehicle for such medical reasons is permitted to include the out-of-pocket vehicle expenses incurred—the expenses for gas and oil, for example—or deduct medical travel expenses at the standard medical mileage rate. For 2025, the standard medical mileage rate is 21¢ per mile, unchanged from 2024. The taxpayer may also deduct any parking fees or tolls, regardless of whether actual expense or the standard mileage rate is used.

1.2.4 Basis Reduction Amount

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

- 26¢ for 2022
- 28¢ for 2023
- 30¢ for 2024
- 33¢ for 2025

1.3 Payment Card and Third-Party Transaction Reporting Requirements

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

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

ARPA changed those requirements for years after December 31, 2021, to require reporting and furnishing of Form 1099-K by TPSOs to participating payees when amounts exceeded $600. However, the IRS has regarded calendar year 2022 as a transition period for enforcement and administration of the new limits. IRS Notice 2023-74 expanded the transition period to include 2023 while Notice 2024-85 regards 2024 and 2025 as the final transition period. Therefore, the requirement to furnish Form 1099-K ***does not apply*** to participating payees in 2022 and 2023 unless the taxpayer had sales totaling more than $20,000 and more than 200 sale transactions. For 2024, the requirement to furnish Form 1099-K applies to payees having sales totaling more than $5,000 regardless of the number of transactions.

Beginning January 1, 2025, the total sale requirement to furnish Form 1099-K has been further reduced from $5,000 to $2,500 in aggregate sales. It is anticipated that for 2026 and years after, the number will be reduced to $600. The *de minimis* exemption applicable to TPSOs does not apply to PSEs that are merchant acquiring entities.

Note: Regardless of whether or not the taxpayer received a 1099-K*,* if the taxpayer received payments for services or for selling goods at a gain, the taxpayer must report all income on his or her tax return.

1.3.1 Transactions that Require Reporting

The transactions that require reporting are transactions for "Goods and Services" only. Goods are generally defined as consumables, physical objects that are tangible items that can be bought and sold. Examples of goods include items such as food, clothing, cars, houses, electronics, etc. Services, on the other hand, are non-physical intangibles that typically involve a process or expertise. Examples of services include massage, medical care, legal advice, lawn care, etc. Therefore, goods and services paid for by payment card or third party settlement organizations require reporting

1.3.2 Transactions not Requiring Reporting

Transactions not requiring reporting include:

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

1.3.3 Reporting Sale of Personal Items

Taxpayers may receive a Form 1099-K for selling personal items. A personal item is any item that the taxpayer owned for personal use such as electronics, furniture, appliances, or a vehicle, etc. If the taxpayer made a profit on the sale of a personal item, that profit is taxable. If the taxpayer sold a personal item at a loss, that loss can offset reported gross income reducing taxes owed on it. If the taxpayer sells a personal item at a gain, the gain is both calculated and reported by using:

- Form 8949, Sales and Other Dispositions of Capital Assets, and
- Schedule D (Form 1040), Capital Gains and Losses.

If the taxpayer sells a personal item at a loss, the loss cannot be deducted from taxes owed, however, it can reduce taxes, potentially to zero, on reported gross income. Personal items sold at a loss are generally reported by using either:

- Schedule 1 (Form 1040), Additional Income and Adjustments to Income:
  - Box 1a Part I-Line 8z *Other Income*
  - Box 1a Part II- Line 24z *Other Adjustments*
- Form 8949, Sales and Other Dispositions of Capital Assets.

1.4 IRS Direct File Program

The U.S. Department of the Treasury and Internal Revenue Service (IRS) launched the [Direct File Pilot Program](#) in 2024 that provides a free, secure option for taxpayers with simple tax situations in 12 pilot states to file their taxes directly with the IRS. For 2025, the Direct File Program has grown to include 25 participating states. Direct File is designed to be easy to use, with no hidden fees, and to work well on a smartphone, laptop, tablet, or desktop computer. Direct File shows taxpayers the math so they can be sure that their return is accurate, and they are getting the refund they are entitled to. Live customer service support is also available for Direct File users.

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

1.4.1 Participating States

Taxpayers in 25 states who meet certain requirements can use Direct File through the April tax deadline. Participating states include:

- Alaska,
- California,

- Arizona,
- Connecticut,
- Florida,
- Idaho,
- Illinois,
- Kansas,
- Maine,
- Maryland,
- Massachusetts,
- Nevada,
- New Hampshire,
- New Jersey,
- New Mexico,
- New York,
- North Carolina,
- Oregon,
- Pennsylvania,
- South Dakota,
- Tennessee,
- Texas, and
- Washington State,
- Wisconsin
- Wyoming,

After completing their federal returns, taxpayers in the states with a state-income tax will be guided to a state-sponsored tool to complete their state tax return.

Note: Direct File does not support a taxpayer's request for an extension.

1.4.2 Eligible Identification

Eligible identification is required to use the Direct File Program. Eligible identification includes any of the following:

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

1.4.3 Eligible Income

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

- Income from an employer (Form W-2, *Wage and Tax Statement*);
- Unemployment compensation (Form 1099-G, *Certain Government Payments*);
- Most distributions from employer-sponsored retirement plans (401(k), 403(b), government 457(b) plans) and pensions (Form 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.)*;
- Income from a Health Savings Account (HSA) or Flexible Spending Account (FSA) distribution;
- Alaska Permanent Fund Dividends;
- Social Security benefits (Form SSA-1099, *Social Security Benefit Statement)*); or
- Interest income from savings accounts, checking accounts, US savings bonds or Treasury obligations (Form 1099-INT, *Interest Income,* boxes 1 and 3).

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

- Income received from payment apps, online marketplaces, or payment cards (Form 1099-K);
- Income from independent contractor and gig work (Form 1099-NEC);
- Income from rent, prizes and awards (Form 1099-MISC);
- Unreported cash income, such as tips; and
- Alimony that is required to be included in your income.

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

- Taxpayers using the filing status Married Filing Separately with wages exceeding $125,000 are ineligible for Direct File;
- Taxpayers are ineligible for Direct File if wages exceed $200,000 ($168,600 if the taxpayer has more than one employer);
- Taxpayers are ineligible for Direct File if using the filing status Married Filing Jointly and the spouse's wages are more than $200,000 ($168,600 if the spouse had more than one employer); and
- Taxpayers using the filing status Married Filing Jointly with total taxpayer and spouse's wages exceeding $250,000 are ineligible for Direct File.

1.4.4 Direct File and the Standard Deduction

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

- Credits:
  - Earned Income Tax Credit,
  - Child Tax Credit,
  - Credit for Other Dependents,
  - Child and Dependent Care Credit,
  - Premium Tax Credit,
  - Savers Credit,
  - Credit for Elderly or Disabled; and
- Deductions:
  - Student loan interest,
  - Educator expenses, and
  - Health Savings Account (HSA) Contributions.

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

1.4.5 Direct File Eligibility based on Health Insurance Coverage Status

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

- Health insurance from their employer,
- Medicare,
- Veterans Affairs health care,
- Private health insurance the taxpayer paid for out of pocket,
- State Medicaid or Children's Health Insurance Program (CHIP), and
- In most cases, government Marketplace like HealthCare.gov or a State Marketplace.

However, Direct File is not available to taxpayers claiming the Premium Tax Credit who:

- Have more than one Form 1095-A, *Health Insurance Marketplace Statement* for the tax year,
- Were enrolled in a qualified Marketplace plan and employer-sponsored health coverage for one or more months during the tax year,
- Were eligible, or whose spouse was eligible, for affordable health coverage through an employer while also being enrolled in a qualified Marketplace plan for at least one month,
- Have a Marketplace plan that covers an individual listed on the taxpayers Form 1095-A, *Health Insurance Marketplace Statement* who is part of another tax family,
- Were enrolled in a qualified Marketplace plan by someone else and listed as a covered individual on their Form 1095-A,

- List someone on their Form 1095-A who was not eligible for coverage under a qualified Marketplace plan because of their immigration status, and
- Meet the requirements for and use the alternative calculation for year of marriage.

1.4.6 Direct File and ID.me

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

ID.me requires the taxpayer to have:

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

ID.me further requires the taxpayer to:

- Be 18 years or older;
- Prove his or her identity using a -
    - Current state issued driver's license;
    - State identification;
    - Passport; or
    - Passport card.
- Take a video selfie to match their face to the picture on their identification (ID.me not video selfie), or
- Have a video call with an ID.me agent who will confirm that the taxpayer's face matches the identification submitted if the taxpayer is unable or does not want to take a video selfie.

Learn more about ID.me by clicking here.

1.5 Higher Catch-up Contribution Limits – Ages 60 - 63

Section 109 of the SECURE 2.0 Act, beginning in 2025, authorizes increased catch-up contributions for plan participants aged 60, 61, 62, and 63. These increased catch-up limits are as follows:

- For Savings Incentive Match Plan for Employees (SIMPLEs), the increased catch-up limit is equal to the greater of –
    - $5,000, or
    - 150% of the dollar amount applicable for 2025 to plan participants eligible to make catch-up contributions who are not aged 60 through 63; and
- For other qualified plans, the increased catch-up limit is equal to the greater of –
    - $10,000, or
    - 150% of the dollar amount applicable for 2024 to plan participants eligible to make catch-up contributions who are not aged 60 through 63.

Thus, the increased catch-up limit applicable to SIMPLE plan participants age 60, 61, 62 and 63 in 2025 is $5,250 ($3,500 x 150%). The increased catch-up limit applicable to plan participants in employer-sponsored retirement plans other than SIMPLE plans who are age 60, 61, 62 and 63 in 2025 is $11,250 ($7,500 x 150%).

1.6 Qualified ABLE Programs – Age Onset Limit Increased

Achieving a Better Life Experience Act (ABLE)—the act that authorized ABLE accounts—was enacted in 2014 to help people with disabilities or who are blind save money in a tax-favored account to maintain their health, independence, and quality of life. ABLE accounts are excluded from resources, in whole or in part, for purposes of certain means-tested Federal programs. Examples of such programs are the Supplemental Nutrition Assistance Program (SNAP) and Medicaid. Before passage of the SECURE 2.0 Act, an ABLE account could be established by an individual only if his or her blindness or disability occurred before age 26. Section 124 of the SECURE 2.0 Act increases the age limit for establishing an ABLE account, after December 31, 2025, to "before age 46."

Further discussion on Achieving a Better Life Experience Act (ABLE) is provided in Domain 2.15.6

Review #1

1. Harry qualifies to take the Foreign Earned Income Exclusion and has an income of $140,000 in 2025. What is his exclusion amount if he works five-day weeks, has a four-week annual vacation, worked in the United States for six weeks, and the applicable Foreign Earned Income Exclusion limit is $130,000?

   A. $0

   B. $113,750

   C. $122,500

   D. $130,000

2. Sally uses her personal vehicle for business and elected to take the optional standard mileage deduction in 2025. She traveled 10,000 miles on business, incurred toll fees of $347, parking fees of $200 and $1,200 for gasoline. What is the amount of her deduction?

   A. $7,000

   B. $7,347

   C. $7,547

   D. $8,747

3. Alan is age 60 and covered under his employer's 401(k) plan. What is the limit applicable to his 2025 catch-up contribution authorized under the SECURE 2.0 Act?

   A. $3,500

   B. $5,250

   C. $7,500

   D. $11,250

Domain 2 – General Income Tax Review

Introduction

Although the tax laws change and applicable limits may be subject to cost of living adjustments and other changes, much of the tax code and the principles underlying federal income tax return preparation don't vary substantially from year to year. In the domain 2 text that follows, a general review of tax law related to preparation of 2025 individual 1040 tax returns will be provided.

Domain 2 Learning Objectives

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

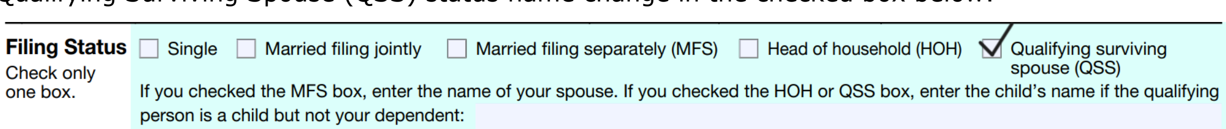
- Describe the filing status name change of qualifying widow(er) to qualifying surviving spouse;
- Identify those items included in a taxpayer's taxable earnings;
- Determine the tax treatment of foreign accounts and trusts;
- Apply the rules governing contributions to and distributions from IRAs;
-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

2.1 Filing Status Name Review

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

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

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


Filing Status Check only one box. ☐ Single ☐ Married filing jointly ☐ Married filing separately (MFS) ☐ Head of household (HOH) ☑ Qualifying surviving spouse (QSS)
If you checked the MFS box, enter the name of your spouse. If you checked the HOH or QSS box, enter the child's name if the qualifying person is a child but not your dependent:

2.1.1 Benefits of Filing as Qualified Surviving Spouse

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

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

2.1.2 Criteria for Filing as Qualifying Surviving Spouse

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

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

2.1.3 Exceptions and Special Circumstances

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

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

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

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

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

2.1.4 Income Limitation for a Qualifying Relative

A qualifying relative who can be claimed as the taxpayer's dependent is one who meets the following four tests:

1. Not a qualifying child test;
2. Member of household or relationship test;
3. Gross income test; and
4. Support test.

Not a Qualifying Child test - The Qualifying Relative cannot be the taxpayer's qualifying child or the qualifying child of any other taxpayer.

Relationship test - The Qualifying Relative must live with the taxpayer all year as a member of his or her household or be related to the taxpayer as the taxpayer's:

- Child, stepchild, or foster child, or a descendant of any of them;
- Brother, sister, half-brother, half-sister, stepbrother, or stepsister;
- Father, mother, grandparent, or other direct ancestor, but not foster parent;
- Stepfather or stepmother;
- Son or daughter of his or her brother or sister;
- Son or daughter of his or her half-brother or half-sister;
- Brother or sister of his or her father or mother; or
- Son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law.

Gross Income test - The Qualifying Relative must have gross income for the year of less than $5,200 for 2025.
Support test - The taxpayer generally must provide more than half of the individual's total support for the year.

2.2 Taxability of Earnings

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

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

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

2.2.1 Advance Commissions and Other Earnings

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

2.2.2 Allowances and Reimbursements

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

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

An accountable plan is characterized by the following:

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

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

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

2.2.3 Back Pay Awards

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

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

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

2.2.4 Bonuses and Awards

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

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

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

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

- A safety achievement award if the taxpayer is a manager, administrator, clerical employee, or other professional employee or if more than 10% of eligible employees previously received safety achievement awards during the year.

2.2.5 Differential Wage Payments

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

2.2.6 Government Cost of Living Allowances

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

2.2.7 Nonqualified Deferred Compensation Plans

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

If at any time during the tax year the plan fails to meet those requirements or is not operated pursuant to them, all amounts deferred under the plan for the tax year and all preceding tax years are included in the taxpayer's income for the current year. In such a case the amount thus shown would be included in the taxpayer's wages included in IRS Form W-2 box 1 and in box 12, using code Z.

2.2.8 Notes Received for Services

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

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

2.2.9 Severance Pay

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

2.2.10 Sick Pay

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

- Payments from a welfare fund;

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

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

2.2.11 Social Security and Medicare Taxes Paid by an Employer

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

2.2.12 Stock Appreciation Rights

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

2.2.13 Tip Income

The taxpayer is required to include in gross income any and all tips received directly, charged tips paid to the taxpayer by the employer, and any tips received by the taxpayer under a tip-splitting or tip-pooling arrangement. The value of non-cash tips is considered income and is also subject to income taxes.

Taxpayers who receive tips must:

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

If any tips received by the taxpayer are unreported to the taxpayer's employer by the 10^{th} of the month following the month received—other than tips received in December 2024 and reported by January 10, 2025 (considered 2025 income)—the taxpayer must file IRS Form 4137, *Social Security and Medicare Tax on Unreported Tip Income.* The form is used to figure the social security and Medicare tax owed on unreported tips, including allocated tips, and attached to the taxpayer's tax return. IRS Form 4137 is shown below.

Form **4137**

Department of the Treasury
Internal Revenue Service

Social Security and Medicare Tax on Unreported Tip Income

Attach to your tax return.
Go to *www.irs.gov/Form4137* for the latest information.

OMB No. 1545-0074
2025
Attachment Sequence No. **24**

Name of person who received tips. If married, complete a separate Form 4137 for each spouse with unreported tips.	**Social security number**

1	**(a)** Name of employer to whom you were required to but didn't report all your tips (see instructions)	**(b)** Employer identification number (see instructions)	**(c)** Total cash and charge tips you **received** (including unreported tips) (see instructions)	**(d)** Total cash and charge tips you **reported** to your employer
A				
B				
C				
D				
E				

2	Total cash and charge tips you **received** in 2025. Add the amounts from line 1, column (c)	2			
3	Total cash and charge tips you **reported** to your employer(s) in 2025. Add the amounts from line 1, column (d)			3	
4	Subtract line 3 from line 2. Include as income on Form 1040, 1040-SR, or 1040-NR, line 1c. (See *Allocated tips* in the instructions.)			4	
5	Cash and charge tips you received but didn't report to your employer because the total was less than $20 in a calendar month (see instructions)			5	
6	Unreported tips subject to Medicare tax. Subtract line 5 from line 4			6	
7	Maximum amount of wages (including tips) subject to social security tax	7	176,100		
8	Total social security wages and social security tips (total of your Form(s) W-2, boxes 3 and 7) and railroad retirement (RRTA) compensation (subject to 6.2% rate) (see instructions)	8			
9	Subtract line 8 from line 7. If line 8 is more than line 7, enter -0-			9	
10	Unreported tips subject to social security tax. Enter the **smaller** of line 6 or line 9. If you received tips as a federal, state, or local government employee, see instructions			10	
11	Multiply line 10 by 0.062 (social security tax rate)			11	
12	Multiply line 6 by 0.0145 (Medicare tax rate)			12	
13	Add lines 11 and 12. Include as tax on Schedule 2 (Form 1040), line 5, or Form 1040-SS, Part I, line 6a. (See instructions there.)			13	

General Instructions

Future Developments

For the latest information about developments related to Form 4137 and its instructions, such as legislation enacted after they were published, go to *www.irs.gov/Form4137*.

What's New

For 2025, the maximum wages and tips subject to social security tax increases to $176,100. The social security tax rate an employee must pay on tips remains at 6.2%.

Reminder

A 0.9% Additional Medicare Tax applies to Medicare wages, Railroad Retirement Tax Act (RRTA) compensation, and self-employment income over a threshold amount based on your filing status. Use Form 8959, Additional Medicare Tax, to figure this tax. See the Instructions for Form 8959 for more information on the Additional Medicare Tax.

Purpose of form. Use Form 4137 **only** to figure the social security and Medicare tax owed on tips you didn't report to your employer, including any allocated tips shown on your Form(s) W-2 that you must report as income. You must also report the income on Form 1040, 1040-SR, or 1040-NR, line 1c. By filing this form, your social security and Medicare tips will be credited to your social security record (used to figure your benefits). Don't use Form 4137 as a substitute Form W-2.

CAUTION

If you believe you're an employee and you received Form 1099-MISC, Miscellaneous Information, or Form 1099-NEC, Nonemployee Compensation, instead of Form W-2, Wage and Tax Statement, because your employer didn't consider you an employee, don't use this form to report the social security and Medicare tax on that income. Instead, use Form 8919, Uncollected Social Security and Medicare Tax on Wages.

Who must file. You must file Form 4137 if you received cash and charge tips of $20 or more in a calendar month and didn't report all of those tips to your employer. You must also file Form 4137 if your Form(s) W-2, box 8, shows allocated tips that you must report as income.

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

Form 1040 Schedule B, *Interest and Ordinary Dividends*, is filed if the taxpayer:

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

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

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

The tax preparer must check the "yes" box on line 7a of Part III of the Form 1040 Schedule B if the taxpayer had a financial interest in or signature authority over a financial account located in a foreign country, including:

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

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

2.4 Retirement Income Reporting and Taxability

Although some retirement income is excludable, in whole or part, from income, most retirement income is taxable as ordinary income in the year received. This section will consider the taxability and reporting requirements of distributions received from:

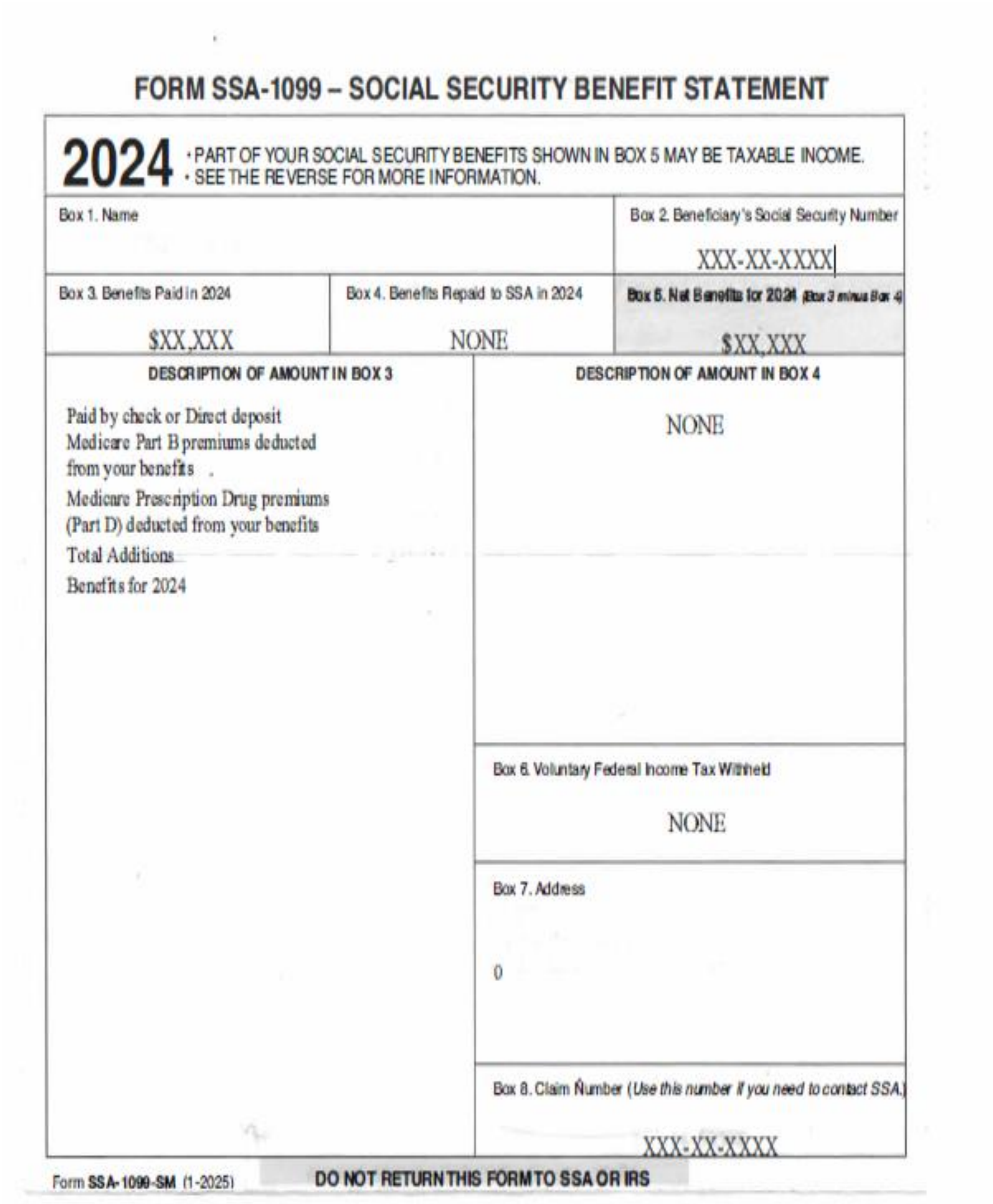
- Social Security;
- Pensions;
- Annuities; and
- 401(k) plans.

2.4.1 Social Security Benefits

Social Security benefits include monthly retirement, survivor and disability benefits paid under the Social Security system. The benefits are reported on Form SSA-1099, *Social Security Benefit Statement,* shown below, and show the benefits:

- paid during the year in Box 3,
- repaid by the taxpayer during the year in Box 4, and
- reduced by the amount repaid in Box 5.

In addition, the amount of any federal income tax withheld is shown in Box 6.



FORM SSA-1099 – SOCIAL SECURITY BENEFIT STATEMENT

2024 • PART OF YOUR SOCIAL SECURITY BENEFITS SHOWN IN BOX 5 MAY BE TAXABLE INCOME.
• SEE THE REVERSE FOR MORE INFORMATION.

Box 1. Name		Box 2. Beneficiary's Social Security Number
		XXX-XX-XXXX
Box 3. Benefits Paid in 2024	Box 4. Benefits Repaid to SSA in 2024	Box 5. Net Benefits for 2024 (Box 3 minus Box 4)
$XX,XXX	NONE	$XX,XXX

DESCRIPTION OF AMOUNT IN BOX 3

Paid by check or Direct deposit
Medicare Part B premiums deducted from your benefits
Medicare Prescription Drug premiums (Part D) deducted from your benefits
Total Additions
Benefits for 2024

DESCRIPTION OF AMOUNT IN BOX 4

NONE

Box 6. Voluntary Federal Income Tax Withheld

NONE

Box 7. Address

0

Box 8. Claim Number (*Use this number if you need to contact SSA.*)

XXX-XX-XXXX

Form **SSA-1099-SM** (1-2025) **DO NOT RETURN THIS FORM TO SSA OR IRS**

2.4.1.1 Taxability of Benefits

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

- Half the net Social Security benefits paid during the year to or for the benefit of the taxpayer (benefits paid during the year less any Social Security benefits repaid during the year); plus

- All other income received by the taxpayer (including tax-exempt interest)

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

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

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

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

If the sum of the adjustments equals or exceeds the total of ½ the net Social Security benefits plus the taxpayer's other income, none of the taxpayer's Social Security benefits are taxable. Thus,

$$\text{Adjustments} \geq \frac{\text{Net Social Security benefits}}{2} + \text{other income} = \text{Tax-free benefits}$$

However, if the sum of the adjustments is less than the total of ½ the net Social Security benefits plus the taxpayer's other income, the sum of the adjustments must be deducted from the total of ½ the net Social Security benefits plus the taxpayer's other income.

1	2	3	4	5
Adjustments	<	$\left(\frac{\text{Net Social Security benefits}}{2} + \text{other income}\right)$	=	Deduct 1 from 3

The resulting amount is then compared with the applicable base amount. If the resulting amount is less than or equal to the applicable base amount, the taxpayer's Social Security benefits are tax-free.

$\left(\frac{\text{Net Social Security benefits}}{2} + \text{other income}\right) - \text{adjustments}$	≤	Applicable base	=	Tax-free benefits

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

$\left(\frac{\text{Net Social Security benefits}}{2} + \text{other income}\right) - \text{adjustments}$	>	Applicable base	=	Partly taxable benefits

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

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

Mathematical symbol key: > means "greater than"; < means "less than"; ≥ means "greater than or equal to"; ≤ means "less than or equal to."

2.4.1.2 Reporting

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

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

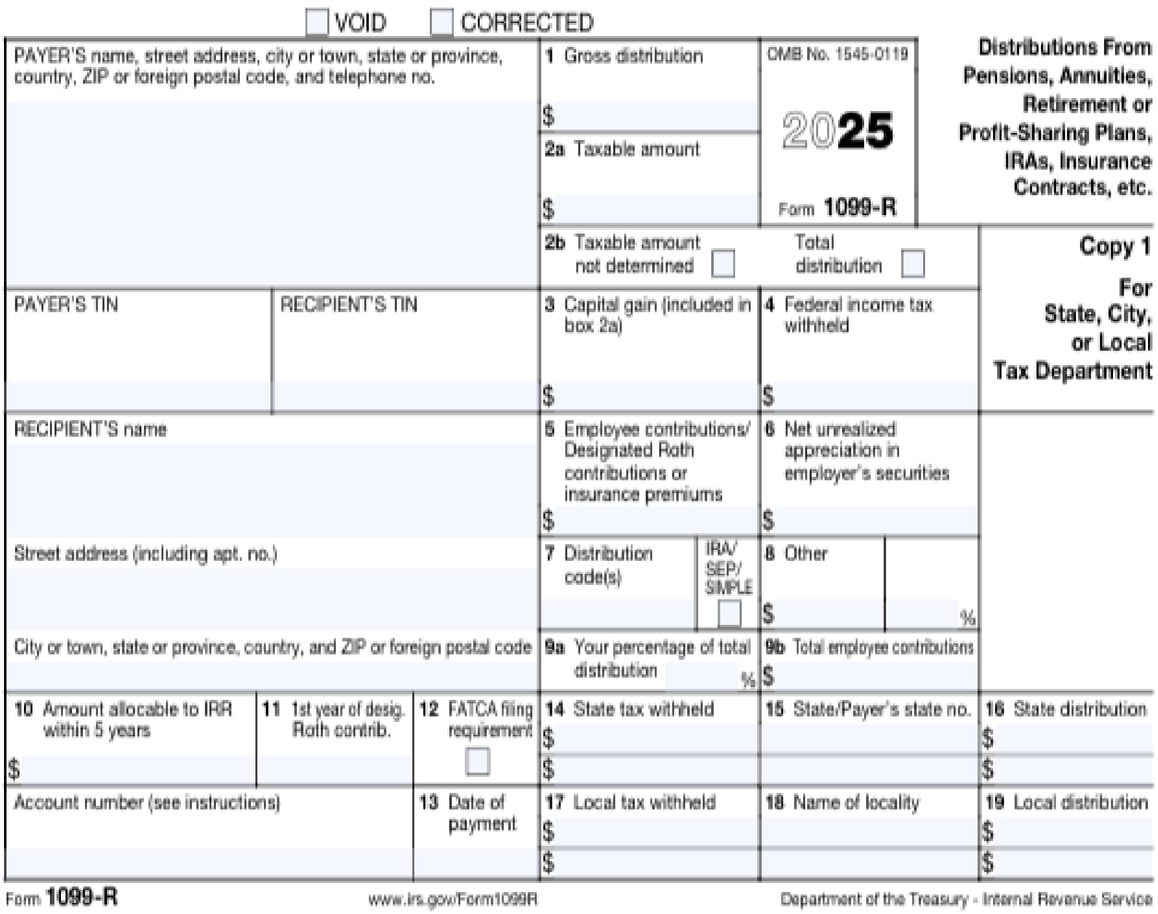
If the Social Security benefits are not taxable, the net benefits should be entered on the appropriate lines, and 0 should be entered on the line for "Taxable amount." If the taxpayer is married filing separately and lived apart from his or her spouse for all the tax year, also enter "D" to the right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

2.4.2 Qualified Retirement Plans

The term "qualified retirement plan" refers to plans maintained by an employer that provide retirement income to employees or result in a deferral of income by employees for periods extending generally to the end of employment. Such plans include traditional pension plans, profit sharing plans, 401(k) plans, stock bonus plans and several other types of plans. Qualified retirement plans are subject to specific IRC and legislative oversight of the Employee Retirement Income Security Act (ERISA).

Distributions from retirement plans—qualified plans, IRAs, 403(b) tax sheltered annuities, and 457(b) plans—are reported on IRS Form 1099-R, *Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.,* shown below.

- Box 1 shows the total amount distributed. The distribution shown may be a direct rollover, the conversion to a Roth IRA, periodic payments, or some other distribution from the retirement plan; thus, it may be either taxable, nontaxable or partly taxable.
- Box 2a shows the amount that is generally taxable.
- Box 2b showing a √ in the first box (while leaving Box 2a blank) will require the preparer to calculate any taxable amount, which can be done using the information contained in the following 2.4.2 sections.



VOID CORRECTED

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.

1 Gross distribution $

2a Taxable amount $

OMB No. 1545-0119

2025

Form 1099-R

Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.

2b Taxable amount not determined

Total distribution

Copy 1

For State, City, or Local Tax Department

PAYER'S TIN

RECIPIENT'S TIN

3 Capital gain (included in box 2a) $

4 Federal income tax withheld $

RECIPIENT'S name

5 Employee contributions/ Designated Roth contributions or insurance premiums $

6 Net unrealized appreciation in employer's securities $

Street address (including apt. no.)

7 Distribution code(s)

IRA/ SEP/ SIMPLE

8 Other $ %

City or town, state or province, country, and ZIP or foreign postal code

9a Your percentage of total distribution %

9b Total employee contributions $

10 Amount allocable to IRR within 5 years $

11 1st year of desig. Roth contrib.

12 FATCA filing requirement

14 State tax withheld $ $

15 State/Payer's state no.

16 State distribution $ $

Account number (see instructions)

13 Date of payment

17 Local tax withheld $ $

18 Name of locality

19 Local distribution $ $

Form 1099-R www.irs.gov/Form1099R Department of the Treasury - Internal Revenue Service

2.4.2.1 Contributions to Qualified Employee Plans

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

2.4.2.2 Employee Plan Contributions

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

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

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

The specified dollar amount in 2025 is $23,500.[1] The applicable limit on elective deferrals generally applies to the total of all elective deferral contributions (in the aggregate) made to such plans.

[1] IRC §402(g)(1).

Participants in 401(k) plans and 403(b) tax sheltered annuity plans that are age 50 or older by the end of the year may make catch-up contributions. The catch-up provision in the law permitting increased contributions by age 50 and older participants increases the otherwise applicable dollar limit on elective deferrals.

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

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

The applicable dollar amount for 2025 catch-up contributions is $7,500 and is indexed for inflation in subsequent years.

2.4.2.3 Qualified Retirement Plan Distributions

The tax treatment of distributions from a qualified retirement plan—other than qualified distributions from a designated Roth 401(k) or Roth 403(b) account—are generally taxable as ordinary income to the plan participant or beneficiary who receives them. Any distribution made to a participant from a qualified plan—even if the distribution will be rolled over to another plan—requires that the trustee of the distributing plan withhold 20% of the distribution for taxes. Qualified distributions from a designated Roth 401(k) or Roth 403(b) account are tax free.

2.4.2.3.1 Early Distributions

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

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

2.4.2.4 Required Qualified Plan Minimum Distributions

The age at which RMDs must begin is age 73. Accordingly, traditional IRA holders may defer receipt of their first RMD until April 1st of the year following their 73rd birthday. Qualified plan participants continuing to be employed by the employer sponsoring the plan in which they participate may delay their RMDs until the later of age 73 or retirement.

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

2.4.2.5 Qualified Plan Rollovers

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

2.4.2.6 Plan Death Benefits

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

2.4.2.7 Designated Roth Account Distributions

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

2.4.2.7.1 Qualified Roth Account Distributions Tax-Free

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

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

2.4.2.7.2 Nonqualified Roth Account Distributions

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

2.4.3 Annuities

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

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

2.4.3.1 Nonqualified Annuity

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

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

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

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

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

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

- Payments made on or after the individual becomes age 59½;
- Payments attributable to the individual's becoming disabled;
- Payments allocable to investment in the contract before August 14, 1982;
- Payments made on or after the contract owner's death;
- Payments made under an immediate annuity contract;
- Payments made from an employer-purchased annuity upon the termination of a qualified employee plan; and
- Payments that are part of a series of substantially equal periodic payments made for the life or life expectancy of the individual or the joint lives or joint life expectancies of the individual and his or her designated beneficiary.

2.5 Individual Retirement Accounts

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

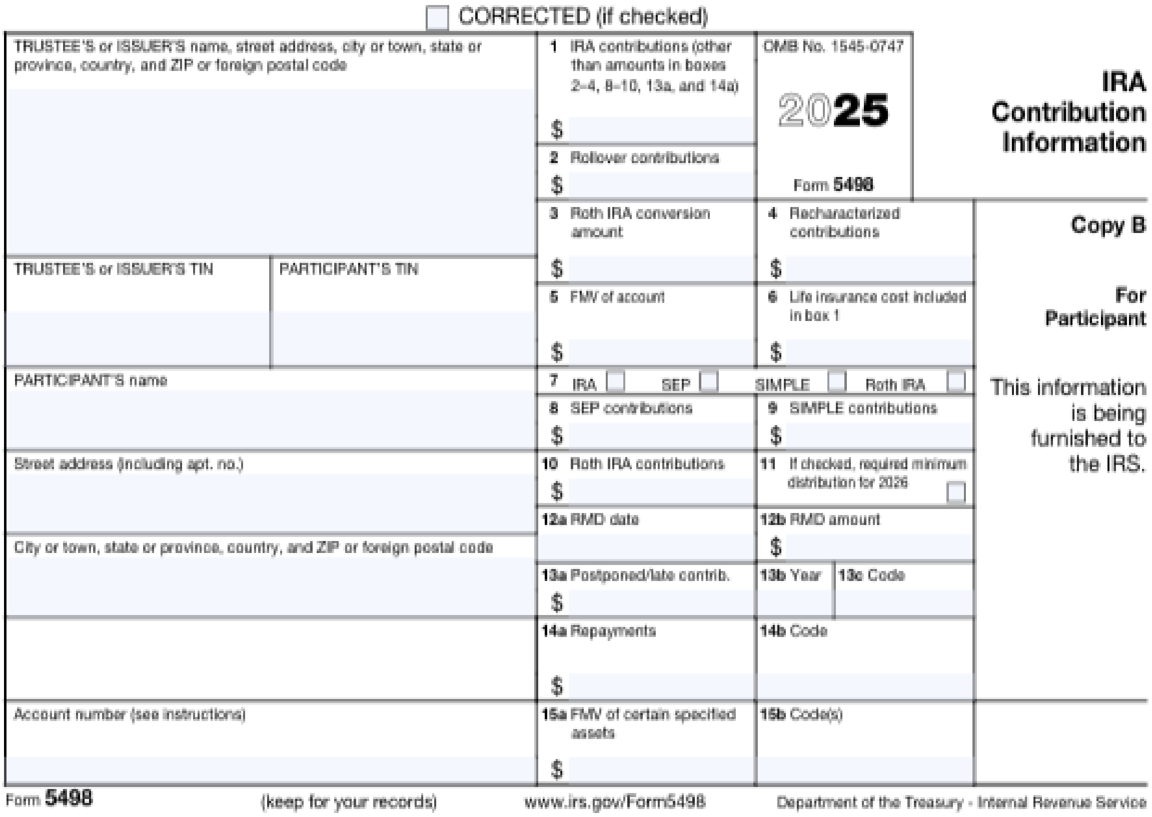
Unless the taxpayer is age 50 or older by the end of the year, the total contribution to all IRAs made for the year cannot exceed the lesser of $7,000 or the individual's compensation includable in gross income. If the taxpayer is age 50 or older by the end of 2025, a maximum additional contribution—a catch-up contribution—of $1,000 may be made.

Form 5498, *IRA Contribution Information*, shown below, is submitted to the IRS and the taxpayer by the trustee or issuer of the taxpayer's IRA to report contributions and various other items of information of considerable value to the preparer. The information on Form 5498 that should prompt the preparer to ask pertinent questions of the taxpayer to determine tax treatment are as follows:

- Box 1 shows the traditional individual retirement account (IRA) contributions for 2025 the taxpayer made in 2025 and through April 15, 2026;
- Box 2 shows rollover contributions, including direct rollover contributions, the taxpayer made in 2025 to an IRA (other than conversions done through a rollover contribution from a traditional IRA or traditional savings incentive match plan for employees (SIMPLE) IRA to a Roth IRA or Roth SIMPLE IRA, which are reported in box 3). Any late rollover contributions are shown in box 13a;
- Box 3 shows the amount converted from traditional IRAs or traditional SIMPLE IRAs to Roth IRAs or Roth SIMPLE IRAs in 2025;
- Box 4 shows amounts recharacterized from transferring any part of the contribution (plus earnings) from one type of IRA to another;
- Box 5 shows the fair market value (FMV) of all investments in the taxpayer's account at year end and, if the taxpayer is aged 73 or older and required to take a distribution may provide the information needed to determine any required minimum distribution;
- Box 6 shows (for endowment contracts only) the amount allocable to the cost of life insurance that should be subtracted to determine the taxpayer's traditional IRA deduction;
- Box 7 may show the kind of IRA being reported, i.e., a traditional or Roth IRA, a simplified employee pension (SEP) or a SIMPLE;
- Boxes 8 and 9 show SEP (box 8) and SIMPLE (box 9) contributions made in 2025, including

contributions made in 2025 for 2024, but not including contributions made in 2026 for 2025;

- Box 10 shows Roth IRA contributions and rollovers from a qualified tuition plan (QTP) the taxpayer made in 2025 and through April 15, 2026;
- Box 11, if checked, indicates the taxpayer must take an RMD for 2026, although an RMD may be required even if it is not checked;
- Box 12a shows the date by which the RMD amount in box 12b must be distributed to avoid the excise tax on the undistributed amount for 2026;
- Box 12b shows the amount of the RMD for 2026. However, if box 11 is checked and there is no amount shown in this box, the trustee or issuer must provide the taxpayer the amount or offer to calculate the amount in a separate statement by January 31, 2026;
- Box 13a shows the amount of a late rollover contribution (more than 60 days after distribution) made in 2025 that may taxable to the taxpayer or a postponed contribution made in 2025 for a prior year;
- Box 13b shows the year to which the postponed contribution in box 13a was credited. If a late rollover contribution is shown in box 13a, this box will be blank;
- Box 13c shows the applicable code for a postponed contribution amount shown in box 13a. The possible codes are FD (due to an extension of the contribution due date because of a federally designated disaster), PO (a rollover of a qualified plan loan offset), and SC (the self-certification procedure for a late rollover contribution). For participants who served in designated combat zones, qualified hazardous duty areas, or direct support areas, the codes are –
    - EO13239 for Afghanistan and associated direct support areas,
    - EO12744 for the Arabian Peninsula areas,
    - PL115-97 for the Sinai Peninsula of Egypt, and
    - EO13119 (or PL106-21) for the Yugoslavia operations areas. (See Pub. 3 for additional information);
- Box 14a shows the amount of any repayment of a distribution related to a qualified reservist, qualified disaster, qualified birth or adoption, emergency personal expense, domestic abuse victim, or terminally ill individual;
- Box 14b shows the applicable repayment code for the amount shown in box 14a –
    - QR (qualified reservist),
    - DD (qualified disaster),
    - BA (qualified birth or adoption),
    - EP (emergency personal expense),
    - DA (domestic abuse victim), or
    - TI (terminally ill individual);
- Box 15a shows the FMV of the investments in the IRA that are specified in the categories identified in box 15b;
- Box 15b shows the type(s) of investments held in the taxpayer's account for which the FMV is required to be reported in box 15a –
    - A—Stock or other ownership interest in a corporation that is not readily tradable on an established securities market,
    - B—Short- or long-term debt obligation that is not traded on an established securities market,
    - C—Ownership interest in a limited liability company or similar entity (unless the interest is traded on an established securities market),
    - D—Real estate,
    - E—Ownership interest in a partnership, trust, or similar entity (unless the interest is traded on an established securities market),
    - F—Option contract or similar product that is not offered for trade on an established option exchange,
    - G—Other asset that does not have a readily available FMV, or
    - H—More than two types of assets (listed in A through G) are held in this IRA.
- Free File Program. Go to *www.irs.gov/FreeFile* to see if the taxpayer qualify for no-cost online federal tax preparation, e-filing, and direct deposit or payment options.



CORRECTED (if checked)

TRUSTEE'S or ISSUER'S name, street address, city or town, state or province, country, and ZIP or foreign postal code

1 IRA contributions (other than amounts in boxes 2–4, 8–10, 13a, and 14a)
$

2 Rollover contributions
$

OMB No. 1545-0747

2025

Form 5498

IRA Contribution Information

3 Roth IRA conversion amount
$

4 Recharacterized contributions
$

Copy B

For Participant

TRUSTEE'S or ISSUER'S TIN

PARTICIPANT'S TIN

5 FMV of account
$

6 Life insurance cost included in box 1
$

PARTICIPANT'S name

7 IRA ☐ SEP ☐ SIMPLE ☐ Roth IRA ☐

This information is being furnished to the IRS.

8 SEP contributions
$

9 SIMPLE contributions
$

Street address (including apt. no.)

10 Roth IRA contributions
$

11 If checked, required minimum distribution for 2026 ☐

12a RMD date

12b RMD amount
$

City or town, state or province, country, and ZIP or foreign postal code

13a Postponed/late contrib.
$

13b Year

13c Code

14a Repayments
$

14b Code

Account number (see instructions)

15a FMV of certain specified assets
$

15b Code(s)

Form 5498 (keep for your records) www.irs.gov/Form5498 Department of the Treasury - Internal Revenue Service

Individual retirement accounts are fundamentally of two types:

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

2.5.1 Traditional IRAs – Contributions & Distributions

Contributions to traditional IRAs are normally fully tax-deductible to a taxpayer unless the taxpayer or the taxpayer's spouse is an active participant in an employer-sponsored qualified plan and has a modified adjusted gross income in excess of a specified amount for his or her filing status.

Distributions from traditional IRAs to which no after-tax contributions have been made are fully taxable as ordinary income and are reported on IRS Form 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.*. Traditional IRA distributions of after-tax contributions are received tax-free as a return of basis on a pro rata basis, and the remainder of the distribution is taxable.

2.5.1.1 Premature Distributions

In order to ensure that traditional IRAs (and other tax-favored accounts) are used for the purpose for which they were designed—to accumulate retirement savings—Congress imposed a limitation on their liquidity by specifying a penalty for premature, i.e., early, distributions. Usually, in order to avoid a premature distribution penalty, the taxpayer must be at least age 59½ before receiving a distribution from an IRA or other tax-favored account.

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

If the taxpayer has taken a premature distribution from an IRA, complete IRS Form 5329, *Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts,* shown below. The Form 5329 should be completed as follows:

- Enter the amount of the early distribution on line 1,
- Enter the amount of the early distribution NOT SUBJECT to the additional tax on line 2,
- Enter the amount of the early distribution subject to the additional tax on line 3, and
- Enter 10% of the amount on line 3 on line 4 and on Form 1040 Schedule 2, *Additional Taxes.*

Attach Form 5329 and Form 1040 Schedule 2, *Additional Taxes* to Form 1040*,* Form 1040NR or Form 1040SR*.*

Form **5329**

Department of the Treasury
Internal Revenue Service

Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts

Attach to Form 1040, 1040-SR, 1040-NR, or 1041.

Go to www.irs.gov/Form5329 for instructions and the latest information.

OMB No. 1545-0074

2024

Attachment Sequence No. **29**

Name of individual subject to additional tax. If married filing jointly, see instructions. | **Your social security number**

Fill in Your Address Only if You Are Filing This Form by Itself and Not With Your Tax Return

Home address (number and street), or P.O. box if mail is not delivered to your home | Apt. no.

City, town or post office, state, and ZIP code. If you have a foreign address, also complete the spaces below. See instructions. | If this is an amended return, check here ☐

Foreign country name | Foreign province/state/county | Foreign postal code

If you **only** owe the additional 10% tax on the full amount of the early distributions, you may be able to report this tax directly on Schedule 2 (Form 1040), line 8, without filing Form 5329. See instructions.

Part I **Additional Tax on Early Distributions.** Complete this part if you took a taxable distribution (other than a qualified disaster distribution) before you reached age 59½ from a qualified retirement plan (including an IRA) or modified endowment contract (unless you are reporting this tax directly on Schedule 2 (Form 1040)—see above). You may also have to complete this part to indicate that you qualify for an exception to the additional tax on early distributions or for certain Roth IRA distributions. See instructions.

1	Early distributions includible in income (see instructions). For Roth IRA distributions, see instructions	1	
2	Early distributions included on line 1 that are not subject to the additional tax (see instructions). Enter the appropriate exception number from the instructions: ______	2	
3	Amount subject to additional tax. Subtract line 2 from line 1	3	
4	**Additional tax.** Enter 10% (0.10) of line 3. Include this amount on Schedule 2 (Form 1040), line 8	4	
	Caution: If any part of the amount on line 3 was a distribution from a SIMPLE IRA, you may have to include 25% of that amount on line 4 instead of 10%. See instructions.		

Part II **Additional Tax on Certain Distributions From Education Accounts and ABLE Accounts.** Complete this part if you included an amount in income, on Schedule 1 (Form 1040), line 8z, from a Coverdell education savings account (ESA) or a qualified tuition program (QTP), or on Schedule 1 (Form 1040), line 8q, from an ABLE account.

5	Distributions included in income from a Coverdell ESA, a QTP, or an ABLE account	5	
6	Distributions included on line 5 that are not subject to the additional tax (see instructions)	6	
7	Amount subject to additional tax. Subtract line 6 from line 5	7	
8	**Additional tax.** Enter 10% (0.10) of line 7. Include this amount on Schedule 2 (Form 1040), line 8	8	

Part III **Additional Tax on Excess Contributions to Traditional IRAs.** Complete this part if you contributed more to your traditional IRAs for 2024 than is allowable or you had an amount on line 17 of your 2023 Form 5329.

9	Enter your excess contributions from line 16 of your 2023 Form 5329. See instructions. If zero, go to line 15			9	
10	If your traditional IRA contributions for 2024 are less than your maximum allowable contribution, see instructions. Otherwise, enter -0-	10			
11	2024 traditional IRA distributions included in income (see instructions)	11			
12	2024 distributions of prior year excess contributions (see instructions)	12			
13	Add lines 10, 11, and 12			13	
14	Prior year excess contributions. Subtract line 13 from line 9. If zero or less, enter -0-			14	
15	Excess contributions for 2024 (see instructions)			15	
16	Total excess contributions. Add lines 14 and 15			16	
17	**Additional tax.** Enter 6% (0.06) of the **smaller** of line 16 **or** the value of your traditional IRAs on December 31, 2024 (including 2024 contributions made in 2025). Include this amount on Schedule 2 (Form 1040), line 8			17	

Part IV **Additional Tax on Excess Contributions to Roth IRAs.** Complete this part if you contributed more to your Roth IRAs for 2024 than is allowable or you had an amount on line 25 of your 2023 Form 5329.

18	Enter your excess contributions from line 24 of your 2023 Form 5329. See instructions. If zero, go to line 23			18	
19	If your Roth IRA contributions for 2024 are less than your maximum allowable contribution, see instructions. Otherwise, enter -0-	19			
20	2024 distributions from your Roth IRAs (see instructions)	20			
21	Add lines 19 and 20			21	
22	Prior year excess contributions. Subtract line 21 from line 18. If zero or less, enter -0-			22	
23	Excess contributions for 2024 (see instructions)			23	
24	Total excess contributions. Add lines 22 and 23			24	
25	**Additional tax.** Enter 6% (0.06) of the **smaller** of line 24 **or** the value of your Roth IRAs on December 31, 2024 (including 2024 contributions made in 2025). Include this amount on Schedule 2 (Form 1040), line 8			25	

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Part V **Additional Tax on Excess Contributions to Coverdell ESAs.** Complete this part if the contributions to your Coverdell ESAs for 2024 were more than is allowable or you had an amount on line 33 of your 2023 Form 5329.

26	Enter the excess contributions from line 32 of your 2023 Form 5329. See instructions. If zero, go to line 31			26	
27	If the contributions to your Coverdell ESAs for 2024 were less than the maximum allowable contribution, see instructions. Otherwise, enter -0-	27			
28	2024 distributions from your Coverdell ESAs (see instructions)	28			
29	Add lines 27 and 28			29	
30	Prior year excess contributions. Subtract line 29 from line 26. If zero or less, enter -0-			30	
31	Excess contributions for 2024 (see instructions)			31	
32	Total excess contributions. Add lines 30 and 31			32	
33	**Additional tax.** Enter 6% (0.06) of the **smaller** of line 32 **or** the value of your Coverdell ESAs on December 31, 2024 (including 2024 contributions made in 2025). Include this amount on Schedule 2 (Form 1040), line 8			33	

Part VI **Additional Tax on Excess Contributions to Archer MSAs.** Complete this part if you or your employer contributed more to your Archer MSAs for 2024 than is allowable or you had an amount on line 41 of your 2023 Form 5329.

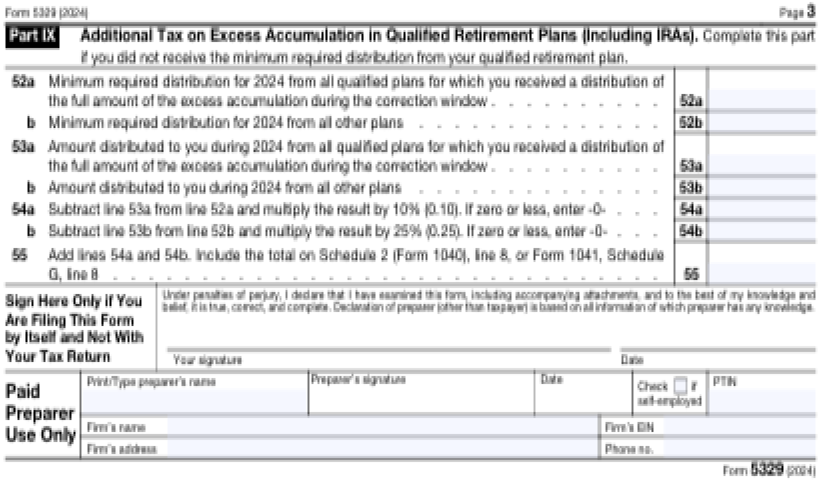
34	Enter the excess contributions from line 40 of your 2023 Form 5329. See instructions. If zero, go to line 39			34	
35	If the contributions to your Archer MSAs for 2024 are less than the maximum allowable contribution, see instructions. Otherwise, enter -0-	35			
36	2024 distributions from your Archer MSAs from Form 8853, line 8	36			
37	Add lines 35 and 36			37	
38	Prior year excess contributions. Subtract line 37 from line 34. If zero or less, enter -0-			38	
39	Excess contributions for 2024 (see instructions)			39	
40	Total excess contributions. Add lines 38 and 39			40	
41	**Additional tax.** Enter 6% (0.06) of the **smaller** of line 40 **or** the value of your Archer MSAs on December 31, 2024 (including 2024 contributions made in 2025). Include this amount on Schedule 2 (Form 1040), line 8			41	

Part VII **Additional Tax on Excess Contributions to Health Savings Accounts (HSAs).** Complete this part if you, someone on your behalf, or your employer contributed more to your HSAs for 2024 than is allowable or you had an amount on line 49 of your 2023 Form 5329.

42	Enter the excess contributions from line 48 of your 2023 Form 5329. If zero, go to line 47			42	
43	If the contributions to your HSAs for 2024 are less than the maximum allowable contribution, see instructions. Otherwise, enter -0-	43			
44	2024 distributions from your HSAs from Form 8889, line 16	44			
45	Add lines 43 and 44			45	
46	Prior year excess contributions. Subtract line 45 from line 42. If zero or less, enter -0-			46	
47	Excess contributions for 2024 (see instructions)			47	
48	Total excess contributions. Add lines 46 and 47			48	
49	**Additional tax.** Enter 6% (0.06) of the **smaller** of line 48 **or** the value of your HSAs on December 31, 2024 (including 2024 contributions made in 2025). Include this amount on Schedule 2 (Form 1040), line 8			49	

Part VIII **Additional Tax on Excess Contributions to an ABLE Account.** Complete this part if contributions to your ABLE account for 2024 were more than is allowable.

50	Excess contributions for 2024 (see instructions)	50	
51	**Additional tax.** Enter 6% (0.06) of the **smaller** of line 50 **or** the value of your ABLE account on December 31, 2024. Include this amount on Schedule 2 (Form 1040), line 8	51	



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Part IX **Additional Tax on Excess Accumulation in Qualified Retirement Plans (Including IRAs).** Complete this part if you did not receive the minimum required distribution from your qualified retirement plan.

52a	Minimum required distribution for 2024 from all qualified plans for which you received a distribution of the full amount of the excess accumulation during the correction window	52a	
b	Minimum required distribution for 2024 from all other plans	52b	
53a	Amount distributed to you during 2024 from all qualified plans for which you received a distribution of the full amount of the excess accumulation during the correction window	53a	
b	Amount distributed to you during 2024 from all other plans	53b	
54a	Subtract line 53a from line 52a and multiply the result by 10% (0.10). If zero or less, enter -0-	54a	
b	Subtract line 53b from line 52b and multiply the result by 25% (0.25). If zero or less, enter -0-	54b	
55	Add lines 54a and 54b. Include the total on Schedule 2 (Form 1040), line 8, or Form 1041, Schedule G, line 8	55	

Sign Here Only if You Are Filing This Form by Itself and Not With Your Tax Return — Under penalties of perjury, I declare that I have examined this form, including accompanying attachments, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Your signature | Date

Paid Preparer Use Only — Print/Type preparer's name | Preparer's signature | Date | Check ☐ if self-employed | PTIN

Firm's name | Firm's EIN

Firm's address | Phone no.

Form **5329** (2024)

2.5.1.1.1 Premature Distributions Avoiding Tax Penalty

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

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

2.5.1.2 Required Distributions during Owner's Lifetime

The Internal Revenue Code requires that minimum distributions from a traditional IRA begin at age 73. Traditional IRA holders may defer receipt of their first RMD until April 1st of the year following their 73rd birthday. Lifetime distributions are not required from a Roth IRA or from a designated Roth account..

2.5.2 Roth IRAs

A Roth IRA provides income tax deferral of gain before distribution and may provide tax-free distribution of earnings. It does not provide for contribution deductibility, however.

A nonqualified distribution—one that fails to meet the requirements to be a qualified distribution—from a Roth IRA receives FIFO tax treatment under which all contributions are deemed to be distributed tax free before any earnings are distributed.

2.5.2.1 Limits on Roth IRA Contributions

The maximum amount an individual can contribute to a Roth IRA is the same as a contribution that could be made to a traditional IRA: that is $7,000 (in 2025) or, if he or she is age 50 or older, $8,000.

The maximum contribution that may be made to a Roth IRA is reduced, based on the individual's modified adjusted gross income, according to the following formula:

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

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

Federal Income Tax Filing Status	Applicable Dollar Amount (2025)
Single & head of household	$150,000
Married, filing a joint return	$236,000
Married, filing separately	$0

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

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

2.5.2.3 No Required Roth IRA Lifetime Distributions

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

2.5.3 IRA Rollover Per-Year Limit

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

Alternatively, taxpayers may withdraw funds from an IRA and deposit them in another (or the same) IRA within 60 days of the distribution without having to recognize any income. This withdrawal and deposit treated as a rollover may be done once in any one-year period. A taxpayer making such an IRA rollover must contribute 100% of the amount within 60 days of distribution to the new IRA or recognize income on the amount not timely deposited.

Review #2

1. Peter, age 45, made his first Roth IRA contribution ten years ago and has made contributions to the IRA every year since. His total contributions amount to $40,000, and he has never previously taken a distribution from the IRA. If he withdrew $50,000 this year from the Roth IRA in a nonqualified distribution, what is the maximum amount of the distribution, if any, he may exclude from income?

    A. $0

    B. $10,000

    C. $40,000

    D. $50,000

2. Bill Walters is a 52-year-old single client. His adjusted gross income in 2025 is $200,000, and he is not an active participant in an employer-sponsored retirement plan. What is the maximum 2025 traditional IRA contribution that he may deduct?

   A. $0

   B. $2,000

   C. $7,000

   D. $8,000

2.6 Reporting and Taxability of Unemployment Compensation

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

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

2.6.1 Unemployment Compensation Taxable

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

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

2.6.1.1 Nondeductible Contributions to Governmental Unemployment Compensation Plan

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

2.6.1.2 Repayment of Unemployment Compensation

If the taxpayer repaid employment compensation received in 2025 in the same year, the tax preparer should subtract the amount repaid from the total amount of unemployment compensation received and enter the difference on line 7 of Form 1040, Schedule 1. On the dotted line next to the entry, enter "repaid" and the amount repaid by the taxpayer.

If the amount of unemployment compensation repaid during the year was more than $3,000, the taxpayer may take a tax credit for the year of repayment. In order to take a tax credit for repayment the taxpayer must have believed that he or she had an unrestricted right to the unemployment compensation at the time it was received.

2.7 Alimony – Pre 2019 and Post 2018 Divorce Agreements

Alimony payments made in 2018 and before are deductible to the payer and includible in the recipient's income.

However, alimony payments are no longer tax-deductible to the payer or includible in the income of the recipient if made under:

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

The tax treatment of alimony payments made and received in 2025 is based on the date of the divorce agreement or any subsequent modified agreement.

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

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

A self-employed taxpayer is one who:

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

2.8.1 Income & Expenses Defined

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

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

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

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

- The amount on Schedule C (Form 1040);
- The amount on Schedule C–EZ (Form 1040); and
- The amount on Schedule F (Form 1040).

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

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

7. Gross income (add lines 5 & 6)	$

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

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

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

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

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

- Ordinary, i.e., one that is common and accepted in the taxpayer's field of business, and
- Necessary[2], i.e., one that is helpful and appropriate for the taxpayer's business.

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

2.8.2 Business vs. Hobby

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

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

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

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

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

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

A hobby, for tax purposes, is an activity **not** engaged in for profit or income. The gross income from a hobby is reported on Form 1040, as "Other income." However, hobby expenses are not deductible even to offset hobby income.

2.8.3 Business Use of a Home

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

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

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

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

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

2.8.3.1 Methods of Figuring the Home-Office Deduction

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

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

2.8.3.1.1 Actual Expense Method

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

2.8.3.1.1.1 Nature of the Expense

Expenses fall into one of the following three categories:

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

Direct expenses are expenses applicable to and affecting only the business part of the taxpayer's home. These expenses are normally deductible in full, subject to any applicable deduction limit.

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

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

2.8.3.1.1.2 Percentage of the Home Used for Business

Indirect expenses are deductible under the permitted home-office deduction only in an amount equal to the total of such indirect expenses multiplied by the percentage of the home used for business.

2.8.3.1.1.3 Calculating Percentage of Home Used for Business

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

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

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

2.8.3.1.1.4 Deductible Expenses for Home-Office Deduction

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

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

2.8.3.1.1.5 Expenses Deductible by All Homeowners

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

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

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

2.8.3.1.1.6 Expenses Deductible only by Taxpayers Using a Home for Business

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

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

- Expenses for utilities and services, deductible in an amount equal to the expenses incurred for the utilities and services multiplied by the percentage of business use.

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

2.8.3.1.1.7 Deduction Limit

If a taxpayer uses the actual expense method for claiming a home-office deduction, the deduction of otherwise nondeductible expenses—expenses such as insurance, utilities and depreciation allocable to the business—is limited to the taxpayer's gross income from the business use of the home minus the sum of the following:

1. The business portion of expenses the taxpayer could deduct even if he or she did not use the home for business purposes; and
2. The business expenses that relate to the business activity carried on in the home but not to the home itself. Such expenses include the costs of business telephone, supplies and equipment depreciation. (A self-employed taxpayer should not include the deductible one half of self-employment tax in the business expenses that must be subtracted from gross income.)

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

2.8.3.1.2 Simplified Method

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

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

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

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

2.8.3.1.2.2 No Deduction of Actual Expense Carryover for Simplified Method Users

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

2.8.3.1.2.3 Expenses Deductible Irrespective of Business Use

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

2.8.3.1.2.4 Special Rules Applicable to Simplified Method

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

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

2.8.3.1.2.5 Gross Income Limitation

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

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

2.8.4 Recordkeeping Requirements

Documents supporting the taxpayer's gross receipts, amounts paid for inventory and business expenses should be maintained for as long as they are material to the administration of tax law. If the self-employed taxpayer is involved in multiple businesses he or she should keep a complete and separate set of records and supporting documents for each business.

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

- Gross receipts;
- Deductions; and
- Credits.

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

2.8.4.1 Gross Receipts

The documents supporting a self-employed taxpayer's gross receipts include:

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

2.8.4.2 Inventory

If a self-employed taxpayer buys items for resale to customers, the supporting documents should show the amount paid and that the payment was for inventory. Such supporting documents include:

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

2.8.4.3 Expenses

Documents supporting a self-employed taxpayer's expenses should be kept for the later of 3 years following the date the taxpayer's original tax return was filed or 2 years following the date any tax payment was made. Such documents should show a) the amounts paid, and b) that the amounts paid were for business expenses.

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

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

2.8.5 Entertainment Expenses

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

- Activities normally considered to be entertainment, amusement or recreation;
- Club dues or fees for any club organized for the purpose of –
  - business,
  - pleasure,
  - recreation, or
  - any other social purpose; or
- A facility used in connection with any of those activities.

However, taxpayers can continue to deduct 50% of the cost of meals for themselves and or employees provided the food or beverages are not considered lavish or extravagant.

2.8.5.1 Exceptions to Food and Beverage Expenses

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

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

For example, suppose Loudin Beverages, Inc. has an annual picnic for its employees at which the company furnishes food, beverages, and various games throughout the day. Assuming the picnic is open to all employees, rather than just those that are highly-paid, the entire cost for the picnic would be fully deductible to Loudin Beverages, Inc. Although taxpayers are generally permitted to deduct no more than 50% of the expenses for food and beverages paid or incurred in conducting their trade or business as well as the expenses for food and beverages provided by the taxpayer on the taxpayer's premises primarily for employees, the 50% limitation on the deduction of an employer's food and beverage expenses does not apply to any expenses if, among other exceptions, the expenses are for recreational, social or similar activities primarily for the benefit of employees other than highly compensated employees.

2.8.6 Section 179 Expense Limits

The amount a business is permitted to expense rather than being required to depreciate with respect to section 179 property the taxpayer places in service in tax years beginning after December 31, 2017 is as follows:.

- The dollar limitation on the value of property that may be expensed in the year in which it is placed in service is $1,250,000 (2025);
- The phaseout threshold for a taxpayer's ability to expense eligible property is $3,130,000 (2025);
- The definition of Code Section 179 property is expanded to include –
    - depreciable tangible personal property used principally to furnish lodging, such as –
        - furniture,
        - appliances, and
        - other equipment for use in the living quarters, and
    - certain improvements to nonresidential real property, including –
        - roofs,
        - heating, ventilation and air-conditioning property,
        - fire protection and alarm systems, and
        - security systems.

Improvements will not qualify if they are attributable to other than the building's interior. So, improvements attributable to:

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

… do not qualify for immediate expensing.

The cost of any sport utility vehicle (SUV) that may be taken into account under Section 179 cannot exceed$31,300.

2.8.7 Depreciation

Depreciation is an allowance for the wear and tear, deterioration, or obsolescence of depreciable property. The taxpayer can depreciate most types of tangible property (except land), such as buildings, machinery, vehicles, furniture, and equipment. The taxpayer also can depreciate certain intangible property, such as patents, copyrights, and computer software.

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

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

2.8.7.1 Bonus Depreciation

Under the enhanced bonus depreciation provisions of the TCJA, a business may take a 100% first year tax deduction equal to the adjusted basis of qualified property purchased and placed in service after September 27, 2017 and before January 1, 2023. The bonus depreciation percentage for qualified property purchased before September 28, 2017 and placed in service before January 1, 2018 continued to be 50%. That bonus depreciation is reduced to 80% for property placed in service in

2023 and to 60% for property placed in service in 2024 and is further reduced to 40% for property purchased and placed in service during 2025.

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

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

The 100% expensing permitted under the TCJA declines by 20% each year for qualified property purchased and placed in service after December 31, 2022:

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

2.8.7.1.1 Qualified Property

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

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

2.8.7.2 Luxury Auto Depreciation Limits

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

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

The luxury auto depreciation limits applicable to passenger automobiles acquired after September 27, 2017 and placed in service during calendar year 2025 are as shown below:

Year	Limits When 1st Year Bonus Depreciation Deduction Applies	Limits When no 1st Year Bonus Depreciation Deduction Applies
Placed in service	$20,200	$12,200
2	$19,600	$19,600
3	$11,800	$11,800
4 and later	$7,060	$7,060

A "luxury vehicle" is a four-wheeled vehicle regardless the cost of the vehicle, used mostly on public roads, and which has an unloaded gross weight of no more than 6,000 pounds. It includes vehicles not normally considered "luxury" vehicles on the basis of their price. (Rev. Proc. 2025-16)

2.8.7.3 Listed Property Updates

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

Under prior tax law, listed property included:

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

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

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

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

2.8.7.3.1 Deduction for Employees

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

2.8.7.3.2 Business-use Requirement

If the property is not used more than half the time for qualified business use, the taxpayer cannot claim the section 179 deduction or a special depreciation allowance. In addition, the taxpayer must figure any depreciation deduction under the Modified Accelerated Cost Recovery System (MACRS) using the straight line method over the ADS recovery period. The taxpayer may also have to recapture (include in income) any excess depreciation claimed in previous years. A similar inclusion amount applies to certain leased property.

2.8.7.3.3 Passenger Automobile Limits and Rules

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

Review #3

1. What is George's business expense deduction if he uses a 400 square foot office in his rented home, assuming he qualifies for a home office deduction, pays $1,200 for business telephone service, uses 20% of the home for business and elects the simplified home office deduction method?

   A. $1,500

   B. $1,740

   C. $2,000

   D. $2,700

2. Harold is a sole proprietor of a small company. He sponsors an employee picnic each year at a local park that costs him $25,000. If he incurs $15,000 in food and $10,000 in beverage expenses for his 2025 employee picnic, how much of the expense may he deduct for income tax purposes, assuming that all employees are encouraged to attend?

A. $0

B. $10,000

C. $12,500

D. $25,000

2.9 Capital Gains and Losses

Most assets owned by a taxpayer for personal purposes, pleasure or investment are referred to as "capital assets," and the sale or exchange of a capital asset may result in a capital gain or loss. If the transaction involves personal use property, in contrast to property held for investment, any gain realized upon the sale of the property is a capital gain; however, any loss that results from the sale of personal use property cannot be deducted. If the sale or trade of investment property results in a gain or loss, such gain or loss is generally a capital gain or loss. Capital gains tax rates applicable to capital assets sold or exchanged in 2025 are discussed in Domain 1.

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

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

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

2.9.2 Reporting Capital Gains and Losses

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

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

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

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

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

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

2.9.2.2 Schedule D, Capital Gains and Losses

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

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

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

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

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

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

2.10 Standard Deduction Eligibility

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

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

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

2.10.1 Standard Deduction Amounts

The standard deductions for 2025 are:

- $30,000 for married couples whose filing status is "married filing jointly" and surviving spouses;
- $15,000 for singles and married couples whose filing status is "married filing separately"; and
- $22,500 for taxpayers whose filing status is "head of household."

A taxpayer who can be claimed as a dependent is generally limited to a smaller standard deduction, regardless of whether the individual is actually claimed as a dependent. For 2025 returns, the standard deduction for a dependent is the greater of:

- $1,350; or
- The dependent's earned income from work for the year plus $450 (but not more than the standard deduction amount, generally $15,000), if greater.

2.10.2 Standard Deduction for Blind and Senior Taxpayers

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

- $1,600 for married individuals; and
- $2,000 for singles (other than a surviving spouse) and heads of household.

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

2.10.3 Standard Deduction Summary

	2025	
Filing Status	Standard	Blind/Age 65+ add
Married filing jointly & surviving spouses	$30,000	$1,600
Unmarried (other than surviving spouses)	$15,000	$2,000
Married filing separately	$15,000	$1,600
Head of household	$22,500	$2,000
Dependent	$1,350 or earned income + $450	

2.11 Itemized Deductions Schedule A

The various Schedule A itemized deductions include deductions for:

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

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

2.11.1 Medical and Dental Expenses

If the taxpayer itemizes deductions for a taxable year on Form 1040 Schedule A, *Itemized Deductions,* the taxpayer may be able to deduct expenses paid that year for medical and dental care for the taxpayer, spouse, and dependents. Such expenses include payments for the diagnosis, cure, mitigation, treatment, or prevention of disease, or payments for treatments affecting any structure or function of the body.

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

Tax-qualified long term care insurance policy premiums are included in the definition of "medical care" and are, therefore, eligible for income tax deduction within certain limits. (See 1.1.8 for 2025 long-term care insurance premium limitations.)

2.11.2 State and Local Tax Deduction

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

2.11.3 Home Mortgage Interest and Home Equity Loans

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

1. Mortgages taken out before October 13, 1987, called "grandfathered debt";
2. Mortgages taken out by the taxpayer (or spouse if married filing a joint return) after October 13, 1987 to buy, build or improve the taxpayer's home, i.e., "acquisition debt," but only if the total of such mortgages plus any grandfathered debt was $1 million or less ($500,000 or less if married filing separately) throughout the year; and
3. Mortgages taken out by the taxpayer (or spouse if married filing a joint return) after October 13, 1987 that were home equity debt, i.e., any indebtedness (other than acquisition indebtedness) secured by a qualified residence, but only if the total of such mortgages was $100,000 or less ($50,000 or less if married filing separately) and totaled no more than the fair market value of the taxpayer's home reduced by 1 and 2 above.

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

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

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

2.11.3.1 Indebtedness Refinancing

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

2.11.4 Charitable Contributions

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

2.11.4.1 60% AGI Limit for Cash Contributions

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

2.11.4.2 Contemporaneous Written Acknowledgement

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

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

2.11.4.2.1 Content and Timing of Contemporaneous Written Acknowledgement

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

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

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

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

2.11.5 Casualty Loss Deduction

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

Personal casualty and theft losses attributable to a federally-declared disaster are subject to $100 per casualty and 10% of adjusted gross income (AGI) reductions unless they are attributable to a qualified disaster loss. Personal casualty and theft losses attributable to a qualified disaster loss are **not** subject to the 10% of AGI reduction, and the $100 reduction is increased to $500. An exception to the rule limiting the personal casualty and theft loss deduction to losses attributable to a federally-declared disaster applies if the taxpayer has personal casualty gains for the tax year.

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

2.11.5.1 Special Rules for Qualified Disaster-Related Personal Casualty Losses

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

2.11.6 Moving Expense Deduction

Many taxpayers change their residence each year, and many of those taxpayer relocations involve new jobs. Prior law permitted a taxpayer to deduct moving expenses by car provided the new location was at least 50 miles farther from the taxpayer's former home than the former main job location. However, except in the case of military relocations, the TCJA has suspended the moving expense deduction and made any moving expense reimbursement taxable income.

2.11.6.1 Moving Expenses in Active Military Relocations

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

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

…are includible in gross income or reported.

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

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

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

2.11.7 Recordkeeping and Documentation of Deductions

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

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

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

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

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

2.12 Tax Credit Eligibility

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

- Refundable tax credits that are treated as having been withheld from the taxpayer's income and payable to the taxpayer regardless of income tax liability; and
- Nonrefundable tax credits that reduce the amount of tax owed on the tax return, dollar-for-dollar by the lesser of the credit or the tax liability.

Among the most frequently-claimed tax credits are:

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

Schedule 8812, *Credits for Qualifying Children and Other Dependents*, shown below, is used to figure the taxpayer's child tax credit (CTC), credit for other dependents (ODC), and additional child tax credit (ACTC) employing the rules explained in the following text.

SCHEDULE 8812 (Form 1040)

Department of the Treasury
Internal Revenue Service

Credits for Qualifying Children and Other Dependents

Attach to Form 1040, 1040-SR, or 1040-NR.

Go to *www.irs.gov/Schedule8812* for instructions and the latest information.

OMB No. 1545-0074

2024

Attachment Sequence No. **47**

Name(s) shown on return	**Your social security number**

Part I Child Tax Credit and Credit for Other Dependents

1	Enter the amount from line 11 of your Form 1040, 1040-SR, or 1040-NR			**1**	
2a	Enter income from Puerto Rico that you excluded	**2a**			
b	Enter the amounts from lines 45 and 50 of your Form 2555	**2b**			
c	Enter the amount from line 15 of your Form 4563	**2c**			
d	Add lines 2a through 2c			**2d**	
3	Add lines 1 and 2d			**3**	
4	Number of qualifying children under age 17 with the required social security number	**4**			
5	Multiply line 4 by $2,000			**5**	
6	Number of other dependents, including any qualifying children who are not under age 17 or who do not have the required social security number	**6**			
	Caution: Do not include yourself, your spouse, or anyone who is not a U.S. citizen, U.S. national, or U.S. resident alien. Also, do not include anyone you included on line 4.				
7	Multiply line 6 by $500			**7**	
8	Add lines 5 and 7			**8**	
9	Enter the amount shown below for your filing status. • Married filing jointly—$400,000 • All other filing statuses—$200,000			**9**	
10	Subtract line 9 from line 3. • If zero or less, enter -0-. • If more than zero and not a multiple of $1,000, enter the next multiple of $1,000. For example, if the result is $425, enter $1,000; if the result is $1,025, enter $2,000, etc.			**10**	
11	Multiply line 10 by 5% (0.05)			**11**	
12	Is the amount on line 8 more than the amount on line 11?			**12**	
	☐ **No. STOP.** You cannot take the child tax credit, credit for other dependents, or additional child tax credit. Skip Parts II-A and II-B. Enter -0- on lines 14 and 27. ☐ **Yes.** Subtract line 11 from line 8. Enter the result.				
13	Enter the amount from **Credit Limit Worksheet A**			**13**	
14	Enter the smaller of line 12 or line 13. **This is your child tax credit and credit for other dependents** **Enter this amount on Form 1040, 1040-SR, or 1040-NR, line 19.**			**14**	

If the amount on line 12 is more than the amount on line 14, you may be able to take the **additional child tax credit** on Form 1040, 1040-SR, or 1040-NR, line 28. Complete your Form 1040, 1040-SR, or 1040-NR through line 27 (also complete Schedule 3, line 11) before completing Part II-A.

Part II-A Additional Child Tax Credit for All Filers

Caution: If you file Form 2555, you cannot claim the additional child tax credit.

15	Check this box if you **do not** want to claim the additional child tax credit. Skip Parts II-A and II-B. Enter -0- on line 27 . . . . . . ☐				
16a	Subtract line 14 from line 12. If zero, **stop here**; you cannot take the additional child tax credit. Skip Parts II-A and II-B. Enter -0- on line 27			16a	
b	Number of qualifying children under age 17 with the required social security number: ______ x $1,700. Enter the result. If zero, **stop here**; you cannot claim the additional child tax credit. Skip Parts II-A and II-B. Enter -0- on line 27			16b	
	TIP: The number of children you use for this line is the same as the number of children you used for line 4.				
17	Enter the **smaller** of line 16a or line 16b			17	
18a	Earned income (see instructions)	18a			
b	Nontaxable combat pay (see instructions) 18b				
19	Is the amount on line 18a more than $2,500? ☐ **No.** Leave line 19 blank and enter -0- on line 20. ☐ **Yes.** Subtract $2,500 from the amount on line 18a. Enter the result	19			
20	Multiply the amount on line 19 by 15% (0.15) and enter the result			20	
	Next. On line 16b, is the amount $5,100 or more? ☐ **No.** If you are a bona fide resident of Puerto Rico, go to line 21. Otherwise, skip Part II-B and enter the **smaller** of line 17 or line 20 on line 27. ☐ **Yes.** If line 20 is equal to or more than line 17, skip Part II-B and enter the amount from line 17 on line 27. Otherwise, go to line 21.				

Part II-B Certain Filers Who Have Three or More Qualifying Children and Bona Fide Residents of Puerto Rico

21	Withheld social security, Medicare, and Additional Medicare taxes from Form(s) W-2, boxes 4 and 6. If married filing jointly, include your spouse's amounts with yours. If your employer withheld or you paid Additional Medicare Tax or tier 1 RRTA taxes, or if you are a bona fide resident of Puerto Rico, see instructions	21			
22	Enter the total of the amounts from Schedule 1 (Form 1040), line 15; Schedule 2 (Form 1040), line 5; Schedule 2 (Form 1040), line 6; and Schedule 2 (Form 1040), line 13 .	22			
23	Add lines 21 and 22	23			
24	**1040 and 1040-SR filers:** Enter the total of the amounts from Form 1040 or 1040-SR, line 27, and Schedule 3 (Form 1040), line 11. **1040-NR filers:** Enter the amount from Schedule 3 (Form 1040), line 11.	24			
25	Subtract line 24 from line 23. If zero or less, enter -0-			25	
26	Enter the **larger** of line 20 or line 25			26	
	Next, enter the **smaller** of line 17 or line 26 on line 27.				

Part II-C Additional Child Tax Credit

27	**This is your additional child tax credit. Enter this amount on Form 1040, 1040-SR, or 1040-NR, line 28** . .	27	

Schedule 8812 (Form 1040) 2024

2.12.1 Child Tax Credit

Schedule 8812*,* Part I is used to determine the taxpayer's child tax credit and uses the various requirements discussed in this section to do so. The child tax credit for 2025 is limited to no more than $2,000 for each qualifying child. If the child meets the requirements—and the taxpayer's modified adjusted gross income (MAGI) does not exceed specified amounts—the taxpayer may claim the tax credit in an amount not exceeding his or her federal income tax liability.

- An eligible child is a child younger than age 17 by the end of 2025;
- The maximum credit is $2,000 per child;
- The credit is non-refundable; and
- The credit is not available in advance.

A qualifying child, for purposes of the Child Tax Credit, is a child who:

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

The current law providing for the Child Tax Credit is set to expire after 2025 and—absent additional legislation—the Child Tax Credit will revert to $1,000 per child. Additionally, the Credit for Other Dependents (ODC) will not be available after 2025.

2.12.1.1 Child Tax Credit Phaseout and Nonrefundable Amounts

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

- The amount of the tax liability shown on the taxpayer's Form 1040, Form 1040-SR, or Form 1040-NR is less than the credit; or
- The taxpayer's modified adjusted gross income[3] is more than –
    - $400,000 if married filing jointly, or
    - $200,000 if filing as other than married filing jointly.

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

2.12.1.2 Social Security Number Requirement

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

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

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

2.12.2 Credit for Other Dependents

In addition to figuring the Child Tax Credit, Schedule 8812, *Credits for Qualifying Children and Other Dependents,* Part I is also used to determine the taxpayer's credit for other dependents in accordance with the following requirements. A taxpayer may be eligible for a Credit for Other Dependents (ODC) of up to $500 with respect to:

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

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

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

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

2.12.2.1 Limits on the CTC and ODC

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

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

2.12.2.2 Claiming CTC and ODC

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

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

Enter the amount in Schedule 8812 Part I, line 14 on the taxpayer's Form 1040, Form 1040–SR, or Form 1040–NR, line 19.

2.12.3 Additional Child Tax Credit

In addition to figuring the Child Tax Credit and Credit for Other Dependents, Schedule 8812*,* Part II-A (and Part II-B for taxpayers with three or more qualifying children and residents of Puerto Rico) is used to determine the taxpayer's eligibility for and amount of Additional Child Tax Credit. The Additional Child Tax Credit (ACTC), unlike the Child Tax Credit (CTC), is a refundable tax credit. The ACTC—a tax credit that may not exceed a maximum amount of $1,700 (2025) per qualifying child—is available only to taxpayers who have been denied some or all of the CTC because their tax liability is less than the full CTC for which they would otherwise be eligible. (Note: only the CTC may be used to figure the amount of any ACTC that can be claimed by a taxpayer; the ODC is not taken into account for purposes of figuring the ACTC.) Enter the amount in Schedule 8812 Part II-C, line 27 on the taxpayer's Form 1040, Form 1040–SR, or Form 1040–NR, line 28.

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

2.12.4 Child and Dependent Care Credit

Internal Revenue Code § 21 offers assistance, in the form of the child and dependent care credit, to taxpayers responsible for child and dependent care who are, or are seeking to become, gainfully employed.

The tax credit for 2025 is a percentage from 20% to 35% of the taxpayer's work-related child and dependent care expenses not to exceed $3,000 for one qualifying person and $6,000 for two or more qualifying persons. It is further subject to an earned income limit. The amount of work-related expenses used to figure the credit cannot be greater than:

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

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

2.12.4.1 Eligible Care Recipients Limited to Qualifying Persons

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

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

2.12.4.2 Eligible Taxpayers

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

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

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

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

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

2.12.5 Education Credits

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

2.12.5.1 American Opportunity Credit

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

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

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

2.12.5.1.1 Figuring the American Opportunity Credit

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

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

Thus, in order to claim the full $2,500 American opportunity credit for each eligible student, the taxpayer must have paid at least $4,000 of qualified education expenses. (100% x $2,000 = $2,000; $25% x $2,000 = $500; $2,000 + $500 = $2,500) However, a taxpayer's American opportunity credit may be reduced based on his or her MAGI. A taxpayer claims the American opportunity credit by completing Form 8863, and submitting it with his or her Form 1040. Additionally, when the American Opportunity Tax Credit is claimed, part of the due diligence requirements require the preparer to obtain substantiation for the claimed AOTC, such as a Form 1098-T, *Tuition Statement,* and/or receipts for qualified tuition and related expense.

2.12.5.2 Lifetime Learning Credit

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

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

Maximum credit	Up to $2,000 credit per return
Income limitations (2025)	Credit will be reduced if taxpayer's MAGI exceeds $80,000 ($160,000 MFJ) and will fully phase out at $90,000 ($180,000 MFJ).
Credit type	Credit is nonrefundable, i.e., it is limited to the amount of taxpayer's federal income tax liability
Eligible education years	Available for all years of postsecondary education and for courses to acquire or improve job skills
Maximum tax years	Available for an unlimited number of tax years
Degree requirement	Student not required to be pursuing a degree or other recognized credential
Enrollment status	Available for one or more courses
Qualified expenses	Tuition, required enrollment fees (and course materials, i.e. books, supplies and equipment the student needs for a course of study only if paid to the institution)
Drug convictions	Felony drug convictions do not disqualify
Academic periods	Payments made during the tax year for academic periods beginning during the tax year or in the first three months of the following year

2.12.5.2.1 Figuring the Lifetime Learning Credit

The maximum annual amount of Lifetime Learning Tax Credit a taxpayer may claim is $2,000 per return. The credit is equal to 20% of the first $10,000 of qualified education expenses paid for all eligible students but may be reduced if the taxpayer's MAGI exceeds an income threshold of $80,000 ($160,000 for a joint return). A taxpayer claims the lifetime learning credit by completing Form 8863, and submitting it with his or her Form 1040. The lifetime learning credit should be entered on the applicable line of Form 1040. Unlike an American opportunity credit, no part of a lifetime learning credit is refundable.

Review **#4**

1. Bob, an Army colonel, was transferred from Germany to Budapest for a permanent change of station. His spouse chose not to accompany him and returned to the United States. If she received a $10,000 relocation allowance and was later reimbursed an additional $2,500, how much of the $12,500 relocation payment, if any, must she include in her income?

   A. $0

   B. $2,500

   C. $10,000

   D. $12,500

2. Howard and Sharon, a married couple, purchased their primary residence and took out a $400,000 mortgage for the purchase. Since the house required repairs and updating, they took an additional home equity loan of $150,000 which they used to improve their home. If the 2025 interest paid on their $400,000 mortgage was $12,000 and on the home equity loan was $7,000, what is their 2025 mortgage interest deduction?

A. $0

B. $7,000

C. $12,000

D. $19,000

3. Harry's daughter, Alice, is a full-time college student in her sophomore year with eligible expenses of $10,000, and Harry intends to claim the American Opportunity Tax Credit (AOTC). What AOTC can he claim if he files a joint tax return and his modified adjusted gross income (MAGI) is $175,000, i.e. $15,000 in excess of the threshold amount?

A. $0

B. $625

C. $1,875

D. $2,500

2.12.6 Earned Income Tax Credit

The Earned Income Tax Credit (EITC) is a refundable tax credit. Eligibility to claim the credit requires, among other things, that the taxpayer have an earned income and also have an adjusted gross income (AGI) that is below a specified level, have no excluded foreign income or have investment income exceeding $11,950 (2025). The applicable maximum AGI level generally changes annually. The rules that apply to claiming the EITC fall into three categories: a) rules that apply to everyone, b) rules that apply if the taxpayer has a qualifying child, and c) rules that apply if the taxpayer does not have a qualifying child.

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

2.12.6.1 Adjusted Gross Income Limits

The applicable AGI limits generally change each year and, for 2025, are as shown in the following chart:

2025 EITC Income Limits				
Children	**Married Filing Jointly**	**Phaseout Range Married Filing Jointly**	**Other Than Married Filing Jointly***	**Phaseout Range Other Than Married Filing Jointly***
3 or more qualifying children	$68,675	$30,470 - $68,675	$61,555	$23,350 - $61,555
2 qualifying children	$64,430	$30,470 - $64,430	$57,310	$23,350 - $57,310
1 qualifying child	$57,554	$30,470 - $57,554	$50,434	$23,350 -$50,434
No qualifying children	$26,214	$17,730 - $26,214	$19,104	$10,620 - $19,104

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

2.12.6.2 Valid Social Security Number Required

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

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

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

2.12.6.3 Tax Filing Status

A taxpayer who is otherwise eligible to claim the EITC may have a tax filing status of single, married filing jointly or head of household. If the taxpayer is married, he or she must normally file a joint return to claim the EITC. However, there is a special rule for separated spouses to claim the EITC. The special rule requires that if the taxpayer is married, not filing as Married Filing Jointly, had a qualifying child who lived with the taxpayer for more than half of 2025 and either of the following applies:

- The taxpayer lived apart from their spouse for the last 6 months of 2025, or
- The taxpayer is legally separated according to their home state law under a written separation agreement or a decree of separate maintenance and did not reside in the same household as their spouse at the end of 2025.

2.12.6.3.1 Separated Spouses

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

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

2.12.6.4 Citizenship or Residency

If the taxpayer (or spouse, if married) was a nonresident alien for any part of the tax year, the taxpayer cannot claim the EITC unless the taxpayer's filing status is married filing jointly.

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

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

If the taxpayer meets all the EITC eligibility rules applicable to all filers—the rules just discussed—then proceed to the next step. The appropriate next step depends on whether or not the taxpayer has a qualifying child.

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

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

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

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

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

2.13 Energy Credits

Residential energy credits—the residential clean energy credit and the energy efficient home improvement credit—are both figured and taken using Form 5695, *Residential Energy Credits*, shown below. The residential clean energy credit, figured on Part I of Form 5695, is available for both existing homes and homes under construction. The energy efficient home improvement credit, figured on Part II of the form is available only for existing homes.

Before beginning to complete Form 5695, preparers should complete Residential Clean Energy Credit Limit Worksheet – Line 14 and/or Energy Efficient Home Improvement Credit Limit Worksheet – Line 31, depending on whether the Residential Clean Energy Credit or the Energy Efficient Home Improvement Credit is being claimed, both of which are found in the Instructions for Form 5695. These worksheets calculate the applicable Residential Energy Credit limit by subtracting certain credits/adjustments (if being taken by the taxpayer in 2025) from the taxpayer’s tax.

Form **5695**

Department of the Treasury
Internal Revenue Service

Residential Energy Credits

Attach to Form 1040, 1040-SR, or 1040-NR.

Go to www.irs.gov/Form5695 for instructions and the latest information.

OMB No. 1545-0074

2024

Attachment Sequence No. 75

Name(s) shown on return | Your social security number

Part I **Residential Clean Energy Credit** (See instructions before completing this part.)

Note: Skip lines 1 through 11 if you only have a **credit carryforward from 2023.**

Enter the complete address of the home where you installed the property and/or technology associated with lines 1 through 4 and 5b. For more than one home, see instructions.

Number and street	Unit no.	City or town	State	ZIP code

1	Qualified solar electric property costs	**1**	
2	Qualified solar water heating property costs	**2**	
3	Qualified small wind energy property costs	**3**	
4	Qualified geothermal heat pump property costs	**4**	
5a	Qualified battery storage technology. Does the qualified battery storage technology have a capacity of at least 3 kilowatt hours? (See instructions.) If you checked the "No" box, you cannot claim a credit for qualified battery storage technology	**5a**	☐ Yes ☐ No
b	If you checked the "Yes" box, enter the qualified battery technology costs	**5b**	
6a	Add lines 1 through 5b	**6a**	
b	Multiply line 6a by 30% (0.30)	**6b**	
7a	Qualified fuel cell property. Was qualified fuel cell property installed on, or in connection with, your **main home** located in the United States? (See instructions.)	**7a**	☐ Yes ☐ No
	If you checked the "No" box, you cannot claim a credit for qualified fuel cell property. Skip lines 7b through 11.		
b	Enter the complete address of the main home where you installed the fuel cell property.		

Number and street	Unit no.	City or town	State	ZIP code

c	If the special rule for joint occupants applies, check here ☐ and attach a statement. (See instructions.)				
8	Qualified fuel cell property costs	**8**			
9	Multiply line 8 by 30% (0.30)	**9**			
10	Kilowatt capacity of property on line 8 above . × $1,000	**10**			
11	Enter the smaller of line 9 or line 10			**11**	
12	Credit carryforward from 2023. Enter the amount, if any, from your 2023 Form 5695, line 16			**12**	
13	Add lines 6b, 11, and 12			**13**	
14	Limitation based on tax liability. Enter the amount from the Residential Clean Energy Credit Limit Worksheet. (See instructions.)			**14**	
15	**Residential clean energy credit.** Enter the smaller of line 13 or line 14. Also include this amount on Schedule 3 (Form 1040), line 5a			**15**	
16	Credit carryforward to 2025. If line 15 is less than line 13, subtract line 15 from line 13	**16**			

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 13540P Form **5695** (2024)

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Part II **Energy Efficient Home Improvement Credit**

Section A—Qualified Energy Efficiency Improvements

17a	Are the qualified energy efficiency improvements installed in or on your main home located in the United States? (See instructions.)	17a	☐ Yes ☐ No
b	Are you the original user of the qualified energy efficiency improvements?	17b	☐ Yes ☐ No
c	Are the components reasonably expected to remain in use for at least 5 years?	17c	☐ Yes ☐ No
	If you checked the "No" box for line 17a, 17b, or 17c, you cannot claim the energy efficient home improvement credit. Do not complete Part II, Section A.		
d	Enter the complete address of the main home where you made the qualifying improvements. **Caution:** You can only have one main home at a time. (See instructions.)		
	Number and street / Unit no. / City or town / State / ZIP code		
e	Were any of these improvements related to the construction of this main home?	17e	☐ Yes ☐ No
	If you checked the "Yes" box, you can only claim the energy efficient home improvement credit for qualifying improvements that were not related to the construction of the home. Do not include expenses related to the construction of your main home, even if the improvements were made after you moved into the home.		
18	Insulation or air sealing material or system.		
a	Enter the cost of insulation material or system (include air sealing material or system) specifically and primarily designed to reduce heat loss or gain of your home that meets the criteria established by the IECC. (See instructions.)	18a	
b	Multiply line 18a by 30% (0.30). Enter the results. Do **not** enter more than $1,200	18b	
19	Exterior doors that meet the applicable Energy Star requirements.		
a	Enter the cost of the most expensive door you bought	19a	
b	Multiply line 19a by 30% (0.30). Do **not** enter more than $250	19b	
c	Enter the cost of all other qualifying exterior doors	19c	
d	Multiply line 19c by 30% (0.30)	19d	
e	Add lines 19b and 19d. Do **not** enter more than $500	19e	
20	Windows and skylights that meet the Energy Star certification requirements.		
a	Enter the cost of exterior windows and skylights that meet the Energy Star certification requirements. (See instructions.)	20a	
b	Multiply line 20a by 30% (0.30). Enter the results. Do **not** enter more than $600	20b	

Section B—Residential Energy Property Expenditures

21a	Did you incur costs for qualified energy property installed on or in connection with a home located in the United States?	21a	☐ Yes ☐ No
b	Was the qualified energy property originally placed into service by you?	21b	☐ Yes ☐ No
	If you checked the "No" box for line 21a or 21b, you cannot claim the credit for your residential energy property costs. Skip lines 22 through 25 and line 29. Go to line 26.		
c	Enter the complete address of each home where you installed qualified energy property.		

Number and street	Unit no.	City or town	State	ZIP code

22	Residential energy property costs (include labor costs for onsite preparation, assembly, and original installation). (See instructions.)		
a	Enter the cost of central air conditioners	22a	
b	Multiply line 22a by 30% (0.30). Enter the results. Do **not** enter more than $600	22b	
23a	Enter the cost of natural gas, propane, or oil water heaters	23a	
b	Multiply line 23a by 30% (0.30). Enter the results. Do **not** enter more than $600	23b	
24a	Enter the cost of natural gas, propane, or oil furnace or hot water boilers	24a	
b	Multiply line 24a by 30% (0.30). Enter the results. Do **not** enter more than $600	24b	

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Section B—Residential Energy Property Expenditures (continued)

25a	Enter the cost of improvements or replacement of panelboards, subpanelboards, branch circuits, or feeders	25a			
b	Multiply line 25a by 30% (0.30). Enter the results. Do **not** enter more than $600			25b	
26	Home energy audits.				
a	Did you incur costs for a home energy audit that included an inspection of your main home located in the United States and a written report prepared by a certified home energy auditor? (See instructions.)			26a	☐ Yes ☐ No
	If you checked the "No" box, you cannot claim the home energy audit credit. Stop. Go to line 27.				
b	Enter the cost of the home energy audits	26b			
c	Multiply line 26b by 30% (0.30). Enter the results. Do **not** enter more than $150			26c	
27	Add lines 18b, 19a, 20b, 22b, 23b, 24b, 25b, and 26c	27			
28	Enter the smaller of line 27 or $1,200			28	
29	Heat pumps and heat pump water heaters; biomass stoves and biomass boilers.				
a	Enter the cost of electric or natural gas heat pumps	29a			
b	Enter the cost of electric or natural gas heat pump water heaters	29b			
c	Enter the cost of biomass stoves and biomass boilers	29c			
d	Add lines 29a, 29b, and 29c	29d			
e	Multiply line 29d by 30% (0.30). Enter the results. Do **not** enter more than $2,000			29e	
30	Add lines 28 and 29e			30	
31	Limitation based on tax liability. Enter the amount from the Energy Efficient Home Improvement Credit Limit Worksheet. (See instructions.)			31	
32	**Energy efficient home improvement credit.** Enter the smaller of line 30 or line 31. Also include this amount on Schedule 3 (Form 1040), line 5b			32	
a	If the special rule for joint occupants applies, check here ☐ and attach a statement. (See instructions.)				

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2.13.1 Modified Energy Efficient Home Improvement Credit

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

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

In addition, the provision makes tax credits available for amounts paid or accrued for the installation of qualified energy property.

2.13.2 Qualified Energy Efficiency Improvements

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

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

2.13.2.1 Energy Efficient Building Envelope Component

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

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

An energy efficient building envelope component means a building envelope component meeting the following requirements:

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

2.13.2.2 Tax Credit Limitations

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

- Windows, for which the maximum credit allowed with respect to any taxpayer for any taxable year shall not exceed $600 in the aggregate for all exterior windows and skylights;
- Doors, for which the credit allowed with respect to any taxpayer for any taxable year doesn't exceed—
    - $250 in the case of any exterior door, and
    - $500 in the aggregate with respect to all exterior doors.
- Home energy audits, for which the amount of the credit allowed shall not exceed $150 and the tax credit only applies to the taxpayers principal residence. A taxpayer may not claim the credit on a second home. (FS-2025-01)

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

2.13.3 Qualified Energy Property

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

2.13.3.1 Heat Pumps and Heat Pump Water Heaters

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

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

2.13.3.2 Biomass Stoves and Boilers

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

Thus, a biomass stove or boiler that:

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

…is considered qualified energy property.

2.13.3.3 Oil Furnace and Hot Water Boilers

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

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

2.13.3.4 Panelboard, Circuity Replacements, or Improvements

An improvement to, or replacement of, a panelboard[4], sub-panelboard, branch circuits, or feeders is considered qualified energy property and eligible for a tax credit provided it:

- Is installed in a manner consistent with the National Electric Code;
- Has a load capacity of not less than 200 amps;
- Is installed in conjunction with—
  - any qualified energy efficiency improvements, or
  - any qualified energy property for which a credit is allowed under this section for expenditures with respect to such property; and
- Enables the installation and use of qualified energy efficiency improvements or qualified energy property for which a credit is allowed.

2.13.3.5 Residential Energy Property Expenditures

The term "residential energy property expenditures" means expenditures made by the taxpayer for qualified energy property:

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

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

2.13.3.6 Eligible Fuel

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

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

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

2.13.3.7 Home Energy Audits

A home energy audit means an inspection and written report concerning a dwelling unit located in the United States and owned or used by the taxpayer as the taxpayer's principal residence that:

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

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

2.13.4 Subsidized Energy Financing

When calculating the energy efficient home improvement tax credit, do not take into account taxpayer expenditures that are made from subsidized energy financing. Subsidized energy financing means financing provided under a federal, state, or local program a principal purpose of which is to provide subsidized financing for projects designed to conserve or produce energy.

2.13.5 Tax Credits Reduce Taxpayer's Basis

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

2.13.6 Product Identification Number Required

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

- The item is produced by a qualified manufacturer; and
- The taxpayer includes the qualified product identification number (PIN) to specified property items on Form 5695, *Residential Energy Credits* in order to claim the credit for tax years beginning in 2025.

> NOTE: Taxpayers must include the PIN for any item of specified property they place in service on or after January 1, 2025, on their tax return. **For items placed in service in 2025, taxpayers can use the QM code in place of the full PIN.** A full PIN is required for all specified property placed in service on or after January 1, 2026. Taxpayers must also include a PIN for enabling property, but they can use the QM code regardless of when the property was placed in service.

2.13.6.1 Qualified Manufacturer/Identification Number

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

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

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

2.13.7 Effective Dates

The tax credits for qualified energy efficiency improvements, residential energy property expenditures, and home energy audits are effective for property placed in service after December 31, 2021.

2.13.8 Modifications to the Residential Clean Energy Property Credit

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

2.13.8.1 Extension of the Credit

The energy efficient home improvement credit is allowed with respect to property placed in service no later than December 31, 2034. The applicable percentage rate phases down as the date in which property placed in service approaches December 31, 2034.

2.13.8.1.1 Credit Phaseout

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

- 30 percent in the case of property placed in service after December 31, 2016, and before January 1, 2020;
- 26 percent in the case of property placed in service after December 31, 2019, and before January 1, 2022;
- 30 percent in the case of property placed in service after December 31, 2021, and before January 1, 2033;
- 26 percent in the case of property placed in service after December 31, 2032, and before January 1, 2034; and
- 22 percent in the case of property placed in service after December 31, 2033, and before January 1, 2035.

2.13.8.1.2 Battery Storage Technology Expenditures

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

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

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

2.14 New Clean Vehicle Credit

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

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

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

2.14.1 New Clean Vehicle Tax Credit Requirements

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

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

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

- Critical mineral component percentages are required to be domestically produced or extracted increased from a minimum of 40% in 2023, 50% in 2024, and 60% in 2025, 70% in 2026, and 80% for years thereafter. Vehicles acquired in 2025 must have no applicable critical minerals in the vehicles battery from a Foreign Entity of Concern(FEOC).
- The qualifying percentage of North American battery components for a vehicle to receive the tax credit increased from 50% in 2023 to 60% in 2024 and 2025, 70% in 2026, 80% in 2027, 90% in 2028 and 100% for years thereafter.

2.14.2 Manufacturer's Suggested Retail Price Affects Tax Credit Eligibility

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

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

2.14.3 Income-Based EV Tax Credit Limitations

No new vehicle tax credit is available if the taxpayer's MAGI for the current or prior taxable year exceeds the threshold amount which is:

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

2.14.4 Transfer of Credit

A taxpayer may elect to transfer the clean vehicle tax credit to an eligible entity, i.e., the dealer who sold the vehicle to the taxpayer, and receive the credit at the time of purchase of the vehicle in cash or in the form of a partial payment or down payment. A transferred credit does not result in includible income to the purchaser and is not deductible by the dealer.

2.14.5 Special Rules Applicable to New Clean Vehicle Credit

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

- Basis is reduced by the tax credit allowable;
- The amount of any deduction or other credit allowable under this chapter is reduced by the amount of clean vehicle credit allowed;

- No clean vehicle credit is allowable for vehicles used outside the U.S.;
- Clean vehicle tax credits may be recaptured if the vehicle ceases to be eligible for the credit;
- No clean vehicle tax credit is allowed if the taxpayer elects not to have the credit apply to the vehicle;
- A vehicle is ineligible for a clean vehicle credit unless it complies with –
  - the applicable provisions of –
    - the Clean Air Act for the make and model year of the vehicle, or
    - the air quality provisions of State law if adopted under a Clean Air Act waiver, and
  - the motor vehicle safety provisions of sections 30101 through 30169 of title 49, United States Code;
- If the credit has been transferred, it may not also be taken by the transferring taxpayer; and
- No clean vehicle tax credit is allowed unless the taxpayer includes the vehicle identification number (VIN) of the vehicle on the tax return for the taxable year.

2.14.6 Previously-Owned Clean Vehicle Credit

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

2.14.7 Income-Based EV Tax Credit Limitations

No previously-owned vehicle tax credit is available if the taxpayer’s MAGI for the current or prior taxable year exceeds the threshold amount which is:

- $150,000 in the case of a joint return or a surviving spouse taxpayer;
- $112,500 in the case of a head of household taxpayer; and
- $75,000 in the case of any other taxpayer.

2.14.8 Transfer of Credit

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

2.14.9 Special Rules Applicable to a Previously-Owned Clean Vehicle

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

- Basis is reduced by the tax credit allowable;
- No double credit is permitted. Thus, the amount of any deduction or other credit allowable under this chapter is reduced by the amount of previously-owned vehicle credit allowed;
- No previously-owned vehicle credit is allowable for vehicles used outside the U.S.;
- Previously-owned vehicle tax credits may be recaptured if the vehicle ceases to be eligible for the credit;
- No previously-owned vehicle tax credit is allowed if the taxpayer elects not to have the credit apply to the vehicle;
- A vehicle is ineligible for a previously-owned vehicle credit unless it complies with –
  - the applicable provisions of –
    - the Clean Air Act for the make and model year of the vehicle, or
    - the air quality provisions of State law if adopted under a Clean Air Act waiver, and

- the motor vehicle safety provisions of sections 30101 through 30169 of title 49, United States Code;
- If the credit has been transferred, it may not also be taken by the transferring taxpayer;
- No clean vehicle tax credit is allowed unless the taxpayer includes the vehicle identification number (VIN) of the vehicle on the tax return for the taxable year.

2.14.10 Rev. Proc. 2023-33

IRS Revenue Procedure 2023-33[5] addresses various procedures and requirements implementing the provisions of the IRA including those for the transfer of the new or previously-owned clean vehicle credit from the taxpayer who elects to transfer such credit to an eligible entity. Additionally, it supersedes sections 5.01 and 6.03 of Rev. Proc. 2022-42 with respect to the method and timing of submission of written agreements by manufacturers to the IRS. These procedures apply to transfers of credits after December 31, 2023.

Review **#5**

1. Tanya is a single taxpayer who has two qualifying children and qualifies for the Earned Income Credit in 2025. What is the maximum investment income she can have in 2025 and still be eligible for the credit?

   A. A taxpayer eligible for EIC cannot have any investment income

   B. $1,000

   C. $3,650

   D. $11,950

2. Edward, an unmarried taxpayer, is interested in purchasing a new clean vehicle and receiving the tax credit. Assuming he meets all other criteria for credit eligibility, what is the maximum modified adjusted gross income he may have and still be eligible for the credit?

   A. $75,000

   B. $150,000

   C. $225,000

   D. $300,000

3. John spent $700 in total for qualified energy improvements during the taxable year. If his total tax liability was $500, for what tax credit is he eligible?

   A. $150

   B. $210

   C. $500

   D. $700

2.15 Overview Topics

2.15.1 Tax Treatment of Virtual Currency

The term "virtual currency" refers to a digital representation of value not issued by any public authority but which may be, nonetheless, accepted as a means of payment between persons. It

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

functions as a medium of exchange and/or a store of value although it doesn't have status as legal tender. Such virtual currency having an equivalent value in real currency is referred to as "convertible" virtual currency. The IRS in [Notice 2014–21][6] describes how existing general tax principles apply to transactions using virtual currency as indicated below.

- Virtual currency is treated as property;
- Virtual currency is not treated as currency;
- Virtual currency as payment requires the recipient to include the fair market value of the virtual currency in U.S. dollars when computing gross income;
- Virtual currency basis is its fair market value in U.S. dollars as of the date of receipt;
- Gain or loss on exchange of virtual currency is considered a capital gain or capital loss;
- Type of gain or loss realized generally depends on whether or not the virtual currency is a capital asset in the hands of the taxpayer;
- Mining virtual currency results in realized gross income for tax purposes upon receipt of the virtual currency to the extent of its fair market value as of the date of receipt;
- Virtual currency mining as a trade or business, if not undertaken as an employee results in net earnings from self-employment and constitutes self-employment income subject to the self-employment tax;
- Virtual currency received by independent contractors for performing services, measured in U.S. dollars as of the date of receipt, constitutes self-employment income subject to self-employment tax;
- Virtual currency paid to an employee is subject to federal income tax withholding, FICA tax and FUTA tax based on its fair market value when paid and must be reported on Form W-2, Wage and Tax Statement;
- Information reporting of virtual currency payments requires a person who, in the course of a trade or business, makes a payment of fixed and determinable income using virtual currency with a value of more than $600 to a U.S. nonexempt recipient in a taxable year must report the payment to the IRS and to the payee;
- Information reporting of virtual currency payments to independent contractors generally requires a person who, in the course of a trade or business, makes a virtual currency payment of $600 or more in a taxable year to an independent contractor for the performance of services must report the fair market value in U.S. dollars on the date made of the payment to the IRS and to the payee on Form 1099–NEC, *Nonemployee Compensation*;
- Virtual currency payments are subject to backup withholding to the same extent as other payments made in property;
- Third-party settlement organizations (TPSOs) must report payments made to a merchant on form 1099-k if the gross amount of payments made to the merchant in 2025 exceeds $2,500, regardless of the number of transactions; and
- Incorrect tax treatment of virtual currency transactions will subject a taxpayer to penalties for failure to comply with tax laws.

IRS [Notice 2023-34][7] modifies previous IRS Notice 2014-21 by revising a sentence in the Background section to remove the statement that virtual currency does not have legal tender status in any jurisdiction.

2.15.2 Alternative Minimum Tax (AMT)

Imposition of an alternative minimum tax was designed to ensure that at least a minimum amount of tax is paid by higher-income taxpayers who enjoy significant tax savings through the use of certain tax preference items. After the tax-preference items are added back into the taxpayer's income, the applicable alternative minimum taxable income (AMTI) exemption, discussed below, is subtracted.

2.15.2.1 Alternative Minimum Tax Exemption Amount Increased

The applicable AMTI exemption amounts[8] for 2025 are as follows:

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[6] Notice 2014-21 may be accessed at https://www.irs.gov/pub/irs-drop/n-14-21.pdf.
[7] Notice 2023-34 may be accessed at https://www.irs.gov/pub/irs-drop/n-23-34.pdf
[8]AMTI exemption amounts are indexed for inflation.

Filing Status	Threshold for Phaseout of Exemption Amount	Complete Phaseout Amount	Alternative Minimum Taxable Income Exemption
Single or Head of Household	$626,350	$978,750	$88,100
Married Filing Jointly & Qualifying Surviving Spouse	$1,252,700	$1,800,700	$137,000
Married Filing Separately	$626,350	$900,350	$68,500
Estates and Trusts	$102,500	$225,300	$30,700

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

2.15.3 QBI Deduction

The QBI deduction is a deduction of up to 20% of qualified business income derived from a qualified trade or business.

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

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

2.15.3.1 Deduction Eligibility

Taxpayers who may be eligible for the deduction are those who operate a business as a sole proprietorship or under a pass-through entity—a partnership or LLC taxed as a partnership—or an S corporation. Individuals, trusts and estates with qualified business income, qualified REIT dividends or qualified PTP income may qualify for the deduction.

Eligibility for the pass-through deduction is unaffected by the taxpayer's election to itemize deductions or take the standard deduction.

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

The deduction of up to 20% of a pass-through business' qualified business income may reduce the taxpayer's income tax liability significantly. Other factors that may affect the deduction include:

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

2.15.3.2.1 Qualified Trade or Business

A qualified trade or business means any trade or business ***other than***:

- A specified service trade or business (SSTB);
- Any trade or business where the principal asset is the reputation or skill of one or more of its employees or owners; or
- The trade or business of performing services as an employee.

2.15.3.2.1.1 Exception for Specified Service Trade or Business

The rule cited just above that disqualifies SSTBs from being considered qualified trades or businesses eligible for the pass-through deduction does not apply to individuals whose taxable income is less than the threshold amount[9]. The threshold amount and phase-in range are as shown in the chart below:

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

Taxpayer's Filing Status	2025 Threshold Amount	Phase-In Range
Married filing jointly	$394,600	$100,000
Married filing separately	$197,300	$50,000
Single & head of household filers	$197,300	$50,000

However, the pass-through deduction is not available for specified service trades or businesses if the taxpayer's taxable income is equal to or greater than the applicable threshold amount plus $100,000 in the case of a taxpayer filing a joint tax return or the applicable threshold amount plus $50,000 for all other taxpayers. So, a married taxpayer who owns an SSTB, files jointly, and has a taxable income in 2025 of $494,600 or more ($394,600 + $100,000) would be ineligible for the deduction.

For specified service trades or businesses of taxpayers whose taxable income falls within the phase-in range, the deduction may be reduced. Under the phase-in reduction, only the applicable percentage of qualified business income, W-2 wages and unadjusted basis immediately after acquisition (UBIA) of qualified property held by the trade or business is taken into account in determining the § 199A deduction.

For example, assume Shirley, the taxpayer owns and operates a business classified as an SSTB. If Shirley is married, files jointly, has a 2025 income of $444,600, i.e. $50,000 in excess of the $394,600 applicable income threshold, pays no W-2 wages and has no qualified property, and has a $300,000 qualified business income in 2025, the phased-in reduction (Part III of Form 8995-A, *Qualified Business Income Deduction)* is as follows:

Part III Phased-in Reduction

Complete Part III only if your taxable income is more than $191,950 but not $241,950 ($383,900 and $483,900 if married filing jointly) and line 10 is less than line 3. Otherwise, skip Part III.

17	Enter the amounts from line 3 *(20% of QBI)*		$60,000
18	Enter the amounts from line 10 *(the appropriate %age of the allocable share of W-2 wages and UBIA)*		$0
19	Subtract line 18 from line 17		$60,000
20	Taxable income before qualified business income deduction	$444,600	
21	Threshold. Enter $191,950 ($383,900 if married filing jointly)	$394,600	
22	Subtract line 21 from line 20	$50,000	
23	Phase-in range. Enter $50,000 ($100,000 if married filing jointly)	$100,000	
24	Phase-in percentage. Divide line 22 by line 23	50%	
25	Total phase-in reduction. Multiply line 19 by line 24		$30,000
26	Qualified business income after phase-in reduction. Subtract line 25 from line 17. Enter this amount here and on line 12, for the corresponding trade or business		$30,000

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

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

- Qualified business income (QBI);

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

Determining which of the forms to use to figure the deduction is based on whether the taxpayer's taxable income is greater than the applicable threshold or the taxpayer is a patron in a specified agricultural or horticultural cooperative.

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

2.15.3.3.1 Qualified Business Income Deduction Simplified Computation - Form 8995

Form 8995,[10] *Qualified Business Income Deduction Simplified Computation*, shown below, permits a taxpayer or preparer to compute the pass-through deduction for a taxpayer whose taxable income doesn't exceed the applicable threshold amount and who is not a patron in a specified agricultural or horticultural cooperative.

2.15.3.3.2 Qualified Business Income Deduction - Form 8995-A

Form 8995-A,[11] shown below, permits a taxpayer or preparer to compute the pass-through deduction for a taxpayer whose taxable income exceeds the applicable threshold amount or who is a patron in a specified agricultural or horticultural cooperative.

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

Form **8995** | **Qualified Business Income Deduction Simplified Computation** | OMB No. 1545-2294

2025

Department of the Treasury
Internal Revenue Service

Attach to your tax return.

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

Attachment Sequence No. **55**

Name(s) shown on return | **Your taxpayer identification number**

Note: *You can claim the qualified business income deduction* ***only*** *if you have qualified business income from a qualified trade or business, real estate investment trust dividends, publicly traded partnership income, or a domestic production activities deduction passed through from an agricultural or horticultural cooperative. See instructions.*

Use this form if your taxable income, before your qualified business income deduction, is at or below $197,300 ($394,600 if married filing jointly), and you aren't a patron of an agricultural or horticultural cooperative.

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

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

For Privacy Act and Paperwork Reduction Act Notice, see instructions. Cat. No. 37806C Form **8995** (2025)

Form **8995-A** Department of the Treasury Internal Revenue Service

Qualified Business Income Deduction

Attach to your tax return.

Go to *www.irs.gov/Form8995A* for instructions and the latest information.

OMB No. 1545-2294

2025

Attachment Sequence No. **55A**

Name(s) shown on return	**Your taxpayer identification number**

Note: *You can claim the qualified business income deduction* ***only*** *if you have qualified business income from a qualified trade or business, real estate investment trust dividends, publicly traded partnership income, or a domestic production activities deduction passed through from an agricultural or horticultural cooperative. See instructions.*

Use this form if your taxable income, before your qualified business income deduction, is above $197,300 ($394,600 if married filing jointly), or you're a patron of an agricultural or horticultural cooperative.

Part I Trade, Business, or Aggregation Information

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

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

Part II Determine Your Adjusted Qualified Business Income

			A	B	C
2	Qualified business income from the trade, business, or aggregation. See instructions	2			
3	Multiply line 2 by 20% (0.20). If your taxable income is *$197,300* or less *($394,600* if married filing jointly), skip lines 4 through 12 and enter the amount from line 3 on line 13	3			
4	Allocable share of W-2 wages from the trade, business, or aggregation	4			
5	Multiply line 4 by 50% (0.50)	5			
6	Multiply line 4 by 25% (0.25)	6			
7	Allocable share of the unadjusted basis immediately after acquisition (UBIA) of all qualified property	7			
8	Multiply line 7 by 2.5% (0.025)	8			
9	Add lines 6 and 8	9			
10	Enter the greater of line 5 or line 9	10			
11	W-2 wage and UBIA of qualified property limitation. Enter the smaller of line 3 or line 10	11			
12	Phased-in reduction. Enter the amount from line 26, if any	12			
13	Qualified business income deduction before patron reduction. Enter the greater of line 11 or line 12	13			
14	Patron reduction. Enter the amount from Schedule D (Form 8995-A), line 6, if any. See instructions	14			
15	Qualified business income component. Subtract line 14 from line 13	15			
16	Total qualified business income component. Add all amounts reported on line 15	16			

For Privacy Act and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 71661B Form **8995-A** (2025)

Form 8995-A (2025) Page 2

Part III Phased-in Reduction

Complete Part III only if your taxable income is more than $197,300 but not $247,300 ($394,600 and $494,600 if married filing jointly) and line 10 is less than line 3. Otherwise, skip Part III.

					A	B	C
17	Enter the amounts from line 3			17			
18	Enter the amounts from line 10			18			
19	Subtract line 18 from line 17			19			
20	Taxable income before qualified business income deduction	20					
21	Threshold. Enter $197,300 ($394,600 if married filing jointly)	21					
22	Subtract line 21 from line 20	22					
23	Phase-in range. Enter $50,000 ($100,000 if married filing jointly)	23					
24	Phase-in percentage. Divide line 22 by line 23	24	%				
25	Total phase-in reduction. Multiply line 19 by line 24			25			
26	Qualified business income after phase-in reduction. Subtract line 25 from line 17. Enter this amount here and on line 12, for the corresponding trade or business			26			

Part IV Determine Your Qualified Business Income Deduction

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

Form **8995-A** (2025)

2.15.3.4 Rental Real Estate Safe Harbor

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

2.15.4 Kiddie Tax – Unearned Income of Minor Children

Effective for taxable years beginning after December 31, 2019, any income subject to the Kiddie Tax is taxable at the child's parents' marginal tax rate.

2.15.4.1 Kiddie Tax Applicability

The law imposing the Kiddie Tax is applicable to the unearned income of children 18 years old or younger (ages 19 to 24 if dependent full-time students). For taxable years beginning in 2025, the amount of unearned income used to reduce the net unearned income reported on the child's return subject to the Kiddie Tax is $1,350. To take the parental election, a child's gross income must be more than $1,350 but less than 10 times that amount, i.e., $13,500.

2.15.4.2 Alternative Minimum Tax

A child may be subject to the alternative minimum tax (AMT) if he or she has certain items given preferential treatment under the tax law. These items include accelerated depreciation and certain tax-exempt interest income. The AMT for a child subject to the kiddie tax is calculated in the same way as it is for any other person, and the 2025 AMT exemption amount for a child subject to the kiddie tax may not exceed the lesser of:

- The sum of the child's earned income for the taxable year plus $9,550; and
- The 2025 AMT exemption applicable to an unmarried taxpayer other than a surviving spouse, i.e., $88,100.

2.15.5 Section 529 Plans

Qualified tuition programs enable a taxpayer to contribute funds for the purpose of paying a designated beneficiary's qualified education expenses. A qualified tuition program may take one of two forms:

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

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

Earnings on the funds invested in a college savings plan are tax-deferred and may be entirely tax-free if used to pay qualified education expenses at any eligible educational institution.

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

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

The definition of qualified education expenses has been broadened to permit an annual qualified distribution of up to $10,000 from all of a taxpayer's §529 plans for elementary or secondary school tuition. Such schools may be:

- Public;
- Private; or
- Religious.

Subsequent legislation has further expanded the definition of *qualified higher education expense* applicable to include distributions for:

- Expenses for fees, books, supplies, and equipment required for the participation of a designated beneficiary in an apprenticeship program; and
- Principal or interest paid on a qualified education loan of the designated beneficiary or a sibling of the designated beneficiary in an amount not exceeding $10,000 in the aggregate; the deduction otherwise allowable for education loan interest is reduced (but not below zero) by the amount of the distributions treated as a qualified higher education expense.

Beginning in 2024, tax law also provides for a limited penalty-free rollover from a §529 plan to a Roth IRA.

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

2.15.6 Achieving a Better Life Experience (ABLE) Account

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

2.15.6.1 Tax-Deferred Account

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

2.15.6.2 ABLE Account Distributions

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

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

2.15.6.3 ABLE Account Contributions

Cash contributions to an ABLE account may be made by the designated beneficiary and others. The maximum amount of annual contribution to the account, in total, is generally limited to the annual gift tax exclusion amount ($19,000 in 2025).

Rollovers from a section 529 plan count toward the annual contribution limit. Rollover amounts and other contributions made to an ABLE account are reported on Form 5498-QA, box 1 and 2.

2.15.6.4 TCJA Changes to ABLE Accounts

The TCJA made three important changes to ABLE accounts:

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

2.15.6.4.1 Additional Designated Beneficiary Contributions Permitted

Under the provisions of the TCJA, a designated beneficiary who meets the special rules related to the contribution limit may make an additional contribution, after the overall limitation on contributions is reached. The maximum additional contribution that may be made by a designated beneficiary is an amount not exceeding the designated beneficiary's compensation includable in gross income for the taxable year or the poverty line for a one-person household for the calendar year preceding the calendar year in which the taxable year begins.

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

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

2.15.6.4.2 Saver's Credit

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

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

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

The tax credit is a *nonrefundable* credit that is limited to the applicable percentage of the taxpayer's eligible contribution; the credit cannot exceed $1,000 per taxpayer.

The percentage of the contribution (not exceeding a contribution of $2,000) available to the taxpayer as a tax credit, up to a $1,000 maximum tax credit, depends upon the individual's adjusted gross income and income tax filing status. The applicable percentages for 2025 contributions are as shown below:

Saver's Credit Adjusted Gross Income Limits (2025)[12]						
Joint Return		**Head of Household Return**		**All Other Statuses**		**Applicable Credit**
Over	Not over	Over	Not over	Over	Not over	Percentage
$0	$47,500	$0	$35,625	$0	$23,750	50%
$47,500	$51,000	$35,625	$38,250	$23,750	$25,500	20%
$51,000	$79,000	$38,250	$59,250	$25,500	$39,500	10%
$79,000		$59,250		$39,500		0%

2.15.7 Discharge of Student Loan Indebtedness

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

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

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

[12] Note that the adjusted gross income limits may change from year to year.

discharged in other cases was normally included in the individual debtor's gross Income for tax purposes.

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

- Death; or
- Total and permanent disability.

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

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

2.15.8 Net Operating Loss (NOL)

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

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

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

2.15.9 Premium Tax Credit

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

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

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

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

2.15.9.1 Federal Poverty Level

The federal government's poverty levels for 2025 are as shown in the chart below:

HHS Poverty Guidelines			
Persons in family/household	**48 Contiguous States and D.C.**	**Alaska**	**Hawaii**
1	$15,650	$19,550	$17,990
2	$21,150	$26,430	$24,320
3	$26,650	$33,310	$30,650
4	$32,150	$40,190	$36,980
5	$37,650	$47,070	$43,310
6	$43,150	$53,950	$49,640
7	$48,650	$60,830	$55,970
8	$54,150	$67,710	$62,300
For each additional person add	$5,500	$6,880	$6,330

2.15.9.2 Amount of the Credit

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

Tax Credit = Benchmark Plan Premium - Taxpayer's Expected Contribution

2.15.9.3 Benchmark Plan

The "benchmark plan" is the second-lowest-cost plan that would cover the family at the silver level of coverage, i.e., one designed to provide benefits that are actuarially equivalent to 70 percent of the full actuarial value of the benefits provided under the plan. In other words, the plan pays at least 70 percent of covered charges after any applicable deductible amount.

2.15.9.4 Additional Tax Limitation

Taxpayers who are granted advanced subsidies are required to reconcile the advanced credit when filing their federal tax return, and, in the case of overpayment, a limitation on repayment is applied to those whose household income is less than 400% of the federal poverty line. The limitation for 2025 is as shown in the chart below:

If the household income (expressed as a percent of poverty line) is:	Limitation Amount for Unmarried Individuals (other than surviving spouses or heads of households)	Limitation Amount for All Other Taxpayers
Less than 200%	$375	$750
At least 200% but less than 300%	$975	$1,950
At least 300% but less than 400%	$1,625	$3,250

2.15.9.5 Health Insurance Marketplace Statements

The Health Insurance Marketplace Statement, Form 1095-A, *Health Insurance Marketplace Statement,* is issued to a taxpayer that purchased an insurance plan through the marketplace.

Information provided in Form 1095-A is used to complete the taxpayer's income tax return, claim any premium tax credits that may be due, and calculate any of the tax credit the taxpayer may be required to repay if the taxpayer received advance premium tax credit during the year in excess of the amount for which he or she was eligible.

Form 1095-B, *Health Coverage* is used to report taxpayers and the taxpayers dependents health care coverage and serves as verification that the taxpayer and dependents all meet the health insurance eligibility requirements of the Affordable Care Act.

Lastly, Applicable Large Employers (ALEs) with more than 50 full-time employees are required to send Form 1095-C, *Employer-Provided Health Insurance Offer and Coverage,* a statement of health coverage to each employee, regardless of whether the employee participated in employer health insurance coverage or not. Form 1095-C provides the following taxpayer information:

- Employee and employer identifying information,
- Months during the year the employee was eligible for coverage, and
- The cost of the cheapest monthly premium the employee could have paid under the plan.

Forms 1095-A, B, and C are all required in completing income tax filing for a taxpayer who receives an Advance Premium Tax Credit for health insurance through the Health Insurance Marketplace.

2.15.10 Employee Fringe Benefits

2.15.10.1 Qualified Transportation Fringe Benefits

Under prior tax law, employers could offer their employees various commuting benefits that were tax-deductible to the employer.

However, the following changes are made to these employee fringe benefits for tax years after December 31, 2017:

- No tax deduction will be allowed an employer for any expense incurred for providing any transportation or for any payment or reimbursement to an employee in connection with travel between the employee's residence and place of employment except as necessary for ensuring the employee's safety.
- Although qualified bicycle commuting reimbursements will continue to be tax-deductible, within applicable limits, to the employer providing them, employees' exclusion of qualified bicycle commuting reimbursements from income for tax purposes is suspended for taxable years beginning after December 31, 2017 and before January 1, 2026.

For 2025, the monthly limitation with respect to the aggregate fringe benefit exclusion amount for transportation in a commuter highway vehicle and any transit pass is $325. The monthly limitation amount for qualified parking is $325.

2.15.10.2 Medical Savings Accounts

The Health Insurance Portability and Accountability Act (HIPAA) authorized the establishment of a pilot program designed to make individuals more cost-conscious in their selection and use of healthcare. The pilot program which ended on December 31, 2007 allowed individuals to establish medical savings accounts. These medical savings accounts have been renamed and are now referred to as "Archer MSAs."

Archer MSAs are trusts created solely to pay the qualified medical expenses of the individuals for whom established and call for an individual to:

- Buy a high-deductible health insurance policy, and
- Make tax-deductible contributions to the Archer MSA trust.

Contributions made to the trust could be expected to earn tax-deferred interest. An individual covered under an Archer MSA could withdraw funds from the trust to pay any qualified healthcare expenses.

2.15.10.3 Archer MSA Tax Benefits

Archer MSAs offer account holders a tax deduction for contributions, tax-deferral of earnings, and tax-free distributions to pay qualified medical expenses. Nonqualified distributions—distributions for other than to pay qualified medical expenses—if taken before age 65 are generally subject to a 20% tax penalty.

2.15.10.4 Archer MSA Eligibility

Only employees of small employers and self-employed individuals and their families were eligible to establish an Archer MSA while the pilot program remained in effect.

An individual eligible to establish an Archer MSA is a self-employed individual or an employee of a small employer who:

- For any month, is covered under a high deductible health plan as of the first day of that month; and
- Is NOT covered under any non-high deductible health plan providing coverage for any benefit covered under the high deductible health plan.

2.15.10.5 Archer MSA Pilot Program Ended

The Archer MSA pilot program ended on December 31, 2007. Although existing Archer MSAs may continue in force, a taxpayer cannot be treated as an eligible individual for Archer MSA purposes unless the taxpayer:

- Was an active participant in an Archer MSA for any tax year ending before January 1, 2008; or
- Became an active participant for a tax year ending after December 31, 2007 by reason of coverage under a high deductible health plan of an Archer MSA participating employer.

2.15.10.5.1 High Deductible Health Plan Requirement

A "high-deductible health plan" is defined differently for individuals and families. For a policy that covers *only the individual*, a high deductible health plan in 2025 is one whose annual deductible is at least $2,850 but not more than $4,300. It must also provide that annual out-of-pocket expenses, other than for premiums, do not exceed $5,700.

A high-deductible health plan providing *family coverage* in 2025 must have an annual deductible of at least $5,700 but not more than $8,550 and must require annual out-of-pocket expenses, other than for premiums, of not more than $10,500.

2.15.10.6 Archer MSA Contributions

The maximum deductible contribution that may be made to an Archer MSA depends on whether the high deductible health plan provides self-only coverage or family coverage and the amount of the applicable deductible.

An eligible individual may deduct the contributions he or she makes to an Archer MSA during the taxable year in an amount not to exceed:

- 65% of the annual deductible for individuals with self-only coverage; or
- 75% of the annual deductible for individuals with family coverage.

The date during the year the qualifying high deductible coverage began is important for determining the maximum MSA contribution since the maximum amount that may be contributed to the trust is based on a full taxable year; thus, if the high-deductible health plan coverage began later than January 1st, the maximum trust contribution permitted for that calendar year would be reduced.

2.15.10.7 Health Savings Accounts

Based, in part, on the experience of the Archer MSA pilot program, legislation was signed into law establishing health savings accounts (HSAs).

Like MSAs, HSAs are trusts created solely to pay the qualified medical expenses of an account beneficiary and call for an individual to:

- Buy a high-deductible health insurance policy, and
- Make tax-deductible contributions to the HSA trust.

Contributions made to the trust and any earnings are tax-deferred for as long as they remain in the trust. HSA account holders may withdraw funds from the trust to pay any qualified healthcare expenses. When the account holder's expenses for healthcare exceed the policy's deductible, those expenses are covered, in whole or in part, by the health insurance.

Although HSAs and their accompanying high-deductible health plans (HDHPs) are intended to provide insurance coverage for covered costs only to the extent they exceed the HDHP deductible, the CARES Act has modified this requirement, effective on and after January 1, 2020, by:

- Allowing HDHP participants with HSAs to obtain telemedicine[13] and other remote care services free of any cost sharing without jeopardizing the HSA;
- Eliminating the ACA ban on the pre-tax reimbursement of over-the-counter drugs not prescribed by a physician; and
- Treating expenses incurred for menstrual care products as qualified medical expenses.

Additionally, the Families First Coronavirus Response Act (FFCRA) requires all group health plans and health insurers to cover coronavirus tests and related services without any type of cost sharing. Thus, no deductible or coinsurance charges apply to testing for the coronavirus, and receiving such first-dollar benefits will not adversely affect the HSA or the individual's eligibility.

Distributions from an HSA may be taken by an account holder at any time. If taken to pay or be reimbursed for qualified healthcare expenses, such distributions are tax free. If taken for any purpose other than to pay qualified healthcare expenses, the distribution is taxable as ordinary income and may be subject to a tax penalty.

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[13] "Telemedicine" refers to the use of technology to provide remote medical services to individuals over a smart phone or computer.

2.15.10.8 HSA Benefits

HSAs offer account holders several benefits. Principal among those benefits are the following:

- A taxpayer can claim a tax deduction for contributions made to the HSA even if he or she does not itemize deductions;
- Contributions made to the HSA by the taxpayer's employer, including contributions made through a cafeteria plan, may be excluded from the taxpayer's gross income;
- The earnings on amounts contributed to the HSA are tax-deferred;
- Distributions from an HSA to pay qualified medical expenses are entirely tax free;
- A taxpayer's contributions and HSA earnings, if any, remain in the HSA from year to year until the taxpayer uses them;
- An HSA is non-forfeitable and portable, so that it remains with the account holder if he or she changes employers or leaves the work force; and
- Distributions from an HSA for other than qualified medical expenses—if taken after the account holder reaches age 65, becomes disabled or dies—are taxable but not subject to tax penalties.

2.15.10.9 HSA Eligibility

An individual eligible to establish an HSA is one who meets the following requirements. The individual:

- Is covered under a high deductible health plan (HDHP) on the first day of the month;
- Has no other health coverage except for certain specified coverages;
- Is not enrolled in Medicare; and
- Cannot be claimed as a dependent on another person's tax return for the year.

The specified types of coverage the individual is permitted to have and still be eligible to establish an HSA are the same as those permitted under Archer MSA regulations and are:

- A policy providing coverage for a specified disease;
- A policy providing disability insurance;
- A policy providing coverage relating to certain liabilities;
- A policy providing a fixed daily (or other period) hospitalization benefit;
- A policy providing dental or vision care insurance;
- A policy providing accident insurance; or
- A policy providing long term care insurance.

If a taxpayer meets these eligibility requirements, he or she is an eligible individual even if the taxpayer's spouse has non-HDHP coverage, provided the spouse's coverage does not cover the taxpayer.

2.15.10.10 HSA High Deductible Health Plan Requirement

To be eligible for an HSA, an otherwise eligible individual must be covered under a high-deductible health plan. A "high-deductible health plan" is defined variously for individuals and families. For a policy that covers only the individual, a high deductible health plan in 2025 is one whose annual deductible is at least $1,650.   The coverage must also provide that annual out-of-pocket expenses, other than premiums, do not exceed $8,300.

A high-deductible health plan providing family coverage in 2025 must have an annual deductible of at least $3,300 and must require annual out-of-pocket expenses, other than premiums, of not more than $16,600.   (These limits tend to be adjusted upward each year.)

High Deductible Health Plan – 2025

Contribution, deductible and out-of-pocket limits in an HSA high deductible health plan for a specific year depend on whether the plan provides self-only coverage or family coverage. The limits applicable to an HSA in 2025 are the following:

Coverage Type	Minimum Deductible	Maximum Annual Out-of-Pocket*	Maximum Individual Annual Contribution	Individual Annual Catch-up Contribution
Self-only coverage	$1,650	$8,300	$4,300	$1,000

Family coverage	$3,300	$16,600	$8,550	$1,000

*The maximum out-of-pocket limit does not apply to deductibles and expenses for out-of-network services if the plan uses a network of providers. Instead, only deductibles and out-of-pocket expenses for services within the network should be used to figure whether the limit applies.

2.15.10.11 HSA Contributions

Contributions to an HSA must be made in cash and may be made up until April 15th of the year following the year for which contributions are made.

An eligible individual who has not attained age 55 by the end of the taxable year may deduct the contributions he or she makes to an HSA during 2025 in an amount not to exceed:

- $4,300 for account holders with self-only coverage; or
- $8,550 for account holders with family coverage.

Under the general rule applicable to HSA contributions, a person younger than age 55 with self-only coverage under an HDHP is limited to a maximum monthly contribution of no more than $358.33. ($4,300 ÷ 12 = $358.33) Similarly, the general rule would limit an account holder with family coverage to a monthly contribution of no more than $712.50 ($8,550 ÷ 12 = $712.50)

2.15.10.12 HSA Contributions from Multiple Sources

Contributions made to an account holder's HSA may come from multiple sources. If the account holder has an HSA under an employer's plan, contributions may be made by the employer, the employee or both for the same year. In addition, family members or any other person may also contribute to an HSA on behalf of an eligible individual.

2.15.10.13 Additional Contributions for Age 55 and Older Account Holders

HSA account holders who attain age 55 before the close of a taxable year are eligible to make an additional contribution of up to $1,000. If both spouses are age 55 or older, each may make a catch-up contribution of up to $1,000.

2.15.10.14 Health Flexible Spending Arrangement Contributions

Health FSAs enable workers to contribute before-tax amounts to an account that may then be accessed tax-free to pay various out-of-pocket health-related expenses.

For years 2013 and 2014 a $2,500 per year limit was imposed on the amount that may be contributed to a flexible spending arrangement for medical expenses. That limit may be increased annually by a cost of living adjustment and, for 2025, is $3,300. If the cafeteria plan permits the carryover of unused amounts, the maximum carryover amount is $660.

2.15.11. Depreciation of Rental Property

It was noted earlier (2.8.7) that depreciation is an allowance for the wear and tear, deterioration, or obsolescence of depreciable property, a category that includes most types of tangible property except land. Thus, buildings, machinery, vehicles, furniture, and equipment used in the production of income—as well as certain types of intangible property, such as patents, copyrights—may be depreciated.

Depreciable property generally is depreciated using the Modified Accelerated Cost Recovery System (MACRS), which consists of two systems:

1. The General Depreciation System (GDS); and
2. The Alternative Depreciation System (ADS).

Under the MACRS system, the recovery period and method applicable to rental property generally depends on the type of property being rented and the depreciation system—ADS or GDS—being used.

2.15.11.1 General Depreciation System vs Alternative Depreciation System

Both residential rental property and non-residential rental property generally may be depreciated using GDS. The property that must use ADS includes tangible property used principally outside the United States and tax-exempt property.

Taxpayers depreciating residential and non-residential buildings must use straight-line depreciation over which depreciation is determined by dividing the cost basis of the property, not including the land, by the applicable recovery period. The recovery period applicable to residential property under the GDS system is 27.5 years; the recovery period applicable to non-residential property under the GDS system is 39 years.

For example, a taxpayer whose cost basis in **residential** rental property is $500,000 would be able to take a deduction for an annual tax deduction (in other than the first and last years of the recovery period) equal to $18,181 ($500,000 ÷ 27.5). In contrast, a taxpayer having an identical cost basis in **non-residential** rental property ($500,000) would have an annual tax deduction (in other than the first and last years of the recovery period) equal to $12,820 due to the longer recovery period ($500,000 ÷ 39).

Although depreciable buildings are subject to straight-line depreciation, other depreciable property such as land improvements and assets used within the property like furniture, appliances, and fixtures may be depreciated under one of the accelerated methods that offer a larger early tax deduction.

2.16 Tax Withholding and Estimated Tax Payments

Federal income tax is a pay-as-you-go tax. Two methods are used by the federal government to collect income taxes and facilitate the pay-as-you-go nature of the tax:

- Tax withholding; and
- Estimated tax payments.

When the taxpayer's tax return is prepared, credit is taken for the income tax withheld and any estimated tax payments made.

2.16.1 Tax Withholding

Income tax is withheld from the salaries and wages of most employees and may also be withheld from certain other income, such as pensions, bonuses, tips, taxable fringe benefits, sick pay, unemployment compensation and gambling winnings. The amount withheld is paid to the IRS on behalf of the taxpayer.

2.16.1.1 Form W-4 Employee's Withholding Certificate

The amount of income tax withheld by an employer from a taxpayer's regular pay depends on the amount earned by the taxpayer and spouse, if any, in the payroll period and the information provided by the taxpayer to his or her employer on IRS Form W–4, *Employee's Withholding Certificate*. The taxpayer-provided information includes whether to withhold at the single, head of household, or married rate, whether the taxpayer holds multiple jobs at a time and/or the taxpayer's spouse is employed, the number of dependents claimed, whether an additional withholding amount is requested, and whether an exemption from withholding is claimed.

The taxpayer is ***required*** to provide the employer with a new Form W-4 within 10 days following any change that would affect withholding. If events during the current year will increase required withholding for the following year, the taxpayer must provide the employer with a new Form W-4, by December 1 of the current year; if the event affecting withholding occurs in December of the current year, a new Form W-4 must be submitted within 10 days following the event. The taxpayer should provide the employer with a new Form W-4 to change the amount of withholding if too little tax is likely to be withheld.

Taxpayers who hold more than one job at a time or who are married filing jointly with a working spouse may choose to use the multiple jobs worksheet, included in the Form W-4 instructions, or use the estimator to determine the correct amount of withholding. Taxpayers should consider using the estimator, found at www.irs.gov/W4App, if they:

- Expect to work only part of the year;
- Have dividend or capital gain income, or are subject to additional taxes, such as Additional Medicare Tax;
- Have self-employment income; or
- Prefer the most accurate withholding for multiple job situations.

Income taxes are also withheld from an employee's tips (indirectly by withholding from the employee's regular pay), taxable fringe benefits and sick pay

2.16.1.2 Exemption from Withholding

A taxpayer may claim an exemption from income tax withholding if both the following situations apply:

1. The taxpayer had a right to a refund of all federal income tax withheld because of having no tax liability in the current year; and
2. The taxpayer expects a refund of all federal income tax withheld in the next year because of having no income tax liability.

2.16.1.3 Penalties

A taxpayer may be subject to a penalty of $500 if both the following apply:

- The taxpayer made statements on Form W-4 that reduced the amount of tax withheld; and
- The taxpayer had no reasonable basis for those statements at the time Form W-4 was prepared.

A criminal penalty may also apply for willfully supplying false or fraudulent information on the form or for willfully failing to supply information that would increase the amount withheld. The penalty upon conviction can be a fine of up to $1,000 or imprisonment for up to one year, or both

2.16.1.4 Withholding from Nonwage Income

Although a taxpayer is generally required to have income tax withheld from his or her gambling winnings, a taxpayer may also have income tax withheld from other types of nonwage income. Accordingly, a taxpayer may have income tax withheld from:

- Pensions and annuities by requesting withholding using Form W-4P, *Withholding Certificate for Periodic Pension or Annuity Payments* or Form W-4R, *Withholding Certificate for Nonperiodic Payments and Eligible Rollover Distributions*; and
- Unemployment compensation and federal payments, such as Social Security benefits by requesting withholding using Form W-4V, *Voluntary Withholding Request*.

If the taxpayer chooses not to have income tax withheld from nonwage income, he or she may have to pay estimated tax.

Note that Form W-4P (previously titled Withholding Certificate for Pension or Annuity Payments), was updated to include updates to the deduction worksheet for inflation adjustments. Additionally, Step 2: (a) of Form W-4P introduces the taxpayer to an online tax withholding estimator with a link to www.irs.gov/W4App. The withholding tax estimator allows taxpayers to determine the most accurate withholding for self-employment income.

2.16.2 Estimated Tax

The payment of estimated taxes is the method used to pay tax on income that is not subject to income tax withholding, including income tax and self-employment tax as well as other taxes and amounts reported on the taxpayer's tax return. If the taxpayer does not pay enough tax, either through withholding or by paying estimated tax (or a combination of both), he or she may be subject to a penalty.

2.16.2.1 Requirement to Pay Estimated Tax

A taxpayer must pay estimated tax if both of the following apply:

1. The taxpayer expects to owe at least $1,000 for the year after subtracting withholding and refundable credits; and
2. The taxpayer expects withholding plus refundable credits to be less than the smaller of –
   a. 90% of the tax to be shown on the current year's tax return, or
   b. 100% of the tax shown on the previous year's tax return (provided the return covers all 12 months).

However, a taxpayer may avoid paying estimated tax if:

- The taxpayer receives a salary or wages and asks his or her employer to take more tax out of earnings; or
- All the following conditions apply –
  - The taxpayer had no tax liability for the previous year,
  - The taxpayer was a U.S. citizen or resident alien for the whole year, and
  - The taxpayer's previous tax year covered a 12-month period.

Estimated tax payments are generally due in four installments, due April 15, June 15, September 15 and January 15.

Estimated income taxes may be paid using any of the following methods:

- Crediting an overpayment of tax on the previous year's tax return to the current year's estimated tax;
- Payment of the estimated tax by direct transfer from the taxpayer's bank account, making payment by use of a credit or debit card, by using a pay-by-phone system, or via the Internet; or
- Remitting a payment using a check or money order along with a payment voucher Form 1040-ES, *Estimated Tax for Individuals*.

2.17 Balance Due and Refund Options

After the taxpayer's income tax liability, if any, is determined and the tax return prepared, the taxpayer will usually have paid more or less income tax than owed. Accordingly, the taxpayer will either be required to pay an additional tax amount or will be due a tax refund. The taxpayer has several options in either case.

2.17.1 Payment of Income Tax Owed

If the taxpayer has paid less income tax than due, several methods are available to him or her to pay any amount owed. When paying the taxes owed, no estimated tax payment for the following year should be included; such estimated tax should be paid separately.

A taxpayer may make income tax payments:

- Online or by telephone using a –
  - Direct transfer from the taxpayer's bank account, or
  - Credit or debit card;
- By check or money order; or
- In cash.

Individuals wishing to take advantage of the cash payment option should visit the IRS.gov payments page, select the cash option in the "Other Ways You Can Pay" section of the web page and follow the instructions.

2.17.2 Refunds

Taxpayers who are due a tax refund also have several choices with respect to its receipt. The options available to a taxpayer owed a refund include that the refund:

- Be applied to the taxpayer's estimated tax for the following year;
- Be deposited to a prepaid debit card;
- Be sent to him or her in a check; or
- Be direct deposited to one account (See Limit on Direct Deposit Refunds below).

Additional options may be selected by using Form 8888, Allocation of Refund, directing a refund:

- Be deposited into two or three accounts at a bank or other financial institution (such as a mutual fund, brokerage firm, or credit union) in the United States. (See **Limit on Direct Deposit Refunds** below)
- Be credited to a TreasuryDirect® online account in order to buy U.S. Treasury marketable securities or savings bonds; or
- Be deposited directly to a traditional, Roth or SEP IRA, HSA, or Archer MSA.

If the taxpayer is due an income tax refund but has not paid certain amounts owed, the refund may be used to pay any past-due amounts.

2.17.2.1 Limit on Direct Deposit Refunds

The IRS limits the number of refunds electronically deposited into a single financial account or pre-paid debit card to three per calendar year. Any refunds in excess of three will be made as a paper refund check and will be mailed to the taxpayer.

Tax return preparers are prohibited from negotiating client refund checks or accepting such payments in an account owned or controlled by the preparer. No direct deposits of tax refunds should be requested to an account not in the taxpayer’s name.

2.18 Federal Income Tax Return Filing Due Dates and Filing for Extensions

The due date for filing a federal income tax return depends on whether the taxpayer uses the calendar year or a fiscal year. In addition, the applicable due date may be extended:

- Under an automatic extension;
- If the taxpayer is outside the United States; or
- If the taxpayer is serving in a combat zone.

2.18.1 Calendar Year and Fiscal Year Taxpayers

For taxpayers who use the calendar year, the due date for filing the federal income tax return is generally April 15th of the year following the end of the calendar year for which the tax return is being filed. The federal income tax returns for taxpayers who use a fiscal year, i.e., a year ending on the last day of any month except December, are due by the 15th day of the fourth month after the close of the taxpayer’s fiscal year. A taxpayer’s failure to file a timely income tax return may subject the taxpayer to a failure-to-file penalty and interest.

The federal income tax return of a nonresident-alien taxpayer who does not earn wages subject to such withholding is due:

- June 15th for calendar year taxpayers; or
- The 15th day of the 6th month after the end of the taxpayer’s fiscal year for fiscal year taxpayers.

The federal income tax return of a decedent, i.e., a taxpayer who died during the year, must be filed by the decedent’s representative by the 15th day of the fourth month after the end of the decedent’s normal tax year.

2.18.2 Extensions of Time to File

A taxpayer may be able to get an extension of the time to file his or her federal income tax return. However, despite obtaining an extension of the time to file, any tax due must generally be paid by the regular due date. Failure to pay any tax due by the regular date will result in the imposition of interest and possible penalties on the unpaid amount from the date due until the date actually paid.

A taxpayer may qualify for an extension of time to file:

- Under an automatic extension;
- If the taxpayer is outside the United States; or
- The taxpayer is serving in a combat zone.

2.18.2.1 Automatic Extension of Time to File

A taxpayer who is unable to file a federal income tax return by the normal due date may be able to get an automatic six-month extension of the time to file. The automatic extension may be obtained by:

- Using IRS e-file; or
- Filing a paper form.

An automatic six-month extension of the time to file a federal income tax return may be obtained by timely filing IRS form 4868, Application for Automatic Extension of Time to File U.S. Individual Income Tax Return.[14] The application for automatic extension is considered timely filed if filed by the due date for the taxpayer's income tax return. A representation of that form is shown below:

Form **4868**
Department of the Treasury
Internal Revenue Service

Application for Automatic Extension of Time To File U.S. Individual Income Tax Return

OMB No. 1545-0074

2024

For calendar year 2024, or other tax year beginning , 2024, and ending , 20 .

Part I Identification			**Part II** Individual Income Tax	
1 Your name(s) (see instructions)			**4** Estimate of total tax liability for 2024 . .	$
Address (see instructions)			**5** Total 2024 payments	
			6 **Balance due.** Subtract line 5 from line 4. See instructions	
			7 Amount you're paying (see instructions) .	
City, town, or post office	State	ZIP code	**8** Check here if you're "out of the country" and a U.S. citizen or resident. See instructions	☐
2 Your social security number	**3** Spouse's social security number		**9** Check here if you file Form 1040-NR and didn't receive wages as an employee subject to U.S. income tax withholding	☐

For Privacy Act and Paperwork Reduction Act Notice, see page 4. Cat. No. 13141W Form **4868** (2024)

When the taxpayer's income tax return is subsequently filed, enter any payment made when the application for extension was filed on Form 1040 Schedule 3, *Additional Credits and Payments* , line 10, i.e., on the line stating "Amount you're paying."

2.18.2.2 Individuals Outside the United States

A taxpayer is allowed an automatic two-month extension, without filing Form 4868, *Application for Automatic Extension of Time To File U.S. Individual Income Tax Return*, to file the federal income tax form ***and pay any federal income tax due*** if:

- The taxpayer is a U.S. citizen or resident, and
- On the due date of the taxpayer's return, he or she is –
  - Living outside the United States and Puerto Rico, and the taxpayer's main place of business or post of duty is outside the United States and Puerto Rico, or
  - In the military or naval service on duty outside the United States and Puerto Rico.

If the taxpayer files a joint return, only one spouse needs to qualify in order to take advantage of this automatic extension. However, if the taxpayer and spouse file separate returns, the automatic extension applies only to the spouse who qualifies. To obtain the automatic extension, the taxpayer simply needs to attach a statement to his or her federal income tax return explaining what situation qualified him or her for the extension. Although a taxpayer who meets the criteria for an automatic two-month extension may defer payment of any federal income tax due, if the tax due is paid after the regular due date, interest—but no penalties—will be charged from the regular due date until the date the tax is paid.

[14] IRS Form 4868 and its instructions may be accessed at https://www.irs.gov/pub/irs-pdf/f4868.pdf

If the taxpayer cannot file his or her federal income tax return within the automatic two-month extension period, the taxpayer may be able to get an additional four-month extension by filing IRS Form 4868 and checking the box on line eight of the form.

2.18.2.3 Individuals Serving in a Combat Zone

Individuals serving in a combat zone receive a substantial deferral with respect to their income tax returns. The due date for filing the taxpayer's federal income tax return, paying any tax owed, and filing a claim for refund is automatically extended if the taxpayer serves in a combat zone. The deferral applies to:

- Members of the Armed Forces;
- Merchant marines serving aboard vessels under the operational control of the Department of Defense;
- Red Cross personnel;
- Accredited correspondents; and
- Civilians under the direction of the Armed Forces in support of the Armed Forces.

For taxpayers who serve in a combat zone, the deadline for filing the federal income tax return, paying any taxes due, and filing a claim for refund is extended for at least 180 days after the later of:

- The last day the taxpayer is in a combat zone or the last day the area qualifies as a combat zone; or
- The last day of any continuous qualified hospitalization for injury from service in the combat zone.

In addition to the 180 day extension, the taxpayer's deadline for filing the income tax return is also extended by the number of days the taxpayer had left to take action with the IRS when entering the combat zone.

Review **#6**

1. As a single taxpayer, Arthur's alternative minimum taxable income exemption in 2025 would be $88,100 if his income does not exceed $626,350. What is his AMTI exemption amount if his alternative taxable income is $726,350, i.e., $100,000 more than the applicable threshold amount?

   A. $0

   B. $25,000

   C. $63,100

   D. $81,300

2. Audrey is a single sole proprietor who owns and operates an accounting business, a business considered an SSTB. She has no REIT or PTP interests. She has no capital gains or losses and, after allowable deductions not relating to her business, her total taxable income for 2025 is $110,000. The applicable taxable income threshold in 2025 is $197,300. The business's QBI is $100,000. What is her pass-through deduction, if any?

   A. $20,000

   B. $22,000

   C. $32,145

   D. Audrey is ineligible for a deduction because her business is an SSTB

Domain 3 – Practices, Procedures & Professional Responsibility

Introduction

Tax return preparers are held to a high standard of conduct in their preparation of clients' income tax returns. Their failure to maintain that standard may subject them to financial, reputational and other penalties. The following textual material addresses certain of those standards and the applicable penalties for failing to maintain them.

Domain 3 Learning Objectives

When you have completed the domain 3 text, you should be able to:

- Identify the red flags indicating possible tax-related identity theft and suggested assistance to its victims;
- Understand the laws and regulations requiring privacy and security of taxpayer data and the best practices tax preparers may implement to help assure it;
- Describe the purpose of individual taxpayer identification numbers, their effect on tax credits and how to renew them;
- Recognize the penalties applicable to a tax return preparer under Title 26;
- Identify the due diligence requirements imposed on tax return preparers with respect to claiming head of household filing status, Earned Income Tax Credit (EITC), Child Tax Credit (CTC) and American Opportunity Tax Credit (AOTC);
- Understand the e-file requirements; and
- Recognize the Annual Filing Season Program requirements.

3.1 Tax Related Identity Theft (Publication 5199)

Tax-related identity theft usually occurs when someone uses a stolen Social Security number to file a tax return claiming a fraudulent refund. Thieves may also use stolen Employer Identification Numbers to create false Forms W-2, *Wage and Tax Statement* to support refund fraud schemes.

The IRS has created and published Publication 5199[15], *Tax Preparer Guide to Identity Theft*, which identifies the various warning signs of identity theft and suggests additional identity theft-prevention resources for preparers. Among the identified warning signs for individual clients that the client's Social Security number has been compromised, putting him or her at risk, are the following:

- A client's return is rejected and IRS reject codes indicate the taxpayer's Social Security number has already been used;
- The client notices activity on or receives IRS notices regarding a tax return after all tax issues have been resolved, refund paid or account balances have been paid; and
- An IRS notice indicates the client received wages from an employer unknown to the client.

To prevent filing returns with stolen identities, tax preparers should ask taxpayers not known to them to provide ***two forms of identification***—preferably forms of identification containing the individual's picture—that include the taxpayer's name and current address. In addition, tax return preparers must confirm the identities and Social Security numbers of taxpayers, spouses and dependents.

Preparers should require taxpayers to show the Social Security cards for themselves, their spouses and dependents and should take special care to ensure that they transcribe all Social Security numbers correctly. Furthermore, the Social Security number entered on the IRS Form W-2 must be identical to the taxpayer's Social Security number on the Social Security card provided by the

[15]Publication 5199, *Tax Preparer Guide to Identity Theft* may be accessed at http://www.irs.gov/pub/irs-pdf/p5199.pdf.

taxpayer. Tax return preparers should enter the Social Security number exactly as shown on the Form W-2 provided to them by taxpayers.

In order to minimize Social Security number-related rejects, it is important to verify taxpayer Social Security numbers and names before submitting a return to the IRS.

3.1.1 Assisting Victims of Identity Theft

You should take the following steps if a client's SSN is compromised and they suspect or know they're a victim of tax-related identity theft:

- Respond promptly to IRS notices; and
- Complete Form 14039, *Identity Theft Affidavit*, if –
    - the IRS rejected the client's e-file return and the reject code indicates a duplicate filing under their SSN, or
    - you're instructed to do so.

Attach Form 14039 to the client's paper return and mail it according to the instructions. The form allows the IRS to put an indicator on the client's tax records for questionable activity. Clients should continue to file returns and pay taxes, even if the filing must be done on paper while the IRS researches their case.

If you or your client previously contacted the IRS and didn't get a resolution, call the IRS for specialized assistance at 800-908-4490. (The IRS has teams ready to assist individuals who are victims of tax-related identity theft.) Information about how IRS identity theft victim assistance works is available at irs.gov/idtVictimAssistance.

3.2 Safeguarding Taxpayer Data (Publication 4557)

We live in a dangerous time with respect to the theft of information about ourselves. We see evidence of it repeatedly as major retailers suffer severe business declines when it becomes known that their computer data has been compromised and our credit card and other personal information has been exposed. According to Javelin Strategy & Research[16], a research-based advisory firm, identity fraud scams in 2024 accounted for losses of $56 billion.

Tax preparers, frequently required to warehouse sensitive personal information needed to prepare clients' tax returns, are increasingly being targeted for data theft. Unsurprisingly, safeguarding taxpayer data—defined as any information obtained or used in the preparation of a tax return—is an important IRS priority. Safeguarding that data is a legal responsibility and needs to be an equally important priority for tax preparers.

3.2.1 Laws and Regulations Requiring Privacy/Security

Various federal laws have been passed and regulations promulgated to safeguard taxpayer data. Principal among those laws and regulations are the:

- FTC Safeguards Rule under which professional tax preparers are required to ensure the security and confidentiality of customer records and information. The Rule requires that tax preparers develop, implement and maintain an information security program. Such a program should contain –
    - Administrative safeguards,
    - Technical safeguards, and
    - Physical safeguards;
- Sarbanes-Oxley Act of 2002 (17 CFR Parts 232, 240 and 249) section 404, applicable to all SEC reporting companies having a market capitalization in excess of $75 million, that requires companies to preserve records and data from destruction, loss, unauthorized alteration or other misuse;
- FTC Financial Privacy Rule requiring professional tax preparers to give customers privacy notices explaining the preparer's information collection and sharing practices;

[16] 2025 Identity Fraud Study: Resolving the Shattered Identity Crisis | Javelin (javelinstrategy.com) .

- IRC §301.7216 and IRC §6713 that impose criminal and monetary penalties, respectively, on preparers who make unauthorized disclosures or uses of information provided to them by taxpayers; and
- Internal Revenue Procedure 2007-40 that requires authorized IRS e-file providers to have security systems in place to prevent unauthorized access to taxpayer accounts and personal information.

3.2.2 Best Practices to Safeguard Data

The IRS publication 4557 available to tax preparers titled "Safeguarding Taxpayer Data: A Guide for your Business" can help preparers understand and meet their obligations with respect to safeguarding taxpayer data. It provides various checklists and other information preparers should consult that address:

- Administrative activities;
- Facilities security;
- Personnel security;
- Information systems security;
- Computer systems security;
- Media security;
- Certifying information systems for use; and
- Reporting incidents.

In addition, the publication provides a list of resources (Appendix A) that may be accessed for additional information and guidance on various data-security concerns, including:

- Writing effective financial privacy notices;
- Complying with the Safeguards Rule;
- How to safely dispose of taxpayer data; and
- Reducing risks to your computer systems.

The IRS has also made available other information specifically for tax professionals concerning identity theft and creating a data-security plan. Online providers also must follow the six security and privacy standards in Publication 1345, Handbook for Authorized IRS e-file Providers of Individual Income Tax Returns.[17]

The IRS has mandated six security, privacy, and business standards to supplement the Gramm-Leach-Bliley Act to better serve taxpayers and protect their information collected, processed and stored by Online Providers of individual income tax returns. The first five standards continue to apply to Online Providers, while Standard number six, "Reporting of Security Incidents," is now mandated for all Providers.

3.2.2.1 Extended Validation SSL Certificate

Online Providers of individual income tax returns must have a valid and current Extended Validation Secure Socket Layer (SSL) certificate using Transport Layer Security (TLS) 1.2 or later and minimum 2048-bit RSA/128-bit AES.

3.2.2.2 External Vulnerability Scan

Online Providers of individual income tax returns must contract with an independent third-party vendor to run weekly external network vulnerability scans of all their "system components" in accordance with the applicable requirements of the Payment Card Industry Data Security Standards (PCIDSS). All scans must be performed by a scanning vendor certified by the Payment Card Industry Security Standards Council and listed on their current list of Approved Scanning Vendors (ASV). In addition, Online Providers of individual income tax returns whose systems are hosted must ensure that their host complies with all applicable requirements of the PCIDSS. For the purposes of this standard, "system components" is defined as any network component, server, or application that is included in or connected to the taxpayer data environment. The taxpayer data environment is that part of the

[17] Publication 1345 may be accessed at https://www.irs.gov/pub/irs-pdf/p1345.pdf

network that has taxpayer data or sensitive authentication data. If scan reports reveal vulnerabilities, action must be taken to address the vulnerabilities in line with the scan report's recommendations. Retain weekly scan reports for at least one year. The ASV and the host (if present) must be in the United States.

3.2.2.3 Information Privacy and Safeguard Policies

This standard applies to Authorized IRS e-file Providers participating in Online Filing of individual income tax returns that own or operate a website through which taxpayer information is collected, transmitted, processed or stored. These Providers must have a written information privacy and safeguard policy consistent with the applicable government and industry guidelines and including the following statement: "we maintain physical, electronic and procedural safeguards that comply with applicable law and federal standards." In addition, Providers' compliance with these policies must be certified by a privacy seal vendor acceptable to the IRS.

3.2.2.4 Protection Against Bulk Filing of Fraudulent Income Tax Returns

This standard applies to Online Providers of individual income tax returns that own or operate a website through which taxpayer information is collected, transmitted, processed or stored. These Online Providers must implement effective technologies to protect their website against bulk filing of fraudulent income tax returns. Taxpayer information must not be collected, transmitted, processed or stored otherwise.

3.2.2.5 Public Domain Name Registration

This standard applies to Online Providers of individual income tax returns that own or operate a website through which taxpayer information is collected, transmitted, processed or stored. These Online Providers must have their website's domain name registered with a domain name registrar that is in the United States and accredited by the Internet Corporation for Assigned Names and Numbers (ICANN). The domain name must be locked and not be private.

3.2.2.6 Reporting of Security Incidents

Authorized IRS e-file Providers of individual income tax returns must report security incidents to the IRS as soon as possible but not later than the next business day after confirmation of the incident. For the purposes of this standard, an event that can result in an unauthorized disclosure, misuse, modification, or destruction of taxpayer information (e.g., breach) must be considered a reportable security incident. Providers with multiple roles must follow instructions for submitting incident reports at "Instructions for Reporting Security Incidents." Those that are EROs only must contact their local stakeholder liaison by following the instructions at "Data Theft Information for Tax Professionals." In addition, if the Provider's website is the cause of the incident, the Provider must cease collecting taxpayer information via their website immediately upon detection of the incident and until the underlying causes of the incident are successfully resolved.

3.3 Individual Taxpayer Identification Numbers

Individual Taxpayer Identification Numbers (ITINs) are tax processing numbers issued by the IRS to individuals who:

- Are required to have a U.S. taxpayer identification number;
- Do not have a Social Security number; **and**
- Are NOT eligible to obtain a Social Security number from the Social Security Administration.

ITINs are used only for federal tax reporting and are not intended to serve any other purpose.

Effective January 1, 2018, the deduction for personal exemptions was suspended for tax years 2018 through 2025 by the Tax Cuts and Jobs Act. For tax years after December 31, 2017, spouses and dependents are not eligible for an ITIN or to renew an ITIN unless they are claimed for an allowable tax benefit or they file their own tax return.

Spouses and dependents must be listed on an attached U.S. federal tax return and include the schedule or form that applies to the allowable tax benefit. Dependents claimed for an allowable tax benefit must prove U.S. residency unless from Canada or Mexico. An allowable tax benefit includes a spouse filing a joint return, Head of Household (HOH) filing status, the American Opportunity Tax

Credit (AOTC) Form 8863, Premium Tax Credit (PTC) Form 8962, Credit for Other Dependents (ODC), and Child and Dependent Care Credit (CDCC) Form 2441.

ITIN applicants who submit a Form W-7, *Application for IRS Individual Taxpayer Identification Number* based on the HOH filing status must be listed as a dependent on an attached tax return as a qualifying child or a qualifying relative. A dependent applicant must prove U.S. residency unless from Canada or Mexico.

If Form W-7 is submitted to claim ODC, the dependent applicants must be listed on an attached tax return with the "Credit for other dependents" box checked next to their name and prove U.S. residency or be a U.S. National. A dependent applicant from Canada or Mexico is not eligible for an ITIN if the only allowable tax benefit claimed is ODC unless they prove U.S. residency

3.3.1 Who Needs an ITIN?

As discussed in Publication 1915,[18] the IRS issues ITINs to foreign nationals and others who have federal tax reporting or filing requirements and who don't qualify for a Social Security number. ITINs are issued to help individuals comply with the U.S. tax laws, and to provide a means for the IRS to efficiently process and account for tax returns and payments for those not eligible for Social Security numbers. They are issued regardless of immigration status, because both resident and nonresident aliens may have a U.S. filing or reporting requirement under the Internal Revenue Code.

An ITIN does not:

- Authorize work in the U.S.
- Provide eligibility for Social Security benefits
- Qualify a dependent for Earned Income Tax Credit Purposes

Your client will need an ITIN if he or she does not have one and:

- Does not have an SSN and is ineligible to obtain one, and
- Has a requirement to furnish a federal tax identification number or file a federal tax return, and is in one of the following categories –
  - Nonresident alien who is required to file a U.S. tax return,
  - U.S. resident alien who is (based on days present in the United States) filing a U.S. tax return,
  - Dependent or spouse of a U.S. citizen/resident alien,
  - Dependent or spouse of a nonresident alien visa holder,
  - Nonresident alien claiming a tax treaty benefit, or
  - Nonresident alien student, professor or researcher filing a U.S. tax return or claiming an exception.

All individuals must have a tax purpose for requesting an ITIN, whether or not a U.S. Federal income tax return is submitted to the IRS with Form W-7.

3.3.2 ITIN Renewals

If your client's ITIN wasn't included on a U.S. federal tax return at least once in the last three consecutive tax years, his or her ITIN expired on December 31, of the third consecutive tax year. ITINs with middle digits (the fourth and fifth positions) "70," through "88" have expired. In addition, ITINs with middle digits "90," "91," "92," "94," "95," "96," "97," "98," or "99," IF assigned before 2013, have also expired.

If your client previously submitted a renewal application and it was approved, no renewal is required. Otherwise, the client should submit:

- a completed Form W-7, *Application for IRS Individual Taxpayer Identification Number*,
- a US federal tax return, and

[18] Pub 1915 may be accessed at https://www.irs.gov/pub/irs-pdf/p1915.pdf

- all required identification documents to the IRS.

If your client's ITIN is only being used on information returns for reporting purposes, the client's ITIN does not need to be renewed at this time. However, in the future, if the client needs to use the ITIN to file a U.S. federal tax return, the client will need to renew the ITIN at that time.

ITIN holders must submit a Form W-7 and usually must attach a U.S. federal tax return, to renew their expired ITIN, along with the required documentation. A renewing taxpayer must attach a U.S. federal tax return unless eligible for one of the five exceptions involving:

- Third party withholding on passive income;
- Wages, salary, compensation and honoraria payments with tax treaty benefits claimed; scholarships, fellowships and grants with tax treaty benefits claimed; scholarships, fellowships and grants – no tax treaty benefits claimed; or gambling winnings with tax treaty benefits claimed;
- Third party reporting of mortgage interest;
- Third party withholding – disposition by a foreign person of united states real property interest; or
- A non-U.S. representative of a foreign corporation who needs to obtain an ITIN for the purpose of meeting their e-filing requirements.

The exceptions are explained more fully in the Instructions for Form W-7, and in Publication 1915, *Understanding Your IRS Individual Taxpayer Identification Number (ITIN).*

3.4 Preparer Penalties

Professional tax preparers are expected to demonstrate a high level of competence, diligence and ethical behavior in their preparation of taxpayers' tax returns and are penalized for their failure to meet those expectations. The penalties that may be imposed under Title 26 for various preparer failures are as follows:

Scenario	**Per Return or Claim for Refund**	**Maximum Penalty for Multiple Offenses**
Failure to furnish copy of tax return to taxpayer (§ 6695(a))	$65	$32,500
Failure to sign taxpayer's return (§ 6695(b))	$65	$32,500
Failure to furnish identifying number (§ 6695(c))	$65	$32,500
Failure to retain a copy or list of a return or claim (§ 6695(d))	$65	$32,500
Failure to file correct information returns (§ 6695(e))	$65 per return and item in return	$32,500
Negotiation of a check issued to a taxpayer (§ 6695(f))	$650 per check	No limit
Failure to be diligent in determining eligibility for head of household filing status, Child Tax Credit, American Opportunity Tax Credit, and Earned Income Tax Credit (§ 6695(g))	$650 per failure	No limit
Unauthorized disclosure or use of information furnished for, or in connection with, the preparation of a return (§ 6713)	$250	$10,000

In addition, tax preparer penalties may also be imposed for the following:

Scenario	**Penalty**

Understatement of taxpayer's liability due to unreasonable positions (§ 6694(a))	Greater of $1,000 or 50% of income derived by preparer with respect to the return or claim for refund.
Understatement of taxpayer's liability due to willful or reckless conduct (§ 6694(b))	Greater of $5,000 or 75% of income derived by preparer with respect to the return or claim for refund.
Aiding and abetting understatement of a taxpayer's tax liability (§ 6701)	$1,000 ($10,000 if the conduct relates to a corporation's tax return)
Fraud and false statements (§ 7206)	Guilty of a felony; upon conviction, a fine of $100,000 ($500,000 in the case of a corporation), imprisonment of not more than three years or both, together with costs of prosecution.

3.5 Due Diligence in Tax Preparation

Due diligence is the care and attention to detail appropriate to the subject to which it refers. Thus, due diligence with respect to tax preparation is the care and attention to detail required of each preparer in his or her preparation of taxpayers' tax returns. Not surprisingly, the tax issues that create the greatest amount of confusion and resultant errors are the ones that require the highest level of diligence. Among the tax preparation topics responsible for a significant level of errors are:

- Qualifying for head of household (HOH) filing status; and
- Claiming the –
  - Child tax credit (CTC),
  - Credit for Other Dependents (ODC),
  - Education tax credits (AOTC), and
  - Earned income tax credit (EITC).

Filing as head of household and claiming the refundable tax credits are each governed by different eligibility rules. In order to avoid errors, it is important to take the following three steps:

1. Know the tax law for filing as head of household and claiming each refundable credit including its eligibility rules;
2. Remember that your software is not a substitute for your knowledge of the tax law; and
3. Follow the Due Diligence Must Do's.

In addition, the due diligence requirements require the preparer to meet four standards in preparing a tax return claiming head of household filing status, the EITC, American Opportunity Tax Credit, Credit for Other Dependents, or the Child Tax Credit. Those requirements call for the preparer to:

1. Complete and submit IRS Form 8867, *Paid Preparer's Due Diligence Checklist*;
2. Complete the applicable worksheet;
3. Know the law relative to claiming the credit or filing status and, by interviewing and asking questions, the taxpayer; and
4. Document and maintain appropriate records related to preparation of the tax return, including keeping the following records for 3 years:
   - A copy of Form 8867*,*
   - The applicable worksheet(s) or your own worksheet(s) for any credits claimed,
   - Copies of any documents provided by the taxpayer on which you relied to determine the taxpayer's eligibility for the credit(s) and/or HOH filing status and to figure the amount(s) of the credit(s),
   - A record of how, when, and from whom the information used to prepare Form 8867 and the applicable worksheet(s) was obtained, and
   - A record of any additional information you relied upon, including questions you asked and the taxpayer's responses, to determine the taxpayer's eligibility for the credit(s) and/or HOH filing status and to figure the amount(s) of the credit(s).

The various questions posed on Form 8867, act as memory-joggers and identify areas about which the tax preparer should obtain information from the taxpayer when filing as Head of Household, or claiming the Earned Income Tax Credit, the Child Tax Credit, the Credit for Other Dependents or the

American Opportunity Tax Credit. (Note: Satisfying the due diligence requirement may require filing multiple IRS Forms 8867.)

Treasury Regulations prescribe the due diligence requirements a paid tax return preparer must meet with respect to completion and submission of IRS form 8867. According to the regulations, a paid tax return preparer is required to complete the form based on information provided by the taxpayer to the tax return preparer or otherwise reasonably obtained by the preparer and provide the completed form for submission as follows:

- In the case of a ***signing tax return preparer who electronically files*** the tax return or claim for refund, the completed Form 8867 must be electronically filed with the tax return or refund claim;
- In the case of a ***signing tax return preparer who does not file the tax return or claim for refund electronically***, the completed Form 8867 must be provided to the taxpayer for inclusion when filing the tax return or claim for refund; and
- In the case of a ***non-signing tax return preparer***, the completed Form 8867 must be provided to the taxpayer in electronic or non-electronic format for inclusion when filing the tax return or claim for refund.

Pay particular attention to the important eligibility issues to avoid errors with respect to filing HOH and claiming EITC, CTC, ODC or AOTC. In every case, make sure your client has the documents needed to show the IRS if audited.

3.5.1 Head of Household Filing Status

A taxpayer who is eligible may find head of household (HOH) filing status advantageous when compared to filing as single or married filing separately, including:

- Possible eligibility for the Earned Income Tax Credit and dependent care credit;
- Higher income limits at which various tax credits are reduced;
- A lower tax rate; and
- A higher standard deduction.

However, eligibility to file as HOH is limited to those taxpayers who meet the qualification requirements. Those requirements are as follows:

- The taxpayer must be either unmarried or considered unmarried on the last day of the tax year;
- The taxpayer must have paid more than half the cost of keeping up the taxpayer's home for the tax year; and
- A qualifying person must live with the taxpayer in the taxpayer's home for more than half the tax year, not counting temporary absences for school, illness, business, vacation or military service.

3.5.1.1 Taxpayer Considered Unmarried

To be considered unmarried on the last day of the tax year, for the purposes of HOH filing status, the:

- Taxpayer must file a separate tax return, i.e., other than married filing jointly;
- Taxpayer must have paid more than half the cost of keeping up the taxpayer's home for the tax year;
- Taxpayer's spouse must not have lived in the taxpayer's home during the last six months of the tax year;
- Taxpayer's home must be the main home for the taxpayer's child, stepchild or foster child for more than half of the tax year; and
- Taxpayer must be able to claim the child.

3.5.1.1.1 Required Marriage Test Supporting Documents

The supporting documents required to substantiate the taxpayer's meeting the marriage test for the purposes of HOH filing status depends upon whether the taxpayer is:

- Single,
- Divorced or legally separated, or

- Married but not living with spouse during last 6 months of the tax year.

If the taxpayer is single, no documents supporting the taxpayer's meeting the marriage test need to be obtained.

If the taxpayer is divorced or legally separated, photocopies of the following documents should be obtained:

- Entire divorce decree;
- Separate maintenance decree; or
- Separation agreement.

If the taxpayer is married but did not live with the taxpayer's spouse during the last six months of the tax year, obtain photocopies of documents verifying the taxpayer did not live with his or her spouse during the last six months of the year. Appropriate documents include:

- A lease agreement;
- Utility bills;
- A letter from a clergy member, or
- A letter from social services.

All such documents obtained by the paid preparer should be retained by the preparer as verification that supports his or her decision for the filing.

3.5.1.2 Keeping up the Taxpayer's Home

A taxpayer is deemed to be keeping up a home, for the purposes of HOH filing status, only if the taxpayer pays more than half the cost of its upkeep for the year. The cost of keeping up a home includes:

- Rent;
- Mortgage interest (***but not principal payments***);
- Real estate taxes;
- Insurance on the home;
- Repairs;
- Utilities; and
- Food eaten in the home.

The cost of keeping up a home doesn't include the cost of clothing, education, medical treatment, vacations, life insurance, or transportation for any member of the household.

3.5.1.2.1 Required Keeping Up a Home Test Supporting Documents

The tax preparer should obtain the following supporting documents to substantiate the taxpayer's meeting the keeping up a home test for the purposes of HOH filing status, including:

- Rent receipts;
- Utility bills;
- Grocery receipts;
- Property tax bills;
- Mortgage interest statement;
- Upkeep and repair bills;
- Property insurance statement; and
- Other household bills.

All such documents obtained by the paid preparer should be retained by the preparer as verification that supports his or her decision for the filing.

3.5.1.3 Qualifying Person

A person is a qualifying person for purposes of the taxpayer's filing as head of household if the person is the taxpayer's:

- Qualifying child (such as a son, daughter, or grandchild who lived with the taxpayer more than half the year) if –
    - Single, or

    - Married <u>and</u> the taxpayer can claim him or her as a dependent;
- Qualifying relative who is the taxpayer's father or mother and the taxpayer can claim the relative as a dependent;
- Qualifying relative other than the taxpayer's father or mother (such as a grandparent, brother, or sister) who lived with the taxpayer more than half the year, <u>and</u> is related to the taxpayer in one of the following ways –
    - The taxpayer's brother, sister, half-brother, half-sister, stepbrother, or stepsister,
    - The taxpayer's stepfather or stepmother,
    - A son or daughter of the taxpayer's brother or sister,
    - A son or daughter of the taxpayer's half-brother or half-sister,
    - A brother or sister of the taxpayer's father or mother, or
    - The taxpayer's son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law.

Note: Neither the taxpayer's mother nor father is required to live with the taxpayer in order for the taxpayer to qualify for HOH filing status based on the relative.

3.5.1.4 Qualifying Child

A child is considered a qualifying child, for the purposes of HOH filing status, if both the taxpayer and child satisfy five tests:

- The child must be the taxpayer's son, daughter, stepchild, foster child, brother, sister, half-brother, half-sister, stepbrother, stepsister, or a descendant of any of them.
- The child must be (a) under age 19 at the end of the year and younger than the taxpayer (or the taxpayer's spouse if filing jointly), (b) under age 24 at the end of the year, a student, and younger than the taxpayer (or the taxpayer's spouse if filing jointly), or (c) any age if permanently and totally disabled.
- The child must have lived with the taxpayer for more than half of the year.
- The child must not have provided more than half of his or her own support for the year.
- The child isn't filing a joint return for the year (unless that joint return is filed only to claim a refund of withheld income tax or estimated tax paid).

3.5.1.4.1 Required Qualifying Person Test Supporting Documents

The tax preparer should obtain and retain the supporting documents needed to substantiate the taxpayer's meeting the qualifying person test for the purposes of HOH filing status, including, as appropriate:

- Birth certificate or other official document of birth;
- Marriage certificate;
- Letter from an authorized adoption agency;
- Letter from the authorized placement agency; or
- Applicable court document.

In order to show that both the taxpayer and the taxpayer's child lived together for more than half of the year, obtain:

- School, medical, day care, or social service records; or
- A letter on the unofficial letterhead from a school, medical provider, social service agency, or place of worship that shows –
    - Names,
    - Common address, and
    - Dates.

Note: If the taxpayer furnishes a letter from a relative who provides the taxpayer's day care services, the preparer should obtain at least one additional letter.

3.5.1.5 Common Head of Household Errors

Common errors involving head of household filing status include the following:

- Both parents file as head of household, using the same child as a qualifying child;
- Both parents file as head of household, claiming that they each provided more than half the cost of upkeep for the same home;

- The taxpayer claims head of household status but did not pay for more than half the cost of keeping up a home (for example, the parent is living with a grandparent or the other parent paid for the cost of the home);
- The taxpayer is divorced and lives with his or her ex-spouse in the same home and both file as head of household;
- The taxpayer is married and the taxpayer's spouse lived in the taxpayer's house for one or more days during the last six months of the tax year;
- The taxpayer is married and lives with his or her spouse who does not work (for example income below the IRS filing threshold);
- A qualifying child did not live with the taxpayer for more than half of the tax year;
- The qualifying child was age 19 or older (or, if a student, age 24 or older) as of the last day of the tax year;
- The qualifying child was age 19-23 and a student, but was an enrolled on less than a full-time basis;
- The qualifying child was age 19-23 and a full-time student, but only for four or fewer months during the tax year (for example, the child enrolled in college starting in September after a gap year);
- The child provided more than half of his or her own support during the tax year; or
- The child filed a joint federal income tax return with his or her spouse.

IRS Form 886-H-HOH, *Supporting Documents to Prove Head of Household Filing Status* may be accessed to help ensure the necessary supporting documents to prove head of household filing status have been obtained. Complete and submit the Paid Preparer's Due Diligence Checklist, IRS Form 8867, *Paid Preparer's Due Diligence Checklist.*

3.5.2 Earned Income Tax Credit

The eligibility requirements for the earned income tax credit may be found in this document at 2.12.6.

3.5.2.1 EITC Due Diligence Requirements

In addition to completing and submitting IRS Form 8867, the due diligence requirements require the preparer to:

- Compute the applicable Earned Income Tax Credit using a worksheet—either Worksheet A or B, as applicable;
- Know the law related to claiming the Earned Income Tax Credit and his or her client; and

Maintain appropriate records related to preparation of the tax return.

3.5.2.2 Most Common EITC Errors

The most common EITC errors are:

- ***Claiming EITC for a child who does not meet the qualifying child requirements*** – To help avoid errors involving qualifying child requirements make sure you find out if the child –

    - Lived with your client for more than half the year,
    - Is related to him or her, and
    - Meets the age test.

  Thus, you must ask the client how long the child lived with your client, at what address, and did anyone else live with the child for more than half the year. Also, find out how the child is related to the client, i.e., by blood, by marriage or by law. To determine if the age test is met for an older child, determine if the child is a student or permanently and totally disabled.

- ***Filing as single or head of household when married*** – To avoid errors with respect to filing status, ask questions to find out if your client –

    - Is married under state law, including common law, or
    - Was ever married.

  If your client is married, make sure your client did not live with his or her spouse at any time during the last six months of the year.

- ***Incorrectly reporting income or expenses*** – To avoid errors involving the incorrect reporting of income or expenses, consider the following:
    - Does the Form W-2 look similar to the Forms W-2 of other clients who have the same employer?
    - Is your client saying they own a business but not claiming any business expenses? In such a case, ask enough questions to make sure your client has a true business and claims all income and deducts all allowable expenses.

3.5.3 Education Tax Credits

The eligibility requirements for the education tax credits may be found in this document at 2.12.5 Click on eligibility requirements to review them before proceeding.

In addition to completing and submitting IRS Form 8867 when the American Opportunity Tax Credit is claimed, the due diligence requirements require the preparer to:

- Complete the AOTC Credit Limit Worksheet and Adjusted Qualified Education Expenses Worksheet found in the instructions to Form 8863, Education Credits;
- Document the inquiries made of the taxpayer; and
- Obtain substantiation for the claimed AOTC, such as –
    - Form 1098-T, *Tuition Statement,* and/or
    - Receipts for qualified tuition and related expense.

3.5.3.1 Most Common AOTC Errors

The most common AOTC errors are:

- ***Claiming AOTC for a student who didn't attend an eligible educational institution*** - The AOTC is for post-secondary education, which may include education at a college, university or technical school. It does not include a high school. To be an eligible institution, the school must be able to participate in the student aid program administered by the U.S. Department of Education (note: they don't have to participate but must be eligible to participate).
- ***Claiming AOTC for a student who didn't pay qualifying college expenses*** – Ask questions to ensure the educational expenses were paid or considered paid by –
    - Your client,
    - Your client's spouse or
    - The dependent student claimed on the tax return.
- ***Claiming AOTC for a student for too many years*** - The AOTC is only available for the first four years of post-secondary education and your client can only claim it for four tax years per eligible student. This limitation includes any year(s) your client claimed the Hope Credit.

3.5.4 Child Tax Credit

The eligibility requirements for the Child Tax Credit may be found in this document at **2.12.1**

In addition to completing and submitting IRS Form 8867 when the Child Tax Credit is claimed, due diligence requires the preparer to:

- Complete the Child Tax Credit and Credit for Other Dependents worksheet found in the instructions to Form 1040;
- Document the inquiries made of the taxpayer; and
- Determine that each qualifying person for the CTC/ACTC/ODC is the taxpayer's dependent who is a citizen, national or resident of the United States;
- Determine that all children for whom the taxpayer is claiming the CTC/ACTC reside with the taxpayer;

If not all children for whom the taxpayer is claiming the credit reside with the taxpayer inquire whether there is an active Form 8332, Release/Revocation of Claim to Exemption for Child by Custodial Parent, or a similar statement in place? (Must be attached to the return if applicable)

3.5.4.1 Most Common CTC/ACTC/ODC Errors

The most common CTC/ACTC/ODC errors involve:

- ***Claiming the CTC/ACTC for a child who does not meet the age requirement*** - The child must be under the age of 17 at the end of 2025.
- ***Claiming the CTC/ACTC/ODC for a child or other person who doesn't meet dependency requirements*** - The child must be claimed as a dependent on your client's return and meet all the eligibility rules for a dependent.
- ***Claiming the CTC/ACTC for a child who does not meet the residency requirement*** - The child must be a U.S. citizen, U.S. national or a resident alien and the child must have lived with your client for more than half the year. If the qualifying child uses an ITIN, Individual Taxpayer Identification Number, the child must meet the substantial presence test to qualify.

3.6 Compliance with E-file Procedures

Section 6011(e)(3) of the Internal Revenue Code requires specified tax return preparers to electronically file certain federal income tax returns that they prepare and file for individuals, trusts, or estates.

A taxpayer may request an electronic filing waiver by submitting IRS Form 8508, *Application for a Waiver from Electronic Filing of Information Returns,* which allows filers to submit paper forms instead of electronically for the current tax year. The completed form must be submitted at least 45 days prior to the tax return filing deadline. The IRS grants waivers based on financial hardship, religious exemption, natural disaster, or other undue hardship.

IRS Publication 1345, *Handbook for Authorized IRS e-file Providers of Individual Income Tax Returns,* addresses rules and requirements for participation in IRS e-file of individual income tax returns and related forms and schedules.

3.6.1 Affected Tax Return Preparers

A tax preparer generally required to electronically file federal income tax returns is one who reasonably expects to file 11 or more covered returns in a calendar year. The returns that are "covered" under the e-file requirement are income tax returns on individuals, trusts or estates, such as Forms 1040 and 1041.

The requirement to e-file does not apply to individuals who do not meet the definition of "tax return preparer" under the Internal Revenue Code.

3.6.2 Timing of Taxpayer Signature

Both taxpayers and paid preparers are required to sign an electronic income tax return. Taxpayers must sign individual income tax returns electronically under one of two methods:

- Self-Select PIN method requires taxpayers to provide their prior year adjusted gross income (AGI) amount or prior year PIN for use by the IRS to authenticate the taxpayer; or
- Practitioner PIN method.

Regardless of the method used, taxpayers must agree by signing IRS Form 8879 IRS e-file signature authorization containing the PIN *after reviewing the completed return*.

Form 8878, *IRS e-file Signature Authorization for Form 4868, Application for Automatic Extension of Time to File U.S. Individual Tax Return* or Form 2350, *Application for Extension of Time to File U.S. Income Tax Return* must be completed when Form 4868 is filed using the Practitioner PIN method, or when the taxpayer authorizes the Electronic Return Originator (ERO) to enter or generate the taxpayer's personal identification number (PIN) on either Form 4868 or Form 2350.

3.6.3 Timing of Filing

A return is considered filed by a tax return preparer when the preparer submits the return to the IRS either electronically or in paper form. When received by the IRS, the return is automatically checked by computers for errors and missing information. If the return cannot be processed, it is returned to the originating transmitter to clarify any needed information. Within 48 hours of electronically sending the return to the IRS, the IRS sends an acknowledgment to the transmitter stating that the return is accepted for processing. The notice is proof of filing and assurance that the IRS has the return information.

3.6.4 Recordkeeping

A tax return preparer who originates the electronic submission of returns to the IRS must make various records easily accessible until the end of the calendar year. The required records must be kept at the business address from which the preparer originated the return or at a location that allows the tax return preparer to readily access the material if requested by the IRS.

The records that must be retained are:

- A copy of Form 8453, U.S. Individual Income Tax Transmittal for an IRS e-file Return, and supporting documents not included in the electronic records submitted to the IRS;
- Copies of Forms W-2, W-2G, *Certain Gambling Winnings* and 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.*;
- A copy of signed IRS e-file consent to disclosure forms;
- A complete copy of the electronic portion of the return that can be readily and accurately converted into an electronic transmission that the IRS can process; and
- The acknowledgement files for IRS-accepted returns.

Forms 8878 and 8879, IRS e-file Signature Authorization forms, must be available to the IRS for three years from the due date of the return or the IRS received date, whichever is later. Preparers may electronically image and store all paper records they are required to retain for IRS e-file.

3.6.5 Prohibited Filing with Pay Stub

If a taxpayer is unable to secure and provide a correct Form W-2, W-2G, or 1099-R the return may be electronically filed after Form 4852, *Substitute for Form W-2, or Form 1099-R* is completed. This is the only time that information from pay stubs is allowed.

3.6.6 Proper Handling of Rejects

E-file rejects identify problems that usually lead to IRS correspondence and slow down processing of tax returns. This e-file feature enables preparers to correct mistakes before returns are processed, decreasing overall processing time and shortening the time it takes to receive a refund. If the reject is for a simple mistake, the preparer should correct the error and resubmit the return electronically. This usually solves the problem.

However, you may not be able to correct some rejects. For example, if the return rejects because an exemption has been claimed on another taxpayer's return, check that the Social Security number of the exemption was entered correctly on the return. If the SSN is correct, you will not be able to file this return electronically unless the exemption is removed from the return. If you believe the taxpayer is entitled to claim the exemption, it is not necessary to remove the exemption, but the return must be filed on paper. Attach Form 8948, *Preparer Explanation for Not Filing Electronically*, to the paper return; check box 4 and enter the reject code number. The number of attempts to resolve is zero.

There are other situations where the reject may or may not be corrected but it takes one or more tries to resolve. When this happens, the return must be filed on paper. Attach Form 8948, *Preparer Explanation for Not Filing Electronically* to the paper return and check box 4; enter the reject code number and the number of attempts you made to resolve the reject before deciding that the error could not be fixed. Preparers generally learn from experience when trying to resolve an error is no longer productive.

Some reject conditions permit returns to be e-filed without correcting the error. If you encounter a reject that you try to resolve but cannot and this option is available, submit the return electronically.

3.7 Annual Filing Season Program Requirements

The annual filing season program is a voluntary program designed to encourage non-credentialed tax return preparers to participate in continuing education. After successfully completing the program, the preparer:

1. Will receive a Record of Completion that may be displayed by the preparer; and
2. Will be included, if desired, in a public database on IRS.gov that taxpayers may use when searching for a qualified tax return preparer.

The searchable public database includes the name, type of credential possessed and location of:

- Attorneys,
- Certified public accountants (CPAs),
- Enrolled agents (EAs),
- Enrolled retirement plan agents (ERPAs),
- Enrolled actuaries, and
- Individuals who have received an Annual Filing Season Program Record of Completion.

Participation in the Annual Filing Season Program (AFSP) requires that a tax return preparer:

- Possess an active Preparer Tax Identification Number (PTIN) for the year of participation;
- Have completed all required continuing education credits from an IRS-approved CE provider no later than December 31st of the year prior to the year of participation;
- Obtain an Annual Filing Season Program—Record of Completion from the IRS for the year of participation; and
- Consent to abide by the duties and restrictions relating to practice before the IRS contained in subpart B and section 10.51 of Treasury Department Circular No. 230 for the entire period covered by the Record of Completion.

Information on acquiring and maintaining a PTIN may be obtained at IRS Tax Professional PTIN System.

Tax return preparers requiring 15 hours of continuing education include:

- Anyone who passed the Registered Tax Return Preparer test administered by the IRS between November 2011 and January 2013;
- A person who is duly qualified to practice as a CPA in any state;
- An attorney in good standing of the bar of the highest court of any state;
- An Enrolled Retirement Plan Agent (ERPA) enrolled to represent clients before the IRS;
- An Enrolled Agent (EA) enrolled to practice before the IRS with unlimited practice rights;
- Return preparers who are active registrants of the –
  - Oregon Board of Tax Practitioners,
  - California Tax Education Council (CTEC), and/or
  - Maryland State Board of Individual Tax Preparers;
- Tax practitioners who have passed the Special Enrollment Exam (SEE) Part I within the past three years;
- VITA volunteers; and
- Other accredited tax-focused credential-holders of –
  - The Accreditation Council for Accountancy and Taxation's Accredited Business Accountant/Advisor (ABA), and
  - Accredited Tax Preparer (ATP) programs.

All other Annual Filing Season Program participants must have 18 hours of continuing education.

The types of continuing education required for AFSP participants needing 15 or 18 hours of continuing education are as shown in the chart below:

Category	15-Hour Continuing Education Requirement	18-Hour Continuing Education Requirement
Federal Tax Law	10 hours	10 hours
Federal Tax Law Updates	3 hours	Not required
Annual Federal Tax Refresher	Not required	6 hours
Ethics	2 hours	2 hours

Total	15 hours	18 hours

Additional information concerning the Annual Filing Season Program may be obtained in IRS Publication 5227, and IRS Publication 5646.

3.7.1. Consent to Adhere to Circular 230 Requirements

As part of the requirements that must be met to participate in the Annual Filing Season Program, a tax ***preparer must sign the Circular 230 Consent statement that can be accessed in the tax preparer's PTIN account*** at IRS Tax Professional PTIN System. More information about the Annual Filing Season Program is available on IRS.gov here: https://www.irs.gov/tax-professionals/annual-filing-season-program.

By signing the Circular 230 Consent statement, the participant consents to the following:

> I agree to abide by the duties and restrictions relating to practice before the IRS in subpart B and section 10.51 of Treasury Department Circular No. 230 for the entire period covered by the Record of Completion.
>
> I understand that failing to comply with the duties and restrictions relating to practice before the IRS in these sections may result in the revocation of my Annual Filing Season Program—Record of Completion, and I may be prohibited from participating in the Annual Filing Season Program in the future.

3.7.1.1 Tax Return Preparer Duties and Restrictions

By signing the Circular 230 Consent statement, an AFSP participant agrees to abide by the duties and restrictions relating to:

Topic	**Circular 230 Section Number**
Required response to IRS request for information	§10.20
Knowledge of client omissions	§10.21
Requirement for practitioner accuracy	§10.22
Prompt disposition of pending matters	§10.23
Assistance from or to disbarred or suspended persons and former IRS employees	§10.24
Practice by former government employees, their partners and associates	§10.25
Prohibition against acting as a notary as to matters administered by the IRS	§10.26
Fees	§10.27
Return of client records	§10.28
Conflicting interests	§10.29
Solicitation of business	§10.30
Negotiation of checks issued to a taxpayer	§10.31
Unauthorized practice of law	§10.32
Adherence to best practices for tax advisors	§10.33
Maintaining standards with respect to tax returns and other documents	§10.34
Practitioner competence	§10.35
Adoption of and adherence to procedures to ensure compliance	§10.36
Requirements for written advice	§10.37
Incompetence and disreputable conduct	§10.51

3.7.2 AFSP Participants' Limited Representation Rights

A return preparer who is not an attorney, CPA, or enrolled agent and who does not participate in the Annual Filing Season Program will only be permitted to prepare tax returns. The return preparer will not be permitted to represent clients before the IRS except in regard to returns prepared by the return preparer before January 1, 2016.

Participants in the Annual Filing Season Program, however, have limited representation rights. Pursuant to those limited representation rights, AFSP participants may represent clients whose returns they prepared and signed:

- Involving initial audits;
- Regarding customer service matters; and
- Before the Taxpayer Advocate Service.

Note: To have limited representation rights for any return or claim for refund prepared and signed after December 31, 2015, return preparers must participate in the Annual Filing Season Program in both **the year of return preparation and the year of representation**.

Review #7 – Practices, Procedures and Professional Responsibility

1. Harriet, a tax return preparer, failed to comply with the EITC due diligence requirements in completing her client's income tax return. If the IRS determined that her failure was NOT due to reckless disregard for the EITC rules or maintaining an unreasonable position, to what dollar penalty is she subject?

   A. $100

   B. $650

   C. $1,000

   D. $5,000

2. Phil, a tax return preparer, charged his client $500 to prepare her income tax return that claimed a $5,000 refund based on an unreasonable position. To what penalty is Phil subject if Phil knew the position was unreasonable, but it was not determined to be the result of his willful and reckless conduct?

   A. $250

   B. $500

   C. $1,000

   D. $5,000

3. For how long is a tax return preparer required to make a client's e-file signature authorization available to the IRS?

   A. Until the end of the current calendar year

   B. For three years

   C. For five years

   D. For seven years

Glossary

Adjustment to income	An adjustment to income is a deduction that reduces a taxpayer's income to arrive at the adjusted gross income. It is also called an "above the line" deduction, meaning it is taken above the line on the tax form for adjusted gross income.
American opportunity credit	The American opportunity credit is an education tax credit available only for the first four years of postsecondary education during which time the student must be pursuing a degree or other recognized credential.
Capital asset	A capital asset includes everything owned by a taxpayer and used for personal purposes, pleasure, or investment.
Capital gains and losses	A capital gain or loss is the gain or loss sustained by a taxpayer on a sale or trade of a capital asset.
Child and dependent care tax credit	The child and dependent care credit is a nonrefundable tax credit available to a taxpayer who pays someone for the care of a qualifying person while the taxpayer is working or looking for work.
Child tax credit	The Child Tax Credit is a credit of up to $2,000 for each qualifying child.
Credit for Other Dependents	The Credit for Other Dependents is a credit a taxpayer may claim for dependent other than a child or for a qualifying child for whom a credit is disallowed solely because the taxpayer failed to include the child's Social Security number on the tax return for the taxable year.
Deduction	A dollar amount that reduces the taxpayer's taxable income.
Dependent	A dependent is a taxpayer's qualifying child or qualifying relative.
Dividend	A dividend is a distribution of money, stock, or other property paid to a taxpayer by a corporation or by a mutual fund.
Earned income tax credit	The Earned Income Tax Credit—usually referred to simply as "EIC" or "EITC"—is a refundable tax credit for certain lower-income working taxpayers who meet income, filing status and other requirements.
Estimated tax payment	Estimated tax payments are amounts paid quarterly by a taxpayer to the state and local governments to cover income taxes on amounts not subject to tax withholding.
Filing status	Filing status refers to one of the five statuses a taxpayer falls into and depends on whether the taxpayer is single or married and on the taxpayer's family situation. It is determined on the last day of the taxpayer's tax year, which is December 31 for most taxpayers.
Health insurance premium tax credit	A tax credit available to individuals who meet specified income, coverage and other criteria to enable them to purchase a qualified health plan through the Health Insurance Marketplace.
Interest	Interest is the fee paid by a borrower to a taxpayer for the use of money. Interest is normally taxable to the receiving taxpayer.
Lifetime learning credit	The Lifetime Learning Credit is an education tax credit available for all years of postsecondary education as well as for courses to acquire or improve job skills.
Pass-through deduction	A deduction authorized by the Tax Cuts and Jobs Act of 2017 equal to 20% of qualified business income available to businesses organized as other than regular corporations

Pension	An income received from an employer-sponsored qualified retirement plan.
Roth IRA	A Roth IRA is a personal retirement savings plan, funded by an annuity or trust/custodial account, which provides income tax deferral and may provide tax-free distribution of earnings. It does not provide for contribution deductibility.
Self-employment income	Self-employment income is income earned by a taxpayer in business for himself or herself.
Standard deduction	The standard deduction is a dollar amount that reduces the taxpayer's taxable income. It is a benefit that eliminates the need for many taxpayers to itemize actual deductions, such as medical expenses, charitable contributions, and taxes, on Schedule A (Form 1040).
Student loan interest deduction	The student loan interest deduction is a special deduction allowed for interest payments made on a student loan used solely to pay higher education expenses up to a maximum deduction of $2,500.
Tax credit	A dollar amount that directly reduces the taxpayer's tax liability.
Tax Cuts and Jobs Act of 2017 (TCJA)	Tax reform legislation that, among other things, authorized a pass-through deduction, generally lowered taxes for individuals and businesses, temporarily suspended exemptions and increased standard deductions.
Tax withholding	Tax withholding is the employer's retention of funds from an employee's salary or wages and paid to the government to pay the Income tax due.
Traditional IRA	A traditional IRA is a personal retirement savings plan, funded by an annuity or a trust that meets certain requirements, which may permit tax-deductible contributions and tax-deferral of earnings.

Answers to Review Quizzes

Review #1

Question 1 Feedback

A. Your answer is incorrect. Although Harry's annual income exceeds the applicable Foreign Earned Income Exclusion limitation, the exclusion is not eliminated.

B. Your answer is incorrect. You determined the proper percentage to use in calculating the duration of Harry's work in the foreign country. However, you applied it to the applicable limit rather than to Harry's annual income.

C. Your answer is correct. Harry's Foreign Earned Income Exclusion is $122,500, determined by calculating the percentage of the year Harry worked in a foreign country and then multiplying his annual income by the percentage.

D. Your answer is incorrect. Although you correctly identified the Foreign Earned Income Exclusion limit applicable in 2025, that is not the amount of Harry's Foreign Earned Income Exclusion. Instead, you must determine the percentage of Harry's annual earned income derived from his work in the foreign country.

Question 2 Feedback

A. Your answer is incorrect. Although Sally's optional standard mileage deduction for business travel is $7,000, she may also deduct other travel-related expenses.

B. Your answer is incorrect. While Sally can deduct $7,000 as her optional standard mileage deduction and her tolls, she has an additional business-travel deduction she may take.

C. Your answer is correct. Sally can deduct $7,547. In addition to using the standard mileage rate, a taxpayer may also deduct any business-related parking fees and tolls paid while engaging in deductible business travel. However, parking fees paid by a taxpayer to park his or her vehicle at the usual place of business are considered commuting expenses and are not deductible.

D. Your answer is incorrect. Sally could deduct the $1,200 she spent on gas and oil if she chose to deduct her actual travel expenses. However, she elected to use the optional standard mileage deduction and cannot also deduct her actual gas expenses.

Question 3 Feedback

A. Your answer is incorrect. You have identified the 2025 catch-up contribution limit that applies to SIMPLE participants who are age 50 or older but not aged 60 to 63.

B. Your answer is incorrect. That is the 2025 catch-up contribution limit that applies to SIMPLE participants who are aged 60 to 63. Alan, however, is covered under his employer's 401(k) plan rather than a SIMPLE.

C. Your answer is incorrect. $7,500 is the catch-up contribution limit that applies to qualified plan participants who are age 50 or older but not aged 60 to 63.

D. Your answer is correct. The limit applicable to Alan's catch-up contribution in 2025 is $11,250. The SECURE 2.0 Act, beginning in 2025, authorizes increased catch-up contributions for plan participants aged 60, 61, 62, and 63 for SIMPLEs and other qualified plans. The increased catch-up limit applicable to SIMPLES is the greater of $5,000, or 150% of the dollar amount applicable for 2025 to plan participants eligible to make catch-up contributions who are not aged 60 through 63. For other qualified plans, the increased catch-up limit is the greater of $10,000, or 150% of the dollar amount applicable for 2024 to plan participants eligible to make catch-up contributions who are not aged 60 through 63.

Review #2

Question 1 Feedback

A. Your answer is incorrect. Although a nonqualified distribution from a Roth IRA would not shield the gain from taxation, after-tax amounts consisting of Roth IRA contributions receive FIFO income tax treatment.

B. Your answer is incorrect. $10,000 of the distribution is gain, and the gain in a nonqualified Roth IRA distribution is includible in income.

C. Your answer is correct. Peter may exclude $40,000 of the distribution from his income, i.e., an amount equal to his total contributions. Because a Roth IRA receives FIFO tax treatment, all contributions to the Roth IRA are deemed to be distributed *before any earnings are distributed*. Since Roth IRA contributions are made with after-tax dollars, they are withdrawn tax free, even though earnings withdrawn in a distribution that is not a "qualified distribution" would be subject to income tax and, possibly, to a premature distribution tax penalty.

D. Your answer is incorrect. If Peter's Roth IRA distribution had been a qualified distribution, all of the distribution would be tax free. However, since the distribution is a nonqualified distribution, earnings are includible in income and potentially subject to a tax penalty.

Question #2 Feedback

A. Your answer is incorrect. Bill's adjusted gross income of $200,000 in 2025 neither prohibits a traditional IRA contribution nor—given the facts of the question—affects his ability to take a tax deduction for the contribution.

B. Your answer is incorrect. It reflects the limits and rules applicable to IRA contributions in effect prior to the passage of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA).

C. Your answer is incorrect. Although Bill would certainly be able to contribute $7,000 to a regular traditional IRA in 2025 and deduct that amount, your answer does not account for Bill's age.

D. Your answer is correct. Bill may make and deduct a traditional IRA contribution in 2025 that is neither eliminated nor reduced by his relatively high adjusted gross income. Because he is age 50 or older, the maximum contribution allowable in 2025 includes both a *regular* IRA contribution of $7,000 and a *catch-up* contribution of an additional $1,000. Since he is not an active participant in an employer-sponsored qualified plan, his entire traditional IRA contribution is tax-deductible.

Review #3

Question #1 Feedback

A. Your answer is incorrect. Although the home-office deduction is limited to no more than $1,500, George's business expenses not related to the business use of his home continue to be deductible.

B. Your answer is incorrect. Since George's costs for business telephone and internet apply solely to the business, they are not subject to the business percentage use of the house.

C. Your answer is incorrect. The simplified method limits George's home-office deduction to the prescribed rate times no more than 300 square feet, and his business telephone and internet service expenses are deductible.

D. Your answer is correct. George's business deduction is $2,700, comprised of a $1,500 home-office deduction and business expenses not related to his home of $1,200.

Question #2 Feedback

A. Your answer is incorrect. Although the TCJA disallows a full deduction for expenses incurred by a taxpayer for food and beverages after December 31, 2017 and before January 1, 2026, even though being directly related to the taxpayer's trade or business, in some cases the disallowance doesn't apply. With respect to activities normally considered to be entertainment, amusement or recreation, the disallowance does not apply when the expenses are for recreational, social or similar activities primarily for the benefit of employees other than highly compensated employees.

B. Your answer is incorrect. Expenses incurred for beverages are treated the same as food expenses for tax purposes.

C. Your answer is incorrect. Even though taxpayers are generally limited under the TCJA to a 50% deduction of the expenses for food and beverages paid or incurred in conducting their trade or business as well as the expenses for food and beverages provided by the taxpayer on the taxpayer's premises primarily for employees, in some cases the limitation does not apply. The limitation is inapplicable when the expenses are for recreational, social or similar activities primarily for the benefit of employees other than highly compensated employees.

D. Your answer is correct. Taxpayers are generally permitted to deduct 50% of the expenses for food and beverages paid or incurred in conducting their trade or business as well as the expenses for food and beverages provided by the taxpayer on the taxpayer's premises primarily for employees. However, the 50% limitation on the deduction of an employer's food and beverage expenses does not apply to any expenses if, among other exceptions, the expenses are for recreational, social or similar activities primarily for the benefit of employees other than highly compensated employees.

Review #4

Question #1 Feedback

A. Your answer is correct. In the case of a military relocation, the taxpayer's move must be pursuant to a military order and involve a permanent change of station. In such a case, no paid or incurred moving and storage expenses:

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

…are includible in gross income or reported.

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

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

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

B. Your answer is incorrect. Moving reimbursements are treated, for tax purposes, in a manner identical to the treatment of allowances.

C. Your answer is incorrect. Allowances for moving expenses—whether for a member of the military or his or her family—are treated identically for tax purposes.

D. Your answer is incorrect. Although the exclusion of moving expenses is generally suspended under the TCJA for moves occurring in 2018 through 2025, military moves are an exception.

Question #2 Feedback

A. Your answer is incorrect. The TCJA made significant changes to the mortgage interest deduction; however, it did not eliminate the deduction.

B. Your answer is incorrect. While the TCJA reduced the mortgage interest that a taxpayer may deduct to the interest on no more than $750,000 of principal, interest paid on a mortgage to purchase a residence continues to be tax-deductible provided the aggregate mortgage debt doesn't exceed $750,000.

C. Your answer is incorrect. Although interest paid on home equity mortgages would appear, at first glance, to no longer be deductible, such interest ***would be deductible*** if used to buy, build or substantially improve the taxpayer's home securing the loan.

D. Your answer is correct. They may deduct the entire amount. The TCJA made the following changes to the existing home mortgage interest deduction for taxable years 2018 through 2025:

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

Question #3 Feedback

A. Your answer is incorrect. Although Harry's federal income tax liability affects the value of the tax credit he can use when claiming the AOTC for his daughter's college costs, it is not lost in its entirety.

B. Your answer is correct. Although the AOTC is a refundable tax credit, it is reduced for married taxpayers filing a joint return whose income is between $160,000 and $180,000. The reduction is determined by dividing the amount of the taxpayer's income in excess of the $160,000 threshold by the range over which it declines ($15,000 ÷ $20,000). By making the calculation we can see the tax credit is reduced by 75%. When applied to the maximum tax credit of $2,500, the result is a reduction of $1,875 and a reduced tax credit of $625 ($2,500 - $1,875).

C. Your answer is incorrect. You have identified the amount of the reduction in the tax credit caused by the taxpayer's income in excess of $160,000 ($15,000 ÷ $20,0000.

D. Your answer is incorrect. The answer chosen is the tax credit to which the taxpayer could be eligible if his income was $160,000 or less. Since his income exceeded that threshold, the tax credit is reduced.

Review #5

Question 1 Feedback

A. Your answer is incorrect. Receiving investment income in 2025 does not necessarily make an otherwise eligible EIC recipient ineligible.

B. Your answer is incorrect. Although Tanya may be eligible for EIC if she had a $1,000 investment income in 2025, that is not the maximum amount she may receive and remain eligible.

C. Your answer is incorrect. The 2025 investment income of a taxpayer eligible for EIC cannot be greater than a specified amount. Although a lower maximum permitted investment income would have applied under prior tax law, the passage of ARPA changed the amount of investment income considered excessive for EIC eligibility purposes.

D. Your answer is correct. Internal Revenue Code § 32(i) denies the Earned Income Tax Credit to those taxpayers having excessive investment income. ARPA modifies IRC § 32(i) and provides that, for 2025, excessive investment income is that investment income in excess of $11,950, subject to annual inflation adjustment.

Question 2 Feedback

Question 2

A. Your answer is incorrect. Your answer would have been correct if Edward had been interested in purchasing a previously-owned clean vehicle. However, he is interested in purchasing a new clean vehicle.

B. Your answer is correct. No new clean vehicle tax credit is available if the taxpayer's MAGI for the current or prior taxable year exceeds the threshold amount which is $150,000 in the case of any taxpayer not filing a married filing jointly or head of household return.

C. Your answer is incorrect. Edward would have been eligible for a tax credit for purchasing a new clean vehicle with a MAGI of $225,000 if he filed his tax return as head of household. However, he filed as unmarried.

D. Your answer is incorrect. Edward would have needed to file his tax return as married filing jointly to be eligible for a tax credit for purchasing a new clean vehicle if he had a MAGI of $300,000. Instead, he filed as unmarried and would be ineligible for a credit.

Question 3 Feedback

A. Your answer is incorrect. The applicable tax credit is equal to 30 percent of the aggregate expenditures for qualified energy improvements, not 30 percent of the taxpayer's tax liability.

B. Your answer is correct. A non-refundable tax credit is available in an amount equal to 30 percent of the sum of the amounts paid or incurred during the taxable year, subject to an aggregate annual limitation of $1,200, by the taxpayer for qualified energy efficiency improvements including energy efficient windows and skylights, exterior doors, and energy audits. Since John's aggregate expenditures for qualified energy improvements amounted to $700, his tax credit is $210 ($700 x 30% = $210).

C. Your answer is incorrect. You have identified John's tax liability which, although it could be a limiting factor with respect to a non-refundable tax credit, is not a limit in this case.

D. Your answer is incorrect. You have identified John's aggregate expenditures for qualified energy improvements. The tax credit, however, is limited both as to the percentage of qualified expenditures and limits applicable to the type of property purchased and installed.

Review #6

Question #1 Feedback

A. Your answer is incorrect. Although Arthur's AMTI exemption is reduced in 2025 because of his alternative taxable income, it is not eliminated.

B. Your answer is incorrect. You have identified the amount of the reduction in Arthur's AMTI exemption. The reduction must be subtracted from the unreduced AMTI exemption.

C. Your answer is correct. Arthur's reduced AMTI exemption is $63,100. The AMTI exemption amount is reduced (but not below zero) by 25 percent of the amount by which the taxpayer's alternative minimum taxable income exceeds the applicable threshold, i.e., $626,350, for taxpayers whose filing status is "single," "head of household," "married filing separately."

D. Your answer is incorrect. Arthur's AMTI exemption is reduced in 2025 because his alternative taxable income exceeds $626,350, the level at which the exemption begins to be reduced.

Question #2 Feedback

A. Your answer is correct. Audrey's § 199A deduction for 2025 is equal to $20,000, computed as the lesser of A and B where:

   A equals 20 percent of Audrey's QBI from the business, and

   B equals 20 percent of Audrey's total taxable income for the taxable year.

   Accordingly, the deduction for Audrey is the smaller of:

   $100,000 x 20 percent = $20,000; or

$110,000 x 20 percent = $22,000.

Since she has no REIT dividends or PTP income, her pass-through deduction is $20,000, i.e., the smaller number.

B. Your answer is incorrect. Although Audrey's pass-through deduction is limited to no more than 20 percent of QBI, it is also limited with respect to her taxable income.

C. Your answer is incorrect. The applicable threshold comes into play only if the individual's taxable income exceeds it. In this case, Audrey's taxable income is well below the applicable threshold.

D. Your answer is incorrect. Although you are correct with respect to Audrey's business being an SSTB, the SSTB limitation neither limits nor excludes the pass-through deduction in this case.

Review #7

Question #1 Feedback

A. Your answer is incorrect. Although the financial penalty was $100 for the failure to comply with EITC due diligence requirements, that penalty was increased for returns filed after December 31, 2011 and is subject to annual inflation adjustments.

B. Your answer is correct. Harriet is subject to a $650 penalty. IRC section 6695(g) imposes a financial penalty on any income tax return preparer failing to comply with the due diligence requirements related to determining a taxpayer's eligibility for the credit or its amount. The financial penalty was increased by subsequent legislation from $100 to $500 for returns filed after December 31, 2011 and is subject to annual inflation adjustments.

C. Your answer is incorrect. A minimum penalty of $1,000 may be assessed if the tax return preparer prepares a client return and the IRS finds any part of the amount of taxes owed is due to an unreasonable position. In this case that condition, i.e. maintaining an unreasonable position, was not found.

D. Your answer is incorrect. A minimum penalty of $5,000 may be imposed if the tax return preparer prepares a client return and the IRS finds any part of the amount of taxes owed is due to a reckless or an intentional disregard of rules or regulations.

Question #2 Feedback

A. Your answer is incorrect. Although the IRS could levy a penalty equal to 50% of the income derived by the preparer for knowingly preparing a return based on an unreasonable position, the minimum penalty is greater.

B. Your answer is incorrect. While simply requiring the preparer to pay a penalty equal to his income from preparing the return could be reasonable, the minimum penalty is higher than $500.

C. Your answer is correct. In this case, the preparer is subject to a $1,000 penalty. If a tax return preparer prepares a tax return or claim of refund based on an unreasonable position and the preparer knew or reasonably should have known it was an unreasonable position, the preparer is subject to a penalty equal to the greater of a) $1,000, or b) 50% of the income derived, or to be derived, by the tax return preparer with respect to the return or claim.

D. Your answer is incorrect. A penalty of $5,000 in this case would have been levied only if Phil's actions were due to willful and reckless conduct.

Question #3 Feedback

A. Your answer is incorrect. Although a tax return preparer who originates the electronic submission of returns to the IRS must make various records easily available until the end of the calendar year, e-file signature authorizations have a longer retention requirement.

B. Your answer is correct. Forms 8878 and 8879, IRS e-file Signature Authorization forms, must be available to the IRS for three years from the due date of the return or the IRS received date, whichever is later.

C. Your answer is incorrect. E-file signature authorization forms must generally be retained for an extended period of time; however, the required period is not five years.

D. Your answer is incorrect. Despite the longer retention period applicable to E-file signature authorization forms they may be destroyed before the end of seven years.

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Appendix A

References to Applicable Standards and Best Practices for Safeguarding Taxpayer Data

Resource	Available at...
"Getting Noticed: Writing Effective Financial Privacy Notices"	https://iapp.org/resources/article/getting-noticed-writing-effective-financial-privacy-notices/
"Information Compromise and the Risk of Identity Theft: Guidance for Your Business"	https://www.ftc.gov/tips-advice/business-center/guidance/data-breach-response-guide-business.
"FTC Facts for Business: Financial Institutions and Customer Information: Complying with the Safeguards Rule"	https://www.ftc.gov/business-guidance/resources/ftc-safeguards-rule-what-your-business-needs-know
FTC Disposal Rule (2005) – "FTC Business Alert: Disposing of Consumer Report Information? Rule Tells How"	https://www.ftc.gov/tips-advice/business-center/guidance/disposing-consumer-report-information-rule-tells-how.
"Security Check: Reducing Risks to Your Computer Systems"	https://www.ftc.gov/tips-advice/business-center/guidance/security-check-reducing-risks-your-computer-systems.
NIST SP 800-18, Guide for Developing Security Plans for Federal Information Systems: Provides guidance on developing an Information Security Plan and includes a sample plan in Appendix A.	http://dx.doi.org/10.6028/NIST.SP.800-18r1.
NIST SP 800-53, Recommended Security Controls for Federal Information Systems and Organizations	http://dx.doi.org/10.6028/NIST.SP.800-53r4.
NIST SP 800-61 Revision 2, Computer Security Incident Handling Guide	https://nvlpubs.nist.gov/nistpubs/SpecialPublications/NIST.SP.800-61r2.pdf
NIST SP 800-30 Revision 1, Guide for Conducting Risk Assessments	http://dx.doi.org/10.6028/NIST.SP.800-30r1

Appendix B

Specified Service Trade or Business

The list of Specified Service Trades or Businesses, as amplified by IRS final regulations, includes trades or businesses involving the performance of services in one or more of the following fields:

- **Health** - the performance of services in the field of health means the provision of medical services by individuals such as physicians, pharmacists, nurses, dentists, veterinarians, physical therapists, psychologists, and other similar healthcare professionals performing services in their capacity as such.

  The performance of services in the field of health does not include the provision of services not directly related to a medical services field, even though the services provided may purportedly relate to the health of the service recipient.

- **Law** - the performance of services in the field of law means the performance of legal services by individuals such as lawyers, paralegals, legal arbitrators, mediators, and similar professionals performing services in their capacity as such.

  The performance of services in the field of law does not include the provision of services that do not require skills unique to the field of law.

- **Accounting** - the performance of services in the field of accounting means the provision of services by individuals such as accountants, enrolled agents, return preparers, financial auditors, and similar professionals performing services in their capacity as such.
- **Actuarial science** - the performance of services in the field of actuarial science means the provision of services by individuals such as actuaries and similar professionals performing services in their capacity as such.

- **Performing arts** - the performance of services in the field of the performing arts means the performance of services by individuals who participate in the creation of performing arts, such as actors, singers, musicians, entertainers, directors, and similar professionals performing services in their capacity as such.

  The performance of services in the field of performing arts does not include the provision of services that do not require skills unique to the creation of performing arts, such as the maintenance and operation of equipment or facilities for use in the performing arts. Similarly, the performance of services in the field of the performing arts does not include the provision of services by persons who broadcast or otherwise disseminate video or audio of performing arts to the public.

- **Consulting** - the performance of services in the field of consulting means the provision of professional advice and counsel to clients to assist the client in achieving goals and solving problems. Consulting includes providing advice and counsel regarding advocacy with the intention of influencing decisions made by a government or governmental agency and all attempts to influence legislators and other government officials on behalf of a client by lobbyists and other similar professionals performing services in their capacity as such.

  The performance of services in the field of consulting does not include the performance of services other than advice and counsel, such as sales (or economically similar services) or the provision of training and educational courses. For purposes of the preceding sentence, the determination of whether a person’s services are sales or economically similar services will be based on all the facts and circumstances of that person’s business. Such facts and circumstances include, for example, the manner in which the taxpayer is compensated for the services provided.

  Performance of services in the field of consulting does not include the performance of consulting services embedded in, or ancillary to, the sale of goods or performance of services on behalf of a trade or business that is otherwise not an SSTB (such as typical services provided by a building contractor) if there is no separate payment for the consulting services.

Services within the fields of architecture and engineering are not treated as consulting services.

- **Athletics** - the performance of services in the field of athletics means the performance of services by individuals who participate in athletic competition such as athletes, coaches, and team managers in sports such as baseball, basketball, football, soccer, hockey, martial arts, boxing, bowling, tennis, golf, skiing, snowboarding, track and field, billiards, and racing.

  The performance of services in the field of athletics does not include the provision of services that do not require skills unique to athletic competition, such as the maintenance and operation of equipment or facilities for use in athletic events. Similarly, the performance of services in the field of athletics does not include the provision of services by persons who broadcast or otherwise disseminate video or audio of athletic events to the public.

- **Financial services** - the performance of services in the field of financial services means the provision of financial services to clients including managing wealth, advising clients with respect to finances, developing retirement plans, developing wealth transition plans, the provision of advisory and other similar services regarding valuations, mergers, acquisitions, dispositions, restructurings (including in title 11 or similar cases), and raising financial capital by underwriting, or acting as a client's agent in the issuance of securities and similar services. This includes services provided by financial advisors, investment bankers, wealth planners, retirement advisors, and other similar professionals performing services in their capacity as such.

  Solely for purposes of section 199A, the performance of services in the field of financial services does not include taking deposits or making loans, but does include arranging lending transactions between a lender and borrower.

- **Brokerage services** - the performance of services in the field of brokerage services includes services in which a person arranges transactions between a buyer and a seller with respect to securities (as defined in section 475(c)(2)) for a commission or fee.

  This includes services provided by stock brokers and other similar professionals, but does not include services provided by real estate agents and brokers, or insurance agents and brokers.

- **Investing and investment managemen**t - the performance of services that consist of investing and investment management refers to a trade or business involving the receipt of fees for providing investing, asset management, or investment management services, including providing advice with respect to buying and selling investments.

  The performance of services of investing and investment management does not include directly managing real property.

- **Trading** - the performance of services that consist of trading means a trade or business of trading in securities (as defined in section 475(c)(2)), commodities (as defined in section 475(e)(2)), or partnership interests. Whether a person is a trader in securities, commodities, or partnership interests is determined by taking into account all relevant facts and circumstances, including the source and type of profit that is associated with engaging in the activity regardless of whether that person trades for the person's own account, for the account of others, or any combination thereof.

- **Dealing in securities, partnership interests or commodities** – the performance of services that consist of –

  - dealing in securities means regularly purchasing securities from and selling securities to customers in the ordinary course of a trade or business or regularly offering to enter into, assume, offset, assign, or otherwise terminate positions in securities with customers in the ordinary course of a trade or business. Solely for purposes of the preceding sentence, the performance of services to originate a loan is not treated as the purchase of a security from the borrower in determining whether the lender is dealing in securities.

  - dealing in partnership interests means regularly purchasing partnership interests from and selling partnership interests to customers in the ordinary course of a trade or business or regularly offering to enter into, assume, offset, assign, or otherwise terminate positions in partnership interests with customers in the ordinary course of a trade or business.

  - dealing in commodities means regularly purchasing commodities from and selling commodities to customers in the ordinary course of a trade or business or regularly offering to enter into, assume, offset, assign, or otherwise terminate positions in commodities with customers in the ordinary course of a trade or business. Solely for purposes of the preceding sentence, gains and losses from qualified active sales* are not taken into account in determining whether a person is engaged in the trade or business of dealing in commodities.

- **Any trade or business where the principal asset is the reputation or skill of one or more of its employees or owners** - the term any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners means any trade or business that consists of any of the following:
  - a trade or business in which a person receives fees, compensation, or other income for endorsing products or services,
  - a trade or business in which a person licenses or receives fees, compensation, or other income for the use of an individual's image, likeness, name, signature, voice, trademark, or any other symbols associated with the individual's identity, or
  - receiving fees, compensation, or other income for appearing at an event or on radio, television, or another media format.

*The term qualified active sale means the sale of commodities in the active conduct of a commodities business as a producer, processor, merchant, or handler of commodities if the trade or business is as an active producer, processor, merchant or handler of commodities. A hedging transaction is treated as a qualified active sale. The sale of commodities held by a trade or business other than in its capacity as an active producer, processor, merchant, or handler of commodities is not a qualified active sale. For example, the sale by a trade or business of commodities that were held for investment or speculation would not be a qualified active sale.