2026 Annual Federal Tax Refresher

Contents

Form **8814**

Department of the Treasury
Internal Revenue Service

Parents' Election To Report Child's Interest and Dividends

Attach to parents' Form 1040, 1040-SR, or 1040-NR.
Go to *www.irs.gov/Form8814* for the latest information.

OMB No. 1545-0074

2026

Attachment Sequence No. **40**

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

Caution: The federal income tax on your child's income, including qualified dividends and capital gain distributions, may be less if you file a separate tax return for the child instead of making this election. This is because you cannot take certain tax benefits that your child could take on his or her own return. For details, see *Tax benefits you cannot take* in the instructions.

A Child's name (first, initial, and last) | **B Child's social security number**

C If more than one Form 8814 is attached, check here . . . ☐

Part I **Child's Interest and Dividends To Report on Your Return**

1a	Enter your child's **taxable** interest. If this amount is different from the amounts shown on the child's Forms 1099-INT and 1099-OID, see the instructions	**1a**	
b	Enter your child's **tax-exempt** interest. **Do not** include this amount on line 1a **1b**		
2a	Enter your child's ordinary dividends, including any Alaska Permanent Fund dividends. If your child received any ordinary dividends as a nominee, see the instructions	**2a**	
b	Enter your child's qualified dividends included on line 2a. See the instructions **2b**		
3	Enter your child's capital gain distributions. If your child received any capital gain distributions as a nominee, see the instructions	**3**	
4	Add lines 1a, 2a, and 3. If the total is $2,700 or less, skip lines 5 through 12 and go to line 13. If the total is $13,500 or more, **do not** file this form. Your child **must** file his or her own return to report the income	**4**	
5	Base amount	**5**	$2,700
6	Subtract line 5 from line 4	**6**	
	If both lines 2b and 3 are zero or blank, skip lines 7 through 10, enter -0- on line 11, and go to line 12. Otherwise, go to line 7.		
7	Divide line 2b by line 4. Enter the result as a decimal (rounded to at least three places) **7** .		
8	Divide line 3 by line 4. Enter the result as a decimal (rounded to at least three places) **8** .		
9	Multiply line 6 by line 7. Enter the result here. See the instructions for where to report this amount on your return **9**		
10	Multiply line 6 by line 8. Enter the result here. See the instructions for where to report this amount on your return **10**		
11	Add lines 9 and 10	**11**	
12	Subtract line 11 from line 6. Include this amount in the total on Schedule 1 (Form 1040), line 8z. In the space next to that line, enter "Form 8814" and show the amount. If you checked the box on line C above, see the instructions. Go to line 13 below	**12**	

Part II **Tax on the First $2,700 of Child's Interest and Dividends**

13	Amount not taxed	**13**	$1,350
14	Subtract line 13 from line 4. If the result is zero or less, enter -0-	**14**	
15	**Tax.** Is the amount on line 14 less than $1,350? ☐ **No.** Enter $135 here and see the **Note** below. ☐ **Yes.** Multiply line 14 by 10% (0.10). Enter the result here and see the **Note** below.	**15**	

Note: If you checked the box on line C above, see the instructions. Otherwise, include the amount from line 15 in the tax you enter on Form 1040,1040-SR, or 1040-NR, line 16. Be sure to check box 1 on Form 1040, 1040-SR, or 1040-NR, line 16.

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 10750J Form **8814**

For illustration purposes only

Introduction to the Course

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

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

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

Course Learning Objectives

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

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

Domain 1 – New Tax Law/Recent Updates

Introduction

Federal tax law requires that various limits be adhered to in the preparation of tax returns, and such limits may change from year to year based on an inflation adjustment or on other factors. Included in those changes for 2026 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 2026 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;
- Recognize the One Big Beautiful Bill Act (OBBBA) provisions affecting various income tax credits;
- Identify the OBBBA provisions affecting various income tax deductions; and
- Describe the OBBBA provisions affecting-
    - Charitable Contributions,
    - 529 Plan Account Disbursements,
    - Trump Accounts, and
    - Health Savings Accounts.

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;
- Interest on education loans;
- Foreign earned income exclusion; 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 2026, OBBBA has enhanced the above-the-line deduction for qualified education expenses of elementary and secondary school teachers by increasing the deduction allowed under §162 to $350. In addition, OBBBA, for tax years after 2025,

- Allows qualified educator expenses in excess of $350 above-the-line deductible as a 2 percent miscellaneous itemized deduction not subject to the 2 percent floor;
- Allows athletic supplies for courses of instruction in health or physical education;
- Adds interscholastic sports administrators and coaches as eligible educators; and
- Broadens the criteria for eligible expenses criteria from being limited to "in the classroom" to "as part of instructional activity."

1.1.2 Interest on Education Loans

Student loan interest is 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.

Beginning in 2026, the maximum deductible interest on qualified education loans is $2,500. The income limit phaseout begins for taxpayers with a modified adjusted gross income (MAGI) of $85,000 ($175,000 for MFJ) and is completely phased out for taxpayers with a MAGI of $100,000 ($205,000 for MFJ) or more.

1.1.2.1 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, 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 Foreign Earned Income Exclusion

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, or
- 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.

For taxable years beginning in 2026, the foreign earned income exclusion amount is $132,900.

1.1.3.1 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.

1.1.3.2 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 2026 income of $125,000, 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 $125,000 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 $125,000 income by 87.5%, we can see that her foreign income is $109,375 ($125,000 x .875 = $109,375).

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 $265,800 in 2026.

1.1.4. 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:

- Gifts valued at not more than the annual gift tax exclusion;
- Tuition or medical expenses paid by the taxpayer for another;
- Gifts to a spouse who is a U.S. citizen; and
- 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 2026 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.

The annual gift tax exclusion for gifts to non-U.S. citizen spouses in 2026 increased to $194,000 from $190,000 in 2025.

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

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 2026 standard mileage rate applicable to ***eligible*** business use of a vehicle is 72.5¢ per mile, up from 70¢ in 2025. 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.

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 2026, the standard medical mileage rate is 20.5¢ per mile. 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 Moving Expenses in Military and Intelligence Community Relocations

The tax deduction for moving expenses for all taxpayers other than taxpayers moving due to a permanent change of military or intelligence community station is eliminated. A taxpayer who uses a personal vehicle as part of a move for which expenses are deductible—a military or intelligence community move meeting the deductibility requirements, in other words—is permitted to include the out-of-pocket vehicle expenses incurred as part of the move or use the standard mileage rate. For 2026, the standard mileage rate for such moves is 20.5¢ per mile. The taxpayer may also deduct any parking fees or tolls, regardless of whether actual expense or the standard mileage rate is used.

Additional discussion of the tax treatment of military and intelligence-community moves may be found at 2.11.6.1.

1.2.5 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

35¢ for 2026

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 years 2022 through 2025 have been a transition period during which third-party settlement organizations were required to furnish a 1099-K based on diminishing amounts, and beginning January 1, 2025, the total sale requirement to furnish Form 1099-K was reduced to $2,500 in aggregate sales. It was anticipated that for 2026 and years after, the number would be reduced to the $600 level provided for in ARPA.

1.3.1 OBBBA Repeals Change to Third-Party Network Reporting

OBBBA, §70432, repeals the changes to third-party network reporting to be effective as if the repeal had been included in the American Rescue Plan Act. Accordingly, for 2026, a third party settlement organization is required to report information to participating payees who had:

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

Although there is a threshold of greater than $20,000 in aggregate payments and more than 200 transactions for payments received through a TPSO, there is no threshold amount that must be met to require a Form 1099-K from payments received through a ***payment card*** transaction. Payment cards include:

- Credit cards;
- Debit cards;
- Stored-value cards (including gift cards); and
- Payment through any distinctive marks of a payment card (such as a credit card number).

Therefore, a transaction as low as $0.01 made from a payment card transaction is required to be reported using Form 1099-K.

1.3.2 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

1.3.3 Transactions not Requiring Reporting

Transactions not requiring reporting include:

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

1.4 Information Reporting Threshold Changes- Forms 1099-MISC and 1099-NEC

OBBBA §70433 made changes to the reporting thresholds for Form 1099-MISC and Form 1099-NEC. Section 70433 of OBBBA changes the reporting threshold for both Form 1099-MISC and 1099-NEC from $600 to $2,000 beginning in 2026. For 2027 and subsequent years, the threshold for both forms will be adjusted for inflation.

Starting in 2027, the new law amends backup withholding requirements by requiring payors to issue 1099-MISC and 1099-NEC forms only when the aggregate for the calendar year exceeds the established threshold for that year.

1.5 OBBBA Increases Child and Dependent Care Credit & Income Limit

OBBBA, §70405, increases the maximum dependent care percentage rate from 35% to 50% for tax years after December 31, 2025. The applicable percentage is based on the taxpayer’s adjusted gross income, up to 50% of such expenses. A more complete explanation may be found at 2.12.4.

1.6 Adoption Credit Now Partially Refundable

The adoption credit is a tax credit designed to offset qualified adoption expenses for eligible taxpayers adopting an eligible child or children. A portion of the adoption credit is refundable. For 2026, the adoption credit is $17,670 and the refundable portion of the adoption credit is $5,120. The adoption assistance program enables a taxpayer to exclude from income any amounts:

- Paid by the taxpayer to adopt an eligible child; or
- Paid for the taxpayer by an employer to offset qualified adoption expenses under a qualified adoption assistance program.

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

Before passage of OBBBA, the adoption credit was limited to no more than the taxpayer's tax liability, i.e. it was entirely nonrefundable. The One Big Beautiful Bill Act (OBBBA), §70402, provides that up to $5,000 of the adoption credit is refundable. That broadens the application of the credit by increasing its value to lower-income taxpayers and means a taxpayer may receive an adoption tax credit of up to $5,000 ($5,120 in 2026) despite not having any income tax liability. Obtaining the balance of the adoption credit requires that the taxpayer have a commensurate income tax liability.

1.6.1 Eligible Child

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

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

- Under age 18 (if the child turned age 18 during the year, the child is an eligible child for the part of the year he or she was under age 18); or
- A disabled individual physically or mentally unable to care for himself or herself, regardless of age.

A physically or mentally disabled individual unable to care for himself or herself is generally referred to in connection with the adoption credit and exclusion as a "special needs" child. However, it is important not to confuse "children with special needs" for purposes of the adoption credit with the definitions of "children with special needs" for other purposes. While foreign children aren't considered to have special needs for purposes of the adoption credit, even U.S. children who have disabilities may not have special needs for purposes of the adoption credit. Generally, "special needs adoptions" are the adoptions of children whom the state's child welfare agency considers difficult to place for adoption.

Thus, a child is deemed to have special needs for purpose of the adoption expenses if:

- The child is a citizen or resident of the United States or its territories when the adoption effort began;
- A state determines that the child can't or shouldn't be returned to its parents' home; and
- The state determines that the child probably won't be adoptable without assistance provided to the adoptive family.

1.6.2 Qualified Adoption Expenses

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

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

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

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

1.7 Social Security Number Requirement for American Opportunity and Lifetime Learning Credits

Two tax credits are available to assist taxpayers in offsetting the costs of higher education: the American opportunity credit and the lifetime learning credit. Although these tax credits have certain similarities they also differ from one another in several respects.

OBBBA §70606, specifies that, for tax years 2026 and later, only a Social Security Number (SSN) for the taxpayer, the taxpayer's spouse (if filing jointly), and the student will be considered an acceptable form of identification when claiming either the Lifetime Learning Credit or the American Opportunity Credit. A taxpayer's Taxpayer Identification Number (TIN), Individual Taxpayer Identification Number (ITIN), or the Adoption Taxpayer Identification Number(ATIN) will no longer be considered acceptable identification when claiming these credits.

Beginning in 2026, a taxpayer is required to provide the educational institution's Employer Identification Number (EIN) on Form 8863 to claim the American opportunity tax credit or lifetime learning tax credit. This new requirement identifies the eligible institution with the EIN found on Form 1098-T, in which qualified tuition and related expenses were paid.

Additional explanation may be found at 2.12.5.

1.8 Alternative Fuel Vehicle Refueling Property Credit

IRC §30C provides for a nonrefundable credit equal to 30 percent (6 percent in the case of property of a character subject to depreciation) of the cost of any qualified alternative fuel vehicle refueling property placed in service by the taxpayer during the taxable year.

1.8.1 Alternative Fuel Vehicle Refueling Property Credit Limits

The credit allowed is limited to no more than:

- $100,000 in the case of qualified alternative fuel vehicle refueling property subject to an allowance for depreciation by businesses using the property for business or income-producing activities; and
- $1,000 in any other case.

1.8.2 Alternative Fuel Vehicle Refueling Property Defined

Alternative fuel vehicle refueling property includes equipment for storing, dispensing, or charging vehicles that run on electricity, hydrogen, and other clean-burning fuels, such as:

- Electric vehicle (EV) charging stations;
- Alternative fuel pumps and dispensers for non-electric alternative fuels;
- Energy storage equipment for storing electricity or alternative fuels like hydrogen, natural gas, or propane; and
- Associated infrastructure, including essential components and installation costs.

As established in the Inflation Reduction Act (IRA), the credit was set to expire at the end of 2032.

1.8.3 OBBBA Accelerates End of Alternative Vehicle Refueling Property Credit by 5 ½ Years

OBBBA, §70504, impacts the Alternative Fuel Vehicle Refueling Property Tax Credit by accelerating its termination. The legislation requires that qualified alternative fuel vehicle refueling property must be placed in service before July 1, 2026, to be eligible for the credit, reducing the timeframe to take advantage of the credit by about 5 ½ years.

1.9 Itemized Deduction Updates

OBBBA has impacted the following deductions:

- Itemized Deduction Limitations,
- Mortgage Interest Deduction,
- Casualty Loss Deduction,
- Gambling Loss Deduction, and
- State and Local Tax (SALT) Deduction.

1.9.1 Itemized Deduction Limitations

Taxpayers who itemize their deductions prior to passage of TCJA have been able to deduct certain expenses as miscellaneous itemized deductions on schedule A (Form 1040) to the extent that, in the aggregate, they exceeded 2% of the taxpayer's AGI. Under the TCJA these miscellaneous itemized deductions subject to the 2% of AGI floor are suspended for expenses incurred after December 31, 2017 through 2025.

1.9.1.1 OBBBA Permanently Eliminates Miscellaneous Deductions Subject to 2% for Other than Educator Costs

OBBBA, §70110, makes permanent the temporary suspension of miscellaneous itemized deductions provided under the TCJA that applies to virtually all expenses other than qualified educator expenses not exceeding $350 per educator. Educator expenses include:

- Books and supplies;
- Computer equipment; and
- Professional development courses.

1.9.1.2 Limitation on Tax Benefit of Itemized Deductions

Tax law in effect at the time of passage of the TCJA provided for an overall limitation on certain itemized deductions applicable to higher-income individuals whose adjusted gross income (AGI) exceeded specified limits based on the taxpayer's filing status. The specified limits were subject to annual adjustment for inflation. The TCJA temporarily suspended the overall limitation on itemized deductions for tax years beginning after December 31, 2017 through December 31, 2025.

1.9.1.3 OBBBA Imposes Reduction on Itemized Deductions

OBBBA, §70111, effective for taxable years beginning after December 31, 2025, provides that the amount of the itemized deductions otherwise allowable for the taxable year (determined without regard to this section) must be reduced by 2/37 of the lesser of:

- Such amount of itemized deductions, or
- So much of the taxable income of the taxpayer for the taxable year (determined without regard to this section and increased by such amount of itemized deductions) as exceeds the dollar amount at which the 37 percent rate bracket begins with respect to the taxpayer.

For example, suppose Sharon, a single executive, has a $645,600 taxable income in 2026 and has itemized deductions of $30,000. Since her taxable income exceeds the 37 percent threshold ($640,600) by $5,000, her itemized deductions would be reduced by the lesser of:

$$\$30{,}000 \times \frac{2}{37} = \$1{,}621$$

$$\$5{,}000 \times \frac{2}{37} = \$270$$

As the formula indicates, Sharon's itemized deductions are reduced by $270, resulting in total itemized deductions of $29,730.

Note: The limitation on itemized deductions isn't taken into account when determining the deduction for qualified business income.

1.9.2 OBBBA Makes Mortgage Insurance Premiums Deductible for Itemizers

OBBBA, §70108, makes two changes to the existing tax law related to the mortgage interest deduction, beginning in 2026:

- The temporary changes concerning the mortgage interest deduction made by the TCJA are made permanent; and
- Mortgage insurance premiums are included as qualified mortgage interest. (Mortgage insurance provides coverage protecting the mortgage lender if the borrower defaults on the loan payments and is typically required by lenders when borrowers make a down payment of less than 20% of the home's purchase price.)

OBBBA makes permanent the $750,000 **mortgage interest expense** limit ($375,000 in the case of a married individual filing separately) on acquisition indebtedness eligible for deduction.

1.9.3 OBBBA Makes Casualty Loss Changes

OBBBA, §70109, makes several changes to the casualty loss deduction:

- The provision of the TCJA that limited deductible casualty losses to federally-declared disasters is made permanent;
- The $100 per-event deduction is made permanent;
- The 10 percent of AGI limitation is made permanent;
- A provision adds a deduction, for tax years after December 31, 2025, for certain state-declared disasters;
- The requirement that the casualty loss exceed 10 percent of the taxpayer's AGI has been eliminated for "qualified disasters";
- The $100 limitation has been increased to $500 for casualty losses arising from a qualified federally-designated disaster for tax years after December 31, 2023; and
- The requirement that the taxpayer itemize deductions has been removed, permitting both itemizers and non-itemizers to deduct qualified disaster losses.

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. Additionally, personal casualty and theft losses attributable to a federally declared disaster are subject to the $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 the AGI reduction and the $100 reduction is increased to $500. An exception to the rule above, limiting the personal casualty and theft loss deduction to losses attributable to a federally declared disaster, applies if you have personal casualty gains for the tax year.

The term "State declared disaster" means, with respect to any State, any natural catastrophe (including any hurricane, tornado, storm, high water, wind-driven water, tidal wave, tsunami, earthquake, volcanic eruption, landslide, mudslide, snowstorm, or drought), or, regardless of cause, any fire, flood, or explosion, in any part of the State, which in the determination of the Governor of such State (or the Mayor, in the case of the District of Columbia) and the Secretary causes damage of sufficient severity and magnitude to warrant the application of the rules of this section.

1.9.4 Gambling Loss Deduction

Although a taxpayer is generally required to have income tax withheld from his or her gambling winnings, a tax deduction of gambling losses or "wagering losses" can significantly offset taxes owed on gambling winnings. Under prior tax law, a tax deduction of 100% of wagering losses not exceeding wagering winnings was permitted. That changes under OBBBA.

1.9.4.1 OBBBA Reduces Wagering Loss Deduction & Includes Travel & Lodging in Losses

OBBBA, §70114, reduces the deduction to 90% of wagering losses—but still not exceeding winnings—applicable to taxable years beginning after December 31, 2025.

The tax deduction for wagering losses continues to be limited to wagering winnings for the year. Specifically, a taxpayer's wagering losses may not exceed the amount of gambling winnings; therefore wagering losses cannot be used to offset other forms of taxable income.

Travel and lodging, which are considered business expenses for professional gamblers, are also now included in the 90% wagering loss deduction with the passage of OBBBA. Even with the inclusion of these business expenses in the wagering loss deduction, a professional gambler could potentially have no net gain yet still owe taxes because of the reduced deductibility of wagering losses for the year.

1.9.5 Deduction for State & Local Taxes Temporarily Increased (SALT Deduction)

OBBBA, §70120, temporarily increases the deduction for state and local taxes—frequently referred to as the "SALT deduction"—from $10,000 to $40,000 in 2025 for all filing statuses other than married filing separately (MFS). The limit increases to $40,400 in 2026. For calendar years after 2026 and before 2030, the limitation is equal to 101% of the dollar amount in effect in the preceding calendar year. In 2030, the SALT deduction is again reduced to $10,000. The SALT limitation for the MFS filing status is half of the limitation for all other filing statuses.

For example, the amount in 2027 would be $40,400 times 1.01, and would, therefore, be $40,804. Thus, the SALT limitation for each year would be as shown in the chart below:

Year	SALT Limitation (all filing statuses other than married filing separately)	SALT Limitation (married filing separately)
2025	$40,000	$20,000
2026	$40,400	$20,200
2027	$40,804	$20,402
2028	$41,212	$20,606
2029	$41,624	$20,812
2030	$10,000	$5,000

1.9.5.1 Reduction of SALT Limitation Based on Income

The SALT limitation is reduced for taxpayers with incomes in excess of $500,000 ($250,000 in the case of a married taxpayer filing a separate return), adjusted by 1% annually. The reduction in the SALT limitation is 30% of the amount by which the applicable MAGI exceeds the threshold. The applicable thresholds are shown in the chart below:

Year	Threshold	Married Filing Separately Threshold
2025	$500,000	$250,000
2026	$505,000	$252,500
2027	$510,050	$255,025

Year	Threshold	Married Filing Separately Threshold
2028	$515,150	$257,575
2029	$520,302	$260,151
2030	Not applicable	Not applicable

The SALT limitation, reduced by the amount of a taxpayer's MAGI exceeding the applicable threshold, will never be less than $10,000.

1.10 Form 1040, Schedule 1-A, Additional Deductions

OBBBA has impacted the following deductions:

- Deduction for Tip Income;
- Deduction for Overtime Pay;
- Auto Interest Loan Deduction; and
- Enhanced Deduction for Seniors.

1.10.1 Deduction for Tip Income

OBBBA, §70201, effective for tax years beginning after December 31, 2024, provides for a tax deduction for qualified tips to taxpayers who itemize deductions and to taxpayers who are non-itemizers. The maximum amount of the tax deduction is $25,000 but is reduced by $100 for each $1,000 that the taxpayers' MAGI exceeds $150,000 ($300,000 in the case of a joint return).

For example, assume Sheila, a single taxpayer, has a MAGI of $170,000, $150,000 of which is comprised of qualified tips. After identifying the maximum deduction available to Sheila, the MAGI limitation ($150,000 in this case) would be applied. Accordingly, Sheila's potential tax deduction of $25,000 for qualified tips must be reduced to $23,000, as shown in the equation below:

$$\text{Maximum deduction} - \left[\frac{(\text{MAGI} - \text{applicable limit})}{\$1{,}000} \times \$100\right] = \text{Reduced deduction}$$

$$\$25{,}000 - \left[\frac{(\$170{,}000 - \$150{,}000)}{\$1{,}000} \times \$100\right] = \$23{,}000$$

1.10.1.2 Qualified Tips Defined

"Qualified tips," for purposes of the deduction, means cash tips received by a taxpayer in an occupation that normally received tips on or before December 31, 2024. It includes tips received from customers that are paid in cash or charged, and, in the case of an employee, it also includes any tips received under a tip-sharing arrangement.

No amount received by a taxpayer is considered a qualified tip unless:

- It is –
    - paid voluntarily without any consequence in the case of nonpayment,
    - not the subject of negotiation, and
    - determined by the payor; and
- The trade or business in the course of which the taxpayer receives the amount is not a specified trade or business (SSTB) as that term is used in connection with the §199A qualified business income (QBI) deduction.

Statements furnished to payees receiving tips must show:

- The portion of payments received by the taxpayer reasonably designated as cash tips; and
- The occupation of the person receiving the tips.

To claim the deduction, otherwise eligible taxpayers must:

- Include their Social Security Number on the return; and
- File jointly, if married.

1.10.2 Deduction for Overtime Pay

OBBBA, §70202, provides for a deduction beginning in 2025 and extending through 2028 for qualified overtime compensation. The deduction is available to itemizing taxpayers and non-itemizing taxpayers and is limited to no more than $12,500 ($25,000 in the case of a joint account). The deduction may be reduced, based on the taxpayer's MAGI.

1.10.2.1 Qualified Overtime Compensation Defined

"Qualified overtime compensation," for purposes of the deduction, means compensation paid to an individual under section 7 of the Fair Labor Stands Act of 1938 that requires employers to pay nonexempt employees at a rate at least one and one-half times their regular rate for all hours worked over 40 in a workweek. It does not include any qualified tip income.

The overtime compensation included in the term is the "one-half" portion of the "one and one-half" times the taxpayer's regular hourly rate. Thus, a taxpayer whose regular pay rate is $30 per hour would normally have an overtime pay rate of $45 per hour ($30 *x* 1.5). However, the amount of the overtime pay subject to the deduction is $15 per hour, i.e., the amount that exceeds the taxpayer's regular $30 per hour pay rate.

1.10.2.2 Deduction Limited by Modified Adjusted Gross Income

The deduction for overtime, in addition to being limited to no more than $12,500 ($25,000 in the case of a joint return), is further limited based on the taxpayer's modified adjusted gross income (MAGI). Pursuant to the limitation based on the taxpayer's MAGI, the amount allowable as a deduction must be reduced, but not below zero, by $100 for each $1,000 by which the taxpayer's MAGI exceeds $150,000 ($300,000 in the case of a joint return) as shown in the equation below.

$$\text{Maximum deduction} - \left[\frac{(\text{MAGI} - \text{applicable limit})}{\$1{,}000} \times \$100\right] = \text{Reduced deduction}$$

$$\$25{,}000 - \left[\frac{(\$350{,}000 - \$300{,}000)}{\$1{,}000} \times \$100\right] = \$20{,}000$$

1.10.3 Auto Interest Loan Deduction

OBBBA, §70203, provides for a temporary deduction of qualified passenger vehicle loan interest not exceeding $10,000—including interest on refinancing to the extent of the financed indebtedness—beginning in 2025 and continuing through 2028. The deduction is available to taxpayers who itemize deductions as well as those who are non-itemizers. The car loan interest deduction is reduced by $200 for each $1,000 (or portion) by which the taxpayer's MAGI exceeds $100,000 ($200,000 in the case of married taxpayers filing jointly).

1.10.3.1 Qualified Passenger Vehicle Loan Interest Defined

The term "qualified passenger vehicle loan interest" means the interest paid or accrued during the tax year on indebtedness incurred by the taxpayer for the purchase of a new passenger vehicle for personal use. However, interest incurred on indebtedness owed to a person related to the taxpayer is not considered qualified passenger vehicle loan interest deductible by the taxpayer. If a qualifying vehicle loan is later refinanced, interest paid on the refinanced amount is generally eligible for the deduction.

1.10.3.2 Applicable Passenger Vehicle Defined

The term "applicable passenger vehicle" to which the interest deduction may apply means any vehicle:

- The original use of which commences with the taxpayer;
- Which is manufactured primarily for use on public streets, roads, and highways (not including a vehicle operated exclusively on a rail or rails);
- Which has at least two wheels;
- Which is a car, minivan, van, sport utility vehicle, pickup truck, or motorcycle;
- Which is treated as a motor vehicle for purposes of Title II of the Clean Air Act;
- Which has a gross vehicle weight rating of less than 14,000 pounds; and

- Which had its final assembly within the United States.

The taxpayer claiming a deduction for car loan interest must include the vehicle identification number (VIN) on his or her tax return. Qualified passenger vehicle loan interest is interest paid or accrued during the tax year on indebtedness incurred by the taxpayer after Dec. 31, 2024, for the purchase of, and that is secured by a first lien on, an applicable passenger vehicle for personal use. Among other restrictions, applicable passenger vehicles must have had their final assembly in the United States.

1.10.4 Enhanced Deduction for Seniors

The Deduction for Seniors is a new deduction, effective for 2025 through 2028, that enables individuals who are age 65 and older to claim an additional deduction of $6,000. A qualified individual is defined as an individual who has attained age 65 before the close of the taxable year. The deduction for qualified individuals is reduced, but not below zero, by 6% of the taxpayer's modified adjusted gross income (MAGI) exceeding $75,000 ($150,000 in the case of a joint return).

1.11 Charitable Contribution Deduction

OBBBA brings back and expands the earlier (CARES Act) version of the charitable deduction for non-itemizing taxpayers. OBBBA, §70424, authorizes an above-the-line partial deduction for charitable contributions for taxpayers not itemizing deductions beginning after December 31, 2025. Eligible contributions must be made in cash or by check or credit card to qualified public charities. The above-the-line charitable deduction is limited to no more than $1,000 for taxpayers filing single, and up to $2,000 for married taxpayers filing jointly for tax years beginning after December 31, 2025. Although the charitable deduction for *itemizers* is subject to a .5 percent floor (discussed next), the charitable deduction for non-itemizers is not.

1.11.1 0.5 Percent Floor on Deduction of Contributions

OBBBA, §70425, makes the temporary 60 percent contribution limit for cash gifts to certain qualified charitable organizations authorized by the TCJA permanent. In addition, it introduces a new 0.5 percent floor on the deduction of all charitable contributions made by individuals who itemize their deductions, effective for tax years beginning after December 31, 2025. That is, a taxpayer can deduct only the portion of his or her contributions that exceed 0.5 percent of the taxpayers' adjusted gross income (AGI) and not more than:

- 60 percent of AGI for cash gifts; and
- 50 (or 30) percent of AGI for noncash gifts, depending on how the deduction is determined.

If a taxpayer has made charitable contributions exceeding the AGI limit (e.g., 60, 50 or 30 percent of AGI), the portion reduced by the 0.5 percent AGI floor also may be carried over for up to 5 tax years. Any carryover charitable deduction not used within the five-year carryover period will expire.

Section 70425 also mandates the order in which various types of charitable contributions are reduced by the 0.5 percent-of-AGI floor. That specified ordering is as follows:

1. Capital gain property contributed to non-public charities;
2. Capital gain property contributed to public charities using fair market value;
3. Cash contributions to non-public charities;
4. Qualified conservation contributions (a specific type of contribution of land or real estate for conservation purposes);
5. Capital gain property contributed to public charities using cost basis; and
6. Cash contributions to public charities.

1.12 529 Plan Account Disbursements

Section 529 plans, also known as college savings plans, enable individuals to contribute money to an investment plan whose earnings are tax-deferred and from which distributions of contributions and earnings are tax-free when used to meet qualified higher education expenses. As a result of passage of OBBBA, §529 plans consider certain post-secondary credentialing expenses to be qualified higher education expenses effective for distributions made after July 4, 2025. As qualified higher education expenses, a distribution not exceeding such expenses would be tax-free.

OBBBA §70413 increases the annual aggregate per-beneficiary §529 distribution limitation for elementary and secondary school expenses from $10,000 to $20,000 beginning after December 31, 2025

1.13 Trump Accounts and Contribution Pilot Program

OBBBA, §70204, (Notice 2025-68) established "Trump Accounts" to incentivize early savings for children by providing tax-deferred investment accounts for children so long as the account is opened prior to the child turning 18 years of age. An initial deposit of $1,000, called the "pilot program" deposit, will be made to a qualifying child's Trump Account if the child is born during a specified timeframe.

1.13.1 Trump Account Eligibility Requirements

OBBBA specifies that the eligibility requirements to open a Trump Account are as follows:

- To qualify for the $1,000 initial "pilot program" deposit, the eligible child must be born within a specific window of time - January 1st, 2025 and December 31st, 2028.
- Children born prior to January 1st, 2025 are eligible for a Trump Account if they are under age 18 at the opening of the account, however they will not be eligible for the initial $1,000 deposit due to being born outside of the pilot program window of time. Trump Accounts may be opened for eligible children on or after July 4th, 2026.
- Eligibility for the Trump Account is limited to children who are U.S citizens and have a valid work-eligible social security number. Citizenship or immigration status of the child's parents is immaterial.
- Only an authorized individual can open a Trump Account for the eligible child, in the following order of priority, including a/an:
    - legal guardian;
    - parent;
    - adult sibling; or
    - grandparent.
- .

1.13.2 Trump Account Contributions

An annual aggregate limit of up to $5,000 may be contributed to a child's Trump Account until the child turns 18 years of age by the child's parents, relatives, or anyone else. Contribution rules include the following:

- Initial Trump Account contributions may only be made after July 4th, 2026.
- Contributions to a Trump Account are generally non-deductible, after-tax funds.
- Employers may contribute to an employee's child's account, up to $2,500 annually. Employer contributions apply to the overall $5,000 annual contribution limit; however, it is not considered taxable income to the parent or child.
- The $2,500 and $5,000 annual contribution limits will be adjusted for inflation starting in 2028.
- The initial "pilot program" deposit of $1,000 by the federal government does not count against the $5,000 annual contribution limit.
- Certain non-federal government programs and charitable 501(c)(3) organizations may make contributions to a child's Trump Account that will not count towards the $5,000 annual contribution limit.
- Contributions made to Trump Accounts must be invested in "eligible investments." Mutual funds, or exchange-traded funds that track a qualified index, e.g. S&P 500, meet the requirement of eligible investments.
- Contributions must be made by December 31st of the contribution year.
- Excess contributions may result in a 6% penalty by the IRS each year until the excess contributions are rectified.

Contributions may be made to a Trump Account before the year in which the child turns age 18. Employer contributions to a Trump Account made pursuant to a Trump Account Contribution Program (TACP) may be excluded from the employer's income[1].

1.13.3 Trump Account Distributions

Rules on withdrawals generally similar to those applicable to a traditional IRA apply to withdrawals from a Trump Account and are as follows:

- Funds may be withdrawn from the Trump Account beginning on the first day of the calendar year the child turns 18. Withdrawals prior to the child turning 18 are generally prohibited except for limited exceptions, and penalties may be assessed for a distribution that is not permitted.
- Funds withdrawn may be used for eligible expenses such as education expenses or a downpayment on a first home. If the funds are not used for these specific purposes, the account will be subject to the rules applicable to an individual retirement account after age 18.
- Although no contributions to a Trump Account made by parents, guardians or others are deductible, they are included in the distributee's cost basis. Employer contributions, the $1,000 federal contribution, and charitable gifts, however, are not included in the distributee's cost basis. Earnings are tax-deferred until distributed and are taxable when withdrawn.

1.13.4 Form 4547 Trump Account Election

Use IRS Form 4547 to make the election to establish an initial Trump account for the exclusive benefit of an eligible child. Also, use Form 4547 to make an election for a $1,000 pilot program contribution from the U.S. Treasury to a child's Trump account if they are eligible for the contribution.

1.14 Health Savings Accounts

OBBBA §71306 (Notice 2026-5) makes permanent a health savings account (HSA) safe harbor for the absence of a deductible for telehealth and other remote care services applicable retroactively for plan years beginning after December 31, 2024. This provision permits health insurance plans meeting the normal deductible and other requirements for HSAs to provide first-dollar telehealth and other remote care services without losing their status as high deductible health plans (HDHPs).1.14.1 Direct Primary Care Service Arrangements

A Direct Primary Care Service Arrangement is an arrangement under which an individual is provided medical care by primary care practitioners, if the sole compensation for such care is a fixed periodic fee. Direct Primary Care Services include a variety of services including:

- Physical examinations;
- Vaccinations;
- Urgent care;
- Laboratory testing; and
- Diagnosis and treatment of some sicknesses and injuries.

Effective January 1, 2026, OBBBA §71308 allows for Direct Primary Care Service Arrangements (DPSCAs) to no longer be considered disqualifying coverage when paired with an HDHP, allowing for the ability to contribute to an HSA. Direct Primary Care expenses are also eligible for reimbursement under an HSA, subject to a limit of $150 per month (individual coverage) or $300 per month (family coverage).

1.14.2 Bronze & Catastrophic Plans Considered HDHPs

Additionally, OBBBA §71307 provides that the term "high deductible health plan" includes bronze level and catastrophic plans, which is required to provide a level of coverage designed to provide benefits that are actuarially equivalent to 60 percent of the full actuarial value of the benefits provided under the plan and a catastrophic plan.

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[1] Trump Accounts: Overview and Policy Considerations may be accessed at https://www.congress.gov/crs-product/R48910.

Review #1

1. A taxpayer and spouse, both of whom are age 66, file their federal tax return jointly with a modified adjusted gross income (MAGI) of $140,000. For what senior deduction are they eligible?

   A. $1,650

   B. $2,050

   C. $6,000

   D. $12,000

2. Jason and Georgia are married and file a joint federal tax return. They paid $40,400 in state and local taxes in 2026 and have a modified adjusted gross income of $625,000. What is their deduction for state and local taxes?

   A. $0

   B. $4,000

   C. $10,000

   D. $40,000

3. Carol and Bob adopted an eligible child in 2026. What is their adoption credit, assuming they are otherwise eligible for the credit?

   A. $5,120

   B. $12,550

   C. $17,670

   D. $35,340

4. At what amount in 2026 must a third-party service organization furnish Form 1099-K, *Payment Card and Third Party Network Transactions* to participating payees?

   A. When amounts exceed $600, regardless of the number of transactions

   B. When amounts exceed $2,500, regardless of the number of transactions

   C. When amounts exceed $5,000, regardless of the number of transactions

   D. When amounts exceed $20,000 and more than 200 transactions

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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 2026 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 various filing statuses and the change to the gross income limitation for a qualifying relative;
- Identify those items included in a taxpayer's taxable earnings;
- Determine the tax treatment of interest, dividends, 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 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 and spouse 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 for temporary absences, such as school). However, the taxpayer's dependent parent does not have to live with the taxpayer to meet HOH requirements.
- Qualifying surviving spouse(QSS) The IRS changed the filing status name from Qualifying Widow(er)" to "Qualifying Surviving Spouse (QSS)" for tax years 2022 and later. 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.

The taxpayer may use the Married Filing Jointly filing status during the year in which the taxpayer's spouse died and for the 2 years immediately following so long as the surviving spouse does not:

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

Once those two tax years have expired and the taxpayer has not remarried, that taxpayer will then be considered single for tax filing purposes.

2.1.2 Criteria for Filing as Qualifying Surviving Spouse

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

1. The taxpayer filed, or was eligible to file, as Married Filing Jointly the year in which their spouse died;
2. The taxpayer did not remarry during the year of their spouse's death nor in the two years immediately following it;
3. The taxpayer has a qualifying child or stepchild they may claim as a dependent; (Note: A foster child does not qualify. However, a child that was lawfully placed with the taxpayer for legal adoption by the taxpayer does qualify.)
4. The qualifying child resided with the taxpayer for the entire year, except for temporary absences (see 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 qualify for the filing status of Qualifying Surviving Spouse, including:

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 that 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 provided 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 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 Qualifying Relative Tests

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.

2.1.4.1 Not a Qualifying Child Test

The Qualifying Relative cannot be the taxpayer's qualifying child or the qualifying child of any other taxpayer.

2.1.4.2 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.

2.1.4.3 Gross Income Test

The Qualifying Relative must have gross income for the year of less than $5,300 for 2026.

2.1.4.4 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 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 W-2 Form, Wage and Tax Statement

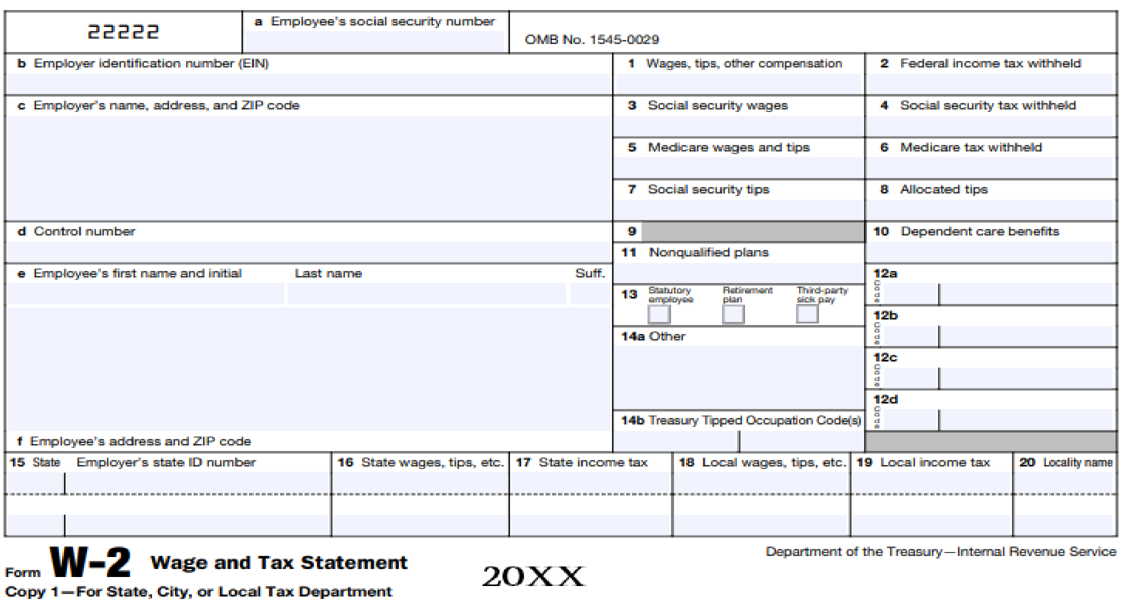
Every employer engaged in a trade or business who pays remuneration of $600 or more for the year (all amounts if any income, social security, or Medicare tax was withheld) for services performed by an employee must file a Form W-2 for each employee from whom:

- Income, Social Security, or Medicare tax was withheld; or
- Income tax would have been withheld if the employee had claimed no more than one withholding allowance or had not claimed exemption from withholding.

While employers use it to report wages, employees' principal use is to file federal and state income tax returns, it is needed for calculating taxable income, tax liability, and determining whether taxes are owed or a refund is due. The form also includes information about certain employer-provided benefits, including:

- Health insurance;
- Adoption assistance benefits paid;
- Dependent care assistance; and
- Health savings account contributions.

Form W-2 is replicated below:



22222
a Employee's social security number
OMB No. 1545-0029
b Employer identification number (EIN)
1 Wages, tips, other compensation
2 Federal income tax withheld
c Employer's name, address, and ZIP code
3 Social security wages
4 Social security tax withheld
5 Medicare wages and tips
6 Medicare tax withheld
7 Social security tips
8 Allocated tips
d Control number
9
10 Dependent care benefits
11 Nonqualified plans
12a
e Employee's first name and initial Last name Suff.
13 Statutory employee Retirement plan Third-party sick pay
12b
14a Other
12c
12d
14b Treasury Tipped Occupation Code(s)
f Employee's address and ZIP code
15 State Employer's state ID number
16 State wages, tips, etc.
17 State income tax
18 Local wages, tips, etc.
19 Local income tax
20 Locality name

Form W-2 Wage and Tax Statement 20XX
Department of the Treasury—Internal Revenue Service
Copy 1—For State, City, or Local Tax Department

Instructions for accessing W-2 information to prepare a client's tax return are included in Appendix C.

2.2.2 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 the year in which such advance commissions or other earnings are repaid.

2.2.3 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 under an accountable or nonaccountable plan.

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's 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 time 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.

2.2.4 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.

2.2.5 Bonuses and Awards

Bonuses or awards the taxpayer receives from an employer for outstanding work 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
- more than 10% of eligible employees previously received safety achievement awards during the year.

2.2.6 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.

2.2.7 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.

2.2.8 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.

2.2.9 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.

2.2.10 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.

2.2.11 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.

2.2.12 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.

2.2.13 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.

2.2.14 Tax on Tips Reduced

Tip income is normally included in taxable earnings. OBBBA, §70201, effective for tax years beginning after December 31, 2024, provides for a tax deduction for qualified tips to taxpayers who itemize deductions and to taxpayers who are non-itemizers. The maximum amount of the tax deduction is $25,000 but is reduced by $100 for each $1,000 that the taxpayers' MAGI exceeds $150,000 ($300,000 in the case of a joint return).

For example, assume Sheila, a single taxpayer, has a MAGI of $170,000, $150,000 of which is comprised of qualified tips as shown in the equation:

$$\text{Maximum deduction} - \left[\frac{\text{(MAGI − applicable limit)}}{\$1{,}000} \times \$100 \right] = \text{Reduced deduction}$$

$$\$25{,}000 - \left[\frac{(\$170{,}000 - \$150{,}000)}{\$1{,}000} \times \$100 \right] = \$23{,}000$$

2.2.14.1 Qualified Tips Defined

"Qualified tips," for purposes of the deduction, means cash tips received by a taxpayer in an occupation that normally received tips on or before December 31, 2024. It includes tips received from customers that are paid in cash or charged, and, in the case of an employee, it also includes any tips received under a tip-sharing arrangement.

No amount received by a taxpayer is considered a qualified tip unless:

- It is –
  - paid voluntarily without any consequence in the case of nonpayment,
  - not the subject of negotiation, and
  - determined by the payor; and
- The trade or business in the course of which the taxpayer receives the amount is not a specified trade or business (SSTB) as that term is used in connection with the §199A qualified business income (QBI) deduction.

Statements furnished to payees receiving tips must show:

- The portion of payments received by the taxpayer reasonably designated as cash tips; and
- The occupation of the person receiving the tips.

2.2.15 Form 4137 - Tax on Unreported Tips

The taxpayer is required to report tips to his or her employer by the 10th day of the month following the month the taxpayer received them, but some tips may be unreported. Form 4137 (replicated below) is used only to calculate the social security and Medicare tax owed on tips the taxpayer didn't report to his or her employer but which the taxpayer must report as income.

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

20XX

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 20XX. Add the amounts from line 1, column (c)	2	
3	Total cash and charge tips you **reported** to your employer(s) in 20XX. 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	
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	

Any unreported tip income must also be entered on line 1c on Form 1040, 1040-SR, or 1040-NR, as appropriate. By filing this form, the taxpayer's social security and Medicare tips will be credited to the taxpayer's social security record (used to figure the taxpayer's benefits).

2.2.15.1 Who Must File

A taxpayer must file Form 4137 if he or she received total tips (cash and charge) of $20 or more in a calendar month and didn't report all of those tips to the employer. The taxpayer must also file Form 4137 if the taxpayer's Form(s) W-2, box 8, shows allocated tips that the taxpayer must report as income.

2.2.15.2 Allocated Tips

The taxpayer must report all tips received as income on Form 1040, 1040-SR, or 1040-NR. Any tips the taxpayer reported to the employer are included in the wages shown on the taxpayer's Form W-2, box 1. So, the taxpayer should enter on Form 1040, 1040-SR, or 1040-NR, line 1c, **only** the tips received and not reported to his or her employer, including any allocated tips shown on the taxpayer's Form(s) W-2, box 8 (unless the taxpayer has adequate records to show that the unreported tips are less than the amount shown in box 8). Although allocated tips are shown on the taxpayer's Form W-2, box 8, they aren't included in Form W-2, box 1, and no tax is withheld from these tips.

2.2.15.3 Tips Reported to the Employer

If the taxpayer receives $20 or more in cash tips, all of those tips must be reported to the taxpayer's employer through a written report. Cash tips include tips paid by:

- Cash;
- Check;
- Debit card; and
- Credit card.

The written report should include tips:

- The employer paid to the taxpayer for tips customers paid electronically;
- The taxpayer received directly from customers;
- The taxpayer received from other employees; and
- The taxpayer received under any other tip-sharing arrangement.

If the taxpayer worked for two or more employers and received tips while working for each, the $20 rule applies separately to the tips received while working for each employer and not to the total the taxpayer received.

2.2.15.4 Payment of Tax

Tips the taxpayer reports to his or her employer are subject to social security and Medicare tax (or railroad retirement tax), Additional Medicare Tax, and income tax withholding. The employer collects these taxes from wages (excluding tips). If the taxpayer's wages were insufficient to cover these taxes, the taxpayer may have given the employer the additional amounts needed. If not, the taxpayer's Form W-2, box 12 (codes A and B), will show the uncollected tax due. The taxpayer's Form W-2 will include the tips the taxpayer reported to the employer and the taxes withheld.

If the taxpayer didn't report tips to the taxpayer's employer as required, the taxpayer may be charged a penalty equal to 50% of the social security, Medicare, and Additional Medicare Taxes due on those tips.

The uncollected social security and Medicare tax on tips should be reported on line 13 of Schedule 2 (Form 1040), Additional Taxes, and included in the total of other taxes owed entered on Schedule 2, line 21 and on Form 1040, 1040-SR or 1040-NR, as appropriate.

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

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

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

Even if Parts I and II of Schedule B must be completed, Part III of the Schedule needs to be completed only if the taxpayer:

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

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

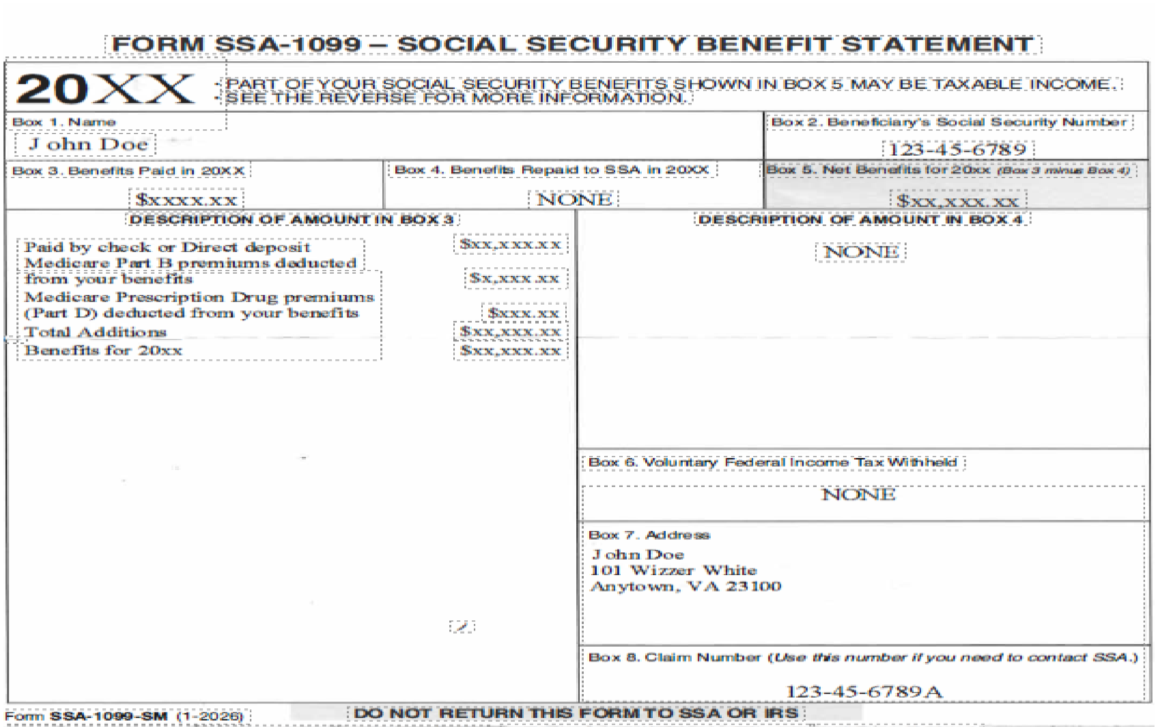
2.4 Retirement Income Reporting and Taxability

Although some retirement income is excludable, in whole or part, from income, most retirement income is taxable as ordinary income in the year received from:

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

2.4.1 Social Security Benefits

Social Security benefits include monthly retirement, survivor and disability benefits paid under the Social Security system. The benefits may be entirely tax-free or partially taxable. Beneficiaries receive Form SSA-1099 containing information needed for filing, as shown below:



FORM SSA-1099 – SOCIAL SECURITY BENEFIT STATEMENT

20XX

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

Box 1. Name: J ohn Doe

Box 2. Beneficiary's Social Security Number: 123-45-6789

Box 3. Benefits Paid in 20XX: $xxxx.xx

Box 4. Benefits Repaid to SSA in 20XX: NONE

Box 5. Net Benefits for 20xx (Box 3 minus Box 4): $xx,xxx.xx

DESCRIPTION OF AMOUNT IN BOX 3

Paid by check or Direct deposit	$xx,xxx.xx
Medicare Part B premiums deducted from your benefits	$x,xxx.xx
Medicare Prescription Drug premiums (Part D) deducted from your benefits	$xxx.xx
Total Additions	$xx,xxx.xx
Benefits for 20xx	$xx,xxx.xx

DESCRIPTION OF AMOUNT IN BOX 4

NONE

Box 6. Voluntary Federal Income Tax Withheld: NONE

Box 7. Address
J ohn Doe
101 Wizzer White
Anytown, VA 23100

Box 8. Claim Number (*Use this number if you need to contact SSA.*): 123-45-6789A

Form SSA-1099-SM (1-2026) DO NOT RETURN THIS FORM TO SSA OR IRS

2.4.1.1 Taxability of Benefits

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

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

…exceeds the base amount for the taxpayer's filing status.

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

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

- Educator expenses;
- Certain business expenses of reservists, performing artists and fee-basis government officials;
- Health savings account deductions;

- Moving expenses;
- The deductible part of self-employment tax;
- Contributions to various tax favored retirement plans;
- Self-employed health insurance premiums;
- The penalty paid on any early withdrawal of savings;
- Alimony paid under pre-2019 agreements; and
- Deductible contributions to an IRA.

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

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

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

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

2.4.1.2 Reporting

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

The taxpayer's net Social Security benefits 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 employers that provide retirement income to employees or result in a deferral of income by employees for periods extending generally to the end of employment. Such plans include traditional pension plans, profit sharing plans, 401(k) plans, stock bonus plans and several other types of plans.

2.4.2.1 Contributions to Qualified Employee Plans

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

2.4.2.2 Employee Plan Contributions

Employee contributions to employer retirement plans are generally known as "elective deferrals." 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 2026 is $24,500.[2] The applicable limit on elective deferrals generally applies to the total of all elective deferral contributions (in the aggregate) made to such plans. Participants in 401(k) plans and 403(b) tax sheltered annuity plans that are age 50 or older by the end of the year may make catch-up contributions. The catch-up provision in the law permitting increased contributions by age 50 and older participants increases the otherwise applicable dollar limit on elective deferrals.

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

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

The applicable dollar amount for 2026 catch-up contributions by participants in 401(k) and 403(b) plans who are age 50 or older - but not age 60 through 63 - is $8,000 and is indexed for inflation in subsequent years.

2.4.2.2.1 SECURE 2.0 Act Affects Catch-Up Contributions

The SECURE 2.0 Act increased the maximum catch-up contributions that may be made by plan participants age 60 through age 63. The maximum catch-up contribution that may be made by such plan participants in 2026 is $11,250.

Additionally, the SECURE 2.0 Act requires that catch-up contributions for employees earning more than $150,000 in prior-year FICA wages, indexed for inflation, be placed in a Roth account.

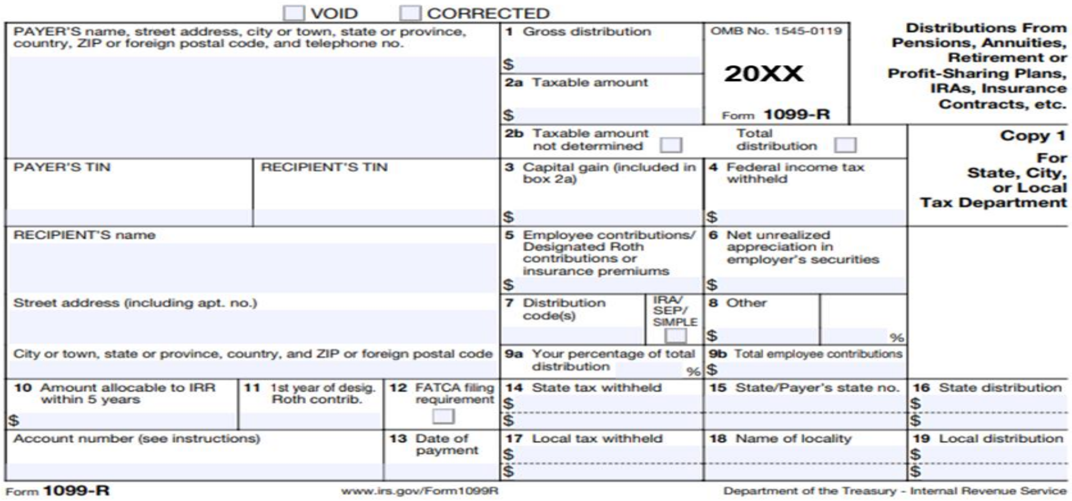
2.4.2.3 Qualified Retirement Plan Distributions

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 Form 1099-R

Generally, distributions from retirement plans (IRAs, qualified plans, section 403(b) plans, and governmental section 457(b) plans), insurance contracts, etc., are reported to recipients on Form 1099-R replicated below:

[2] IRC §402(g)(1).



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

20XX

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

An explanation of the boxes on 1099-R and their use in preparing a client's tax form may be found in Appendix D.

2.4.2.3.2 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

Traditional IRA holders may defer receipt of their first RMD until April 1st of the year following their 73rd birthday. Qualified plan participants—other than 5% owners of the employer—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 dollar difference between the policy's death benefit and its cash value—is generally received entirely free of income taxation upon the insured's death. 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 deferred annuities or immediate annuities and may be qualified annuities or nonqualified annuities. 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. An immediate annuity is one in which the first periodic 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,* 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 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 equal to 10% of the distribution *that is includible in the recipient's income*. However, the tax penalty does not apply to any of the following:

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

2.5 Individual Retirement Accounts

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

An individual retirement account (IRA) is a personal retirement savings plan, funded by an annuity or a trust, that provides for tax-deferral of earnings and may permit either tax-deductible contributions or tax-free qualified distributions. Unless the taxpayer is age 50 or older by the end of the year, the total contribution to all IRAs made for the year cannot exceed the lesser of $7,500 or the individual's compensation includable in gross income. If the taxpayer is age 50 or older by the end of 2026, a maximum additional contribution—a catch-up contribution—of $1,100 may be made.

Individual retirement accounts are fundamentally of two types:

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

2.5.1 Traditional IRAs – Contributions & Distributions

Contributions to traditional IRAs are normally fully tax-deductible to a taxpayer unless the taxpayer or the taxpayer's spouse is an active participant in an employer-sponsored qualified plan and has a modified adjusted gross income in excess of a specified amount for his or her filing status. The specified amount tends to increase each year. The specified amounts for 2026 are shown in the following chart:

Taxpayer's Filing Status	2026 Contributions by active participants tax-deductible	Phase-Out Income Range	2026 Contributions by active participants not deductible
Married filing jointly, qualifying surviving spouse	$129,000	$129,000 - $149,000	$149,000
Single, head of household (HOH)	$81,000	$81,000 - $91,000	$91,000
Unemployed spouse of active participant	$242,000	$242,000 – $252,000	$252,000
Married filing separately*	$0	$0 - $10,000	$10,000

*Not subject to cost-of-living adjustment

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

2.5.1.1 Premature Distributions

There is a penalty for premature distributions equal to 10 percent of the amount of the distribution includible in the taxpayer's gross income . Usually, in order to avoid a premature distribution penalty, the taxpayer must be at least age 59½ before receiving a distribution from an IRA.

2.5.1.1.1 Premature Distributions Avoiding Tax Penalty

Premature distributions that avoid penalty 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. The date on which RMDs must commence is known as the "required beginning date." Lifetime distributions are not required to be taken from a Roth IRA.

RMDs from designated Roth accounts during the lifetime of the account holder are not required.

2.5.2 Roth IRAs

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

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

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

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 taxable 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 $7,500 (in 2026) or, if he or she is age 50 or older, $8,600. 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)	Applicable Dollar Amount (2026)
Single & head of household	$150,000	$153,000
Married, filing a joint return	$236,000	$242,000
Married, filing separately	$0	$0

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

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

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

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

2.5.2.3 No Required Roth IRA Lifetime Distributions

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

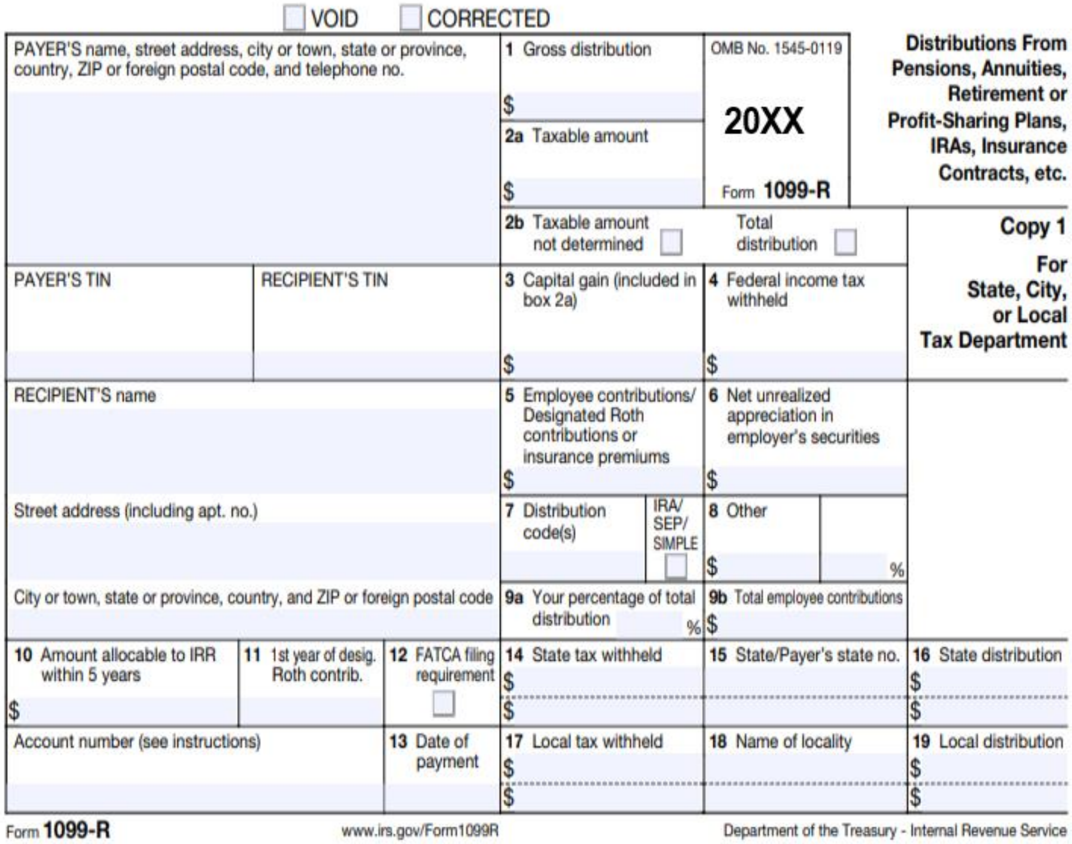
2.5.3 IRA Rollover Per-Year Limit

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

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

2.5.4 Form 1099-R

In addition to retirement income from pensions, 401(k)s, and other qualified plans, distributions from Individual Retirement Accounts (IRAs) are also reported to recipients on IRS Form 1099-R, replicated below:



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

20XX

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

An explanation of the information contained in each box may be found in Appendix D.

2.5.5 Form 5498

Form 5498, replicated below, is submitted to the IRS by the trustee or issuer of the taxpayer's individual retirement arrangement (IRA) to report contributions, including any catch-up contributions, rollovers, repayments, required minimum distributions (RMDs), and the fair market value (FMV) of the account.

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) $	OMB No. 1545-0747 20XX Form 5498	**IRA Contribution Information**
	2 Rollover contributions $		
TRUSTEE'S or ISSUER'S TIN / PARTICIPANT'S TIN	3 Roth IRA conversion amount $	4 Recharacterized contributions $	**Copy B**
	5 FMV of account $	6 Life insurance cost included in box 1 $	**For Participant**
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

- Form 5498, box 1, shows traditional IRA contributions made.
- Form 5498, box 2, shows rollover contributions, made in 2025 to an IRA.
- Form 5498, box 3, shows the amount converted from traditional IRAs or traditional SIMPLE IRAs to Roth IRAs or Roth SIMPLE IRAs.
- Form 5498, box 4, shows amounts recharacterized from transferring any part of the contribution (plus earnings) from one type of IRA to another.
- Form 5498, box 5, shows the FMV of all investments in the taxpayer's account at year end.
- Form 5498, box 6. Shows for endowment contracts only the amount allocable to the cost of life insurance. Subtract this amount from the taxpayer's allowable IRA contribution included in Form 5498, box 1 to compute the taxpayer's IRA deduction.
- Form 5498, boxes 8 and 9, show SEP and SIMPLE contributions made.
- Form 5498, box 10, shows Roth IRA contributions (and rollovers from a QTP) made. These contributions are not deductible.
- Form 5498, box 11. If box 11 is checked, the taxpayer must take an RMD. Boxes 12a and 12b indicate the date and amount of the RMD, respectively.
- (See the instructions on the back of Form 5498 for the meaning of additional boxes.)

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 2026 is $200,000, and he is not an active participant in an employer-sponsored retirement plan. What is the maximum 2026 traditional IRA contribution that he may deduct?

   A. $0

   B. $2,000

   C. $7,500

   D. $8,600

2.6 Reporting and Taxability of Unemployment Compensation

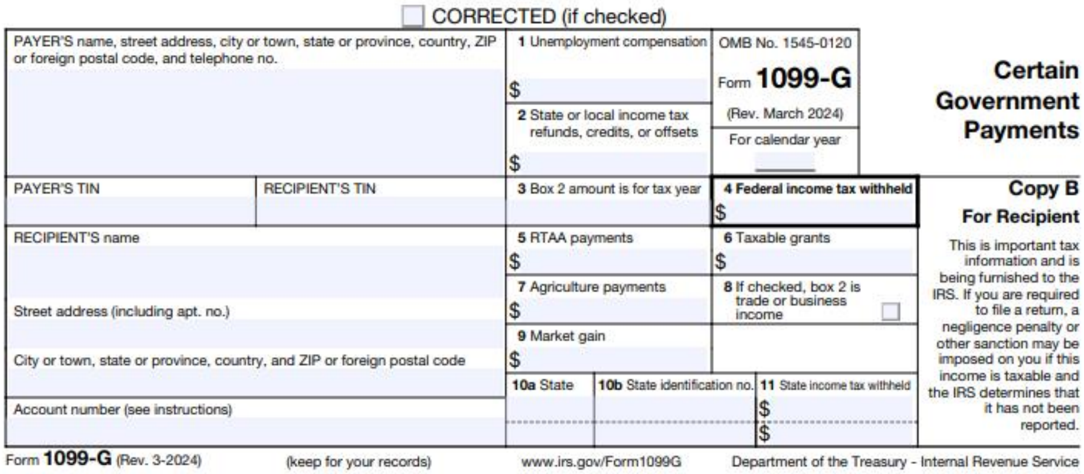
The term "unemployment compensation" includes any amount received under an unemployment compensation law of the United States or of a state. Accordingly, all the following benefits are considered unemployment compensation:

- 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

The taxpayer who received unemployment compensation in the previous year should receive a Form 1099–G showing (in box 1) the total unemployment compensation paid. In most cases, the total amount of unemployment compensation shown should be entered on line 7 of Form 1040, Schedule 1.

In some cases—those involving certain governmental unemployment compensation programs to which the taxpayer contributed and unemployment compensation that was repaid—not all of the amount received during the year should be included as unemployment compensation. IRS Form 1099-G is shown below:



CORRECTED (if checked)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.	1 Unemployment compensation $	OMB No. 1545-0120	Form **1099-G** (Rev. March 2024) For calendar year ____	**Certain Government Payments**
	2 State or local income tax refunds, credits, or offsets $			
PAYER'S TIN / RECIPIENT'S TIN	3 Box 2 amount is for tax year	4 Federal income tax withheld $		**Copy B For Recipient**
RECIPIENT'S name	5 RTAA payments $	6 Taxable grants $		This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.
Street address (including apt. no.)	7 Agriculture payments $	8 If checked, box 2 is trade or business income ☐		
City or town, state or province, country, and ZIP or foreign postal code	9 Market gain $			
Account number (see instructions)	10a State / 10b State identification no.	11 State income tax withheld $ $		

Form **1099-G** (Rev. 3-2024) (keep for your records) www.irs.gov/Form1099G Department of the Treasury - Internal Revenue Service

- Form 1099-G, box 1, shows the total unemployment compensation (UC) paid to the taxpayer. Combine the box 1 amounts from all Forms 1099-G and report the total as income on the UC line of the taxpayer's tax return (Form 1040 Schedule 1). Except as explained below, this is the taxpayer's taxable amount.

  If the taxpayer made contributions to a governmental UC program or to a governmental paid family leave program and received a payment from that program, the payer must issue a separate Form 1099-G to report this amount to the taxpayer. In such a case, if the taxpayer itemizes deductions, the contribution may be deducted on Schedule A (Form 1040) as taxes paid. If the taxpayer doesn't itemize, only include in income the amount that is in excess of the taxpayer's contributions.

- Form 1099-G, box 2, shows refunds, credits, or offsets of state or local income tax the taxpayer received. It may be taxable if the state or local income tax paid had been deducted on Schedule A (Form 1040). Even if the taxpayer didn't receive the amount shown, it is still taxable if it was deducted.

  If the taxpayer received interest on this amount, the taxpayer may receive Form 1099-INT for the interest. However, the payer may include interest of less than $600 in the blank box next to box 9 on Form 1099-G. Regardless of whether the interest is reported to the taxpayer, it must be reported by the taxpayer as interest income.

- Form 1099-G, box 3, identifies the tax year for which the amounts shown in box 2 were made.
- Form 1099-G, box 4, shows backup withholding or withholding the taxpayer requested on unemployment compensation. Include this amount on the taxpayer's income tax return as tax withheld.
- Form 1099-G, box 5, shows reemployment trade adjustment assistance (RTAA) payments the taxpayer received. Include on the "Other income" line of Schedule 1 (Form 1040).
- Form 1099-G, box 6, shows taxable grants the taxpayer received from a federal, state, or local government.
- Form 1099-G, box 7, shows the taxpayer's taxable Department of Agriculture payments. If the payer shown is anyone other than the Department of Agriculture, it means the payer has received a payment, as a nominee, that is taxable to the taxpayer.
- Form 1099-G, box 8, shows the amount attributable to an income tax that applies exclusively to income from a trade or business if this box is checked. If taxable, report the amount in box 2 on Schedule C or F (Form 1040), as appropriate.

- Form 1099-G, box 9, shows market gain on Commodity Credit Corporation (CCC) loans whether repaid using cash or CCC certificates. See the Schedule F (Form 1040) instructions.
- Form 1099-G, boxes 10a–11, show state income tax withheld.

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 2026 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.

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

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

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

A self-employed taxpayer is one who:

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

2.8.1 Income & Expenses Defined

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

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

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

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

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

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

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

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

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

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

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

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

- Ordinary, i.e., one that is common and accepted in the taxpayer's field of business, and
- Necessary[3], i.e., one that is helpful and appropriate for the taxpayer's business.

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

2.8.2 Business vs. Hobby

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

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

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

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

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

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

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

A hobby, for tax purposes, is an activity **not** engaged in for profit or income. Any income from a hobby is reported on Form 1040 as "Other income" and is fully taxable. OBBBA has permanently suspended the deductibility of hobby expenses for years 2026 and later.

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.

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 premiums 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

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

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

2.8.5.2 OBBBA Increases Meal Deduction for Restaurants & Others

OBBBA, §70305, provides a permanent exception allowing a deduction of 100 percent of the cost of preparing and providing meals and beverages:

- Purchased from restaurants and caterers by paying customers; and
- On certain fishing boats and at certain fish processing facilities.

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 $2,560,000 (2026);
- The phaseout threshold for a taxpayer's ability to expense eligible property is $4,090,000 (2026);
- 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.

1. Additionally, for a business to qualify for the §179 Expense Deduction, the following criteria must be met: The property must be used more than 50% for business;

2. The Section 179 expense deduction cannot exceed net business income; and
3. Assets must be placed in service by December 31, 2026.

The cost of any sport utility vehicle (SUV) that may be taken into account under Section 179 cannot exceed $32,000.

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 generally 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

OBBBA, §70301 permanently extends the IRC §168 additional first-year (bonus) depreciation deduction. Under OBBBA, an increased bonus deduction is made retroactive to 2025. Accordingly, in addition to extending bonus depreciation, the allowance is also increased from 40% to 100% for qualified property acquired and placed in service on or after Jan. 19, 2025, as well as for specified plants planted or grafted on or after Jan. 19, 2025. For most qualifying business assets that are *both* **acquired** and **placed in service** after January 19, 2025, (and for 2026) the bonus depreciation rate is 100%.

2.8.7.1.1 Qualified Property

The term "qualified property," for purposes of bonus depreciation means property:

- That has a recovery period of 20 years or less;
- Which is computer software;
- Which is water utility property; or
- Which is a qualified film or television production for which a deduction would have been allowable under section 181; or
- Which is a qualified live theatrical production for which a deduction would have been allowable under section 181; and
- The original use of which begins with the taxpayer or the acquisition of which by the taxpayer meets applicable requirements, including that –
    - 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.

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

Although bonus depreciation remains at 40% for property purchased prior to January 19, 2025, OBBBA increases bonus depreciation to 100% for property purchased and placed in service on or after January 19, 2025.

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 2026 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	\$20,300	\$12,300
2	\$19,800	\$19,800
3	\$11,900	\$11,900
4 and later	\$7,160	\$7,160

A "luxury vehicle" is a four-wheeled vehicle regardless the cost of the vehicle, used mostly on public roads, and which has an unloaded gross weight of no more than 6,000 pounds. It includes vehicles not normally considered "luxury" vehicles on the basis of their price. (Rev. Proc. 2026-16)

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.

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. For 2026, §179 Vehicle Deduction allows eligible business owners to deduct up to 100% of qualifying vehicle costs as long as the vehicle was purchased and put into use the same year and is used more than 50%. of the time for business purposes.

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. Widgets, Inc. purchased new qualified property on January 15, 2026. What percentage bonus depreciation deduction will apply to the property?

   A. 40%

   B. 60%

   C. 80%

   D. 100%

2.9 Capital Gains and Losses

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

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

If a taxpayer sells or trades investment property, the capital gain or loss that results may be either a short-term capital gain/loss or a long-term capital gain/loss.

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

2.9.2 Reporting Capital Gains and Losses

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

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

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

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

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

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

2.9.2.2 Schedule D

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

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

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

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

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

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

2.9.2.3 Maximum Capital Gains Rate

High-income taxpayers are subject to higher capital gain and qualified dividend tax rates. For tax years beginning in 2026, the long-term capital gain and qualified dividend tax rate is as follows:

- The 0% rate applies to –
  - Married filers filing separately with income up to $49,450,
  - Head of household filers with income up to $66,200,
  - Married filing jointly and surviving spouse filers with income up to $98,900,
  - All other individuals with income up to $49,450,
  - Trusts and estates with income up to $3,300;
- The 15% rate applies to –
  - Married filers filing separately with income between $49,450 and $306,850,
  - Head of household filers with income between $66,200 and $579,600,
  - Married filing jointly and surviving spouse filers with income between $98,900 and $613,700,

- All other individuals with income between $49,450 and $545,500,
    - Trusts and estates with income between $3,300 and $16,250; and
- The 20% rate applies to –
    - Married filers filing separately with income exceeding $306,850,
    - Head of household filers with income exceeding $579,600,
    - Married filing jointly and surviving spouse filers with income exceeding $613,700,
    - All other individuals with income exceeding $545,500,
    - Trusts and estates with income exceeding $16,250.

2.10 Standard Deduction Eligibility

The standard deduction is an alternative available to eligible taxpayers choosing not to itemize actual deductions on their income tax returns.

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 Made Permanent & Increased

The One Big Beautiful Bill Act (OBBBA), §70102 makes permanent the standard deduction that was increased under the Tax Cuts & Jobs Act of 2017 and scheduled to end for tax years after 2025. In addition to making the standard deduction permanent, the standard deduction is increased for 2026 to:

- $32,200 for married couples whose filing status is "married filing jointly" and surviving spouses;
- $16,100 for singles and married couples whose filing status is "married filing separately"; and
- $24,150 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 2026 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 $16,100), 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:

- $1,650 for married individuals; and
- $2,050 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

	2026

Filing Status	**Standard**	**Blind/Age 65+ add**
Married filing jointly & surviving spouses	$32,200	$1,650
Unmarried (other than surviving spouses)	$16,100	$2,050
Married filing separately	$16,100	$1,650
Head of household	$24,150	$2,050
Dependent	$1,350 or earned income + $450	

2.11 Itemized Deductions Schedule A

The various Form 1040 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 (permanent military and intelligence moves only).

2.11.1 Medical and Dental Expenses

If the taxpayer itemizes deductions for a taxable year on Schedule A, the taxpayer may be able to deduct expenses paid that year for medical and dental care for the taxpayer, spouse, and dependents.

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).

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

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 and 2026 are as follows:

Attained Age Before Close of Tax Year	2025 Limitation on Premium*	2026 Limitation on Premium*
40 or younger	$480	$500
41 to 50	$900	$930
51 to 60	$1,800	$1,860
61 to 70	$4,810	$4,960
Older than 70	$6,020	$6,200
** Indexed for inflation*		

Note: If the taxpayer received any long-term care benefits, they will receive Form 1099-LTC, Long-Term Care Accelerated Death Benefits, and the policyholder is required to report this information on his or her tax return.

2.11.2 State and Local Tax (SALT) 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. OBBBA, §70120, temporarily increases the deduction for state and local taxes—frequently referred to as the "SALT deduction"—from $10,000 to $40,000 in 2025. The limit increases to $40,400 in 2026. For calendar years after 2026 and before 2030, the limitation is equal to 101% of the dollar amount in effect in the preceding calendar year.

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. Mortgage interest information required to complete a taxpayer's tax return is provided on Form 1098, Mortgage Interest Statement.

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 OBBBA Makes Mortgage Insurance Premiums Deductible for Itemizers

OBBBA, §70108, makes two changes to the existing tax law, beginning in 2026:

- The temporary changes to the existing home mortgage interest deduction (identified just above) made by the TCJA are made permanent; and
- Mortgage insurance[4] premiums are included as qualified mortgage interest.

2.11.3.2 Indebtedness Refinancing

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

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[4] Mortgage insurance provides coverage protecting the mortgage lender if the borrower defaults on the loan payments and is typically required by lenders when borrowers make a down payment of less than 20% of the home's purchase price.

qualified organizations. 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

OBBBA has made permanent the deductibility of 60% of AGI limit for cash contributions to public charities with any excess carried forward for up to five years. Additionally, a new 0.5% floor for taxpayers who itemize deductions is applicable to charitable contributions effective for tax years beginning after December 31, 2025. Accordingly, itemizing taxpayers may only deduct total charitable contributions that exceed 0.5% of their AGI. Non-itemizers are eligible to make deductible charitable contributions of up to $1,000 for taxpayers filing single, and up to $2,000 for married taxpayers filing jointly for tax years beginning after December 31, 2025. The .5% of AGI floor applicable to deductible charitable contributions made by taxpayers itemizing deductions does not apply to non-itemizers.

2.11.4.2 Contemporaneous Written Acknowledgement

Donors making charitable gifts of $250 (cash or property) 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.

2.11.4.2.1 Content and Timing of Contemporaneous Written Acknowledgement

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 itemized deduction for personal casualty and theft losses was temporarily limited in tax years 2018 through 2025 solely to losses attributable to federally-declared disasters.

OBBBA, §70438, extends the casualty loss claim rules in effect and enables taxpayers to claim disaster-related personal casualty losses, without having to itemize, beyond the current expiration date of February 10, 2025.

2.11.5.1 Casualty Loss Deduction Limitation Extension and Modification

Taxpayers normally have been able to deduct some or all of the losses they incur as a result of various casualties—fires, storms, shipwrecks, etc.—and thefts. Under the tax law prior to the passage of the TCJA, the tax deduction for a personal casualty or theft loss was limited to such losses but only to the extent that:

- The amount of each separate casualty or theft loss was more than $100, and
- The total amount of all losses during the year, reduced by $100, was more than 10% of the taxpayer's adjusted gross income.

The rules were revised for net disaster losses occurring in 2016 and 2017 to increase the limitation applicable to each qualified federally-declared casualty from $100 to $500 and eliminate the 10% of AGI limitation for such taxpayers.

2.11.6 Moving Expense Deduction

Except in the case of military relocations, the TCJA has suspended the moving expense deduction and made any moving expense reimbursement taxable income. Beginning in 2026, the One Big Beautiful Bill Act (OBBBA) permanently eliminates the moving expense deduction for most taxpayers, making non-military and intelligence-related moving expense reimbursements fully taxable.

2.11.6.1 Moving Expenses in Active Military and Intelligence Community Relocations

The inclusion of reimbursed moving expenses in the recipient's gross income does not apply to active military relocations meeting certain criteria. 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.

The One Big Beautiful Bill Act (OBBBA) permanently eliminates the tax benefits related to moving expenses and reimbursements while expanding the exceptions. An exception to the elimination of the moving expense deduction also applies in the case of members of the U.S. Intelligence Community.

Accordingly, the inclusion of reimbursed moving expenses in the recipient's gross income does not apply to active military relocations and is further extended under the OBBBA to members of the U.S. Intelligence Community meeting certain criteria. As in the case of a military relocation, an intelligence relocation must be pursuant to an intelligence-related order and involve a permanent change of station. If those criteria are met, no reimbursed expenses incurred for moving and storage are includible in the recipient's gross income.

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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.

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 2026 interest paid on their $400,000 mortgage was $12,000 and on the home equity loan was $7,000, what is their 2026 mortgage interest deduction?

   A. $0

   B. $7,000

   C. $12,000

   D. $19,000

2.12 Tax Credit Eligibility

Tax credits are categorized as:

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

2.12.1 Child Tax Credit

The One Big Beautiful Bill Act (OBBBA), §70104 increases the amount of the nonrefundable child tax credit to $2,200 per child in 2026 and makes the refundable part of the child tax credit (ACTC) permanent. 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.

Requirements for the child tax credit are as follows:

- An eligible child is a child younger than age 17 by the end of 2026;
- An eligible child must be a U.S. citizen/resident, and claimed as a dependent;
- The maximum credit is $2,200 per child;
- The credit is refundable up to $1,700 (ACTC); and
- The taxpayer must have a minimum of $2,500 in earnings to qualify for the credit; and
- At least one parent must have a valid Social Security number.

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

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

2.12.1.1 Child Tax Credit Phaseout and Nonrefundable Amounts

Although the maximum amount of Child Tax Credit a taxpayer may claim for each qualifying child is $2,200, 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[5] 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 $2,200 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.

For 2026, OBBBA requires that both the qualifying child and at least one parent, or spouse if filing jointly, to have a valid Social Security Number to claim the Child Tax Credit.

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. Beginning in 2026, OBBBA permanently retains the $500 credit for other dependents without an SSN requirement.

2.12.2 Credit for Other Dependents

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

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

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

- The person must be claimed as a dependent on the taxpayer's income tax return;

- The person cannot be used by the taxpayer to claim the Child Tax Credit (CTC) or the Additional Child Tax Credit (ACTC); and
- The person must be –
  - a U.S. citizen,
  - a U.S. national, or
  - a U.S. resident alien.

2.12.2.1 Limits on the CTC and ODC

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

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

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

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

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

2.12.2.2 Claiming CTC and ODC

Use Schedule 8812 (Form 1040) to figure the taxpayer's child tax credit (CTC), credit for other dependents (ODC), and additional child tax credit (ACTC). 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.

OBBBA, §70104, increased the amount of the nonrefundable child tax credit to $2,200 per child for 2025, and 2026, and makes the refundable part of the child tax credit (ACTC) permanent. Both are adjusted for inflation. When being adjusted for inflation, any increase that is not a multiple of $100 must be rounded to the next lower multiple of $100. For example, an adjustment of $175 as a result of indexing would be rounded to $100.

2.12.3 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 (2026) 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.

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 2026 has been increased by OBBBA and is a percentage from 35% to 50% 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.

For tax years after December 31, 2025, the applicable percentage is based on the taxpayer's adjusted gross income, up to 50% 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 $105,000 or more. The percentage increases to 35% for taxpayers with adjusted gross incomes between $43,000 and $75,000. The percentage further increases to 50% for taxpayers with adjusted gross income of $15,000 or less. For every $2,000 in adjusted gross income (AGI) above $15,000, the credit rate decreases by 1 percentage point for taxpayers with incomes above $15,000 but below $43,000.

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2.12.4.1 Enhancement of the Dependent Care Assistance Program

The Dependent Care FSA is an employer-provided program offering a pre-tax benefit account used to pay for eligible dependent cares services such as preschool, summer day camp, before and after school programs and child or adult daycare. Prior to the passage of OBBBA, the limit on the contribution was $5,000 ($2,500 for married filing separately).

OBBBA has increased the Dependent Care Assistance Program (DCAP) limit from $5,000 to $7,500 annually ($3,750 for those married filing separately), effective after December 31, 2025.

2.12.4.2 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.

2.12.4.3 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.

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)*].

OBBBA §70606, specifies that, for tax years 2026 and later, only a Social Security Number (SSN) for the taxpayer, the taxpayer's spouse (if filing jointly), and the student will be considered an acceptable form of identification when claiming either the Lifetime Learning Credit or the American Opportunity Credit.

2.12.5.1. American Opportunity Credit

An eligible taxpayer 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 an Form 1098-T, 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	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.

Return to Domain 1.

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 $12,200 (2026). 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. Schedule EIC (Form 1040), Earned Income Credit, must be completed and attached to Form 1040 or 1040-SR to claim the EITC.

2.12.6.1 Adjusted Gross Income Limits

The applicable AGI limits generally change each year and, for 2026, are as shown in the following chart:

2026 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	$70,244	$31,160 - $70,244	$62,974	$23,890 - $62,974
2 qualifying children	$65,899	$31,160 - $65,899	$58,629	$23,890 - $58,629
1 qualifying child	$58,863	$31,160 - $58,863	$51,593	$23,890 -$51,593
No qualifying children	$26,820	$18,140 - $26,820	$19,540	$10,860 - $19,540

*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.)

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, qualifying surviving spouse, 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 2026 and either of the following applies:

- The taxpayer lived apart from their spouse for the last 6 months of 2026, 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 2026.

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.

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.

Review **#5**

1. Tanya is a single taxpayer who has two qualifying children and qualifies for the Earned Income Credit in 2026. What is the maximum investment income she can have in 2026 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. $12,200

2. 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 has a modified adjusted gross income (MAGI) of $160,000?

A. $0

B. $2,000

C. $2.500

D. $10,000

2.13 Overview Topics

2.13.1 Tax Treatment of Virtual Currency

The term "virtual currency" refers to a digital representation of value not issued by any public authority but which may be, nonetheless, accepted as a means of payment between persons. It functions as a medium of exchange and/or a store of value although it doesn't have status as legal tender. Such virtual currency having an equivalent value in real currency is referred to as "convertible" virtual currency. The IRS in Notice 2014–21[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;
- 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, *Payment Card and Third-Party Network Transactions*, if the gross amount of payments made to the merchant in 2026 exceeds $20,000, and over 200 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.

2.13.1.1 Form 1099-DA, Digital Asset Proceeds From Broker Transactions

For the sale of digital assets that are covered securities, occurring on or after January 1, 2026, IRS Form 1099-DA must be completed by the digital asset broker. A covered security is a digital asset acquired after 2025 for cash, stored-value cards, different digital assets, or any property or services the disposition of which the broker is required to report in an account for which the broker provided

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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

custodial services. The Form 1099-DA performs several key functions allowing brokers to report elements of covered digital asset transactions including:

- Gross proceeds;
- Cost basis;
- Date of disposition of digital assets for –
    - sales,
    - exchanges, and
    - redemptions.

Below is Form 1099-DA:

☐ VOID ☐ CORRECTED

FILER'S name

Street address | Room or suite no.

City or town | Telephone number

State or province | Country | ZIP or foreign postal code

FILER'S TIN | RECIPIENT'S TIN

RECIPIENT'S name

Street address | Apt. no.

City or town

State or province | Country | ZIP or foreign postal code

Account number

CUSIP number

Applicable checkbox on Form 8949

OMB No. 1545-2330

2026

Form **1099-DA**

Digital Asset Proceeds From Broker Transactions

Copy 1

For State Tax Department

1a Code for digital asset

1b Name of digital asset

1c Number of units

1d Date acquired | **1e** Date sold or disposed

1f Proceeds $ | **1g** Cost or other basis $

1h Accrued market discount $ | **1i** Wash sale loss disallowed $

2 Check if basis reported to IRS ☐ | **3a** Reported to IRS: ☐ Gross proceeds ☐ Net proceeds

3b Check if proceeds from: ☐ Reserved for future use ☐ QOF | **4** Federal income tax withheld $

5 Check if loss is not allowed based on amount in 1f ☐ | **6** Gain or loss: ☐ Short-term ☐ Long-term ☐ Ordinary | **7** Check if 1f is only cash ☐ | **8** Check if broker relied on customer-provided acquisition information ☐

9 Check if digital asset is a noncovered security ☐ | **10** | **11a** Check if gross proceeds reported in 1f is an aggregate amount for: ☐ Qualifying stablecoins ☐ Specified NFTs

11b If 11a checked, number of transactions | **11c** Aggregate gross proceeds of specified NFTs attributable to first sales by a creator or minter $ | **12a** Number of units transferred in | **12b** If transferred in, provide transfer-in date | **13**

14 State name | **15** State identification no. | **16** State tax withheld $ $

Form **1099-DA** www.irs.gov/Form1099DA Department of the Treasury - Internal Revenue Service

2.13.2 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.

2.13.2.1 Alternative Minimum Tax Exemption Amount Increased

The applicable AMTI exemption amounts[8] for 2026 are as follows:

Filing Status	Threshold for Phaseout of Exemption Amount	Complete Phaseout Amount	Alternative Minimum Taxable Income Exemption
Single or Head of Household	$500,000	$680,200	$90,100
Married Filing Jointly & Qualifying Surviving Spouse	$1,000,000	$1,280,400	$140,200
Married Filing Separately	$500,000	$640,200	$70,100
Estates and Trusts	$104,800	$167,600	$31,400

The AMTI exemption amount is reduced (but not below zero) by 50 percent of the amount by which the taxpayer's alternative minimum taxable income exceeds the phaseout threshold.

2.13.3 QBI Deduction

OBBBA, §70105, extended and enhanced the Qualified Business Income (QBI) deduction through three primary changes:

- Making the deduction permanent;
- Extending the phase-in ranges for taxpayers whose taxable income exceeds applicable income thresholds; and
- Establishing a new minimum deduction for active business owners.

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; or
2. 20% of the taxpayer's taxable income reduced by the taxpayer's net capital gain.

2.13.3.1 Qualified REIT Dividend

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

2.13.3.2 Qualified Publicly Traded Partnership Income

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

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

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

2.13.3.3 Deduction Eligibility

Taxpayers who may be eligible for the deduction are those who operate a business as a sole proprietorship or under a pass-through entity—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.

[8] AMTI exemption amounts are indexed for inflation.

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

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

The deduction of up to 20% of a pass-through business' qualified business income 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.

2.13.3.4.1 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.

2.13.3.4.1.1 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:

Taxpayer's Filing Status	2026 Threshold Amount	Phase-In Range	Taxable Income at which Ineligible
Married filing jointly	$403,500	$150,000	$553,500
Married filing separately	$201,775	$75,000	$276,775
Single & head of household filers	$201,750	$75,000	$276,750

For tax years beginning after December 31, 2025, OBBBA introduces a minimum QBI deduction for active business owners. For eligible owners—owners who have an aggregate QBI of $1,000 or more and who materially participate in a pass-through businesses—the QBI deduction is equal to the greater of:

- The QBI deduction calculated as required; or
- $400.

Both the $1,000 QBI requirement and the $400 minimum deduction will be indexed for inflation for tax years after 2026.

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

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

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

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

Samples of both Forms 8995 and 8995-A are provided below.

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

2.13.3.5.1 Qualified Business Income Deduction Simplified Computation - Form 8995

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

A taxpayer eligible to use Form 8995 in connection with 2026 income is one who has QBI, qualified REIT dividends and/or qualified PTP income or loss and whose taxable income does **NOT exceed**:

- $403,500 if married filing a joint tax return (MFJ);
- $201,775 if married filing a separate return (MFS); or
- $201,750 with any other filing status.

2.13.3.5.2 Qualified Business Income Deduction - Form 8995-A

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

Form **8995**

Department of the Treasury
Internal Revenue Service

Qualified Business Income Deduction Simplified Computation

Attach to your tax return.

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

OMB No. 1545-0074

2026

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 $201,750 ($403,500 *if married filing jointly*), ($201,775 *if married filing separately*), *or you're 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**

For illustration purposes only

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. 1545-0074

2026

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 $201,750 ($403,500 *if married filing jointly),* $201,775 *if married filing separately, 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 $201,750 or less ($403,500 if married filing jointly), $201, 775 if married filing separately, skip lines 4 - 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**

For Illustration purpose only.

Form 8995-A Page **2**

Part III **Phased-in Reduction**

Complete Part III only if your taxable income is more than $201,750 *but not* $276,750 ($403,500 *and* $553,500 *if married filing jointly) ($201,775 and $276,775 if married filing separately), 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 $201,750 ($403,500 if married filing jointly), ($201,775 if MFS)	21				
22	Subtract line 21 from line 20	22				
23	Phase-in range. Enter $75,000 ($150,000 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			

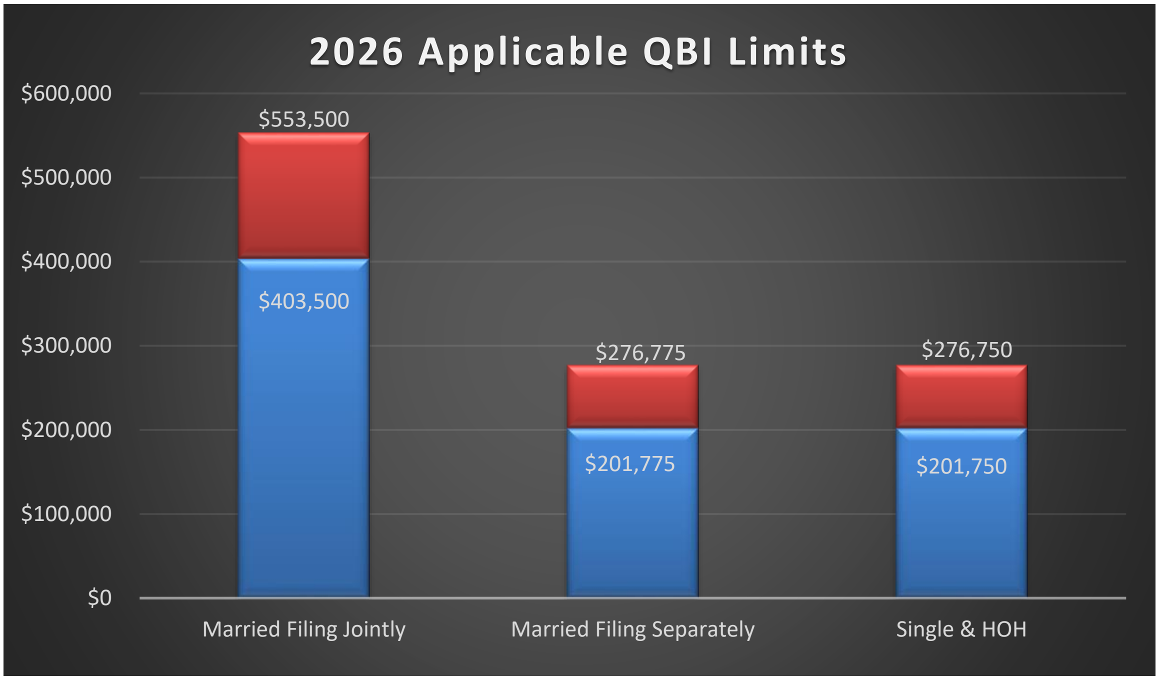
Part IV **Determine Your Qualified Business Income Deduction**

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**
For illustration purposes only

2.13.3.6 Taxable Income Threshold

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



2.13.3.7 Pass-Through Deduction for Qualified Trade or Business Owners

For a pass-through business owner whose taxable income exceeds the applicable threshold, two additional limitations come into play: wages paid and business investment. These limits begin to phase-in when the business owner's taxable income exceeds the applicable threshold and apply in full when the business owner's taxable income exceeds the applicable threshold plus $75,000 ($150,000 for married taxpayers filing jointly).

The section 199A pass-through deduction is determined for qualified trade or business owners with taxable income for the taxable year that exceeds the threshold amount by adding the QBI component and the qualified REIT dividend/qualified PTP income component. That sum is then compared to 20 percent of the amount by which the individual's taxable income exceeds net capital gain. The lesser of these two amounts is the individual's section 199A deduction.

2.13.3.7.1 QBI Component Calculation

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

2.13.3.7.2 Qualified Property

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

The term "qualified property" means tangible property:

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

2.13.3.7.2.1 UBIA of Qualified Property

The abbreviation UBIA simply means unadjusted basis immediately after acquisition and refers to qualified property.

The term "depreciable period" means the period beginning on the date the property was first placed in service and ending on the later of:

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

2.13.3.8 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.

2.13.4 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.

2.13.4.1 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.

2.13.4.2 Tax for Certain Children Who Have Unearned Income - Form 8615

Form 8615 allows taxpayers to calculate their qualifying child's taxes on unearned income if the child has $2,700 or more in unearned income in 2026. Unearned income includes all forms of investment income, such as interest, dividends, rent, royalties, and capital gains. Form 8615 requires the child's name and SSN, as well as the name, SSN, and filing status of a parent.

2.13.4.3 Parents' Election To Report Child's Interest and Dividends - Form 8814

Form 8814 is used when the child's parent chooses to include the child's unearned income on the parent's own tax return only if the child's unearned income is less than $13,500 in 2026. Forms 8615 and 8814 are depicted below.

Form **8615**

Department of the Treasury
Internal Revenue Service

Tax for Certain Children Who Have Unearned Income

Attach only to the child's Form 1040 or 1040-NR.
Go to *www.irs.gov/Form8615* for instructions and the latest information.

OMB No. 1545-0074
2026
Attachment Sequence No. **33**

Child's name shown on return	**Child's social security number**
A Parent's name (first, initial, and last). **Caution:** See instructions before completing.	**B Parent's social security number**

C Parent's filing status (check one):
☐ Single ☐ Married filing jointly ☐ Married filing separately ☐ Head of household ☐ Qualifying surviving spouse

Part I Child's Net Unearned Income

1	Enter the child's unearned income. See instructions	**1**	
2	If the child **did not** itemize deductions on **Schedule A** (Form 1040) or **Schedule A** (Form 1040-NR), enter $2,700. Otherwise, see instructions	**2**	
3	Subtract line 2 from line 1. If zero or less, **stop**; do not complete the rest of this form but **do** attach it to the child's return	**3**	
4	Enter the child's **taxable income** from Form 1040 or 1040-NR, line 15. If the child files Form 2555, see the instructions	**4**	
5	Enter the **smaller** of line 3 or line 4. If zero, **stop**; do not complete the rest of this form but **do** attach it to the child's return	**5**	

Part II Tentative Tax Based on the Tax Rate of the Parent

6	Enter the parent's **taxable income** from Form 1040 or 1040-NR, line 15. If zero or less, enter -0-. If the parent files Form 2555, see the instructions	**6**	
7	Enter the total, if any, from Forms 8615, line 5, of **all other** children of the parent named above. **Do not** include the amount from line 5 above	**7**	
8	Add lines 5, 6, and 7. See instructions	**8**	
9	Enter the tax on the amount on line 8 based on the **parent's** filing status above. See instructions. If the Qualified Dividends and Capital Gain Tax Worksheet, Schedule D Tax Worksheet, or Schedule J (Form 1040) is used to figure the tax, check here ☐	**9**	
10	Enter the parent's tax from Form 1040 or 1040-NR, line 16, minus any alternative minimum tax. **Do not** include any tax from **Form 4972** or **Form 8814**, or any tax from the recapture of an education credit. If the parent files Form 2555, see the instructions. If the Qualified Dividends and Capital Gain Tax Worksheet, Schedule D Tax Worksheet, or Schedule J (Form 1040) was used to figure the tax, check here ☐	**10**	
11	Subtract line 10 from line 9 and enter the result. If line 7 is blank, also enter this amount on line 13 and go to **Part III**	**11**	
12a	Add lines 5 and 7 — **12a**		
b	Divide line 5 by line 12a. Enter the result as a decimal (rounded to at least three places)	**12b**	× .
13	Multiply line 11 by line 12b	**13**	

Part III Child's Tax—If lines 4 and 5 above are the same, enter -0- on line 15 and go to line 16.

14	Subtract line 5 from line 4 — **14**		
15	Enter the tax on the amount on line 14 based on the **child's** filing status. See instructions. If the Qualified Dividends and Capital Gain Tax Worksheet, Schedule D Tax Worksheet, or Schedule J (Form 1040) is used to figure the tax, check here ☐	**15**	
16	Add lines 13 and 15	**16**	
17	Enter the tax on the amount on line 4 based on the **child's** filing status. See instructions. If the Qualified Dividends and Capital Gain Tax Worksheet, Schedule D Tax Worksheet, or Schedule J (Form 1040) is used to figure the tax, check here ☐	**17**	
18	Enter the **larger** of line 16 or line 17 here and on the **child's** Form 1040 or 1040-NR, line 16. If the child files Form 2555, see the instructions	**18**	

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 64113U Form **8615**

For illustration purposes only

Form **8814**

Department of the Treasury
Internal Revenue Service

Parents' Election To Report Child's Interest and Dividends

Attach to parents' Form 1040, 1040-SR, or 1040-NR.
Go to *www.irs.gov/Form8814* for the latest information.

OMB No. 1545-0074

2026

Attachment Sequence No. **40**

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

Caution: The federal income tax on your child's income, including qualified dividends and capital gain distributions, may be less if you file a separate tax return for the child instead of making this election. This is because you cannot take certain tax benefits that your child could take on his or her own return. For details, see *Tax benefits you cannot take* in the instructions.

A Child's name (first, initial, and last) | **B Child's social security number**

C If more than one Form 8814 is attached, check here . . . . . ☐

Part I Child's Interest and Dividends To Report on Your Return

1a	Enter your child's **taxable** interest. If this amount is different from the amounts shown on the child's Forms 1099-INT and 1099-OID, see the instructions	1a	
b	Enter your child's **tax-exempt** interest. **Do not** include this amount on line 1a — 1b		
2a	Enter your child's ordinary dividends, including any Alaska Permanent Fund dividends. If your child received any ordinary dividends as a nominee, see the instructions	2a	
b	Enter your child's qualified dividends included on line 2a. See the instructions — 2b		
3	Enter your child's capital gain distributions. If your child received any capital gain distributions as a nominee, see the instructions	3	
4	Add lines 1a, 2a, and 3. If the total is $2,700 or less, skip lines 5 through 12 and go to line 13. If the total is $13,500 or more, **do not** file this form. Your child **must** file his or her own return to report the income	4	
5	Base amount	5	$2,700
6	Subtract line 5 from line 4	6	
	If both lines 2b and 3 are zero or blank, skip lines 7 through 10, enter -0- on line 11, and go to line 12. Otherwise, go to line 7.		
7	Divide line 2b by line 4. Enter the result as a decimal (rounded to at least three places) — 7 .		
8	Divide line 3 by line 4. Enter the result as a decimal (rounded to at least three places) — 8 .		
9	Multiply line 6 by line 7. Enter the result here. See the instructions for where to report this amount on your return — 9		
10	Multiply line 6 by line 8. Enter the result here. See the instructions for where to report this amount on your return — 10		
11	Add lines 9 and 10	11	
12	Subtract line 11 from line 6. Include this amount in the total on Schedule 1 (Form 1040), line 8z. In the space next to that line, enter "Form 8814" and show the amount. If you checked the box on line C above, see the instructions. Go to line 13 below	12	

Part II Tax on the First $2,700 of Child's Interest and Dividends

13	Amount not taxed	13	$1,350
14	Subtract line 13 from line 4. If the result is zero or less, enter -0-	14	
15	**Tax.** Is the amount on line 14 less than $1,350? ☐ **No.** Enter $135 here and see the **Note** below. ☐ **Yes.** Multiply line 14 by 10% (0.10). Enter the result here and see the **Note** below.	15	

Note: If you checked the box on line C above, see the instructions. Otherwise, include the amount from line 15 in the tax you enter on Form 1040,1040-SR, or 1040-NR, line 16. Be sure to check box 1 on Form 1040, 1040-SR, or 1040-NR, line 16.

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 10750J Form **8814**

For illustration purposes only

2.13.5 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 $20,000 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.

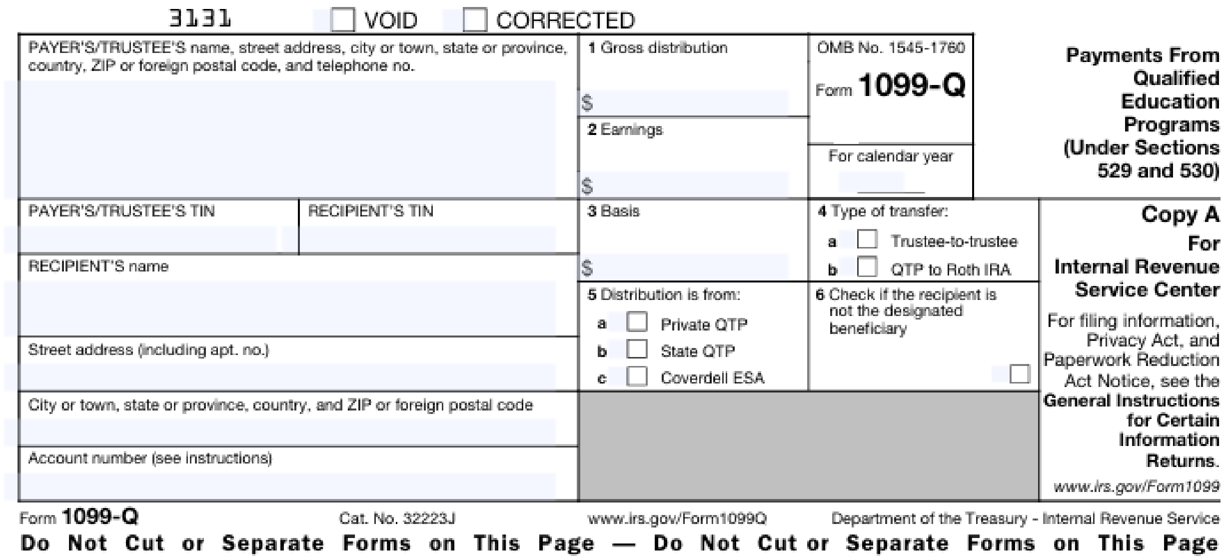
Beginning in 2024, tax law also provides for a limited penalty-free rollover from a §529 plan to a Roth IRA.

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

2.13.5.1 Payments From Qualified Education Programs - Form 1099-Q

Form 1099-Q, reports distributions from a Section 529 plan including the total distribution amount, the basis (contributions), and the earnings. Amounts on Form 1099-Q only need to be reported on a tax return if the distributions were non-qualified, meaning they were spent on expenses other than tuition, fees, room and board, or other required costs. In such cases, the earnings portion is taxable at the individual's marginal tax rate and is subject to a 10% penalty.

Similarly, when a taxpayer receives a distribution from a Section 530 plan—also known as a Coverdell education savings account—he or she will receive a Form 1099-Q. As in the case of a §529 qualified tuition program distribution, the amount of the gross distribution will be shown in box 1, earnings in box 2 and basis in box 3.


3131 ☐ VOID ☐ CORRECTED

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

1 Gross distribution $

2 Earnings $

OMB No. 1545-1760

Form 1099-Q

For calendar year

Payments From Qualified Education Programs (Under Sections 529 and 530)

PAYER'S/TRUSTEE'S TIN | RECIPIENT'S TIN

3 Basis $

4 Type of transfer:
a ☐ Trustee-to-trustee
b ☐ QTP to Roth IRA

Copy A For Internal Revenue Service Center

RECIPIENT'S name

Street address (including apt. no.)

5 Distribution is from:
a ☐ Private QTP
b ☐ State QTP
c ☐ Coverdell ESA

6 Check if the recipient is not the designated beneficiary ☐

For filing information, Privacy Act, and Paperwork Reduction Act Notice, see the **General Instructions for Certain Information Returns.**

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

Account number (see instructions)

www.irs.gov/Form1099

Form 1099-Q Cat. No. 32223J www.irs.gov/Form1099Q Department of the Treasury - Internal Revenue Service

Do Not Cut or Separate Forms on This Page — Do Not Cut or Separate Forms on This Page

For illustration purposes only.

2.13.5.2 Section 529 Plans and Post Secondary Credentials

Pursuant to OBBBA, §70414, a "recognized post-secondary credential" means:

- Any post-secondary employment credential that is industry recognized and is—
  - a post-secondary employment credential issued by a program that is accredited by the Institute for Credentialing Excellence, the National Commission on Certifying Agencies, or the American National Standards Institute,
  - a post-secondary employment credential that is included in the Credentialing Opportunities On-Line (COOL) directory of credentialing programs (or successor directory) maintained by the Department of Defense or by any branch of the Armed Forces, or
  - a post-secondary employment credential identified for purposes of this clause by the Secretary, after consultation with the Secretary of Labor, as being industry recognized;
- Any certificate of completion of an apprenticeship that is registered and certified with the Secretary of Labor under the Act of August 16, 1937 commonly known as the "National Apprenticeship Act";
- Any occupational or professional license issued or recognized by a State or the Federal Government (and any certification that satisfies a condition for obtaining such a license); and
- Any recognized post-secondary credential as defined in section 3(52) of the Workforce Innovation and Opportunity Act (29 U.S.C. 3102(52)), provided through a program described in paragraph (2)(A).''.

In somewhat more common language, an employment credential verifies an individual's qualifications, skills, or authorization to perform a specific job duty and may be an academic degree, professional certification, license, or certificate of completion. In general, employment credentials are designed to ensure that a holder of the credential possesses the knowledge and ability to perform a particular role.

Obtaining such an employment credential may involve significant expense. The term "qualified post-secondary credentialing expenses" means:

- Tuition, fees, books, supplies, and equipment required for the enrollment or attendance of a designated beneficiary in a recognized post-secondary credential program, or any other expense incurred in connection with enrollment in or attendance at a recognized post-secondary credential program if such expense would, if incurred in connection with enrollment or attendance at an eligible educational institution, be covered -

  - Fees for testing if required to obtain or maintain a recognized post-secondary credential; and
  - Fees for continuing education if required to maintain a recognized post-secondary credential.

2.13.5.3 Post-Secondary Credential Program Defined

The term "recognized post-secondary credential program" means any program to obtain a recognized post-secondary credential if:

- The program is included on a state list prepared under the Workforce Innovation and Opportunity Act;
- The program is listed in the public directory of the Web Enabled Approval Management System (WEAMS) of the Veterans Benefits Administration, or successor directory of such program;
- An examination, developed or administered by an organization recognized as providing reputable credentials in the occupation, is required to obtain or maintain the credential and such organization recognizes the program as providing training or education which prepares individuals to take the examination; or
- The program is identified as being a reputable program for obtaining a recognized post-secondary credential.

Section 529 plans consider certain post-secondary credentialing expenses to be qualified higher education expenses effective for distributions made after July 4, 2025. As qualified higher education expenses, a distribution not exceeding such expenses would be tax-free.

Pursuant to OBBBA, §70414, a "recognized post-secondary credential" means:

- Any post-secondary employment credential that is industry recognized and is—
  - a post-secondary employment credential issued by a program that is accredited by the Institute for Credentialing Excellence, the National Commission on Certifying Agencies, or the American National Standards Institute,
  - a post-secondary employment credential that is included in the Credentialing Opportunities On-Line (COOL) directory of credentialing programs (or successor directory) maintained by the Department of Defense or by any branch of the Armed Forces, or
  - a post-secondary employment credential identified for purposes of this clause by the Secretary, after consultation with the Secretary of Labor, as being industry recognized;
- Any certificate of completion of an apprenticeship that is registered and certified with the Secretary of Labor under the Act of August 16, 1937 commonly known as the "National Apprenticeship Act";
- Any occupational or professional license issued or recognized by a State or the Federal Government (and any certification that satisfies a condition for obtaining such a license); and
- Any recognized post-secondary credential as defined in section 3(52) of the Workforce Innovation and Opportunity Act (29 U.S.C. 3102(52)), provided through a program described in paragraph (2)(A).''.

In somewhat more common language, an employment credential verifies an individual's qualifications, skills, or authorization to perform a specific job duty and may be an academic degree, professional certification, license, or certificate of completion. In general, employment credentials are designed to ensure that a holder of the credential possesses the knowledge and ability to perform a particular role.

2.13.6 Achieving a Better Life Experience (ABLE) Account

The Achieving a Better Life Experience (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.

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 $20,000 for

2026. Earnings on ABLE contributions are tax-deferred, and distributions not exceeding qualified disability expenses are 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.* The age limit for establishing an ABLE account, after December 31, 2025, is "before age 46."

2.13.6.1 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.

2.13.6.2 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.*

2.13.6.3 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, for 2026 is $20,000.

OBBBA, §70115, makes several changes to ABLE accounts, effective after December 31, 2025, including permanently:

- Extending the ABLE account contribution limit, keeping the maximum annual amount at $20,000 (for 2026) with future inflation adjustments;
- Establishing the ABLE-to-Work provision allowing employed individuals with disabilities to make additional contributions equal to the lesser of –
    - the beneficiary's compensation included in gross income, or
    - an amount equal to the poverty line for a one-person household for the preceding calendar year; and
- Authorizing tax-free rollovers from 529A savings plans.

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, *ABLE Account Contribution Information,* box 1 and 2.

2.13.6.4 OBBBA Makes Rollovers to ABLE Accounts Permanent

Qualified tuition program distributions that are rolled over to an ABLE account in accordance with the rollover rules are not taxable distributions. OBBBA, §70117, makes nontaxable rollovers from qualified tuition programs (§529 accounts) to ABLE accounts (§529A accounts) permanent for taxable years beginning after December 31, 2025.

The rollover is required to meet the following requirements:

- The rollover must be completed within 60 days after the date of the distribution;
- The ABLE account beneficiary must be -
    - the 529 account beneficiary, or
    - a member of the 529 account beneficiary's family; and
- The maximum rollover amount to an ABLE account in 2026 is $20,000.

2.13.7 Cancellation of Student Debt

OBBBA, §70119, makes the TCJA's exclusion from gross income for forgiven student loans on account of the student's death or permanent disability permanent. In addition, it requires the taxpayer to provide a Social Security number on the tax return in order to qualify. Form 1099-C, Cancellation of Debt is sent to the taxpayer indicating the amount of cancelled debt. Form 1099-C is shown below:

CORRECTED (if checked)

CREDITOR'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.	1 Date of identifiable event 2 Amount of debt discharged $ 3 Interest, if included in box 2 $	OMB No. 1545-1424 Form **1099-C** For calendar year		**Cancellation of Debt**
CREDITOR'S TIN	DEBTOR'S TIN	4 Debt description		**Copy B** **For Debtor**
DEBTOR'S name Street address (including apt. no.) City or town, state or province, country, and ZIP or foreign postal code		5 If checked, the debtor was personally liable for repayment of the debt		This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if taxable income results from this transaction and the IRS determines that it has not been reported.
Account number (see instructions)		6 Identifiable event code	7 Fair market value of property $	

Form **1099-C** (keep for your records) www.irs.gov/Form1099C Department of the Treasury - Internal Revenue Service

For illustration purpose only

2.13.8 Net Operating Loss (NOL)

Non-corporate taxpayers including individuals, trusts, estates, partners, and S corporation shareholders have the ability to deduct business losses, to the extent they exceed income, not exceeding an annual threshold amount indexed for inflation. A taxpayer experiences an excess business loss (EBL) when the total deductions from business activity exceed the total income, including gains, plus the specified threshold amount. For 2026, the threshold amount is $256,000 for single taxpayers, and $512,000 for married taxpayers filing jointly.

Business-related capital gains reduce the disallowed EBL while capital losses increase the disallowed EBL. Business losses in excess of the threshold amount are disallowed, are treated as net operating loss (NOL) and can be carried forward indefinitely to subsequent years, subject to an 80% taxable income limitation. Passive activity loss limitations must be considered prior to applying the EBL limitation.

2.13.8.1 OBBBA Reduces EBL Limitation & Makes Rule Permanent

OBBBA §70601, has made the following changes to excess business losses of noncorporate taxpayers effective for tax years after 12/31/2025:

- Permanently extending the EBL limitation rule; and
- Adjusting the amounts for determining excess business loss to –
    - $256,000 for single taxpayers, and
    - $512,000 for married taxpayers filing jointly

2.13.9 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—
Less than 133%	2.10%	2.10%
133% but less than 138%	3.14%	3.45%
138% but less than 150%	3.45%	4.19%
150% but less than 200%	4.19%	6.60%
200% but less than 250%	6.60%	8.84%
250% but less than 300%	8.44%	9.96%
At 300% to 400%	9.96%	9.96%

2.13.9.1 Federal Poverty Level

The federal government's poverty levels for 2026 are as shown in the chart below:

HHS Poverty Guidelines			
Persons in family/household	**48 Contiguous States and D.C.**	**Alaska**	**Hawaii**
1	$15,960	$19,950	$18,360
2	$21,640	$27,050	$24,890
3	$27,320	$34,150	$31,420
4	$33,000	$41,250	$37,950
5	$38,680	$48,350	$44,480
6	$44,360	$55,450	$51,010
7	$50,040	$62,550	$57,540
8	$55,720	$69,650	$64,070
For each additional person add	$5,680	$7,100	$6,530

2.13.9.2 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.

Tax Credit = Benchmark Plan Premium - Taxpayer's Expected Contribution

Form 8962-Premium Tax Credit is used to calculate the amount of Premium Tax Credit and further allows for the reconciliation of any advance payments of the Premium Tax Credit the taxpayer received in determining underpayment or overpayment.

Form 1095-A Health Insurance Marketplace Statement is used to verify health coverage, reconcile advanced payments received and claim the Premium Tax Credit when filing a return.

Form 1095-B Health Coverage is used to verify that the taxpayer and dependents had minimum essential health coverage for the previous year. Form 1095-B is sent by providers such as insurers, employers, or government programs, to the taxpayer and the IRS, listing covered individuals and months of coverage.

Form 1095-C, Employer-Provided Health Insurance Offer and Coverage allows for Applicable Large Employers (50+ full-time employees) to report to the IRS that the employer offered qualifying, affordable health insurance, allowing the IRS to determine if an employer may owe a shared responsibility penalty payment. Form 1095-C identifies the:

- employee;
- employer;
- months the employee was eligible for coverage; and
- cost of the least expensive monthly premium under the plan.

2.13.9.3 Benchmark Plan

The "benchmark plan" is the second-lowest-cost plan that would cover the family at the silver level of coverage.

2.13.9.4 Taxpayer's Expected Contribution

The applicable percentage of the taxpayer's household income payable as a contribution toward premiums in 2026 increases—from 2.10% of income for families at less than 133% of the federal poverty level to 9.96% of income for families at 400% of the federal poverty level—as the taxpayer's income increases.

2.13.9.5 Additional Tax Limitation Eliminated

If the reconciliation of the premium tax credit with advance tax credit payments made on behalf of the taxpayer shows an excess payment, that excess is owed by the taxpayer as an additional income tax liability.

2.13.10 Employee Fringe Benefits

The various tax-advantaged employee fringe benefits include:

- Cafeteria Plans;
- Qualified Transportation Fringe Benefit;
- Medical Savings Accounts; and
- Health Savings Accounts.

2.13.10.1 Cafeteria Plans

A Cafeteria Plan (Section 125 Plan) allows employed taxpayers offered such a plan the opportunity to pay for certain health benefits on a pre-tax basis, including such benefits as:

- Group health insurance;
- Qualified out-of-pocket medical expenses; and
- Day care for eligible dependents.

For 2026, the dollar limitation under §125(i) is $3,400. The maximum carryover of unused amounts is limited to $680, if the cafeteria plan allows.

2.13.10.2 Qualified Transportation Fringe Benefits

Most excludable transportation fringe benefits for employees are eliminated for 2026 as shown in the chart below:

Reimbursement For	Employer Deductibility	Employee Excludability
Bicycle commuting	Yes	No
Qualified parking	No	Yes, subject to aggregate limit
Vanpooling	No	Yes, subject to aggregate limit
Commuter pass	No	Yes, subject to aggregate limit

For 2026, the monthly limitation with respect to the aggregate fringe benefit exclusion amount for transportation in a commuter highway vehicle and any transit pass under § 132(f)(2)(A) is $340. The monthly limitation amount for qualified parking under § 132(f)(2)(B) is $340.

2.13.10.3 Medical Savings Accounts

Archer medical savings accounts (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 tax-free to pay any qualified healthcare expenses.

2.13.10.3.1 Archer MSA Benefits

Archer MSAs offer account holders the following benefits:

- A tax deduction for contributions made to the MSA even if the taxpayer does not itemize deductions;
- The earnings on amounts contributed to the MSA are tax-deferred;
- Distributions from an MSA to pay qualified medical expenses are entirely tax free;
- A taxpayer's contributions and earnings, if any, remain in the MSA from year to year until the taxpayer uses them;
- An MSA 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 MSA 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.

2.13.10.3.2 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.

2.13.10.3.3 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 2026 is one whose annual deductible is at least $2,900 but not more than $4,400. It must also provide that annual out-of-pocket expenses, other than for premiums, do not exceed $5,850.

A high-deductible health plan providing *family coverage* in 2026 must have an annual deductible of at least $5,850 but not more than $8,750 and must require annual out-of-pocket expenses, other than for premiums, of not more than $10,700.

High Deductible Health Plan – 2026

Deductible and out-of-pocket limits in an Archer MSA 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 Archer MSA in 2026 are the following:

	Minimum Deductible	***Maximum Deductible***	***Maximum Annual Out-of-Pocket***

Self-only coverage	$2,900	$4,400	$5,850
Family coverage	$5,850	$8.750	$10,700

2.13.10.3.4 Archer MSA Contributions

Contributions to an Archer MSA must be made in cash. 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.

2.13.10.4 Health Savings Accounts

Health Savings Accounts (HSAs) were authorized based, in part, on the results of the Archer MSA pilot program. 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 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[10] and other remote care services free of any cost sharing without jeopardizing the HSA eligibility;
- 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.

2.13.10.4.1 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.

2.13.10.4.2 HSA Eligibility

An individual eligible to establish an HSA is one who meets all the following requirements. The individual:

- Is covered under a high deductible health plan (HDHP) on the first day of the month;
- Is not enrolled in Medicare; and
- Cannot be claimed as a dependent on another person's tax return for the year.

2.13.10.4.3 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. For a policy that covers only the individual, a high deductible health plan in 2026 is one whose annual deductible is at least $1,700 and which also provides that annual out-of-pocket expenses do not exceed $8,500. A high-deductible health plan providing family coverage in 2026 must have an annual deductible of at least $3,400 and must require annual out-of-pocket expenses of not more than $17,000. (These limits tend to be adjusted upward each year.)

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 2026 are the following:

High Deductible Health Plan (HSA) – 2026				
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 2026 are the following:				
Coverage Type	Minimum Deductible	Maximum Annual Out-of-Pocket*	Maximum Individual Annual Contribution	Individual Annual Catch-up Contribution
Self-only coverage	$1,700	$8,500	$4,400	$1,000
Family coverage	$3,400	$17,000	$8,750	$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.				

Beginning in 2026, all bronze level and catastrophic plans are eligible for an HSA.

2.13.10.4.4 HSA Contributions

Contributions to an HSA may be made up until April 15th of the year following the year for which contributions are made and 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.

HSA account holders who attain age 55 before the close of a taxable year are eligible to make an additional contribution. The maximum additional contribution amount is $1,000.

2.13.10.4.5 HSA Distributions

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 provided they are not compensated by insurance or otherwise. 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.

Form 8889-Health Savings Accounts allows a taxpayer to calculate HSA contributions and associated tax deductions, as well as distributions and any tax or penalty owed for distributions not used for qualified expenses.

Distributions from a health savings account (HSA), Archer medical savings account. (MSA), or Medicare Advantage (MA) MSA are reported to the taxpayer on **Form 1099-SA** as seen below:

9494 ☐ VOID ☐ CORRECTED

TRUSTEE'S/PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone number			OMB No. 1545-1517 Form **1099-SA** For calendar year	**Distributions From an HSA, Archer MSA, or Medicare Advantage MSA**
PAYER'S TIN	RECIPIENT'S TIN	1 Gross distribution $	2 Earnings on excess cont. $	**Copy A** **For Internal Revenue Service Center**
RECIPIENT'S name		3 Distribution code	4 FMV on date of death $	For filing information, Privacy Act, and Paperwork Reduction Act Notice, see the **General Instructions for Certain Information Returns.**
Street address (including apt. no.)		5 HSA ☐ Archer MSA ☐ MA MSA ☐		
City or town, state or province, country, and ZIP or foreign postal code				
Account number (see instructions)				*www.irs.gov/Form1099*

Form **1099-SA** Cat. No. 38471D www.irs.gov/Form1099SA Department of the Treasury - Internal Revenue Service

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Annual contributions made by a taxpayer to Health Savings Accounts, Archer MSAs, or Medicare Advantage MSAs are reported on Form 5498-SA HSA, Archer MSA, or Medicare Advantage MSA Information seen below:

2727 ☐ VOID ☐ CORRECTED

TRUSTEE'S name				1 Employee's or self-employed person's Archer MSA contributions made in the calendar year and the subsequent year for the calendar year $	OMB No. 1545-1518 Form **5498-SA** (Rev. December 2026) For calendar year	**HSA, Archer MSA, or Medicare Advantage MSA Information**
Street address			Room/suite no.			
City/town	State/province	Country	ZIP/foreign code			
Telephone number:				2 Total contributions made in the calendar year $		**Copy A** **For Internal Revenue Service Center**
TRUSTEE'S TIN	PARTICIPANT'S TIN					
PARTICIPANT'S name				3 Total HSA or Archer MSA contributions made in the subsequent year for the calendar year $		
Street address			Apt. no.	4 Rollover contributions $	5 Fair market value of HSA, Archer MSA, or MA MSA $	For filing information, Privacy Act, and Paperwork Reduction Act Notice, see the **General Instructions for Certain Information Returns.**
City/town	State/province	Country	ZIP/foreign code			
Account number (see instructions)				6 HSA ☐ Archer MSA ☐ MA MSA ☐		*www.irs.gov/Form1099*

Form **5498-SA** (Rev. 12-2026) Created 9/18/25 Cat. No. 38467V www.irs.gov/Form5498SA Department of the Treasury - Internal Revenue Service

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2.14 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.

2.14.1 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.

2.14.1.1 Form W-4

The amount of income tax withheld by an employer from a taxpayer's regular pay depends on the amount earned by the taxpayer and spouse, if any, in the payroll period and the information provided by the taxpayer to his or her employer on IRS Form W–4. The taxpayer-provided information includes whether to withhold at the single, head of household, or married rate, whether the taxpayer holds multiple jobs at a time and/or the taxpayer's spouse is employed, the number of dependents claimed, whether an additional withholding amount is requested, and whether an exemption from withholding is claimed.

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.

2.14.1.2 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.

2.14.1.3 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.

2.14.1.4 Withholding from Nonwage Income

Although a taxpayer is generally required to have income tax withheld from his or her gambling winnings, a taxpayer may also have income tax withheld from other types of nonwage income. Accordingly, a taxpayer may have income tax withheld from:

- Pensions and annuities by requesting withholding using Form W-4P, Withholding Certificate for Periodic Pension or Annuity Payments or Form W-4R, Withholding Certificate for Nonperiodic Payments and Eligible Rollover Distributions; and
- Unemployment compensation and federal payments, such as Social Security benefits by requesting withholding using Form W-4V, Voluntary Withholding Request.

If the taxpayer chooses not to have income tax withheld from nonwage income, he or she may have to pay estimated tax.

Note that Form W-4P, Withholding Certificate for Periodic Pension or Annuity Payments (previously titled Withholding Certificate for Pension or Annuity Payments), 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.

2.14.2 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.

2.14.2.1 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.

2.15 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.

2.15.1 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.

2.15.2 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.

2.15.2.1 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.

2.16 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.

2.16.1 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 failure to file a return required to be filed in 2027 within 60 days of its due date (determined with regard to any extensions of time for filing) will result in an addition to tax of not less than the lesser of:

- $535, or
- 100% of the amount required to be shown as tax on such return.

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.

2.16.2 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.

2.16.2.1 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.[11] 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

For calendar year 2026 or other tax year beginning , 2025, and ending , 20 .

OMB No. 1545-0074

2026

Part I Identification

1 Your name(s) (see instructions)

Address (see instructions)

City, town, or post office | State | ZIP code

2 Your social security number | 3 Spouse's social security number

Part II Individual Income Tax

4 Estimate of total tax liability for 2026 . . . $

5 Total 2025 payments . . . .

6 **Balance due.** Subtract line 5 from line 4. See instructions . . . .

7 Amount you're paying (see instructions) . .

8 Check here if you're "out of the country" and a U.S. citizen or resident. See instructions . . . . ☐

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**

For illustration purposes only

[11] IRS Form 4868 and its instructions may be accessed at https://www.irs.gov/pub/irs-pdf/f4868.pdf

When the taxpayer's income tax return is subsequently filed, enter any payment made when the application for extension was filed on Schedule 3 (Form 1040), line 10, i.e., on the line stating "Amount you're paying."

2.16.2.2 Individuals Outside the United States

A taxpayer is allowed an automatic two-month extension, without filing Form 4868, to file the federal income tax form ***and pay any federal income tax due*** if:

- The taxpayer is a U.S. citizen or resident, and
- On the due date of the taxpayer's return, he or she is –
    - Living outside the United States and Puerto Rico, and the taxpayer's main place of business or post of duty is outside the United States and Puerto Rico, or
    - In the military or naval service on duty outside the United States and Puerto Rico.

If the taxpayer files a joint return, only one spouse needs to qualify in order to take advantage of this automatic extension. However, if the taxpayer and spouse file separate returns, the automatic extension applies only to the spouse who qualifies. To obtain the automatic extension, the taxpayer simply needs to attach a statement to his or her federal income tax return explaining what situation qualified him or her for the extension. Although a taxpayer who meets the criteria for an automatic two-month extension may defer payment of any federal income tax due, if the tax due is paid after the regular due date, interest—but no penalties—will be charged from the regular due date until the date the tax is paid.

If the taxpayer cannot file his or her federal income tax return within the automatic two-month extension period, the taxpayer may be able to get an additional four-month extension by filing IRS Form 4868 and checking the box on line eight of the form.

2.16.2.3 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. Phil's daughter is covered under his group health insurance plan. If she requires regular medical treatments whose annual costs exceed his group health insurance benefits by $10,000, what is the maximum amount Phil may contribute to his employer's flexible spending account for medical expenses in 2026?

    A. $10,000

    B. $3,400

    C. $5,000

D. No dollar limit applies to flexible spending account contributions for medical expenses.

2. Aaron, age 55, has a high deductible health plan with a $5,000 deductible that provides family coverage under his health savings account (HSA). What is the maximum amount he may contribute to his HSA in 2026?

   A. $9,750

   B. $8,750

   C. $4,400

   D. $3,250

3. What is the QBI deduction phase-in range in 2026 applicable to an eligible taxpayer filing federal tax return as head of household?

   A. $50,000

   B. $75,000

   C. $100,000

   D. $150,000

Domain 3 – Practices, Procedures & Professional Responsibility

Introduction

Tax return preparers are held to a high standard of conduct in their preparation of clients' income tax returns. Their failure to maintain that standard may subject them to financial, reputational and other penalties. The following textual material addresses certain of those standards and the applicable penalties for failing to maintain them.

Domain 3 Learning Objectives

When you have completed the domain 3 text, you should be able to:

- Identify the red flags indicating possible tax-related identity theft and suggested assistance to its victims;
- Understand the laws and regulations requiring privacy and security of taxpayer data and the best practices tax preparers may implement to help assure it;
- Describe the purpose of individual taxpayer identification numbers, their effect on tax credits and how to renew them;
- Recognize the penalties applicable to a tax return preparer under Title 26;
- Identify the due diligence requirements imposed on tax return preparers with respect to claiming head of household filing status, EITC, CTC and AOTC;
- Understand the e-file requirements; and
- Recognize the Annual Filing Season Program requirements.

3.1 Tax Related Identity Theft (Publication 5199)

Tax-related identity theft usually occurs when someone uses a stolen Social Security number to file a tax return claiming a fraudulent refund. Thieves may also use stolen Employer Identification Numbers to create false Forms W-2 to support refund fraud schemes.

The IRS has created and published Publication 5199[12], Tax Preparer Guide to Identity Theft, which identifies the various warning signs of identity theft and suggests additional identity theft-prevention resources for preparers. Among the identified warning signs for individual clients that the client's Social Security number has been compromised, putting him or her at risk, are the following:

- A client's return is rejected and IRS reject codes indicate the taxpayer's Social Security number has already been used;
- The client notices activity on or receives IRS notices regarding a tax return after all tax issues have been resolved, refund paid or account balances have been paid; and
- An IRS notice indicates the client received wages from an employer unknown to the client.

To prevent filing returns with stolen identities, tax preparers should ask taxpayers not known to them to provide ***two forms of identification***—preferably forms of identification containing the individual's picture—that include the taxpayer's name and current address. In addition, tax return preparers must confirm the identities and Social Security numbers of taxpayers, spouses and dependents.

Preparers should require taxpayers to show the Social Security cards for themselves, their spouses and dependents and should take special care to ensure that they transcribe all Social Security numbers correctly. Furthermore, the Social Security number entered on the IRS Form W-2, Wage and Tax Statement must be identical to the taxpayer's Social Security number on the Social Security card provided by the taxpayer. Tax return preparers should enter the Social Security number exactly as shown on the Form W-2 provided to them by taxpayers.

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[12]Publication 5199 may be accessed at http://www.irs.gov/pub/irs-pdf/p5199.pdf.

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[13], 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;
- 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

[13] 2025 Identity Fraud Study: Resolving the Shattered Identity Crisis | Javelin (javelinstrategy.com) .

- 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.[14]

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 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 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.

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[14] Publication 1345 may be accessed at https://www.irs.gov/pub/irs-pdf/p1345.pdf

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. OBBBA, §70103, permanently eliminates the deduction for personal exemptions—exemptions that were temporarily eliminated under the Tax Cuts and Jobs Act of 2017—but authorizes a temporary senior deduction in calendar years 2025 through 2028.

Spouses and dependents must be listed on an attached U.S. federal tax return and include the schedule or form that applies to the allowable tax benefit. Dependents claimed for an allowable tax benefit must prove U.S. residency unless from Canada or Mexico. An allowable tax benefit includes a spouse filing a joint return, Head of Household (HOH) filing status, the American Opportunity Tax Credit (AOTC) Form 8863, Premium Tax Credit (PTC) Form 8962, Credit for Other Dependents (ODC), and Child and Dependent Care Credit (CDCC) Form 2441.

ITIN applicants who submit a Form W-7 based on the HOH filing status must be listed as a dependent on an attached tax return as a qualifying child or a qualifying relative. A dependent applicant must prove U.S. residency unless from Canada or Mexico.

If Form W-7 is submitted to claim ODC, the dependent applicants must be listed on an attached tax return with the "Credit for other dependents" box checked next to their name and prove U.S. residency or be a U.S. National. A dependent applicant from Canada or Mexico is not eligible for an ITIN if the only allowable tax benefit claimed is ODC unless they prove U.S. residency

3.3.1 Who Needs an ITIN?

As discussed in Publication 1915,[15] 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.

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
- 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, Application for IRS Individual Taxpayer Identification Number, and usually must attach a U.S. federal tax return, to renew their expired ITIN, along with the required documentation. A renewing taxpayer must attach a U.S. federal tax return unless eligible for one of the five exceptions involving:

- Third party withholding on passive income;

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[15] Pub 1915 may be accessed at https://www.irs.gov/pub/irs-pdf/p1915.pdf

- Wages, salary, compensation and honoraria payments with tax treaty benefits claimed; scholarships, fellowships and grants with tax treaty benefits claimed; scholarships, fellowships and grants – no tax treaty benefits claimed; or gambling winnings with tax treaty benefits claimed;
- Third party reporting of mortgage interest;
- Third party withholding – disposition by a foreign person of united states real property interest; or
- A non-U.S. representative of a foreign corporation who needs to obtain an ITIN for the purpose of meeting their e-filing requirements.

The exceptions are explained more fully in the Instructions for Form W-7 and in Publication 1915, Understanding Your IRS Individual Taxpayer Identification Number (ITIN).

3.4 Preparer Penalties

Professional tax preparers are expected to demonstrate a high level of competence, diligence and ethical behavior in their preparation of taxpayers' tax returns and are penalized for their failure to meet those expectations. The penalties that may be imposed under Title 26 for various preparer failures are as follows:

Scenario	**Per Return or Claim for Refund**	**Maximum Penalty**
Failure to furnish copy of tax return to taxpayer (§ 6695(a))	$65	$33,000
Failure to sign taxpayer's return (§ 6695(b))	$65	$33,000
Failure to furnish identifying number (§ 6695(c))	$65	$33,000
Failure to retain a copy or list of a return or claim (§ 6695(d))	$65	$33,000
Failure to file correct information returns (§ 6695(e))	$65 per return and item in return	$33,000
Negotiation of a check issued to a taxpayer (§ 6695(f))	$665 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))	$665 per failure	No limit
Unauthorized disclosure or use of information furnished for, or in connection with, the preparation of a return (§ 6713)	$250	$10,000

In addition, tax preparer penalties may also be imposed for the following:

Scenario	**Penalty**
Understatement of taxpayer's liability due to unreasonable positions (§ 6694(a))	Greater of $1,000 or 50% of income derived by preparer with respect to the return or claim for refund.
Understatement of taxpayer's liability due to willful or reckless conduct (§ 6694(b))	Greater of $5,000 or 75% of income derived by preparer with respect to the return or claim for refund.
Aiding and abetting understatement of a taxpayer's tax liability (§ 6701)	$1,000 ($10,000 if the conduct relates to a corporation's tax return)
Fraud and false statements (§ 7206)	Guilty of a felony; upon conviction, a fine of $100,000 ($500,000 in the case of a corporation), imprisonment of not more than three years or both, together with costs of prosecution.

3.5 Due Diligence in Tax Preparation

Due diligence is the care and attention to detail appropriate to the subject to which it refers. Thus, due diligence with respect to tax preparation is the care and attention to detail required of each preparer in his or her preparation of taxpayers' tax returns. Not surprisingly, the tax issues that create the greatest amount of confusion and resultant errors are the ones that require the highest level of diligence. Among the tax preparation topics responsible for a significant level of errors are:

- Qualifying for head of household (HOH) filing status; and
- Claiming the –
  - Child tax credit (CTC),
  - Credit for Other Dependents (ODC),
  - Education tax credits (AOTC), and
  - Earned income tax credit (EITC).

Filing as head of household and claiming the refundable tax credits are each governed by different eligibility rules. In order to avoid errors, it is important to take the following three steps:

1. Know the tax law for filing as head of household and claiming each refundable credit including its eligibility rules;
2. Remember that your software is not a substitute for your knowledge of the tax law; and
3. Follow the Due Diligence Must Do's.

In addition, the due diligence requirements require the preparer to meet four standards in preparing a tax return claiming head of household filing status, the EITC, American Opportunity Tax Credit, Credit for Other Dependents, or the Child Tax Credit. Those requirements call for the preparer to:

1. Complete and submit the Paid Preparer's Due Diligence Checklist, IRS Form 8867;
2. Complete the applicable worksheet;
3. Know the law relative to claiming the credit or filing status and, by interviewing and asking questions, the taxpayer; and
4. Document and maintain appropriate records related to preparation of the tax return, including keeping the following records for 3 years:
   - A copy of form 8867,
   - The applicable worksheet(s) or your own worksheet(s) for any credits claimed,
   - Copies of any documents provided by the taxpayer on which you relied to determine the taxpayer's eligibility for the credit(s) and/or HOH filing status and to figure the amount(s) of the credit(s),
   - A record of how, when, and from whom the information used to prepare Form 8867 and the applicable worksheet(s) was obtained, and
   - A record of any additional information you relied upon, including questions you asked and the taxpayer's responses, to determine the taxpayer's eligibility for the credit(s) and/or HOH filing status and to figure the amount(s) of the credit(s).

The various questions posed on Form 8867, Paid Preparer's Due Diligence Checklist, act as memory-joggers and identify areas about which the tax preparer should obtain information from the taxpayer when filing as Head of Household, or claiming the Earned Income Tax Credit, the Child Tax Credit, the Credit for Other Dependents or the American Opportunity Tax Credit. (Note: Satisfying the due diligence requirement may require filing multiple IRS Forms 8867.)

Treasury Regulations prescribe the due diligence requirements a paid tax return preparer must meet with respect to completion and submission of IRS form 8867. According to the regulations, a paid tax return preparer is required to complete the form based on information provided by the taxpayer to the tax return preparer or otherwise reasonably obtained by the preparer and provide the completed form for submission as follows:

- In the case of a ***signing tax return preparer who electronically files*** the tax return or claim for refund, the completed Form 8867 must be electronically filed with the tax return or refund claim. Accordingly, if you are the paid tax return preparer signing the return and filing the return electronically, file the completed Form 8867 electronically with the return;
- 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. If you are the paid tax return preparer

signing the return and you are mailing the return to the IRS for the taxpayer (which should only be done after the taxpayer has reviewed and signed the paper return), mail the completed Form 8867 to the IRS with the return; 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 (see 3.5.1.1);
- 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, 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.

Note: A taxpayer may be considered unmarried for the purpose of using head of household status but not for other purposes, such as claiming the EIC. Different tests apply, depending on the tax benefit claimed.

3.5.1.1.1 Required Marriage Test Supporting Documents

The supporting documents required to substantiate the taxpayer's meeting the marriage test depends upon whether the taxpayer is:

- Single;
- Divorced or legally separated; or
- Married but not living with spouse during last 6 months of the tax year.

If the taxpayer is single, no documents supporting the taxpayer's meeting the marriage test need to be obtained.

If the taxpayer is divorced or legally separated, photocopies of the following documents should be obtained:

- Entire divorce decree;
- Separate maintenance decree; or

- Separation agreement.

If the taxpayer is married but did not live with the taxpayer's spouse during the last six months of the tax year, obtain photocopies of documents verifying the taxpayer did not live with his or her spouse during the last six months of the year. Appropriate documents include:

- A lease agreement;
- Utility bills;
- A letter from a clergy member, or
- A letter from social services.

All such documents obtained by the paid preparer should be retained by the preparer as verification that supports his or her decision for the filing.

3.5.1.2 Keeping up the Taxpayer's Home

A taxpayer is keeping up a home only if the taxpayer pays more than half the cost of its upkeep for the year. The cost of keeping up a home includes:

- Rent;
- Mortgage interest (***but not principal payments***);
- Real estate taxes;
- Insurance on the home;
- Repairs;
- Utilities; and
- Food eaten in the home.

The cost of keeping up a home doesn't include the cost of clothing, education, medical treatment, vacations, life insurance, or transportation for any member of the household.

3.5.1.2.1 Required Keeping Up a Home Test Supporting Documents

The tax preparer should obtain the following supporting documents to substantiate the taxpayer's meeting the keeping up a home test including:

- Rent receipts;
- Utility bills;
- Grocery receipts;
- Property tax bills;
- Mortgage interest statement;
- Upkeep and repair bills;
- Property insurance statement; and
- Other household bills.

All such documents obtained by the paid preparer should be retained by the preparer as verification that supports his or her decision for the filing.

3.5.1.3 Qualifying Person

A person is a qualifying person for purposes of the taxpayer's filing as head of household if the person is the taxpayer's:

- Qualifying child (such as a son, daughter, or grandchild who lived with the taxpayer more than half the year) if –
    - Single, or
    - Married <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 if both the taxpayer and child satisfy five tests:

- The child must be the taxpayer’s son, daughter, stepchild, foster child, brother, sister, half-brother, half-sister, stepbrother, stepsister, or a descendant of any of them.
- The child must be (a) under age 19 at the end of the year and younger than the taxpayer (or the taxpayer’s spouse if filing jointly), (b) under age 24 at the end of the year, a student, and younger than the taxpayer (or the taxpayer’s spouse if filing jointly), or (c) any age if permanently and totally disabled.
- The child must have lived with the taxpayer for more than half of the year.
- The child must not have provided more than half of his or her own support for the year.
- The child isn’t filing a joint return for the year (unless that joint return is filed only to claim a refund of withheld income tax or estimated tax paid).

3.5.1.4.1 Required Qualifying Person Test Supporting Documents

The tax preparer should obtain and retain the supporting documents needed to substantiate the taxpayer’s meeting the qualifying person test including, as appropriate:

- Birth certificate or other official document of birth;
- Marriage certificate;
- Letter from an authorized adoption agency;
- Letter from the authorized placement agency; or
- Applicable court document.

In order to show that both the taxpayer and the taxpayer’s child lived together for more than half of the year, obtain:

- School, medical, day care, or social service records; or
- A letter on the unofficial letterhead from a school, medical provider, social service agency, or place of worship that shows –
    - Names,
    - Common address, and
    - Dates.

Note: If the taxpayer furnishes a letter from a relative who provides the taxpayer’s day care services, the preparer should obtain at least one additional letter.

3.5.1.5 Common Head of Household Errors

Common errors involving head of household filing status include the following:

- Both parents file as head of household, using the same child as a qualifying child;
- Both parents file as head of household, claiming that they each provided more than half the cost of upkeep for the same home;
- The taxpayer claims head of household status but did not pay for more than half the cost of keeping up a home (for example, the parent is living with a grandparent or the other parent paid for the cost of the home);
- The taxpayer is divorced and lives with his or her ex-spouse in the same home and both file as head of household;
- The taxpayer is married and the taxpayer’s spouse lived in the taxpayer’s house for one or more days during the last six months of the tax year;
- The taxpayer is married and lives with his or her spouse who does not work (for example income below the IRS filing threshold);
- A qualifying child did not live with the taxpayer for more than half of the tax year;
- The qualifying child was age 19 or older (or, if a student, age 24 or older) as of the last day of the tax year;

- The qualifying child was age 19-23 and a student, but was an enrolled on less than a full-time basis;
- The qualifying child was age 19-23 and a full-time student, but only for four or fewer months during the tax year (for example, the child enrolled in college starting in September after a gap year);
- The child provided more than half of his or her own support during the tax year; or
- The child filed a joint federal income tax return with his or her spouse.

IRS Form 886-H-HOH may be accessed to help ensure the necessary supporting documents to prove head of household filing status have been obtained. Complete and submit the Paid Preparer's Due Diligence Checklist, IRS Form 8867.

3.5.2 Earned Income Tax Credit

The eligibility requirements for the earned income tax credit may be found in this document at 2.12.6.

3.5.2.1 EITC Due Diligence Requirements

In addition to completing and submitting IRS Form 8867, Paid Preparer's Due Diligence Checklist, the due diligence requirements require the preparer to:

- Compute the applicable Earned Income Tax Credit using a worksheet—either Worksheet A or B, as applicable;
- Know the law 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, Paid Preparer's Due Diligence Checklist, when the American Opportunity Tax Credit is claimed, the due diligence requirements require the preparer to:

- Complete the AOTC Credit Limit Worksheet and Adjusted Qualified Education Expenses Worksheet found in the instructions to Form 8863, Education Credits;
- Document the inquiries made of the taxpayer; and
- Obtain substantiation for the claimed AOTC, such as –
  - Form 1098-T, and/or
  - Receipts for qualified tuition and related expense.

3.5.3.1 Most Common AOTC Errors

The most common AOTC errors are:

- ***Claiming AOTC for a student who didn't attend an eligible educational institution*** - The AOTC is for post-secondary education, which may include education at a college, university or technical school. It does not include a high school. To be an eligible institution, the school must be able to participate in the student aid program administered by the U.S. Department of Education (note: they don't have to participate but must be eligible to participate).

- ***Claiming AOTC for a student who didn't pay qualifying college expenses*** – Ask questions to ensure the educational expenses were paid or considered paid by –

  - Your client,
  - Your client's spouse or
  - The dependent student claimed on the tax return.

- ***Claiming AOTC for a student for too many years*** - The AOTC is only available for the first four years of post-secondary education and your client can only claim it for four tax years per eligible student. This limitation includes any year(s) your client claimed the Hope Credit.

3.5.4 Child Tax Credit

The eligibility requirements for the Child Tax Credit may be found in this document at **2.12.1**

In addition to completing and submitting IRS Form 8867, Paid Preparer's Due Diligence Checklist, when the Child Tax Credit is claimed, due diligence requires the preparer to:

- Complete the Child Tax Credit and Credit for Other Dependents worksheet found in the instructions to Form 1040;
- Document the inquiries made of the taxpayer; and
- Determine that each qualifying person for the CTC/ACTC/ODC is the taxpayer's dependent who is a citizen, national or resident of the United States;
- Determine that all children for whom the taxpayer is claiming the CTC/ACTC reside with the taxpayer;

If not all children for whom the taxpayer is claiming the credit reside with the taxpayer inquire whether there is an active Form 8332, Release/Revocation of Claim to Exemption for Child by Custodial Parent, or a similar statement in place? (Must be attached to the return if applicable)

3.5.4.1 Most Common CTC/ACTC/ODC Errors

The most common CTC/ACTC/ODC errors involve:

- ***Claiming the CTC/ACTC for a child who does not meet the age requirement*** - The child must be under the age of 17 at the end of 2026.

- ***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. For example, an individual filing a federal income tax return as a fiduciary for an estate or trust would not be considered a tax return preparer under the Internal Revenue Code and, accordingly, would not be required to meet the e-file requirement.

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*.

3.6.3 Timing of Filing

A return is considered filed by a tax return preparer when the preparer submits the return to the IRS either electronically or in paper form. When received by the IRS, the return is automatically checked by computers for errors and missing information. If the return cannot be processed, it is returned to the originating transmitter to clarify any needed information. Within 48 hours of electronically sending the return to the IRS, the IRS sends an acknowledgment to the transmitter stating that the return is accepted for processing. The notice is proof of filing and assurance that the IRS has the return information.

3.6.4 Recordkeeping

A tax return preparer who originates the electronic submission of returns to the IRS must make various records easily accessible until the end of the calendar year. The required records must be kept at the business address from which the preparer originated the return or at a location that allows the tax return preparer to readily access the material if requested by the IRS.

The records that must be retained are:

- A copy of Form 8453, U.S. Individual Income Tax Transmittal for an IRS e-file Return, and supporting documents not included in the electronic records submitted to the IRS;
- Copies of Forms W-2, W-2G and 1099-R;
- A copy of signed IRS e-file consent to disclosure forms;

- A complete copy of the electronic portion of the return that can be readily and accurately converted into an electronic transmission that the IRS can process; and
- The acknowledgement files for IRS-accepted returns.

Forms 8878 and 8879, IRS e-file Signature Authorization forms, must be available to the IRS for three years from the due date of the return or the IRS received date, whichever is later. Preparers may electronically image and store all paper records they are required to retain for IRS e-file.

3.6.5 Prohibited Filing with Pay Stub

If a taxpayer is unable to secure and provide a correct Form W-2, W-2G, or 1099-R, the return may be electronically filed after Form 4852 is completed. This is the only time that information from pay stubs is allowed.

3.6.6 Proper Handling of Rejects

E-file rejects identify problems that usually lead to IRS correspondence and slow down processing of tax returns. This e-file feature enables preparers to correct mistakes before returns are processed, decreasing overall processing time and shortening the time it takes to receive a refund. If the reject is for a simple mistake, the preparer should correct the error and resubmit the return electronically. This usually solves the problem.

However, you may not be able to correct some rejects. For example, if the return rejects because an exemption has been claimed on another taxpayer's return, check that the Social Security number of the exemption was entered correctly on the return. If the SSN is correct, you will not be able to file this return electronically unless the exemption is removed from the return. If you believe the taxpayer is entitled to claim the exemption, it is not necessary to remove the exemption, but the return must be filed on paper. Attach Form 8948, Preparer Explanation for Not Filing Electronically, to the paper return; check box 4 and enter the reject code number. The number of attempts to resolve is zero.

There are other situations where the reject may or may not be corrected but it takes one or more tries to resolve. When this happens, the return must be filed on paper. Attach Form 8948 to the paper return and check box 4; enter the reject code number and the number of attempts you made to resolve the reject before deciding that the error could not be fixed. Preparers generally learn from experience when trying to resolve an error is no longer productive.

Some reject conditions permit returns to be e-filed without correcting the error. If you encounter a reject that you try to resolve but cannot and this option is available, submit the return electronically.

3.7 Annual Filing Season Program Requirements

The annual filing season program is a voluntary program designed to encourage non-credentialed tax return preparers to participate in continuing education. 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;
- 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**.

3.8 Tax Pro and Individual Online Accounts

The IRS has created and enhanced the ability of taxpayers and tax preparers to file returns and access tax documents digitally. In doing so, taxpayers are able to set up and access an IRS Individual Online Account (Publication 5533)and the Tax Pro Account (Publication 5533-A) allows tax professionals to perform tax related functions on behalf of their taxpayer clients.

3.8.1 Tax Pro Account

The Tax Pro Account platform provides individual tax professionals with a secure, intuitive digital experience designed to streamline workflows and manage client interactions more efficiently. Specifically, the account allows tax professionals to:

- Manage authorization relationships with taxpayers;
- Link or request individual Centralized Authorization File (CAF) numbers;
- View taxpayer information such as
  - balance due,
  - payment activity, and
  - audit status; and
- Make payments or create payment plans on behalf of individual taxpayers.

3.8.2 IRS Individual Online Account

Individual taxpayers can set up an IRS Individual Online Account so long as their identity can be verified by the IRS. An IRS Individual Online Account allows for the taxpayer and their tax professional to work together more efficiently in preparing the taxpayers return. By the tax professional using their Tax Pro Account, they can complete authorized actions on the taxpayers behalf once the taxpayers account is active. The IRS Individual Online Account allows the taxpayer to:

- View key tax return information, such as their adjusted gross income;
- Request an identity protection PIN and access it throughout the year;
- Check the status of their refund;
- Confirm the status of their amended return;
- Get account transcripts, including wage and income records;
- Approve power of attorney and tax information authorization requests;
- Edit language preferences and request alternative media;
- Receive and view over 200 IRS digital notices;
- Make and cancel payments; and
- Set up or modify payment plans and check their balance.

The IRS Individual Online Account further allows the taxpayer to access and download certain tax documents online, including:

- Form W-2, Wage and Tax Statement;
- Form 1095-A, Health Insurance Marketplace Statement;
- Form 1099-NEC, Nonemployee Compensation;
- Form 1099-DIV, Dividends and Distributions;
- Form 1099-INT, Interest Income; and
- Form 1099-MISC, Miscellaneous Information.

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. $665

   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.
Alternative fuel vehicle refueling property	Equipment for storing, dispensing, or charging vehicles that run on electricity, hydrogen, and other clean-burning fuels.
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.
Differential wage payment	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.
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.
Employment credential	an academic degree, professional certification, license, or certificate of completion that verifies an individual's qualifications, skills, or authorization to perform a specific job duty.
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.
Goods	Consumables and physical objects that are tangible items that can be bought and sold.

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.
Qualified individual, for purposes of the enhanced deduction for seniors	An individual who has attained age 65 before the close of the taxable year.
Qualified overtime compensation, for purposes of the overtime deduction	Compensation paid to an individual under section 7 of the Fair Labor Stands Act of 1938 that requires employers to pay nonexempt employees at a rate at least one and one-half times their regular rate for all hours worked over 40 in a workweek.
Qualified passenger vehicle loan interest	Interest paid or accrued during the tax year on indebtedness incurred by the taxpayer for the purchase of a new passenger vehicle for personal use.
Qualified tips, for purposes of the deduction for tips	Cash tips received by a taxpayer in an occupation that normally received tips on or before December 31, 2024.
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.
Services	Non-physical intangibles that typically involve a process or expertise.
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. You have identified the additional standard deduction available for a blind taxpayer or one who is age 65 or older.

B. Your answer is incorrect. $2,050 is the amount a single taxpayer who is age 65 (or older) or blind receives as a standard deduction.

C. Your answer is incorrect. Although the temporary deduction for seniors is equal to $6,000, that deduction is available for each qualified individual and phases out for MAGI over $75,000 (single) or $150,000 (married filing jointly).

D. Your answer is correct. The temporary deduction for seniors is equal to $6,000 for each qualified individual and phases out for MAGI over $75,000 (single) or $150,000 (married filing jointly). A qualified individual is defined as an individual who has attained age 65 before the close of the taxable year.

Question 2 Feedback

A. Your answer is incorrect. Although their tax deduction for state and local taxes is affected by their MAGI, it is not eliminated.

B. Your answer is incorrect. You are correct in understanding that the limitation on the tax deduction for state and local taxes is reduced by 30% of the amount their MAGI exceeds the applicable threshold, the reduction is further affected by a floor applicable to the deduction.

C. Your answer is correct. The limitation on the tax deduction for state and local taxes is reduced by 30% of the amount their MAGI exceeds the applicable threshold, but the reduction will not reduce the SALT deduction to less than $10,000.

D. Your answer is incorrect. Jason and Georgia's MAGI exceeds the applicable threshold, and their SALT deduction is reduced.

Question 3 Feedback

A. Your answer is incorrect. Carol and Bob are eligible for a credit of $17,670. Your choice would have been correct except that $5,120 is the refundable portion of the adoption credit for 2026.

B. Your answer is incorrect. Carol and Bob are eligible for a credit of $17,670. Your choice would have been correct except that $12,550 is the non-refundable portion of the adoption credit for 2026..

C. Your answer is correct. Carol and Bob are eligible for a credit of $17,670.

D. Your answer is incorrect. If the taxpayer adopts two children, the taxpayer may be eligible for adoption credit of $17,670 times 2 equals $35,340. Carol and Bob adopted one child.

Question 4 Feedback

A. Your answer is incorrect. The $600 with no minimum transactions de minimis level above which TPSOs must report provided for in ARPA was delayed and then repealed.

B. Your answer is incorrect. The $2,500 de minimis level above which TPSOs must report was a transition amount planned for 2025 but was replaced by OBBBA, which repealed the changes to third-party network reporting provided for under ARPA.

C. Your answer is incorrect. The $5,000 with no minimum transactions de minimis level above which TPSOs must report was a transition amount intended to be the revenue threshold in 2024 but was never implemented.

D. Your answer is correct. OBBBA, §70432, repeals the changes to third-party network reporting to be effective as if the repeal had been included in the American Rescue Plan Act. Accordingly, a third party settlement organization is required to report information to participating payees who had sales totaling more than $20,000 in aggregate payments, and more than 200 sale transactions.

Review #2

Question 1 Feedback

A. Your answer is incorrect. Although a nonqualified distribution from a Roth IRA would not shield the gain from complete taxation, distributions from Roth IRAs 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 2026 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 $7,500 to a regular traditional IRA in 2026 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 2026 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 2026 includes both a *regular* IRA contribution of $7,500 and a *catch-up* contribution of an additional $1,100. 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 correct. Since Widgets, Inc purchased the property on January 15, 2025, it is limited to 40% bonus depreciation.

B. Your answer is incorrect. Sixty percent bonus appreciation of qualified property applied in 2024.

C. Your answer is incorrect. Eighty percent bonus appreciation of qualified property applied in 2023.

D. Your answer is incorrect. OBBBA increases bonus depreciation to 100% for property purchased and placed in service on or after January 19, 2025.

Review #4

Question #1 Feedback

A. Your answer is correct. In the case of a military or intelligence-related relocation, the taxpayer's move must be pursuant to a military or intelligence-related 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 such a 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. The exclusion of moving expenses is generally suspended under the TCJA for moves occurring in 2018 through 2025 and made permanent under OBBBA. Military and intelligence-related 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. OBBBA made the following TCJA changes to the existing home mortgage interest deduction permanent:

- 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).

Review #5

Question 1 Feedback

A. Your answer is incorrect. Receiving investment income in 2026 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 2026, that is not the maximum amount she may receive and remain eligible.

C. Your answer is incorrect. The 2026 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 denies the Earned Income Tax Credit to those taxpayers having excessive investment income. for 2026, excessive investment income is that investment income in excess of $12,200, subject to annual inflation adjustment.

Question 2 Feedback

A. Your answer is incorrect. Although a taxpayer's modified adjusted gross income (MAGI) affects the value of the tax credit he can claim, Harry's MAGI does not make him ineligible for the credit.

B. Your answer is incorrect. You have selected the amount of tax credit that would have been available if Harry had claimed a lifetime learning credit. An American opportunity tax credit is not limited to $2,000.

C. Your answer is correct. 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.

D. Your answer is incorrect. Although Alice's eligible expenses amount to $10,000, the tax credit Harry may claim is limited to less than her eligible expenses.

Review #6

Question #1 Feedback

A. Your answer is incorrect. The maximum contribution to a flexible spending account for medical expenses is not governed by a participant's maximum medical expenses. Thus, Phil's daughter's extraordinary medical expenses have no impact on the permitted contribution level.

B. Your answer is correct. PPACA imposes a $3,400 limit on the amount that may be contributed to a flexible spending account for medical expenses in 2026. That limit may be increased annually by a cost of living adjustment.

C. Your answer is incorrect. Although an employer may impose a limit on flexible spending account contributions, a $5,000 limit does not apply to such contributions for medical expenses made in 2026.

D. Your answer is incorrect. While no dollar limit had traditionally applied to flexible spending account contributions, a limit applies to such contributions for medical expenses beginning in 2013.

Question #2 Feedback

A. Your answer is correct. Aaron may make a maximum tax-deductible HSA contribution in 2026 of $9,750. Since Aaron is age 55 by the close of a taxable year he may make an HSA contribution of $8,750 and an additional contribution of not more than $1,000. Thus, his total maximum contribution this year is $9,750.

B. Your answer is incorrect. Although any HSA account holder with a high deductible health plan providing family coverage may make a maximum contribution in 2026 of $8,750, Aaron's age enables him to increase his deductible contribution.

C. Your answer is incorrect. $4,400 is the maximum amount that Aaron would have been able to contribute in 2026 if he had an Archer MSA with a $5,866 deductible. The maximum applicable to an HSA is different.

D. Your answer is incorrect. Your answer selection would be correct if Aaron were covered under a high deductible health plan providing self-only coverage and had a $5,000 Archer MSA deductible. However, he has a health savings account under which he has family coverage.

Question 3 Feedback

A. Your answer is incorrect. That was the phase-in range applicable to head of household filers in 2025. The 2026 range is different.

B. Your answer is correct. Under OBBBA, the phase-in ranges in effect beginning in 2026 are $150,000 for married filing jointly taxpayers, and $75,000 for other taxpayers, including taxpayers filing as head of household.

C. Your answer is incorrect. That was the phase-in range applicable to married taxpayers filing jointly in 2025.

D. Your answer is incorrect. That is the phase-in range applicable to married taxpayers filing jointly in 2026.

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 $665 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.

Appendix C – Form W-2

Form W-2 provides the following information that enables the tax preparer to complete the taxpayer's return:

- Form W-2, box 1. Enter this amount on the wages line of the taxpayer's tax return.
- Form W-2, box 2. Enter this amount on the federal income tax withheld line of the taxpayer's tax return.
- Form W-2, box 5. Consult the Form 1040 instructions to determine if the taxpayer is required to report this amount on Form 8959.
- Form W-2, box 6. This amount includes the 1.45% Medicare tax withheld on all Medicare wages and tips shown in box 5, and the 0.9% Additional Medicare Tax on any of those Medicare wages and tips above $200,000.
- Form W-2, box 8. This amount is additional tip amounts assigned by employers to employees (usually in large food/beverage establishments) when reported tips are less than 8% of the organization's food and drink revenue. Use Form 4137 to figure the social security and Medicare tax owed on tips the taxpayer didn't report to the taxpayer's employer. Enter this amount on the wages line of the taxpayer's tax return.
- Form W-2, box 10. This amount includes the total dependent care benefits that the taxpayer's employer paid to the taxpayer or incurred on the taxpayer's behalf. Any amount over the taxpayer's employer's plan limit is also included in box 1.
- Form W-2, box 11. This amount is –
    - Reported in box 1 if it is a distribution made to the taxpayer from a nonqualified deferred compensation or nongovernmental section 457(b) plan; or
    - Included in box 3 and/or box 5 if it is a prior year deferral under a nonqualified or section 457(b) plan that became taxable for social security and Medicare taxes this year because there is no longer a substantial risk of forfeiture of the taxpayer's right to the deferred amount.
- Form W-2, box 12. The codes shown in box 12 indicate elective deferrals (codes D, E, F, and S) and designated Roth contributions (codes AA, BB, and EE).

Appendix D – Form 1099-R

Form 1099-R provides the following information that enables the tax preparer to complete the taxpayer's return:

- Form 1099-R, box 1, shows the total amount distributed this year. The amount shown may have been:
    - A direct rollover;
    - Periodic payments;
    - Nonperiodic payments; or
    - A total distribution.

  Report the amount on Form 1040, 1040-SR, or 1040-NR on the line for "Pensions and annuities" (or the line for "Taxable amount"). However, if this is a lump-sum distribution, see Form 4972. If the taxpayer hasn't reached minimum retirement age, report the taxpayer's disability payments on the line for "Wages, salaries, tips, etc." on the taxpayer's tax return. Also report on that line permissible withdrawals from eligible automatic contribution arrangements and corrective distributions of excess deferrals, excess contributions, or excess aggregate contributions except if the distribution is of designated Roth contributions or the taxpayer's after-tax contributions or if the taxpayer is self-employed.

  If a life insurance, annuity, qualified long-term care, or endowment contract was transferred tax free to another trustee or contract issuer, an amount will be shown in this box and code 6 will be shown in box 7. If a charge or payment was made against the cash value of an annuity contract or the cash surrender value of a life insurance contract for the purchase of qualified long-term care insurance, an amount will be shown in this box and code W will be shown in box 7. The taxpayer need not report these amounts on the taxpayer's tax return.

  If code C is shown in box 7, the amount shown in box 1 is a receipt of reportable death benefits that is taxable in part.

- Form 1099-R, box 2a. This part of the distribution is generally taxable. If there is no entry in this box, the payer may not have all the facts needed to figure the taxable amount. In that case, the first box in box 2b should be checked.

  If the taxpayer rolls over a distribution (other than a distribution from a designated Roth account) from a qualified plan, section 403(b) plan, or governmental section 457(b) plan to a designated Roth account in the same plan or to a Roth IRA, the taxpayer must include on the "Taxable amount" line of the taxpayer's tax return the amount shown in this box plus the amount in box 6, if any.

  If this is a total distribution from a qualified plan and the taxpayer was born before January 2, 1936 (or the taxpayer is the beneficiary of someone born before January 2, 1936), he or she may be eligible for the 10-year tax option. See the Form 4972 instructions for more information. If the taxpayer is an eligible retired public safety officer who elected to exclude from income distributions from the taxpayer's eligible plan used to pay certain insurance premiums, the amount shown in box 2a hasn't been reduced by the exclusion amount. See the instructions for the taxpayer's tax return for more information.

- Form 1099-R, box 2b. If the first box is checked, the payer was unable to determine the taxable amount and box 2a should be blank. It's the taxpayer's responsibility to determine the taxable amount. If the second box is checked, the distribution was a total distribution that closed out the taxpayer's account.

- Form 1099-R, box 3. If the taxpayer received a lump-sum distribution from a qualified plan and was born before January 2, 1936 (or the taxpayer is the beneficiary of someone born before January 2, 1936), he or she may be able to elect to treat this amount as a capital gain on Form 4972 (not on Schedule D (Form 1040)). See the Form 4972 instructions. For a charitable gift annuity, report as a long-term capital gain as explained in the Instructions for Form 8949.

- Form 1099-R, box 4. Shows federal income tax withheld. Include this amount on the taxpayer’s income tax return as tax withheld. Generally, if the taxpayer receives payments that aren’t eligible rollover distributions, he or she can change the withholding or elect not to have income tax withheld by giving the payer Form W-4P (Periodic Pension or Annuity Payments) or Form W-4R (Nonperiodic Payments and Eligible Rollover Distributions), as applicable.
- Form 1099-R, box 5. Generally, this shows the:
    - employee’s investment in the contract (after-tax contributions), if any, recovered tax free this year;
    - portion that’s the taxpayer’s basis in a designated Roth account;
    - part of premiums paid on commercial annuities or insurance contracts recovered tax free;
    - nontaxable part of a charitable gift annuity; or
    - investment in a life insurance contract reportable under section 6050Y (transfer of a life insurance policy for valuable consideration).

  If the amount shown is the taxpayer’s basis in a designated Roth account, the year the taxpayer first made contributions to that account may be entered in box 11.
- Form 1099-R, box 6. If the taxpayer received a lump-sum distribution from a qualified plan that includes securities of the employer’s company, the net unrealized appreciation (NUA) (any increase in value of such securities while in the trust) is taxed only when the taxpayer sells the securities unless the taxpayer chooses to include it in the taxpayer’s gross income this year. If the taxpayer rolls over the distribution to a designated Roth account in the same plan or to a Roth IRA or Roth SIMPLE IRA, see the instructions for box 2a. In the case of a direct rollover to a designated Roth account in the same plan or to a Roth IRA or Roth SIMPLE IRA, the NUA is included in box 2a. If the taxpayer didn’t receive a lump-sum distribution, the amount shown in box 6 is the NUA attributable to employee contributions, which isn’t taxed until the taxpayer sell the securities.
- Form 1099-R, box 7. identifies the type of distribution the taxpayer received, such as an early distribution, disability or death. A new code "Y" was added this year to the list of codes for box 7 to identify a qualified charitable distribution (QCD). If the taxpayer borrowed money from a qualified plan, section 403(b) plan, or governmental section 457(b) plan, the loan may have to be treated as a distribution and included in his or her income. If the taxpayer’s loan is taxable, code L will be shown in box 7. (See the instructions on the back of Form 1099-R for the key to additional distribution codes.)
- Form 1099-R, box 8. If the taxpayer received an annuity contract as part of a distribution, the value of the contract is shown. It isn’t taxable when the taxpayer receives it and shouldn’t be included in boxes 1 and 2a. When the taxpayer receives periodic payments from the annuity contract, they’re taxable at that time. If the distribution is made to more than one person, the percentage of the annuity contract distributed to the taxpayer is also shown. The taxpayer will need this information if the 10-year tax option (Form 4972) is used.

  If the taxpayer previously received an annuity contract as part of a distribution (or the contract was purchased through a direct rollover from a plan account) and periodic payments from that annuity contract are included in box 1, the value of the contract as of the end of the year is shown. This information may be provided to the taxpayer’s plan administrator to determine any required distribution from that plan. If charges were made for qualified long-term care insurance contracts under combined arrangements, the amount of the reduction in the investment (but not below zero) in the annuity or life insurance contract is reported here.
- Form 1099-R, box 9a. If a total distribution was made to more than one person, the percentage the taxpayer received is shown.
- Form 1099-R, box 9b. For a life annuity from a qualified plan or from a section 403(b) plan (with after-tax contributions), an amount may be shown for the employee’s total investment in the contract. It is used to compute the taxable part of the distribution. See Pub. 575.
- Form 1099-R, box 10. If an amount is reported in this box, see the Instructions for Form 5329 and Pub. 575.

- Form 1099-R, box 11. The first year the taxpayer made a contribution to the designated Roth account reported on this form is shown in this box.
- Form 1099-R, box 12. If checked, the payer is reporting on this Form 1099 to satisfy its Internal Revenue Code chapter 4 account reporting requirement under FATCA. The taxpayer may also have a filing requirement. See the Instructions for Form 8938.
- Form 1099-R, box 13. Shows the date of payment for reportable death benefits under section 6050Y.
- Form 1099-R, boxes 14–19. If state or local income tax was withheld from the distribution, boxes 16 and 19 may show the part of the distribution subject to state and/or local tax.