

# Enrolled Agent Exam - Part 1 (Individuals)

## Comprehensive Outline

### 2026 SEE Exam Current-Year Basis

- The 2026 SEE testing window uses Internal Revenue Code provisions, forms, and IRS publications as amended through December 31, 2025.
- Unless a question states otherwise, current year means calendar year 2025.
- This outline uses tax year 2025 dollar amounts and current provisions, including Schedule 1-A deductions, the enhanced senior deduction, revised standard deductions, the 2025 SALT cap, and the updated Child Tax Credit.
- Candidates should not apply legislation, court decisions, or penalty amounts effective after December 31, 2025.
- The IRS moved SEE administration to PSI for the 2026 cycle; registration and scheduling are handled through PSI.

### 2026 Part 1 Domain Map

| Domain   | Content Area                        | Weight |
|----------|-------------------------------------|--------|
| Domain 1 | Preliminary Work and Taxpayer Data  | 16%    |
| Domain 2 | Income and Assets                   | 20%    |
| Domain 3 | Deductions and Credits              | 20%    |
| Domain 4 | Taxation                            | 18%    |
| Domain 5 | Advising the Individual Taxpayer    | 13%    |
| Domain 6 | Specialized Returns for Individuals | 13%    |

### Domain 1: Preliminary Work and Taxpayer Data (16%)

Covers initial preparation, gathering info, and compliance requirements.

#### Filing Requirements

- Who must file; thresholds; gross income definitions
- Filing status (single, MFJ, MFS, HOH, qualifying surviving spouse)
- Dependents: relationship, residency, age, support tests

#### Income Recordkeeping

- W-2, 1099 series, K-1, brokerage statements
- Documentation for Social Security, retirement, unemployment, gambling

#### Other Information Gathering

- Prior-year returns, estimated tax payments, extensions, withholding
- Taxpayer identification numbers (SSN, ITIN, ATIN)
- Foreign financial assets reporting requirements (FBAR, Form 8938)

### Filing Requirements 1. Who Must File a Return?

Rule (IRC §6012): An individual must file an income tax return if gross income is at least equal to the standard deduction plus the applicable additional standard deduction(s) for their filing status, age, and blindness.

## Key Filing Requirement Thresholds (2025 current year for the 2026 SEE exam):

- Single under 65: must file if gross income  $\geq$  standard deduction.
- Single 65+: threshold is higher (extra standard deduction).
- Married Filing Jointly (MFJ): both under 65 vs. one or both age 65 or blind changes threshold; also consider the separate enhanced senior deduction where applicable.
- Married Filing Separately (MFS): must file if gross income is at least \$5; also check age, blindness, dependency, and special-tax rules.
- Head of Household (HOH) and Qualifying Widow(er): own thresholds.

### Special Filing Situations (must file regardless of income):

- Net self-employment income  $\geq$  \$400 (Schedule SE).
- Received advance premium tax credit (Health Insurance Marketplace).
- Owe special taxes (e.g., AMT, household employment tax, first-time homebuyer credit recapture, etc.).
- Recapture of IRA tax, additional tax on HSAs/MSAs.
- Dependent Filing Requirements:
  - A dependent must file if:
    - Unearned income  $>$  standard deduction for dependents (limited).
    - Earned income  $>$  standard deduction.
    - Gross income  $>$  larger of \$1,350 (2025) or earned income + \$450, but not above the regular standard deduction for single filers.

## 2. Gross Income – Definitions (IRC §61)

General Rule (IRC §61(a)): Gross income = “all income from whatever source derived” unless specifically excluded by law.

### Examples of Gross Income (inclusions):

- Compensation for services (wages, fees, fringe benefits).
- Business income.
- Gains from property dealings.
- Interest, dividends, rents, royalties.
- Alimony (pre-2019 agreements).
- Annuities, pensions.
- Partnership income (K-1).
- Income from discharge of indebtedness (§108 exceptions).
- Unemployment compensation.
- Prizes, awards, gambling winnings.
- Exclusions from Gross Income (not taxable):
  - Gifts & inheritances (§102).
  - Life insurance proceeds (§101).
  - Municipal bond interest (§103).
  - Certain fringe benefits (meals, lodging, employer-provided healthcare, de minimis).
  - Qualified scholarships/fellowships (§117).
  - Certain disaster relief payments (§139).

## 3. Exam Focus Points

### Threshold traps:

- MFS  $\rightarrow$  must file if any gross income, no threshold.
- Self-employed  $\rightarrow$  must file if net earnings  $\geq$  \$400.
- Dependents  $\rightarrow$  need to know earned vs unearned income tests.
- Gross Income “catch-all”: If not specifically excluded, it’s included.
- EA questions often test: “Is this included in gross income?”

### Common trick areas:

- Social Security  $\rightarrow$  partially taxable depending on provisional income.
- Alimony  $\rightarrow$  only taxable/deductible for pre-2019 agreements.
- Cancelled debt  $\rightarrow$  income unless exception applies (bankruptcy, insolvency, etc.).

## 4. Examples for Practice

### 1. Single TP (age 30), gross wages \$13,000, no other income. Must file?

- No, the taxpayer with \$13,000 in gross wages does not need to file for 2025, since their income is below the \$15,750 filing threshold.

### 2. MFS TP earns \$200. Must file?

- Yes, any income requires a return.

### 3. Dependent child, age 16, earned wages \$4,500, no unearned income. Must file?

- Standard deduction for dependent = earned income + \$400 = \$4,900.  $\$4,500 < \$4,900 \rightarrow$  not required, but may want to file for refund.

### 4. SE income \$600 net. Must file?

- Yes,  $>\$400$  threshold.

## Summary for EA Exam

- Who must file: Based on filing status, income thresholds, special taxes, SE income  $\geq \$400$ , dependents with earned/unearned income.
- Gross income definition: IRC §61 = all income unless excluded.
- Key traps: MFS, dependents, SE income, Social Security, alimony rules.

## Income Recordkeeping

### 1. General Recordkeeping Rules

IRS Requirement (IRC §6001; Pub. 583 & 552): Taxpayers must keep permanent books and records sufficient to establish the amounts of gross income, deductions, credits, and other tax items.

Retention Period: Generally 3 years from the date return is filed or due (whichever is later).

- 6 years if income is understated by  $>25\%$ .
- 7 years for records relating to worthless securities or bad debts.
- Indefinite for records related to basis in property until property is sold/disposed of.

Records may be paper, digital, or electronic, as long as they are accurate and accessible.

### 2. Wage & Salary Income

Form W-2 is the official wage/tax record.

Employees should retain W-2 forms and pay stubs for at least 3 years.

**Preparer must verify:**

- Correct Social Security Number (SSN/ITIN).
- Wages, tips, and other comp.
- Federal/state/local withholding.
- Employer identification.

### 3. Non-Employee & Miscellaneous Income

Form 1099-NEC: Reports non-employee compensation (independent contractors).

Form 1099-MISC: Reports rents, royalties, prizes/awards, other income.

Form 1099-K: Reports payment card and third-party network payments for goods or services. For 2025, the general Form 1099-K reporting threshold returned to more than \$20,000 and more than 200 transactions, although taxable business income must be reported even if no form is received.

**Recordkeeping:**

- Invoices, receipts, bank statements.
- Logs of cash payments.

## 4. Investment & Savings Income

Form 1099-INT: Reports interest income.

Form 1099-DIV: Reports dividends and distributions.

Form 1099-B: Reports sales of securities. The taxpayer reports capital transactions on Form 8949 and Schedule D when required, using broker-provided basis and proceeds information.

Supporting Records:

- Brokerage statements.
- Trade confirmations.
- Proof of cost basis (purchase records, reinvested dividends, stock splits).

## 5. Retirement Income

Form 1099-R: Reports pensions, annuities, IRA distributions.

Form SSA-1099: Reports Social Security benefits (taxable portion determined by provisional income).

Form RRB-1099: Reports Railroad Retirement benefits.

**Recordkeeping:**

- Documentation of contributions (traditional IRA, Roth IRA, 401(k)).
- Records of nondeductible IRA contributions (Form 8606).
- Records of rollovers and conversions.

## 6. Other Common Income Records

Unemployment Compensation: Form 1099-G.

Gambling Winnings: Form W-2G + personal log of winnings and losses.

Alimony Received: For pre-2019 divorce decrees (since post-2018 alimony not taxable).

Canceled Debt: Form 1099-C (may be excluded under §108 insolvency/bankruptcy).

**Foreign Assets & Income:**

- Form 8938 (FATCA).
- FinCEN 114 (FBAR).
- Foreign pensions, accounts, trusts.

## 7. Self-Employment / Business Income Records

- Schedule C Income: Invoices, receipts, sales records, mileage logs.
- Form 1099-NEC/1099-K: Reported by clients/customers or payment processors.
- Books & Ledgers: Maintain accounting system (manual or digital).

**Special Logs:**

- Mileage (date, purpose, distance).
- Inventory records.
- Business bank account statements.

## 8. IRS Guidance

- Pub. 17: Individual income tax filing basics.
- Pub. 463: Travel, gift, and car expenses (recordkeeping specifics).
- Pub. 552: Recordkeeping for individuals.
- Pub. 583: Recordkeeping for businesses.

## 9. Exam Focus Points

- Know what forms report which types of income (W-2, 1099 series, SSA-1099, etc.).
- Be able to identify which records must be retained longer (basis in property, nondeductible IRA contributions, securities purchases).
- Be aware of foreign account reporting (FBAR/8938).
- Self-employed taxpayers must keep more extensive books (receipts, invoices, mileage).
- Gambling → both W-2G and personal diary required to substantiate.

## 10. Example Questions for EA Prep 1. TP sells stock through a broker. What records must TP keep?

- Brokerage statement, purchase confirmations, records of reinvested dividends.

## 2. TP has a Roth IRA. Which form should TP retain to prove contributions?

- Form 5498 (contributions) + records of basis (Form 8606 if applicable).

## 3. TP wins \$1,200 at a casino. What records are required?

- Form W-2G + personal log of winnings and losses.

## 4. TP received unemployment compensation. Which form?

- Form 1099-G.

## Summary for EA Exam

- Income Recordkeeping = maintaining forms and supporting documentation that establish gross income (IRC §6001).

Key categories: wages (W-2), independent income (1099-NEC/MISC), investments (1099-INT/DIV/B), retirement (1099-R, SSA-1099), self-employment (Schedule C records), other income (gambling, unemployment, alimony, debt cancellation).

- Retain basis records indefinitely until property disposed.
- IRS pubs 17, 463, 552, 583 are key guidance references.

## Other Information Gathering

### 1. Prior Year Returns & Carryover Information

Why Needed: Many items carry forward from prior years.

#### Examples:

- Capital loss carryovers (Schedule D).
- Charitable contribution carryovers.
- Passive activity loss carryovers (§469).
- NOLs (Net Operating Losses).
- Foreign tax credit carryovers.
- Excess contributions to IRA/retirement plans.

**Exam Tip:** If taxpayer has a loss or credit that cannot be fully used in one year, you must carry it forward — failure to review prior returns risks missing these.

### 2. Estimated Tax Payments & Withholding

#### Forms to Collect:

- W-2 (wages, withholding).
- 1099-INT, 1099-R, 1099-B, etc. (showing withholding).
- Records of quarterly estimated tax payments (Form 1040-ES).
- Prior year's refund applied to current year's taxes.

Why Important: Needed to calculate total payments & credits against liability, and to determine underpayment penalties (§665).

### 3. Filing Status & Dependents

#### Filing Status: Must determine correct filing status:

- Single
- Married Filing Jointly (MFJ)
- Married Filing Separately (MFS)
- Head of Household (HOH)
- Qualifying Surviving Spouse

#### Dependents (IRC §152):

- Qualifying child tests (relationship, age, residency, support, joint return).
- Qualifying relative tests (gross income < exemption amount, support, relationship or household member, not a qualifying child).

**Forms to Collect:** Birth certificates, custody agreements, support records.

## 4. Identification & Taxpayer Information

### Taxpayer Identification:

- SSN (Social Security Number).
- ITIN (Individual Taxpayer Identification Number).
- ATIN (Adoption Taxpayer Identification Number).

Exam Note: Certain credits (EIC, CTC, AOTC) require SSN or ITIN valid by the due date of the return (see IRC §32(m) for EIC rules).

## 5. Health Insurance & ACA Compliance

### Forms to Collect:

- Form 1095-A (Marketplace insurance).
- Form 1095-B/C (other coverage).

Why Important: For Premium Tax Credit (Form 8962) and reconciliation of advance payments.

## 6. Foreign Accounts & Assets

### Required Information:

- Foreign bank and financial accounts (FBAR – FinCEN Form 114).
- Foreign assets (Form 8938, FATCA).
- Foreign trusts (Form 3520, 3520-A).

**Exam Tip: Even if no tax is owed, failure to report foreign accounts can trigger major penalties.**

## 7. Other Special Items

Household employment: If taxpayer paid household employees (e.g., nanny, housekeeper), need records for Schedule H (employment taxes).

Education expenses: Tuition statements (Form 1098-T), records for books/fees (for AOTC/LLC).

Retirement contributions: IRA contribution receipts, Form 5498.

Adoption expenses: Records required for adoption credit.

Casualty losses: Records of federally declared disaster losses (Form 4684).

## 8. IRS Guidance

Pub. 17: Comprehensive guide for individual returns.

Pub. 501: Dependents, standard deduction, filing status.

Pub. 596: Earned Income Credit rules.

Pub. 519: Foreign taxpayers.

Pub. 970: Education credits.

## 9. EA Exam Focus Points

- Dependents and filing status are high-frequency test items.
- Foreign account reporting (FBAR/8938) is commonly tested.
- Prior year carryovers — watch for capital loss or charitable contribution carryover questions.
- Identification rules for credits (EIC, CTC).
- Health insurance forms (1095-A, 8962) for ACA reconciliation.

## 10. Practice Questions

**1. TP made \$3,000 of estimated tax payments in 2025 and had \$4,000 of withholding on W-2. What is the total applied to 2025 liability? \$7,000.**

**2. TP files MFJ in 2022. Spouse dies in 2022. In 2023, with dependent child, what filing status may TP use?**

- Qualifying Surviving Spouse (if with child), otherwise Head of Household.

**3. TP has foreign bank account with \$12,000 balance. What must TP file?**

- FBAR (FinCEN Form 114).

**4. TP had \$6,000 capital loss in 2023, with only \$3,000 deducted. What happens to excess \$3,000?**

- Carried forward to the next tax year.

## Summary for EA Exam

Other Information Gathering goes beyond income — includes prior year carryovers, estimated taxes/withholding, filing status, dependents, ID numbers, ACA health forms, foreign assets, and special credits.

- High exam emphasis on dependents, filing status, foreign reporting, ACA credits, and carryovers.

## Domain 2: Income and Assets (20%)

All gross income inclusions, exclusions, and asset sales.

### Gross Income – IRC §61

- Wages, salaries, tips, fringe benefits
- Interest, dividends, annuities
- Business income, farm income
- Rents, royalties, alimony (pre-2019 vs. post-2018 rules)
- Unemployment, Social Security benefits
- Gambling winnings
- Cancellations of debt (§108 exceptions: bankruptcy, insolvency, principal residence)

### Exclusions from Income

- Gifts and inheritances (§102)
- Life insurance proceeds (§101)
- Scholarships/fellowships (§117)
- Employer-provided benefits (meals, lodging, transportation, adoption, education assistance)
- Municipal bond interest (§103)

### Asset Transactions

- Basis determination (cost, adjusted basis, FMV, carryover, stepped-up basis)
- Sales and exchanges: capital gain/loss rules, netting procedures
- Like-kind exchanges (§1031 – limited to real property after 2017)
- Involuntary conversions (§1033)
- Installment sales (§453)
- Passive activity income and losses (§469)
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# Gross Income – IRC §61

## 1. Statutory Definition

IRC §61(a): Gross income means “all income from whatever source derived,” including (but not limited to):

- Compensation for services, including fees, commissions, fringe benefits.
- Gross income derived from business.
- Gains from dealings in property.
- Interest.
- Rents.
- Royalties.
- Dividends.
- Alimony and separate maintenance payments (for pre-2019 divorce agreements only).
- Annuities.
- Income from life insurance and endowment contracts (to extent not excluded by §101).
- Pensions.
- Discharge of indebtedness.
- Partnership gross income distributive share.
- Income in respect of a decedent.
- Income from estates or trusts.

Key principle: Unless specifically excluded under another Code section, everything is included.

## 2. Common Categories of Gross Income

### A. Wages, Salaries, and Compensation

Form W-2 reporting.

Tips, bonuses, commissions included.

#### Fringe benefits:

- Included unless specifically excluded (see §132).
- Exclusions: de minimis fringes, qualified employee discounts, working condition fringes, transportation (limited), employer-provided health insurance.

### B. Business & Self-Employment Income

Schedule C: all gross receipts, less ordinary/necessary expenses (§162).

Barter transactions: FMV of goods/services received included.

Gig economy (1099-NEC/1099-K) included.

### C. Investment Income

Interest (except municipal bonds, §103).

Dividends: ordinary dividends (taxed as ordinary) vs. qualified dividends (lower capital gain rates).

Capital gains: proceeds – adjusted basis.

### D. Retirement Income

Pensions and annuities: portion representing earnings is taxable.

#### Social Security:

- Up to 85% taxable depending on provisional income (AGI + tax-exempt interest + ½ SS benefits).

#### IRA distributions:

- Traditional IRA: taxable when withdrawn (except nondeductible contributions tracked on Form 8606).
- Roth IRA: qualified distributions excluded.



## E. Other Income

Alimony (taxable to recipient if agreement before 1/1/2019; excluded if after).

Unemployment compensation (fully taxable).

Gambling winnings (W-2G).

Illegal income (must be reported).

Cancellation of debt (COD income), unless excluded by §108 (bankruptcy, insolvency, qualified principal residence, farm indebtedness).

Prizes and awards (FMV included unless qualified transfer to charity).

Jury duty pay, bartering, found property (treasure trove).

## 2026 Exam Addition: Digital Assets and Information Reporting

- Digital asset transactions can produce income, gain, loss, compensation, or self-employment income depending on the facts.
- Exam approach: identify the transaction type first - sale/exchange, payment for services, mining/staking reward, gift, or personal transfer.
- Basis, holding period, FMV at receipt, and wallet/exchange records matter.
- A Form 1099 may be missing or incomplete; taxpayers still must report taxable digital asset income and dispositions.

## 3. Exclusions (Not Gross Income)

Important contrast: EA exam will often test whether something is includable or excludable.

Gifts & Inheritances (§102).

Life insurance proceeds (§101).

Municipal bond interest (§103).

Qualified scholarships/fellowships (§117).

### Employer-provided benefits:

- Health insurance premiums (§106).
- Meals/lodging furnished for employer convenience (§119).
- Dependent care benefits (§129, limits).
- Disaster relief payments (§139).
- Workers' compensation (§104).

## 4. EA Exam Focus Areas

- "All income is taxable unless specifically excluded."
- Distinguish inclusions vs. exclusions.

Special traps:

- Alimony: pre-2019 taxable; post-2018 not taxable.
- Social Security: know 0%, 50%, 85% thresholds.
- Municipal bond interest: excluded, but must be considered for provisional income (SS taxability).
- Cancellation of debt: included unless bankruptcy/insolvency exception.
- Fringe benefits: testable in multiple-choice.
- Gambling: all winnings taxable; losses deductible only to extent of winnings (§165(d)).

## 5. Examples

### 1. TP finds \$5,000 cash hidden in a dresser purchased at an estate sale. Taxable?

- Yes. Treasure trove = income under §61.

### 2. TP receives \$50,000 inheritance from aunt. Taxable?

- No, excluded under §102.

### 3. TP wins a \$1,000 television from a raffle. Taxable?

- Yes, FMV included in income under §61.

### 4. TP receives \$10,000 life insurance proceeds upon brother's death. Taxable?

- No, excluded under §101.

### 5. TP has \$20,000 COD income from credit card debt discharged in bankruptcy. Taxable?

- No, excluded under §108.

## Summary

IRC §61 = all income from whatever source derived.

- Everything is included unless another Code section specifically excludes it.
- Exam hot spots: wages/fringes, self-employment, investment income, Social Security, alimony, COD income, gambling, gifts/inheritances, life insurance, municipal bonds.
- Always ask: "Is there an exclusion section that applies?" If not, it's taxable.

## Exclusions from Income

### 1. General Rule

IRC §61(a): Gross income = "all income from whatever source derived."

BUT: Specific Code sections provide exclusions.

Exam trap: Unless there is a clear statutory exclusion, the item is taxable.

### 2. Common Exclusions from Gross Income

#### A. Gifts & Inheritances – §102

Value of property received by gift, bequest, devise, or inheritance excluded.

BUT: Income derived from such property (interest, dividends, rent) is taxable.

Example: Aunt leaves you \$50,000 → excluded. If you invest and earn \$2,000 interest → taxable.

#### B. Life Insurance Proceeds – §101

Excluded when received by reason of death.

##### Exceptions:

- If transferred for value (with certain exceptions), exclusion may be limited.
- Interest accrued post-death is taxable.

#### C. Scholarships & Fellowships – §117

Qualified scholarships (used for tuition, fees, books, supplies) are excluded.

Amounts used for room, board, stipends = taxable.

Exam trap: Graduate student receiving tuition waiver for teaching = may be excluded if qualified.

## **D. Certain Fringe Benefits – §132**

**Employer-provided benefits excluded if they fall within statutory categories:**

- No-additional-cost services (e.g., standby flights for airline employees).
- Qualified employee discounts.
- Working condition fringes (e.g., business cell phone).
- De minimis fringes (e.g., free coffee, occasional meals).
- Qualified transportation benefits (subject to monthly limits).
- Employer-provided health insurance premiums (§106).
- Adoption assistance (§137).

## **E. Municipal Bond Interest – §103**

Interest on state and local government obligations excluded.

BUT: Still used to calculate Social Security provisional income.

## **F. Foreign Earned Income – §911**

Up to an inflation-adjusted amount (\$130,000 for 2025) of foreign earned income may be excluded if residency/physical presence tests are met.

## **G. Other Specific Exclusions**

Disaster relief payments (§139): Excluded if received for qualified disaster-related expenses.

Workers' compensation (§104(a)(1)): Excluded if for personal injury or sickness under workers' comp law.

Personal injury damages (§104(a)(2)): Excluded if for physical injuries/sickness (not punitive damages, not emotional distress unless attributable to physical injury).

Health insurance benefits (§105, §106): Employer-paid premiums excluded; reimbursements excluded if qualified.

Cafeteria plans (§125): Employee can choose between cash or benefits on pre-tax basis.

Educational assistance (§127): Up to \$5,250/year excluded.

Dependent care assistance (§129): Up to \$5,000 excluded.

Qualified adoption expenses (§137): Up to inflation-adjusted amount excluded.

Military exclusions: Combat pay (§112), moving expenses (limited), certain housing allowances.

Social Security (§86): Partially excluded (0%, up to 50%, or up to 85% taxable).

## **3. EA Exam Focus Areas**

- Gift vs. income from gift.
- Scholarships: tuition/books excluded; room/board taxable.
- Municipal bond interest: excluded but counted for SS provisional income.
- Life insurance proceeds: death benefit excluded; interest taxable.
- Workers' comp vs. unemployment: workers' comp excluded, unemployment taxable.
- Personal injury damages: compensatory for physical excluded; punitive taxable.
- Fringe benefits: know the main categories under §132.

### **4. Examples (Exam Style) 1. TP receives \$20,000 from parents to help buy a car. Taxable?**

- No, excluded under §102 (gift).

### **2. TP receives \$30,000 in life insurance proceeds upon spouse's death, plus \$1,000 interest.**

**Taxable amount?** \$1,000 interest taxable; \$30,000 excluded (§101).

### **3. Student receives \$15,000 scholarship: \$10,000 used for tuition, \$5,000 for dorm fees. How much is taxable? \$5,000 (room/board not qualified).**

### **4. TP injured at work receives \$25,000 in workers' comp and \$5,000 in unemployment.**

**Taxable?** \$25,000 excluded; \$5,000 taxable. **5. Airline employee uses empty seat for free standby flight. Taxable?**

- No, excluded as no-additional-cost service (§132).

## Summary for EA Exam

- General rule: Everything is gross income unless excluded.

Big exclusions to memorize:

- Gifts & inheritances (§102).
- Life insurance proceeds (§101).
- Municipal bond interest (§103).
- Scholarships (§117).
- Certain fringe benefits (§132).
- Workers' comp (§104).
- Disaster relief (§139).
- Foreign earned income (§911).
- Exam traps: Room & board scholarships, life insurance interest, unemployment (taxable vs. workers' comp), punitive damages.

## Asset Transactions

### 1. Basis and Adjusted Basis

Cost Basis (§1012): Purchase price + costs (sales tax, installation, commissions).

**Adjusted Basis (§1016):**

- Increased by: improvements, capital expenditures, assessments.
- Decreased by: depreciation, amortization, §179 expensing, casualty losses.

**Special Rules:**

- Gifted property (§1015): carryover basis (plus portion of gift tax paid if appreciated). Dual-basis if FMV < donor's basis.
- Inherited property (§1014): FMV at date of death (step-up or step-down).
- Transfers between spouses (§1041): no gain/loss, carryover basis.

**Exam Tip: Memorize dual-basis rule for gifts and stepped-up basis for inheritances.**

### 2. Amount Realized (§1001(b))

Amount received (cash + FMV property + liabilities assumed by buyer).

Subtract: selling expenses.

**Formula:**

- $\text{Gain (or Loss)} = \text{Amount Realized} - \text{Adjusted Basis}$

### 3. Capital Gains and Losses

Short-term: Held  $\leq 1$  year  $\rightarrow$  taxed at ordinary rates.

Long-term: Held  $> 1$  year  $\rightarrow$  taxed at preferential capital gain rates (0%, 15%, 20%).

**Netting process:**

#### 1. Net short-term gains/losses.

#### 2. Net long-term gains/losses.

#### 3. Combine results.

**Capital Loss Limitations (§1211, §1212):**

- 1. \$3,000 annual deduction (\$1,500 if MFS).

#### 2. Excess carried forward indefinitely.

### 4. Special Property Transactions

#### A. Principal Residence (§121)

**Exclude up to \$250,000 gain (\$500,000 MFJ) if:**

- Owned  $\geq 2$  years, and
- Used as principal residence  $\geq 2$  years during 5-year period before sale.
- Partial exclusion allowed for unforeseen circumstances (job change, health).

## **B. Like-Kind Exchanges (§1031)**

After TCJA (2017), limited to real property only.

Gain deferred if like-kind property exchanged.

Boot (cash, non-like-kind property, debt relief) triggers gain recognition up to boot received.

## **C. Involuntary Conversions (§1033)**

If property destroyed, stolen, or condemned, gain may be deferred if replacement property acquired within statutory period.

## **D. Installment Sales (§453)**

Gain recognized proportionally as payments are received.

Gross Profit % =  $(\text{Gain} \div \text{Contract Price})$ .

Each payment: Principal  $\times$  Gross Profit %.

Interest is separately taxable.

## **5. Depreciation Recapture**

### **§1245 property (personal property):**

- Gain up to accumulated depreciation = ordinary income.

### **§1250 property (real property):**

- Accelerated depreciation recapture = ordinary income.
- Straight-line depreciation: unrecaptured §1250 gain taxed at max 25%.

## **6. Wash Sales (§1091)**

Loss on sale of securities disallowed if substantially identical securities purchased within 30 days before/after sale.

Disallowed loss added to basis of new securities.

## **7. Other Special Rules**

Worthless securities (§165(g)): Treated as sold on last day of tax year (capital loss).

Small business stock (§1202): May exclude up to 100% of gain if held  $\geq 5$  years and meets QSBS rules.

Collectibles: Long-term capital gain on collectibles taxed at a maximum 28% rate.

Qualified dividends: Taxed at same rates as long-term capital gains.

## **8. EA Exam Hot Spots**

- Basis rules: cost, adjusted, gift vs. inheritance.
- Principal residence exclusion.
- Installment sales (gross profit % calculation).
- Depreciation recapture rules (§1245 vs. §1250).
- Wash sales.
- Capital loss deduction limits.
- Boot in like-kind exchange.
- Social Security interactions with muni bond interest (combined in other EA topics).

## 9. Examples 1. TP buys stock for \$5,000, sells for \$8,000, \$50 commission. Gain?

- Amount realized  $\$8,000 - \$50 = \$7,950$ . Gain =  $\$7,950 - \$5,000 = \$2,950$ .

**2. Gift property basis: Uncle gives TP stock, basis \$10,000, FMV \$8,000. TP sells for \$9,000.** Basis = \$10,000 for gain, \$8,000 for loss. Since sale price is between → no gain or loss.

**3. Installment sale: TP sells land (basis \$40,000) for \$100,000, receives \$20,000 down,** rest in installments. Gross profit =  $\$60,000 \div \$100,000 = 60\%$ . Each \$10,000 payment = \$6,000 taxable gain.

**4. Depreciation recapture: Equipment basis \$20,000, depreciation taken \$8,000, sold for \$18,000.** Gain = \$6,000; ordinary income = \$8,000 recapture, but capped at gain → \$6,000 ordinary.

## Summary for EA Exam

- Gain/Loss = Amount Realized – Adjusted Basis (§1001).
- Basis rules critical: cost, adjusted, gift, inheritance.
- Key provisions: §121 (home sale exclusion), §1031 (like-kind), §1033 (involuntary), §453 (installments).
- Depreciation recapture: §1245 (personal), §1250 (real estate).
- Wash sale rule (§1091).
- Annual \$3,000 capital loss limit, indefinite carryforward.

## Domain 3: Deductions and Credits (20%)

Above-the-line, itemized, and key credits.

Adjustments to Income (“Above-the-line”)

- Educator expenses, HSAs, self-employed health insurance
- IRA contributions, student loan interest
- Alimony paid (pre-2019 agreements)
- Qualified business income deduction (QBI §199A)

## Standard vs. Itemized Deductions

- Standard deduction amounts, additional for age/blindness
- Medical expense deduction (7.5% AGI threshold)
- State/local taxes (SALT capped at \$40,000 for most 2025 filers; \$20,000 MFS; phaseout begins above MAGI \$500,000/\$250,000 MFS)
- Mortgage interest, investment interest
- Charitable contributions (cash vs. property; AGI limits)
- Casualty/theft losses (federally declared disasters only)
- Miscellaneous deductions (suspended through 2025 except gambling losses)

### Credits

- Child tax credit, additional child tax credit
- Credit for other dependents
- Child and dependent care credit
- Earned income credit (EIC – eligibility, phaseouts, due diligence rules)
- Education credits: American Opportunity, Lifetime Learning
- Foreign tax credit
- Adoption credit
- Retirement savings contribution credit

## Adjustments to Income (“Above-the-Line” Deductions)

### 1. General Rule

Above-the-line deductions = allowable regardless of whether taxpayer itemizes or takes the standard deduction.

They reduce AGI, which in turn affects phaseouts and eligibility for many credits and deductions.

Reported on Schedule 1 (Form 1040), Part II.

## 2. Common Adjustments to Income (Key EA Exam Items)

### A. Educator Expenses (§62(a)(2)(D))

Eligible teachers, instructors, counselors, principals, aides (K–12, 900+ hours in school year).  
Deduction up to \$300 (2025) per taxpayer (\$600 MFJ if both educators).  
Can include books, supplies, COVID protective equipment, and professional development.

### B. Health Savings Account (HSA) Deduction (§223)

Contributions deductible if taxpayer covered by high-deductible health plan (HDHP).  
Contribution limits (2025): \$4,300 self-only, \$8,550 family; +\$1,000 catch-up for age 55+.  
Contributions by employer are excluded from income; taxpayer contributions deductible above the line.

### C. Moving Expenses (Military Only, §217)

After TCJA, only active duty Armed Forces members moving due to military order/PCS may deduct moving expenses.

### D. Deductible Part of Self-Employment Tax (§164(f))

Self-employed taxpayers may deduct 50% of SE tax as an adjustment.

### E. Self-Employed SEP, SIMPLE, and Qualified Plan Contributions (§404)

Deductible contributions to retirement plans by self-employed individuals.  
Limits vary by plan type (e.g., SEP IRA = 25% of compensation up to \$70,000 in 2025).

### F. Self-Employed Health Insurance Premiums (§162(l))

Premiums for medical, dental, long-term care insurance paid by self-employed individuals for themselves, spouse, dependents, and children <27.  
Limited to net self-employment income.

### G. Penalty on Early Withdrawal of Savings (§62(a)(9))

Deduction for forfeited interest when cashing in a CD or other time deposit early (reported on Form 1099-INT).

### H. IRA Contributions (§219)

Traditional IRA contributions may be deductible (limits depend on income and participation in employer plan).  
Deduction limit (2025): \$7,000 (\$8,000 if age 50+).  
Phaseouts apply if covered by retirement plan.  
Roth IRA contributions are not deductible.

### I. Student Loan Interest Deduction (§221)

Deduction up to \$2,500 of interest paid on qualified student loans.  
Phaseout range for 2025: MAGI over \$85,000 up to \$100,000 for Single/HOH/QSS, and over \$170,000 up to \$200,000 for MFJ.  
Not available if MFS or dependent.

### J. Tuition and Fees Deduction (Expired)

Note: Expired after 2020 (CARES Act). Not currently available but may appear as historical distractor on exam.

### K. Alimony Paid (Pre-2019 Agreements, §215)

Deductible to payor if divorce agreement executed before 1/1/2019 and not modified to adopt TCJA rules.  
Not deductible for agreements after 2018.

### L. Other Less Common Adjustments

Jury duty pay repaid to employer (§62(a)(13)).  
Certain write-in adjustments (Archer MSAs, qualified performing artists, fee-basis public officials, reservists' travel expenses).

## 3. EA Exam Hot Spots

- Educator expense limit & what qualifies.
- HSA contributions and limits.
- Self-employed adjustments: health insurance, SE tax (50%), retirement contributions.
- Student loan interest deduction rules (max \$2,500, phaseouts, not MFS).
- Alimony deduction cutoff date (pre-2019 only).
- Moving expenses deduction → only active-duty military.
- IRA contribution deductibility and phaseouts.



## 4. Examples (EA Style)

1. TP is a 4th grade teacher, spent \$400 on supplies unreimbursed. How much can deduct? \$300 (max limit).

2. TP earns \$80,000 SE income, pays \$11,304 SE tax. How much deductible above the line?  
 $\$11,304 \times 50\% = \$5,652$ .

3. TP pays \$2,600 student loan interest, MAGI \$60,000, single. How much deductible? \$2,500 (max). 4. TP divorced in 2016, pays \$12,000 alimony. Deductible?

- Yes, \$12,000 (pre-2019).

5. TP has family HDHP, age 56, contributes \$9,550 to HSA. How much deductible? \$8,550 + \$1,000 catch-up = \$9,550 (fully deductible).

## Summary for EA Exam

- Above-the-line deductions reduce AGI and are always allowed (standard or itemized).

Key adjustments: educator expenses, HSA, SE tax (50%), SE retirement contributions, SE health insurance, IRA contributions, student loan interest, alimony (pre-2019), penalty on early savings withdrawal.

Exam traps:

- Moving expenses (military only).
- Roth IRA contributions not deductible.
- Student loan interest deduction not allowed for MFS or dependents.

## Standard vs. Itemized Deductions

### 1. Standard Deduction (IRC §63(c))

Basic Amounts (2025 current-year figures for the 2026 SEE exam):

- Single: \$15,750
- Married Filing Jointly (MFJ): \$31,500
- Head of Household (HOH): \$23,625
- Married Filing Separately (MFS): \$15,750
- Qualifying Widow(er): \$31,500

Additional Standard Deduction:

Age 65+ or blind -> 2025 additional amount is \$1,600 each for MFJ/MFS/QSS and \$2,000 each for Single/HOH; do not confuse this regular additional standard deduction with the separate enhanced senior deduction.

Limitations:

- Dependents: Standard deduction limited to greater of \$1,350 or earned income + \$400 (not to exceed basic SD).
- Nonresident aliens: Generally not eligible.
- MFS & spouse itemizes: Both must itemize — one cannot claim SD while the other itemizes.

### 2. Itemized Deductions (Schedule A)

## 2025 Itemized Deduction Update

- SALT cap: For 2025, taxpayers who itemize may deduct up to \$40,000 of state and local taxes (\$20,000 if MFS), subject to a high-income phaseout beginning above MAGI \$500,000 (\$250,000 MFS). The deduction cannot be reduced below the baseline \$10,000/\$5,000 amount.
- Mortgage interest: The \$750,000 acquisition-debt limit for most post-2017 home mortgage debt remains a major exam point; home equity interest is deductible only when the loan is used to buy, build, or substantially improve the home securing the loan.
- Miscellaneous itemized deductions subject to the 2% floor remain generally unavailable for 2025; gambling losses remain deductible only to the extent of gambling winnings and only as itemized deductions.



### **A. Medical and Dental Expenses (§213)**

Deductible only to extent > 7.5% of AGI.

Includes unreimbursed costs for taxpayer, spouse, dependents.

Qualified: doctor, hospital, prescriptions, insurance premiums, mileage for medical (standard rate).

Not qualified: cosmetic surgery, health club dues.

### **B. Taxes Paid (§164, SALT Cap)**

For 2025, deduction is limited to \$40,000 (\$20,000 MFS) for state & local taxes (SALT), subject to high-income phaseout; the deduction cannot be reduced below the baseline \$10,000 (\$5,000 MFS).

- State/local income or sales taxes.
- Real estate property taxes.
- Personal property taxes (based on value).

Federal income tax & employee payroll taxes are not deductible.

### **C. Home Mortgage Interest (§163(h))**

Acquisition indebtedness: deductible on mortgages up to \$750,000 (post-2017 loans; \$1M pre-TCJA).

Home equity indebtedness: only deductible if proceeds used to buy, build, or substantially improve the home.

Must be secured by the residence.

Points deductible (sometimes amortized if refinancing).

### **D. Charitable Contributions (§170)**

Cash contributions: generally limited to 60% of AGI (50% pre-TCJA).

Noncash property contributions: FMV; special rules for vehicles, appreciated property.

Contributions to individuals or political organizations are not deductible.

Documentation: receipt for >\$250, Form 8283 for >\$500 property.

### **E. Casualty and Theft Losses (§165)**

Only deductible if attributable to a federally declared disaster.

Deductible amount = (Loss – \$100 per event – 10% of AGI).

Must reduce basis of property by any insurance recovery.

### **F. Miscellaneous Itemized Deductions**

Suspended (2018–2025, TCJA): Unreimbursed employee expenses, tax prep fees, investment expenses.

**Still deductible:**

- Gambling losses (up to winnings).
- Impairment-related work expenses.
- Casualty/theft losses of income-producing property.

## **3. When to Itemize vs. Take Standard Deduction**

Itemize if total allowable itemized deductions > standard deduction.

Some taxpayers must itemize (MFS if spouse itemizes, nonresident aliens).

Example: High SALT, mortgage interest, and charity often make itemizing favorable.

## **4. EA Exam Hot Spots**

- Medical deduction: Only >7.5% of AGI.
- SALT cap: \$40,000 (\$20,000 MFS) for 2025, subject to high-income phaseout; baseline minimum cap remains \$10,000 (\$5,000 MFS).
- Mortgage interest: Acquisition indebtedness only; \$750,000 cap post-2017.
- Charitable contributions: % of AGI limits, documentation rules.
- Casualty losses: Only federally declared disasters.
- Miscellaneous deductions suspended: Remember exception for gambling losses.
- Dependents: Limited standard deduction rules.
- MFS: Both must itemize if one does.

## 5. Examples (Exam Style)

### 1. TP has \$8,000 mortgage interest, \$9,000 SALT, \$5,000 charitable contributions, MFJ. Itemize or standard?

- Total = \$22,000 < \$27,700 SD → take standard deduction.

### 2. TP incurs \$20,000 medical expenses, AGI = \$100,000. How much deductible?

- $7.5\% \times \$100,000 = \$7,500$  floor →  $\$20,000 - \$7,500 = \$12,500$ .

### 3. TP donates \$30,000 cash to qualified charity, AGI \$40,000. How much deductible?

- Limited to  $60\% \times \$40,000 = \$24,000$ .

### 4. TP (Single) has \$12,000 SALT, \$5,000 mortgage interest. Deduction allowed?

- SALT capped at \$40,000 for most 2025 filers (\$20,000 MFS), with high-income phaseout + \$5,000 = \$15,000 itemized > \$13,850 standard → itemize.

### 5. TP (MFS) has \$10,000 wages, spouse itemizes. Can TP take standard deduction?

- No, must itemize too.

## Summary for EA Exam

- Standard deduction: Flat amount depending on filing status, increased for age 65+ and blind.
- Itemized deductions: Medical (>7.5% AGI), SALT capped at \$10k, mortgage interest (limited), charity (AGI % limits), casualty (disaster only), limited misc. deductions.
- Exam traps: SALT cap, casualty losses, dependent SD limits, MFS itemization rule, suspended miscellaneous deductions.

## Tax Credits

### 1. Classification of Credits

Nonrefundable credits: Can reduce tax liability to zero, but no refund is given if the credit exceeds liability.

Refundable credits: Excess is refundable, creating a refund even if no tax liability.

Partially refundable credits: Refundable portion available under certain rules.

### 2. Major Individual Credits

A. Child Tax Credit (CTC) – §24 (2025 amount up to \$2,200 per qualifying child; partially refundable Additional CTC rules apply)  
Credit: \$2,000 per qualifying child under age 17 (must have SSN valid for employment).

Phaseout: Begins at \$200,000 MAGI (\$400,000 MFJ).

Partially refundable: Up to \$1,700 (2025) as the Additional Child Tax Credit (ACTC).

Other Dependents: \$500 nonrefundable credit for dependents who don't qualify for CTC (e.g., elderly parents, children over 17).

### B. Child and Dependent Care Credit – §21

Nonrefundable.

Covers expenses for care of qualifying dependents so taxpayer can work or look for work.

Limit: Up to \$3,000 of expenses for one dependent, \$6,000 for two or more.

Percentage of expenses allowed: 35% → phases down to 20% as AGI increases.

Must have earned income; MFS generally not eligible.

Expenses must be for dependents under 13, or disabled spouse/dependent.

### C. Earned Income Credit (EIC) – §32

Refundable credit for low- to moderate-income taxpayers.

Requires earned income (wages, SE income).

Disqualified if investment income exceeds the 2025 threshold (\$11,950).

Amount depends on filing status, earned income, and number of qualifying children.

Special rule: Must have SSN valid for employment issued by due date of return.

Due diligence requirement: Preparer must complete Form 8867.

## **D. Education Credits**

### **1. American Opportunity Tax Credit (AOTC) – §25A(i):**

- Up to \$2,500 per eligible student (100% of first \$2,000 expenses + 25% of next \$2,000).
- 40% refundable (up to \$1,000).
- Available first 4 years of post-secondary education.
- Qualified expenses: tuition, fees, course materials.
- Phaseout at MAGI \$80k–\$90k (single), \$160k–\$180k (MFJ).

### **2. Lifetime Learning Credit (LLC) – §25A(c):**

- Up to \$2,000 per return (20% of first \$10,000 qualified expenses).
- Nonrefundable.
- Available unlimited years (undergraduate, graduate, professional).
- Qualified expenses: tuition and fees (not materials unless required).

Exam tip: AOTC = refundable + limited years; LLC = nonrefundable + unlimited years.

### **E. Adoption Credit – §23**

Nonrefundable.

Credit for qualified adoption expenses (reasonable, necessary, directly related).

Maximum \$17,280 per child for 2025; a portion may be refundable under current law.

Phaseouts apply based on MAGI.

Special-needs adoption: full credit allowed even if actual expenses < limit.

### **F. Retirement Savings Contribution Credit (Saver's Credit) – §25B**

Nonrefundable.

Credit for contributions to IRAs, 401(k), etc.

Credit rate: 50%, 20%, or 10% of contributions up to \$2,000 (\$4,000 MFJ).

Limited to taxpayers age 18+, not full-time students, not dependents.

Income phaseouts apply.

### **G. Foreign Tax Credit – §27**

Nonrefundable.

Credit for income taxes paid to foreign countries.

Limits: Cannot exceed U.S. tax attributable to foreign-source income.

Excess may be carried back 1 year or forward 10 years.

### **H. Other Credits to Know**

Residential energy credits (§25D): Nonrefundable; for solar, wind, geothermal, etc.

Premium Tax Credit (§36B): Refundable; for Marketplace health insurance. Requires Form 8962 reconciliation.

General business credits: May apply to individuals (carryover rules apply).

## **3. EA Exam Hot Spots**

- Refundable vs. nonrefundable: Know which credits can generate a refund.
- Child Tax Credit & ACTC: Distinguish refundable portion.
- EIC: SSN requirement, investment income limits, earned income requirement, due diligence rules.
- Education credits: Compare AOTC vs. LLC.
- Adoption credit: Full credit for special-needs child regardless of expenses.
- Foreign tax credit: Carryback/forward rules.
- Saver's credit: Phaseouts + eligibility restrictions.

#### 4. Examples (Exam Style)

1. TP with 2 children under 17, AGI \$90,000, MFJ. Tax liability \$1,200. CTC = \$4,400 before refundable/nonrefundable limitations for two qualifying children.

How much refundable? \$1,200 offsets tax; remaining \$2,800 → up to \$1,500 refundable (ACTC).

#### 2. TP pays \$5,000 dependent care expenses for two kids, AGI \$50,000. Credit % = 20%.

- Limit  $\$6,000 \times 20\% = \$1,200$ .

#### 3. TP (single) earned \$15,000, 1 qualifying child. Qualifies for EIC?

- Yes, meets income and dependency rules.

#### 4. TP pays \$4,000 qualified education expenses for 1 student (sophomore). AOTC? \$2,500 (100% of \$2,000 + 25% of \$2,000). 5. TP adopts special-needs child, spends \$3,000 expenses. Credit?

- Full \$15,950 (not limited by actual expenses).

#### Summary for EA Exam

- Refundable credits: EIC, Premium Tax Credit, Additional Child Tax Credit, part of AOTC.
- Nonrefundable credits: Child/Dependent Care, LLC, Adoption, Saver's Credit, Foreign
- Tax Credit, energy credits.

Exam traps:

- CTC phaseouts.
- EIC disqualification for investment income.
- Education credits (AOTC refundable vs. LLC not).
- Adoption credit for special-needs children.
- MFS often ineligible for many credits (EIC, education, adoption, etc.).

### Domain 4: Taxation (18%)

Applying tax rates, AMT, and planning.

#### Tax Computation

- Tax tables, tax rate schedules, capital gains tax rates
- Net investment income tax (§1411)
- Kiddie tax rules

#### Alternative Minimum Tax (AMT)

- Adjustments and preference items (state taxes, private activity bond interest, ISO exercises)
- AMT exemption phaseouts

#### Self-Employment Tax

- SE income, SE tax computation, deductible portion of SE tax

#### Taxpayer Advice

- Withholding vs. estimated taxes
- Recordkeeping requirements
- Retirement planning (IRA, Roth IRA, 401(k), SIMPLE, SEP, etc.)
- Education planning (529 plans, Coverdell ESAs)
-

# Tax Computation

## 1. Taxable Income (IRC §63)

Gross Income (§61)

– Above-the-line adjustments (§62)

= Adjusted Gross Income (AGI)

– Standard or itemized deductions (§63(c))

– Qualified business income deduction (§199A), if applicable

= Taxable Income

## 2. Regular Tax Liability

### A. Tax Tables / Rate Schedules

Used for most taxpayers with taxable income under \$100,000.

Marginal brackets vary by filing status (10%, 12%, 22%, 24%, 32%, 35%, 37%).

Effective tax rate usually lower than marginal rate (exam trick).

### B. Capital Gains & Qualified Dividends

Taxed at preferential rates: 0%, 15%, or 20%, depending on taxable income and filing status.

**Netting rules:**

#### 1. Net short-term gains/losses (ordinary rates).

#### 2. Net long-term gains/losses (preferential rates).

#### 3. Combine for overall net.

Collectibles (art, coins, bullion) = max 28%.

Unrecaptured §1250 gain (real estate depreciation) = max 25%.

### C. Kiddie Tax (§1(g))

Applies to unearned income of children under 19 (or full-time students under 24).

Unearned income above annual threshold (\$2,700 in 2025) taxed at parent's marginal rate.

Earned income taxed at child's own rates.

### D. Net Investment Income Tax (NIIT, §1411)

**Additional 3.8% tax on lesser of:**

- Net investment income (interest, dividends, capital gains, rents, royalties, passive business), OR
- Excess of MAGI over threshold (\$250k MFJ, \$200k single/HOH, \$125k MFS).

## 3. Alternative Minimum Tax (AMT, §55–59)

Parallel tax system to ensure high-income taxpayers pay a minimum amount.

AMTI = Taxable income + preference items/adjustments.

AMT exemption (2025): \$88,100 single / \$137,000 MFJ (phased out at higher incomes).

**Common AMT adjustments:**

- Add back state & local taxes (not deductible under AMT).
- Private activity bond interest.
- ISO bargain elements.
- Taxpayer pays greater of regular tax or AMT.

## 4. Self-Employment Tax (IRC §1401, Ch. 2)

SE tax = 12.4% Social Security + 2.9% Medicare = 15.3%.

Social Security wage base applies (\$176,100 for 2025).

Additional Medicare tax 0.9% on earned income > \$250k MFJ / \$200k single.

Deduction: 50% of SE tax allowed above the line (§164(f)).

## 5. Other Taxes

Additional tax on IRAs/retirement (§72(t)): 10% for early withdrawals unless exception.

Household employment tax (Schedule H).

First-time homebuyer credit recapture (if applicable).

## 6. Credits Applied After Tax Computation

Subtract nonrefundable credits (e.g., Child/Dependent Care, Saver's Credit, Education).

Subtract refundable credits (e.g., EIC, Premium Tax Credit, Additional CTC).

Subtract payments (withholding, estimated taxes).

= Final tax due or refund.

## 7. EA Exam Hot Spots

- Computing taxable income vs. tax liability.
- Knowing which income gets preferential rates (capital gains, qualified dividends).
- Kiddie tax rules: when child's unearned income taxed at parent's rate.
- NIIT thresholds and income subject to 3.8% tax.
- AMT adjustments (state/local tax disallowed, preference items).
- Self-employment tax: rate, base, additional Medicare tax, deduction.
- Difference between marginal vs. effective tax rate.

**8. Examples (EA Style) 1. TP single, taxable income \$50,000. Regular tax?** \$11,000 at 10% = \$1,100  
\$33,725 at 12% = \$4,047 \$5,275 at 22% = \$1,161

- Total ≈ \$6,308.

**2. TP has \$60,000 wages + \$5,000 LTCG, MFJ. Which tax rates apply?**

- Wages taxed at ordinary rates. LTCG at 0%/15% depending on bracket threshold.

**3. Child age 17, \$3,500 unearned income, no earned income. Kiddie tax?** \$1,350 standard deduction for dependents. \$1,350 taxed at child's rate. \$1,000 taxed at parent's rate. **4. TP SE income = \$100,000. SE tax?**  
 $\$100,000 \times 92.35\% = \$92,350 \times 15.3\% = \$14,130.$

- Deduction = \$7,065 above the line.

**5. TP MFJ, MAGI \$300,000, \$50,000 investment income. NIIT?**

- Excess over threshold = \$50,000 (MAGI \$50,000 > threshold).
- NIIT =  $3.8\% \times \$50,000 = \$1,900.$

## Summary for EA Exam

Start with taxable income → apply tax tables/rate schedules.

- Preferential treatment for LTCG & qualified dividends.
- Watch for kiddie tax, NIIT, and AMT.
- Don't forget self-employment tax and additional Medicare tax.
- Subtract credits and payments to compute final liability/refund.

## Alternative Minimum Tax (AMT)

### 1. Purpose of AMT

IRC §§55–59: Designed to ensure higher-income taxpayers pay at least a “minimum” amount of tax if they benefit from too many deductions/exclusions under the regular tax system.

Taxpayer calculates both regular tax and tentative minimum tax — and pays the greater.

### 2. Key Concepts & Steps

#### A. AMTI (Alternative Minimum Taxable Income)

Start with regular taxable income

Add back AMT adjustments & preferences

= AMTI

## B. Exemption Amounts (2025 current-year values for the 2026 SEE exam)

Married Filing Jointly (MFJ) / Qualifying Widow(er): \$133,300

Single / Head of Household (HOH): \$85,700

Married Filing Separately (MFS): \$66,650

Phaseout Rules (unchanged mechanics)

Exemption reduced by 25% of Alternative Minimum Taxable Income (AMTI) above the threshold.

### 2025 Phaseout thresholds:

- Single / HOH / MFS: begins at \$609,350
- MFJ / QW: begins at \$1,218,700

## C. AMT Rates (§55(b))

26% on first portion of AMTI above exemption.

28% on AMTI exceeding threshold (~\$220,700 for MFJ).

Certain capital gains & qualified dividends taxed at preferential rates (0%, 15%, 20%) — same as regular tax.

## D. Tentative Minimum Tax vs. Regular Tax

Compute tentative minimum tax on AMTI.

Compare to regular tax liability.

If tentative > regular, pay the difference as AMT.

## 3. Common AMT Adjustments (Add-backs)

The exam often tests whether an item is deductible for AMT.

### State and Local Taxes (SALT, §164):

- Not deductible for AMT purposes (must be added back).

### Miscellaneous Itemized Deductions (§67):

- Suspended under TCJA (2018–2025), but historically not deductible for AMT.

### Personal Exemptions (§151):

- Suspended 2018–2025 under TCJA, but previously an AMT adjustment.

### Medical Expenses:

- Deductible only above 7.5% of AGI (same floor for AMT).

### Standard Deduction (§63):

- Not allowed for AMT — must add back if claimed.

### Interest:

- Home equity loan interest not deductible unless loan used to buy/build/improve home.
- Investment interest subject to limitations.

### Depreciation (§168):

- Accelerated depreciation disallowed; must recalculate using slower method.

### Private Activity Bond Interest (§57):

- Tax-exempt under regular rules, but included in AMTI.

### ISO Stock Options (§56(b)):

- Bargain element (FMV – exercise price) added to AMTI in year of exercise.

## 4. AMT Credits (§53)

If AMT paid due to timing differences (e.g., depreciation, ISO exercise), taxpayer may be eligible for the Minimum Tax Credit (MTC) in future years.

Does not apply to preference items that are permanent (e.g., tax-exempt bond interest).

## 5. EA Exam Hot Spots

- Exemption amounts and phaseouts — don't need to memorize exact numbers, but must know that high income reduces exemption.
- What's added back: SALT, standard deduction, accelerated depreciation, private activity bond interest, ISO bargain element.
- AMT vs. Regular tax: Taxpayer pays whichever is higher.
- Credits: Know when AMT credit applies.
- Capital gains/dividends taxed same under AMT as regular tax.



## 6. Examples (EA Style)

### 1. TP taxable income = \$200,000, takes \$20,000 SALT deduction. How does this affect AMT?

- SALT not deductible for AMT → \$20,000 added back to AMTI.

### 2. TP exercises ISO stock options at FMV \$80, strike price \$30, shares = 1,000. AMT adjustment? $(\$80 - \$30) \times 1,000 = \$50,000$ added to AMTI. 3. TP income \$600,000 MFJ. AMT exemption begins to phase out?

- Yes, exemption reduces above ~\$1.156M, so not fully phased out yet.

### 4. TP pays AMT due to accelerated depreciation. Next year, can they claim credit?

- Yes, AMT credit available because depreciation is a timing difference.

## Summary for EA Exam

- AMT = Tentative Minimum Tax – Regular Tax.
- Exemption reduces AMTI, phased out at high income.
- Key add-backs: SALT, standard deduction, accelerated depreciation, private activity bond interest, ISO bargain element.
- Rates: 26% / 28%.
- Capital gains/dividends = same as regular tax rates.
- Credit available for timing differences, not permanent preferences.

## Self-Employment Tax

### 1. Statutory Basis

IRC §§1401–1403 (Chapter 2) – imposes SE tax on net earnings from self-employment.

Equivalent of FICA (Social Security & Medicare) taxes for employees, but paid by self-employed individuals.

### 2. Who Pays SE Tax?

Sole proprietors (Schedule C).

Independent contractors (Form 1099-NEC).

Partners receiving guaranteed payments or distributive share of active income (Schedule K-1, partnership).

Members of LLCs (if treated as SE activity).

Certain farmers and clergy.

Threshold: Must file SE tax if net SE income  $\geq$  \$400.

### 3. What Income Is Subject to SE Tax?

Net profit from business (gross income – ordinary/necessary expenses).

Guaranteed payments from partnerships.

Income from services performed (e.g., gig economy, freelance).

Clergy income (with special housing allowance rules).

**NOT subject to SE tax:**

- Wages (already subject to FICA).
- Passive income (dividends, interest, rents, royalties).
- Capital gains/losses.
- S corporation shareholder distributions.

### 4. SE Tax Rates (2025 figures)

Social Security portion: 12.4% up to the 2025 Social Security wage base (\$176,100).

Medicare portion: 2.9% on all net SE income.

**Additional Medicare Tax: Extra 0.9% on earned income above:** \$250,000 MFJ, \$200,000 Single/HOH, \$125,000 MFS.

- Total Base Rate: 15.3% (12.4% + 2.9%).



## 5. SE Income Adjustment (§1402(a))

SE tax is computed on 92.35% of net SE earnings.

- Adjustment accounts for the “employer portion” of FICA.

**Formula:**

- $\text{Net SE Income} \times 92.35\% = \text{SE taxable income}$

## 6. Deduction for Employer-Equivalent Portion (§164(f))

50% of SE tax is deductible above-the-line on Schedule 1 (Form 1040).

Deduction does not reduce SE tax itself — only reduces AGI.

## 7. Clergy & Special Rules

Clergy pay SE tax on wages + housing allowance (unless exempt by filing Form 4361).

Farmers may use optional farm methods (rare, but tested).

## 8. EA Exam Hot Spots \$400 filing threshold.

- 92.35% adjustment to income.
- 15.3% base rate split (SS vs. Medicare).
- Additional 0.9% Medicare surtax on high earners.
- Deduction for 50% of SE tax is above the line.
- Income types subject vs. not subject to SE tax.
- Distinction: S corp distributions not subject to SE tax, partnership guaranteed payments are.

## 9. Examples (EA Style)

### 1. TP earns \$50,000 net from Schedule C. Compute SE tax. $\$50,000 \times 92.35\% = \$46,175 \times 15.3\% = \$7,064$ .

- Deduction = \$3,532 above the line.

### 2. TP has \$100,000 SE income. How much subject to SS portion of SE tax if wage base = \$176,100?

- All \$100,000 (since  $< \$176,100$ ).

### 3. TP (MFJ) has \$300,000 SE income. Additional Medicare Tax?

- Excess over \$250,000 =  $\$50,000 \times 0.9\% = \$450$ .

### 4. TP receives \$10,000 in dividends and \$20,000 in Schedule C profit. SE tax base?

- Only \$20,000 counts; dividends not subject to SE tax.

## Summary for EA Exam

- Who: Self-employed with net  $\geq \$400$ .
- Base: Net earnings  $\times 92.35\%$ .
- Rates: 12.4% SS (up to base) + 2.9% Medicare (all) + 0.9% surtax (high earners).
- Deduction: 50% of SE tax is an above-the-line deduction.

Exam traps: \$400 filing threshold.

- Passive vs. earned income distinction.
- Clergy treatment.
- S corp vs. partnership rules.

## Domain 5: Taxpayer Advice (13%)

### 1. Withholding & Estimated Tax Payments

#### A. Withholding Adjustments

Taxpayers can adjust federal income tax withholding on Form W-4. Good advice = ensure withholding covers liability to avoid penalties.

## B. Estimated Tax Payments (§6654)

Required if taxpayer expects to owe  $\geq$  \$1,000 after withholding/credits.

**Safe harbor rules: No penalty if taxpayer pays at least:**

- 90% of current year tax, OR 100% of prior year tax (110% if AGI > \$150,000).
- EA Exam Tip: Knowing safe harbor thresholds is frequently tested.

## 2. Recordkeeping Requirements

### A. General Rule (IRC §6001)

Must keep sufficient records to establish income, deductions, credits.

**Retain:**

- 3 years (normal statute of limitations).
- 6 years if income understated by >25%.
- Indefinitely for basis in property.

### B. Common Documentation

W-2s, 1099s, receipts, invoices, mileage logs, bank/brokerage statements.

Special: Gambling log, charitable contribution substantiation, foreign account records.

## 3. Retirement & Education Planning

### A. Retirement

IRAs (Traditional deductible vs. Roth not deductible).

Contribution limits (\$7,000 + \$1,000 catch-up in 2025).

Early withdrawals = taxable + 10% penalty unless exception applies.

### B. Education

529 plans: growth tax-free if used for qualified education.

Coverdell ESAs: smaller limits, can be used for K–12.

Coordination: Can't double dip (e.g., use same expense for 529 and AOTC).

## 4. Common Taxpayer Advice Scenarios

**Life events:**

- Marriage/divorce → filing status and dependent rules.
- Birth/adoption of child → CTC, adoption credit, EIC.
- Retirement → Social Security taxability, IRA distributions.
- Death → step-up in basis (§1014).

**Investment planning:**

- Long-term vs. short-term capital gains.
- Loss harvesting (limit \$3,000 per year, carry forward).

**Self-employment:**

- SE tax rules (92.35% adjustment, 15.3% rate, additional Medicare tax).
- Deductible expenses (home office, health insurance, SE retirement).
- Need for quarterly estimated payments.

## 5. Penalty Avoidance

Accuracy-related penalty (§6662): 20% for negligence, substantial understatement.

Fraud penalty (§6663): 75%.

Failure to file (§6651(a)(1)): 5% per month (max 25%).

Failure to pay (§6651(a)(2)): 0.5% per month.

Estimated tax penalty (§6654): if insufficient withholding/estimates.

Advice = encourage timely filing, adequate withholding, accurate reporting.

## 6. EA Exam Hot Spots

- Safe harbor for estimated tax payments (90%/100%/110%).
- Recordkeeping retention rules.
- Coordination of retirement and education benefits.
- Advising on filing status and dependent claims after life events.
- SE taxpayers: estimated taxes + deductions.
- Avoiding penalties (filing, payment, accuracy).

## 7. Examples (EA Style)

**1. TP owed \$15,000 in tax last year. This year, AGI > \$200k, TP pays \$16,500 through withholding/estimates. Will TP owe penalty?**

- No; met 110% of prior year rule.

**2. TP sells stock, realizes \$10,000 capital loss. How much deductible in current year? \$3,000 max; \$7,000 carried forward. 3. TP adopts child in July. What credits should TP be advised of?**

- Child Tax Credit; Adoption Credit.

**4. TP withdraws \$5,000 from traditional IRA at age 40 for tuition. Taxable?**

- Taxable income, but penalty waived (qualified higher education expense).

**5. TP fails to file, owes \$20,000. Files 5 months late. Failure-to-file penalty?**

- $5\% \text{ per month} \times 5 \text{ months} = 25\% \times \$20,000 = \$5,000$ .

## Summary for EA Exam

- Taxpayer advice focuses on withholding/estimated payments, recordkeeping, retirement/education planning, life events, SE income, and penalty avoidance.
- Key numbers: \$1,000 threshold for estimated tax; 90%/100%/110% safe harbor; \$3,000 capital loss limit; recordkeeping rules (3/6/indefinite years).
- EA exam often gives real-world scenarios where you must identify what advice reduces liability, ensures compliance, or avoids penalties.
- 

## Domain 6: Specialized Returns for Individuals (13%)

Less common individual situations.

### Property Rentals

- Vacation homes, rental property, passive activity loss limits

### Farm Income and Expenses

- Schedule F, special depreciation rules, farm credits

### Business Income

- Schedule C, ordinary/necessary expenses (§162), hobby loss rules (§183)

### Net Operating Losses (NOLs)

- Carryovers and carrybacks (post-TCJA rules = carryforward only, 80% limit)

### Other Specialized Topics

- Estimated taxes for farmers/fishermen
- Clergy tax issues
- Household employment taxes (Schedule H)

# Property Rentals

## 1. Rental Income (IRC §61(a)(5))

**All amounts received for use of property = rental income:**

- Rent payments (cash, checks, electronic).
- FMV of services received instead of cash.
- Advance rent = taxable in year received.
- Security deposits:
  - ☐
- Taxable if applied to rent.
  - ☐
- Not taxable if refundable and intended to be returned.

## 2. Deductible Rental Expenses (§212)

Ordinary and necessary expenses for production of income.

**Examples:**

- Mortgage interest (Schedule E).
- Real estate taxes.
- Insurance.
- Repairs and maintenance.
- Depreciation (§167, §168).
- Advertising, utilities, management fees.
- Not deductible: Improvements (must be capitalized and depreciated).

## 3. Depreciation Rules

Residential rental property = 27.5 years straight-line (MACRS).

Nonresidential real property = 39 years straight-line.

Land is not depreciable.

Mid-month convention applies.

## 4. Passive Activity Rules (§469)

Rental activities = per se passive, regardless of material participation.

Passive losses only offset passive income (cannot offset wages, interest, dividends).

**Disallowed losses carried forward until:**

- Passive income available, OR Property disposed of in a taxable transaction.

**Special Allowance Exception (Active Participation):**

**Up to \$25,000 loss deduction allowed against non-passive income if:**

- Taxpayer actively participates (approves tenants, sets rents, etc.).
- Phaseout: Reduced by 50% of AGI over \$100,000; fully phased out at \$150,000.

**Real Estate Professionals (§469(c)(7)):**

- If taxpayer qualifies as real estate professional (more than half of personal services and
- >750 hours in real estate trade/business), rental activities are not passive.

## 5. Vacation Homes / Mixed-Use Property (§280A)

**Rented < 15 days/year:**

- No rental income reported.
- No rental expenses deductible (except mortgage interest & taxes as itemized deductions).

**Rented ≥ 15 days and used personally:**

- Must allocate expenses between personal and rental use (based on days).
- Deductions limited to rental income (no rental loss allowed).

**Rented ≥ 15 days and minimal personal use:**

- Treated as full rental property; report all income/expenses; passive activity rules apply.

## 6. Other Special Items

Casualty losses (Form 4684): deductible if federally declared disaster.

Qualified business income deduction (§199A): some rental activities may qualify as a trade/business.

Self-employment tax: Rental income generally not subject to SE tax unless taxpayer provides substantial services (like a hotel or B&B).

## 7. EA Exam Hot Spots

- Advance rent vs. security deposits.
- Passive activity rules: \$25,000 special allowance, phaseout at \$100k–\$150k AGI.
- Vacation homes: 14-day rule, allocation of expenses.
- Depreciation periods (27.5 vs. 39 years).
- SE tax: rentals normally not subject unless services provided.
- Disposition of rental property: Suspended passive losses become deductible.

## 8. Examples (EA Style)

**1. TP rents home for \$1,200/month, receives \$2,400 security deposit (refundable), and \$1,200 advance rent. What's income this year?** \$15,600 (\$14,400 rent + \$1,200 advance rent). Deposit not taxable.

**2. TP earns \$50,000 wages and has \$20,000 passive rental loss. What's deductible?**

- \$25,000 special allowance applies. Deductible = \$20,000 (but phased out if AGI > \$100k).

**3. TP rents vacation home 180 days, uses personally 20 days. Expenses \$12,000. Must allocate?**

- Yes, personal use > 14 days or >10% of rental days. Expenses prorated.

**4. TP has residential rental property worth \$275,000 (building), \$75,000 (land). What's depreciation?**  $\$275,000 \div 27.5 = \$10,000$  per year.

**5. TP rents condo 10 days, uses personally 355 days, earns \$3,000 rent. Must report?**

- No, <15-day rental rule → income excluded, no rental deductions.

## Summary for EA Exam

- Rental income = taxable when received (advance rent included).
- Deductions allowed for ordinary/necessary expenses, depreciation, allocated use.
- Rentals = passive unless exception applies (active participation or real estate professional).
- Special \$25,000 allowance for active participants (phased out).
- Vacation home rules: <15-day rule, expense allocation required.
- Rental income usually not subject to SE tax.

## Farm Income and Expenses

### 1. Reporting Farm Income (Schedule F, Form 1040)

**Sources of Farm Income (IRC §61; IRS Pub. 225)**

- Sale of livestock, produce, grains, or other products.
- Payments from cooperatives.
- Agricultural program payments (e.g., USDA subsidies).
- Crop insurance proceeds and federal disaster payments (special deferral rules apply).
- Income from breeding, dairy, or poultry operations.
- Rents received in crop shares (FMV when received).
- Barter income (e.g., exchange of farm goods for services).
- Farm-related patronage dividends.
- Special Rules
  - Raised animals for sale: No cost basis for livestock raised; full sales price = income.
  - Purchased animals for resale: Cost basis subtracted from sales price to determine gain.
  - Government conservation program payments (CRP): Generally taxable; special SE tax exception for retired/disabled farmers.

## 2. Reporting Farm Expenses (Schedule F, IRC §162, §263A)

Deductible Farm Expenses

Seeds and plants.

Fertilizers and lime.

Feed and veterinary costs.

Labor (hired hands, excluding value of TP's own labor).

Repairs and maintenance of equipment.

Insurance (other than health).

Interest on business loans.

Taxes (real estate, personal property, employment taxes).

Rent and lease costs.

Depreciation/amortization (tractors, barns, irrigation systems).

Conservation expenses (some deductible under §175).

Nondeductible or Capitalized

Cost of purchasing land.

Cost of permanent improvements (must be capitalized and depreciated).

Expenses for TP's own labor.

Personal living expenses.

## 3. Depreciation and Capital Recovery

Farm equipment, machinery = 7-year MACRS (200% DB).

Breeding livestock = depreciable assets (not inventory).

Land itself is not depreciable.

**Special expensing options:** §179 expense election (up to limit).

- Bonus depreciation available on qualifying assets.

## 4. Farm Net Operating Losses (NOLs)

If farm expenses > farm income → farm loss reported on Schedule F.

Net operating loss rules apply (§172).

Can offset against other income (subject to limits).

TCJA: NOLs carried forward indefinitely, limited to 80% of taxable income.

## 5. Self-Employment Tax and Special Methods

Farm net income generally subject to SE tax (Schedule SE).

**Two optional methods of computing SE income (rare, but exam-tested):**

- Farm Optional Method: May allow reporting of a minimum amount of SE income to qualify for Social Security coverage.
- Nonfarm Optional Method: For very small farm operations.

## 6. Farm Income Averaging (Schedule J, §1301)

Farmers can elect to average farm income over the prior 3 years.

Useful if current year has unusually high farm income, pushing TP into a higher bracket.

Applies only to elected portion of farm income (Schedule J).

## 7. EA Exam Hot Spots

- Schedule F: income sources and deductible expenses.
- Raised vs. purchased livestock (no basis vs. cost basis).
- Crop insurance/disaster payments – may elect to defer one year if income normally reported in subsequent year.
- Capitalization vs. deduction – land and improvements must be capitalized.
- Depreciation of farm property (tractors, barns, livestock).
- Farm income averaging – 3-year lookback option.
- CRP payments – subject to SE tax unless retired/disabled exception.
- Optional SE tax methods – allows low-income farmers to still earn SS credits.

## 8. Examples (EA Style)

**1. TP sells corn raised on farm for \$50,000. Expenses = \$30,000. Taxable farm income?** \$20,000 net income (Schedule F). **2. TP sells cow raised on farm (no cost basis) for \$1,200. Income?** \$1,200 fully taxable. **3. TP buys cow for \$800, sells for \$1,200. Income?** \$400 gain.

**4. TP receives \$10,000 crop insurance for drought, normally reports sales next year. Can defer?**

- Yes, if consistently reports in following year.

**5. TP installs new barn for \$50,000. Deductible this year?**

- No, capitalized and depreciated.

## Summary for EA Exam

- Income: Sales of crops, livestock, gov't payments, crop insurance, barter income.
- Expenses: Ordinary/necessary deductible, improvements capitalized.
- Depreciation: Livestock (breeding), equipment, barns.
- Special rules: Crop insurance deferral, farm income averaging, CRP payments, optional
- SE tax methods.
- Exam traps: Raised vs. purchased livestock, personal expenses, capital improvements.

## Business Income

### 1. What Is Business Income? (IRC §61; Pub. 334)

Definition: Gross income from a trade or business = all income from sales of goods or services before expenses.

Reported on Schedule C (Form 1040) if sole proprietor or single-member LLC (disregarded entity).

#### Sources of Business Income

- Cash, checks, electronic payments from customers.
- FMV of property or services received (barter).
- Credit card receipts / third-party network transactions (1099-K).
- Income from inventory sales.
- Miscellaneous fees, commissions, bonuses, prizes related to business.

#### Special Notes:

- Advance payments: Included in year received (unless deferral election under Rev. Proc. 2004-34 applies).
- Barter: Must include FMV of goods/services received.
- 1099-NEC: Reports payments  $\geq$  \$600 for services rendered.

### 2. What Is NOT Business Income?

- Wages (reported on W-2).
- Dividends, interest, capital gains (Schedule B, D).
- Rental income (Schedule E, unless taxpayer provides hotel-like services, then Schedule C).
- Hobby income (must be reported, but no deduction beyond income; IRC §183).



### 3. Business Expenses (IRC §162: “Ordinary and Necessary”)

**Deductible if:**

- Ordinary = common in trade/business.
- Necessary = helpful and appropriate for business.

**Examples of Deductible Expenses**

- Advertising and marketing.
- Car and truck expenses (standard mileage or actual expenses; mileage log required).
- Depreciation/§179 expense of business assets.
- Employee wages, benefits, payroll taxes.
- Rent, utilities, insurance.
- Office supplies, repairs, maintenance.
- Professional fees (legal, accounting).
- Travel, meals (50%).
- Business interest (subject to limits).

**Not deductible:**

- Personal expenses, clothing suitable for everyday use, fines/penalties, lobbying.

### 4. Self-Employment Tax Implications (§1401)

Net profit from Schedule C subject to SE tax if  $\geq \$400$ .

SE tax rate: 15.3% (12.4% SS up to wage base, 2.9% Medicare, +0.9% surtax if above threshold).

Deduction: 50% of SE tax allowed “above the line” on Schedule 1.

### 5. Inventory & Cost of Goods Sold (COGS)

Businesses selling products must account for inventory (§471).

COGS = Beginning Inventory + Purchases – Ending Inventory.

Direct labor, materials, supplies included; indirect overhead may be required under UNICAP (§263A).

Small business exception: If average gross receipts  $\leq \$25M$  (indexed), can use simplified cash accounting.

### 6. Home Office Deduction (IRC §280A)

**Allowed if:**

- Exclusive and regular use, AND Principal place of business or used for meeting clients.

**Two methods:**

- Simplified: \$5/sq. ft., up to 300 sq. ft. (\$1,500 max).
- Actual expenses: Direct + allocable share of indirect expenses (mortgage interest, utilities, insurance).

### 7. Business Use of Vehicle

Deductible if used for business purposes.

Standard mileage rate (2025 = 70¢/mile) or actual expenses (gas, repairs, insurance, depreciation).

Commuting costs NOT deductible.

Substantiation: mileage log (date, miles, business purpose).

### 8. Qualified Business Income Deduction (QBID, §199A)

Deduction = up to 20% of qualified business income (QBI) from pass-through entities (sole proprietorships, partnerships, S corps).

Exclusions: wage income, capital gains, certain service trades at high income levels.

Deduction taken “below the line,” does not reduce SE tax.

## 9. EA Exam Hot Spots

- Definition of ordinary & necessary expenses.
- Schedule C income vs. not business income (wages, rentals, hobbies).
- Barter transactions → must report FMV.
- Home office deduction rules.
- Auto expense deduction (commuting nondeductible).
- Inventory / COGS calculation.
- QBID basics (20% of QBI).
- SE tax threshold (\$400).
- Hobby vs. business distinction (§183).

## 10. Examples (EA Style)

### 1. TP receives \$10,000 via Venmo for graphic design services. Must TP report?

- Yes, business income, even if no 1099 issued.

### 2. TP exchanges accounting services (\$2,000 FMV) for web design services. Income?

- Yes, both must report \$2,000 as business income.

### 3. TP has \$50,000 gross receipts, \$20,000 expenses, \$5,000 ending inventory, \$10,000 beginning inventory. COGS? $\$10,000 + \text{Purchases} - \$5,000$ . If purchases = \$15,000 → $\text{COGS} = \$20,000$ . 4. TP deducts commuting miles from home to office. Allowed?

- No, commuting nondeductible.

### 5. TP uses 200 sq. ft. home office exclusively for business. Simplified deduction?

- $200 \times \$5 = \$1,000$ .

## Summary for EA Exam

- Business income = all receipts from providing goods/services (Schedule C).
- Expenses deductible if ordinary & necessary (§162).
- Net income subject to self-employment tax ( $\geq \$400$ ).
- Must track inventory and COGS for product sales.
- Special deductions: Home office, vehicle use, QBID.

### Exam traps:

- Barter transactions = income.
- Commuting costs not deductible.
- Hobby losses nondeductible beyond income. \$400 SE tax threshold.

## Net Operating Losses (NOLs)

### 1. Definition and Purpose

IRC §172: An NOL occurs when a taxpayer's allowable deductions exceed gross income for the year.

Purpose: To allow income averaging over years — losses in one year can offset income in other years.

### 2. Sources of NOLs

#### Typically arise from:

- Trade or business losses (Schedule C).
- Rental real estate and farm losses.
- Casualty/theft losses (Form 4684).
- Partnership/S corporation pass-through losses.

### 3. Adjustments in NOL Computation

Certain deductions/adjustments are not allowed in computing NOL (so the NOL is smaller than

**“regular” taxable loss):**

- No standard deduction or itemized nonbusiness deductions (e.g., charitable contributions, medical expenses, state/local taxes).
- No personal exemptions (suspended through 2025 anyway).
- No capital losses beyond capital gains (\$3,000 capital loss deduction does not create or increase NOL).
- No nonbusiness deductions in excess of nonbusiness income.

**Allowed:**

- Business deductions, rental/farm losses, casualty/theft losses.

### 4. Carrybacks and Carryforwards

Current Rules (post-TCJA, CARES changes)

**For tax years beginning after 2020:**

- No carryback (except certain farming and insurance company losses).
- Carryforward indefinitely.
- Carryforward limited to 80% of taxable income (before NOL deduction).

**Special rules for farmers:**

- May carryback 2 years unless they elect to waive carryback.

**Pre-TCJA (and CARES Act temporary changes):**

- Historically 2-year carryback, 20-year carryforward.
- CARES Act (2020) temporarily allowed 5-year carryback for 2018–2020 NOLs.
- Exam focus: Know current rules (indefinite carryforward, 80% limitation), but also be aware of farm carryback exception.

### 5. Reporting and Forms

Form 1045 (Application for Tentative Refund): Used for carryback claims (rare under current law).

Form 1040, Schedule 1: NOL carryforwards applied as deductions in future years.

Form 1045, Schedule A: NOL computation.

### 6. EA Exam Hot Spots

- What counts toward NOL: Business, rental, farm, casualty.
- What does NOT count: Standard deduction, personal exemptions, capital losses beyond gains, excess nonbusiness deductions.
- Current rule: Indefinite carryforward, limited to 80% of taxable income.
- Farmers: 2-year carryback option.
- Computation traps: Capital losses don't generate NOL; itemized nonbusiness deductions don't count.

### 7. Examples (EA Style) 1. TP earns \$40,000 wages, \$60,000 business loss. What's NOL?

**\$20,000 NOL (loss exceeds income).**

### 2. TP has \$30,000 wages, \$50,000 business loss, \$5,000 charitable contribution. NOL? \$20,000.

**Charitable contribution does not count toward NOL.**

### 3. TP has \$10,000 capital gains, \$15,000 capital losses, \$30,000 business loss. NOL?

• Net capital loss limited to \$10,000 offset of gains. Excess \$5,000 doesn't increase NOL. \$30,000 business loss – \$0 income = \$30,000 NOL.

### 4. Farmer has \$100,000 NOL. What options?

- Carryback 2 years OR carryforward indefinitely (80% limitation).

### Summary for EA Exam

- NOL = deductions > income (business/rental/farm/casualty).
- Excluded from NOL: standard deduction, excess capital losses, personal exemptions, nonbusiness deductions > nonbusiness income.
- Carryforward indefinitely, limited to 80% of taxable income.
- Farmers exception: 2-year carryback option.
- Exam traps: charitable contributions, medical expenses, and excess capital losses don't generate NOL.

## Other Specialized Topics

### 1. Household Employment Taxes (“Nanny Tax”)

Applies when taxpayer hires household employees (nanny, housekeeper, caregiver).

Must pay if wages exceed threshold (\$2,800 in 2025 for Social Security/Medicare; \$1,000 in a quarter for FUTA).

**Employer (not employee) is responsible for:**

- Withholding and paying FICA.
- FUTA tax (generally 6% up to \$7,000 wages).
- Reported on Schedule H (Form 1040).
- Exam tip: Independent contractors (e.g., plumbers) are NOT household employees.

### 2. Gambling Income and Losses

All winnings taxable (lotteries, raffles, slots, table games). Reported on Form W-2G if above thresholds.

Reported on Schedule 1, Line 8.

Losses deductible only if itemizing and only up to winnings (§165(d)), on Schedule A.

Gambling professional: report on Schedule C (income subject to SE tax).

### 3. Cancellation of Debt (COD Income)

COD = generally taxable under §61(a)(12).

**Exclusions under §108:**

- Bankruptcy.
- Insolvency.
- Qualified principal residence debt (limited).
- Qualified farm debt.
- Qualified real property business debt.
- Reported on Form 1099-C.

### 4. Scholarships and Fellowships (§117)

Excluded to extent used for tuition, fees, books, supplies.

Taxable if used for room & board, stipends, travel.

Graduate teaching/research assistantships: excluded if required for program and no services rendered.

### 5. Jury Duty Pay

Jury duty compensation is taxable.

If taxpayer remits pay to employer (because employer paid salary during duty), an above-the-line deduction allowed.

### 6. Hobby Income (IRC §183)

Must report all hobby income.

No deductions allowed (2018–2025, TCJA suspended hobby expense deductions).

IRS 9-factor test distinguishes hobby vs. business (e.g., intent to profit, expertise, time/effort).

### 7. Alimony & Child Support

**Pre-2019 divorce agreements:**

- Alimony = deductible to payor, taxable to recipient.

**Post-2018 agreements:**

- Alimony = NOT deductible, NOT income.
- Child support: never deductible, never taxable.

### 8. Foreign Reporting

FBAR (FinCEN 114): Must file if aggregate foreign accounts > \$10,000 at any time.

FATCA (Form 8938): Must file if foreign assets > threshold (\$50,000 single, \$100,000 MFJ, higher if abroad).

Penalties severe for noncompliance.

## 9. Education Savings & Distributions

529 Plans: Earnings excluded if used for qualified education expenses (tuition, fees, books, K-12 up to \$10k, student loan repayment up to \$10k).

Coverdell ESAs: Earnings excluded if used for qualified education expenses (K-12 + higher ed).

Nonqualified withdrawals = portion of earnings taxable + 10% penalty.

## 10. Health Care–Related Items

Premium Tax Credit (§36B): Refundable; reconciled on Form 8962.

Advance PTC (APTC): Must reconcile — excess APTC repayments increase tax.

Shared responsibility payment (individual mandate): Repealed federally starting 2019 (some states still impose).

## 11. Miscellaneous Other Topics

Prizes & Awards (§74): Generally taxable unless transferred to charity or qualified employee award (limits apply).

Life Insurance Proceeds (§101): Excluded if paid by reason of death; taxable if interest portion or transfer-for-value.

Disaster Relief Payments (§139): Excluded if federally declared disaster.

Social Security Benefits (§86): Up to 85% taxable, depending on provisional income.

EA Exam Hot Spots

Household employment tax thresholds & reporting (Schedule H).

Gambling income: winnings always taxable, losses deductible only up to winnings if itemizing.

COD income: taxable unless exception applies.

Hobby income vs. business income.

Alimony: pre-2019 vs. post-2018 treatment.

Foreign account reporting (FBAR/FATCA).

Education savings distributions (qualified vs. nonqualified).

Premium Tax Credit reconciliation.

Disaster relief payments.

Social Security taxation thresholds.

Examples (EA Style)

### 1. TP receives \$2,000 jury duty pay, remits to employer since employer continued salary. Deduction?

- Yes, above-the-line deduction for \$2,000.

### 2. TP has \$3,000 gambling winnings, \$5,000 losses. Deduction allowed?

- Only \$3,000 losses deductible, must itemize.

### 3. TP had \$50,000 student loan discharged in bankruptcy. Taxable?

- No, excluded under §108.

### 4. TP receives \$10,000 alimony in 2017 under divorce decree. Taxable?

- Yes, included in gross income.

### 5. TP's provisional income = \$40,000, SS benefits = \$12,000. How much taxable?

- Likely 85% of SS = \$10,200 taxable (exact calc depends on filing status thresholds).

## Summary for EA Exam

- “Other Specialized Topics” = grab bag of items.
- Always taxable: gambling winnings, jury duty, prizes, hobby income.
- Sometimes excluded: scholarships (tuition only), disaster relief, life insurance (death benefit), CRP, disaster relief.
- Special rules: household employment taxes, COD income exceptions, alimony pre/post-
- 2019, foreign account reporting.
- Exam traps: gambling losses only up to winnings, hobby losses not deductible, COD income exceptions, FBAR/FATCA penalties.

# Completion of the Filing Process Review (Integrated Across 2026 Part 1 Domains)

Procedural and compliance requirements.

## When and Where to File

- Due dates, extensions (Form 4868), electronic filing

## Payments and Refunds

- Estimated tax penalties, underpayment calculations
- Refund claims, amended returns (Form 1040-X)

## Recordkeeping Requirements

- Statute of limitations on assessments and refunds (§6501, §6511)

## Signatures and Filing Requirements

- Preparer penalties, due diligence requirements for EIC/CTC/ACTC/AOTC (§6695(g))

## Other Compliance

- Identity theft PINs
- Disclosure and privacy rules (IRC §7216, §6713)
- Foreign asset reporting (Form 8938, FBAR)

## When and Where to File

### 1. General Filing Due Dates

#### Form 1040 (Individual Return):

- April 15 following the tax year.
- If April 15 is a weekend/holiday → next business day.

#### Extensions:

- Automatic 6-month extension available by filing Form 4868 on or before due date.
- Extension to file ≠ extension to pay. Payment of tax due must still be made by original due date to avoid penalties/interest.

#### Estimated Taxes (Form 1040-ES):

- Quarterly due dates: April 15, June 15, Sept 15, Jan 15 (next year).

### 2. Where to File

#### Electronic Filing (e-file)

Strongly encouraged by IRS; fastest for refunds.

E-file available via software, authorized preparers, or Free File.

#### Paper Filing

#### If not e-filing, mailing address depends on:

- State of residence.
- Whether taxpayer is including a payment.
- IRS provides updated mailing addresses in the Form 1040 instructions each year.

### 3. Special Situations

#### U.S. citizens/residents abroad:

- Automatic 2-month extension (to June 15) for filing.
- Still must pay by April 15 to avoid interest.
- May also file Form 4868 for additional 4 months (to Oct 15).

#### Military service in combat zones:

- Filing and payment deadlines extended automatically.
- Extension lasts 180 days after leaving combat zone.

#### Disaster relief:

- IRS grants postponements for taxpayers in federally declared disaster areas (notice on IRS website).

### 4. Penalties for Late Filing/Payment

Failure to file (§6651(a)(1)): 5% per month (up to 25%).

Failure to pay (§6651(a)(2)): 0.5% per month (up to 25%).

If both apply: failure-to-file penalty reduced by failure-to-pay amount.

Filing extension avoids failure-to-file penalty but not failure-to-pay penalty.

### 5. EA Exam Hot Spots

- April 15 filing deadline vs. extension rules.
- Form 4868 = extension to file, not to pay.
- U.S. citizens abroad: automatic 2-month extension.
- Military combat zone rules: 180-day automatic extension.
- Estimated tax due dates.
- Mailing vs. e-file: exam may test knowledge that addresses vary depending on state & whether payment included.

### 6. Examples (EA Style)

**1. TP lives in New York, owes \$3,000, files Form 4868 with no payment. Return filed Oct 15, tax paid Oct 15. Penalties?**

- Failure-to-file avoided, but failure-to-pay applies (0.5%/month from April–Oct).

**2. TP lives in Germany, files June 10. Return on time?**

- Yes, 2-month automatic extension applies. Interest accrues from April 15 on unpaid balance.

**3. TP is active-duty military in combat zone, leaves on May 1. When is return due?**

- 180 days after May 1, plus remaining filing period.

**4. TP estimates owing \$2,500, pays 100% of last year's tax liability through withholding. Does TP owe estimated tax penalty?**

- No, safe harbor rule satisfied.

**5. TP sells stock in June, owes significant tax. When must estimated payment be made?**

- Next quarterly date: Sept 15.

### Summary for EA Exam

- Form 1040 due April 15; extension to file (Form 4868), not to pay.
- U.S. abroad: 2-month automatic filing extension.
- Military in combat zones: 180-day extension after service ends.
- Quarterly estimated tax due dates: Apr 15, Jun 15, Sep 15, Jan 15.
- Late penalties: failure-to-file worse (5%/mo) than failure-to-pay (0.5%/mo).
- Where to file: e-file preferred; paper address depends on residence and payment.



# Payments and Refunds

## 1. Types of Tax Payments

### A. Withholding (IRC §3402)

Federal income tax withheld from wages (Form W-2).

Also withheld from some pensions, Social Security (on election), and gambling winnings.

Creditable toward total tax liability.

### B. Estimated Tax Payments (§6654)

Quarterly payments due Apr 15, Jun 15, Sep 15, Jan 15 (next year).

Required if taxpayer expects to owe  $\geq$  \$1,000 after withholding/credits.

**Safe harbor rule:**

- 90% of current year tax, OR 100% of prior year tax (110% if AGI > \$150k).

### C. Other Payments

Extension payments (Form 4868).

Additional tax payments (e.g., SE tax, AMT, household employment taxes).

## 2. Overpayments & Refunds (§6402)

If payments > total liability, taxpayer entitled to refund.

**Refund options:**

- Direct deposit (fastest).
- Paper check.
- Apply to next year's estimated tax.

**Statute of Limitations (Refund Claims – §6511):**

- Claim must be filed within 3 years from original filing date (including extensions) OR Within 2 years from date tax was paid, whichever is later.
- Exam trap: If taxpayer files late, refund limited to payments made within 2 years before claim.

## 3. Refund Offsets

**Refunds may be reduced by:**

- Past-due federal taxes.
- State income taxes.
- Past-due child support.
- Federal nontax debts (e.g., student loans). (Treasury Offset Program, TOP).

## 4. Penalties and Interest

**Failure-to-File (§6651(a)(1)):**

- 5% per month (max 25%).

**Failure-to-Pay (§6651(a)(2)):**

- 0.5% per month (max 25%).

**Estimated Tax Penalty (§6654):**

- If taxpayer fails to make sufficient estimated payments (safe harbor protects).

**Interest (§6601):**

- Charged on any unpaid tax balance from due date until paid, regardless of extensions.

## 5. Refundable vs. Nonrefundable Credits

Refundable credits (EIC, Additional Child Tax Credit, Premium Tax Credit, AOTC refundable portion) can create or increase a refund.

Nonrefundable credits can only reduce tax to zero, no refund generated.

## 6. EA Exam Hot Spots

- Safe harbor rules for avoiding estimated tax penalty.
- Statute of limitations for refund claims (3 years/2 years rule).
- Offsets against refunds.
- Difference between refundable vs. nonrefundable credits in refunds.
- Extension to file  $\neq$  extension to pay (interest/penalties still accrue).
- Due dates of estimated payments.

## 7. Examples (EA Style)

**1. TP owed \$10,000 in prior year, paid \$11,000 through withholding this year. Liability = \$9,000. Refund?**

- Payments = \$11,000  $\rightarrow$  liability \$9,000  $\rightarrow$  refund = \$2,000.

**2. TP owes \$15,000 this year. Paid \$14,000 through withholding. AGI \$200,000, prior year tax \$12,000. Will TP owe estimated penalty?**

- Safe harbor =  $110\% \times \$12,000 = \$13,200$ . Payments \$14,000  $\geq$  safe harbor  $\rightarrow$  no penalty.

**3. TP files 4 years late, shows refund due. Can TP claim refund?**

- No — past 3-year statute of limitations.

**4. TP refund \$1,500, owes \$1,000 past-due child support. Refund issued?**

- IRS will offset \$1,000  $\rightarrow$  \$500 refund.

**5. TP files Form 4868, pays nothing by April 15, owes \$5,000. Return filed Oct 15. Penalties?**

- Failure-to-file avoided (extension). Failure-to-pay =  $0.5\% \times 6 \text{ months} \times \$5,000 = \$150$ , plus interest.

## Summary for EA Exam

- Payments: Withholding, estimated, extensions, SE tax.
- Refunds: 3-year/2-year statute; may be offset for debts.
- Safe harbor: 90% of current year OR 100%/110% of prior year.
- Refundable credits: Can generate refunds; nonrefundable can't.
- Penalties/interest: Failure-to-file (5%), failure-to-pay (0.5%), estimated tax penalty, statutory interest.

## Recordkeeping Requirements

### 1. Statutory Authority

IRC §6001 – Taxpayers must keep permanent books and records sufficient to establish the amount of gross income, deductions, credits, and other tax matters.

IRS may inspect these records upon request.

### 2. General Retention Periods

#### A. Standard Rule

**Keep records for at least 3 years from the later of:**

- The due date of the return, or The date the return was filed.

#### B. Exceptions (Longer Periods)

6 years – if income omitted  $>25\%$  of gross income shown on return.

7 years – for claims relating to worthless securities or bad debt deductions.

**Indefinitely – for records relating to:**

- Basis of property (until property sold + 3 years after).
- Fraudulent returns (no statute of limitations).
- Failure to file return (no statute).

### 3. Specific Records to Keep

- Income Records
- W-2, 1099s, K-1s.
- Bank statements, brokerage statements.
- Records of bartering transactions.
- Business and farm income ledgers (Schedule C/F).
- Expense/Deduction Records
- Receipts, invoices, canceled checks, bank/credit statements.
- Charitable contribution documentation (receipts >\$250, Form 8283 for >\$500 property).
- Medical expense documentation.
- Business use logs (mileage logs, home office records).
- Property Records (Basis)
- Purchase documents, settlement statements.
- Records of improvements.
- Records of depreciation taken.
- Needed until asset is sold + 3 years.
- Credits
- Education expenses (Form 1098-T, receipts).
- Adoption expenses.
- Child/dependent care provider records.

### 4. Electronic Records

IRS accepts scanned or electronic copies if they are accurate and accessible.

Electronic accounting software (e.g., QuickBooks) acceptable if reliable.

### 5. EA Exam Hot Spots

- 3 years general rule.
- 6 years if >25% of gross income omitted.
- 7 years for worthless securities/bad debts.
- Indefinitely for property basis, fraud, failure to file.
- Charitable substantiation rules (e.g., >\$250 requires written acknowledgment).
- Mileage logs and home office substantiation.
- IRS accepts electronic records if accurate.

### 6. Examples (EA Style)

#### 1. TP sells stock purchased in 2010, sold in 2023. When can they discard purchase records?

- Keep until at least 2026 (sale year + 3 years).

#### 2. TP failed to report \$50,000 income on a \$150,000 return. How long must IRS assess?

- 6 years (omission >25%).

#### 3. TP deducts worthless security in 2022. How long must records be kept?

- 7 years.

#### 4. TP fails to file 2019 return. Can IRS assess tax in 2025?

- Yes, no statute of limitations if return not filed.

#### 5. TP donates \$500 cash to charity, no written acknowledgment. Can they deduct?

- No, contributions  $\geq$ \$250 require written acknowledgment.

## Summary for EA Exam

- General rule: 3 years.
- Exceptions: 6 years (>25% income omission), 7 years (bad debt/worthless securities), indefinitely (basis, no return, fraud).
- Must keep income, expense, property, and credit substantiation records.
- Charitable contributions: strict documentation rules.
- Electronic records are acceptable.

## Signatures and Filing Requirements

### 1. Signature Requirements on Tax Returns

Taxpayer Signatures

Form 1040 must be signed by the taxpayer (and spouse if MFJ).

**Filing status:**

- Married Filing Jointly (MFJ): both spouses must sign.
- Married Filing Separately (MFS): only the filing spouse signs.
- Unsigned returns = not valid returns under IRS rules.
- Electronic Returns (e-file)
- Taxpayer signs electronically with Self-Select PIN or Practitioner PIN.
- Form 8879 (IRS e-file Signature Authorization) used when a preparer transmits return.
- Exceptions to Personal Signature

**Another person may sign for the taxpayer if:**

- Power of Attorney (POA) (Form 2848).
- Court-appointed representative.
- Spouse unable to sign (injury, disease, deployment) — attach explanation.
- Deceased taxpayer: Personal representative (executor, administrator) must sign final return.

### 2. Preparer Signatures (IRC §6695(b))

**Paid preparers must:**

- Sign the return (manual or electronic).
- Provide their Preparer Tax Identification Number (PTIN).
- Date the return.
- Applies to compensated preparers (not volunteers or unpaid family/friends).
- Failure to sign can result in preparer penalties.

### 3. Filing Requirements

#### A. Timely Filing Rule

Return considered filed on postmark date if mailed by due date.

Electronic filing → considered filed on IRS acceptance date.

#### B. Extensions

Form 4868 gives an automatic 6-month extension to file.

Not an extension of time to pay — tax must still be paid by April 15.

#### C. Joint Returns

If one spouse dies during the year, surviving spouse may still file MFJ.

If spouse is unable to sign, the other spouse may sign on their behalf with notation “filing as surviving spouse” or attach explanation.

### 4. Filing with Disabilities or Special Circumstances

Blind taxpayers: May check the box on Form 1040 for additional standard deduction — but still must sign.

Military in combat zones: Filing/payment automatically extended.

## 5. EA Exam Hot Spots

- Unsigned return = not valid (and statute of limitations doesn't start running).
- MFJ requires both signatures unless exception applies.
- Who may sign for a deceased or incapacitated taxpayer (executor, spouse, POA).
- Paid preparer must sign and include PTIN.
- E-file: Form 8879 authorizes preparer to file electronically with PIN.
- Postmark rule: considered timely if mailed by due date, even if received later.

## 6. Examples (EA Style)

### 1. TP files joint return, but only husband signs. IRS accepts return. Is it valid?

- No, both spouses must sign (unless exception applies).

### 2. TP hires paid preparer; preparer completes return but fails to sign. Consequences?

- Preparer subject to penalty; return is still valid.

### 3. TP mails return Apr 15, IRS receives Apr 20. On time?

- Yes, postmark = timely filing.

### 4. Taxpayer dies in November. Who signs final return?

- Executor or administrator of estate.

### 5. TP has POA on file (Form 2848) for spouse. Can they sign spouse's return?

- Yes, with valid POA.

## Summary for EA Exam

- Taxpayer must sign return; MFJ requires both signatures.
- Exceptions: POA, court-appointed, surviving spouse, incapacity, deceased taxpayer's executor.
- Paid preparers must sign returns and provide PTIN.
- Unsigned return is invalid (statute of limitations doesn't start).
- Postmark date = filing date.
- Extensions = 6 months to file, not to pay.
- Electronic filing requires PIN or Form 8879.

## Other Compliance

### 1. Due Diligence Requirements (§6695(g))

#### Preparers must meet due diligence requirements for:

- Earned Income Credit (EIC).
- Child Tax Credit (CTC)/Additional CTC.
- Other Dependent Credit.
- American Opportunity Tax Credit (AOTC).
- Head of Household (HOH) filing status.
- Requires completion and retention of Form 8867 (Paid Preparer's Due Diligence Checklist).

#### Preparer must:

- Compute credit(s) correctly.
- Ask reasonable questions if info seems incorrect.
- Keep records of client-provided info for 3 years.
- Penalty for failure = \$600 per failure, per return (adjusted annually).

## 2. Foreign Asset and Account Compliance

FBAR (FinCEN Form 114)

Must file electronically if aggregate foreign financial accounts > \$10,000 at any time during the year.

Due Apr 15 (automatic extension to Oct 15).

Penalties for non-filing are severe (\$10,000+).

FATCA (Form 8938, IRC §6038D)

Required if specified foreign assets > thresholds (\$50,000 single, \$100,000 MFJ, higher for taxpayers abroad).

Filed with Form 1040.

## 3. Identity Protection & Security

IP PIN (Identity Protection PIN): 6-digit number IRS assigns to taxpayers with identity theft or upon request. Required for e-filing.

If return filed without correct IP PIN, IRS rejects it.

## 4. Penalties (Beyond Filing/Payment)

Accuracy-related (§6662): 20% penalty on underpayments due to negligence or substantial understatement.

Fraud (§6663): 75% penalty on underpayment due to fraud.

**Preparer Penalties (§6694):** \$1,000 per return (unreasonable position). \$5,000 per return (willful or reckless conduct).

**Information Return Penalties (§6721, §6722):**

- Penalties for failure to file/pay correct information returns (W-2s, 1099s).

## 5. Estimated Tax Compliance

Must comply with estimated payment requirements (§6654).

**Avoid penalty if:**

- Withholding + estimates  $\geq$  90% of current year tax, OR 100% of prior year tax (110% if AGI > \$150,000).

## 6. Other IRS Compliance Programs

Voluntary Disclosure Programs for foreign assets (for exam awareness).

PTIN requirement for all paid preparers.

E-file mandate: Preparers filing  $\geq$  11 returns generally must e-file.

## 7. EA Exam Hot Spots

- Form 8867 due diligence (credits + HOH).
- FBAR vs. FATCA (thresholds, which form filed where).
- IP PIN requirement for filing.
- Preparer penalties (due diligence, reckless conduct, failure to sign).
- Estimated tax safe harbors (90%/100%/110%).
- E-file requirement for preparers filing 11+ returns.

## Heavily Tested Areas

### 1. Filing Status & Dependents (Domain 1)

Who qualifies as a dependent (qualifying child vs. qualifying relative, §152).

Filing status rules: Single, MFJ, MFS, HOH, Qualifying Widow(er).

Tie-breaker rules for dependents (custody vs. income).

Support & residency tests.

Exam trap: HOH eligibility and dependency exemptions for divorced/separated parents.

### 2. Gross Income & Exclusions (Domain 2)

IRC §61 – what counts as gross income: wages, interest, dividends, rents, pensions, alimony (pre-2019), unemployment, gambling winnings.

Exclusions (not income): life insurance proceeds (§101), municipal bond interest (§103), gifts & inheritances (§102), qualified scholarships (§117), disaster relief payments (§139).

Social Security benefits (§86): up to 85% taxable depending on provisional income.

Exam trap: distinguishing taxable vs. nontaxable fringe benefits (meals, lodging, education assistance).

### 3. Adjustments to Income (Above-the-Line Deductions, Domain 3)

SE health insurance deduction.

SE retirement contributions (SEP, SIMPLE, Keogh).

Educator expenses.

Student loan interest deduction.

Exam trap: “above-the-line” adjustments reduce AGI and affect eligibility for credits.

### 4. Deductions: Standard vs. Itemized (Domain 3)

Medical expense threshold (7.5% of AGI).

SALT deduction cap = \$40,000 (\$20,000 MFS) for 2025 before high-income phaseout; baseline minimum cap remains \$10,000 (\$5,000 MFS).

Mortgage interest rules (acquisition debt only; \$750k cap post-2017).

Charitable contributions (% of AGI limits, substantiation).

Casualty losses only for federally declared disasters.

Exam trap: when itemizing yields more than standard deduction (and when MFS must itemize if spouse itemizes).

### 5. Tax Credits (Domain 3)

Child Tax Credit & Additional CTC (refundable portion).

Earned Income Credit (EIC) – due diligence, qualifying child rules, disqualification for investment income.

Education credits: AOTC (partially refundable, first 4 years), LLC (nonrefundable, unlimited years).

Child and Dependent Care Credit.

Exam trap: refundable vs. nonrefundable credits.

### 6. Tax Computation & Other Taxes (Domain 4)

Tax tables/rate schedules.

Preferential rates for LTCG and qualified dividends.

Kiddie tax (§1(g)): unearned income taxed at parent’s rate.

Self-employment tax (§1401, 15.3%, 92.35% base, additional 0.9% Medicare).

NIIT (3.8% on investment income over thresholds).

AMT (adjustments, exemptions, preference items).

Exam trap: SE tax vs. income tax; AMT add-backs (SALT, standard deduction, ISOs).

### 7. Property Transactions (Domain 2 & 4)

Basis rules (§1012, §1014, §1015).

Capital gains/losses (short-term vs. long-term). §121 exclusion on sale of principal residence (\$250k/\$500k).

Like-kind exchanges (§1031, only real property now).

Involuntary conversions (§1033).

Exam trap: gain/loss recognition vs. nonrecognition; basis adjustments after inheritance/gift.

### 8. Rental Property & Passive Activity Rules (Domain 5)

Rental income (advance rent taxable, refundable deposits not).

Deductible expenses (interest, depreciation, repairs).

**Passive activity rules (§469):**

- \$25,000 special allowance for active participants, phased out after \$100k AGI.
- Real estate professional exception (>750 hours, >50% of services).
- Exam trap: personal vs. rental days for vacation homes (§280A).

### 9. Farm & Business Income (Domain 5)

Schedule C income & expenses: ordinary & necessary (§162).

Self-employment implications.

Farm income (crop insurance proceeds, raised vs. purchased livestock, depreciation, Schedule F).

Hobby vs. business (§183).

Exam trap: bartering = taxable income; hobby losses not deductible beyond income.



## 10. Compliance, Filing, & Procedural Items (Domain 1)

Filing deadlines & extensions (Form 4868).

Statute of limitations (3 years standard, 6 years for >25% omission, indefinite for fraud/no return).

Recordkeeping requirements (3/6/7 years, indefinite for basis).

Refund claims (§6511: 3 years from filing or 2 years from payment).

Preparer due diligence (Form 8867, \$600 penalty).

Exam trap: unsigned return not valid; extension to file  $\neq$  extension to pay.

### Summary — Top EA Part 1 Tested Areas

1. Filing status & dependents (who qualifies, HOH rules, tie-breaker tests).
2. Gross income vs. exclusions (§61 vs. §101, §102, §103, §117, §139).
3. Adjustments to income & above-the-line deductions.
4. Standard vs. itemized deductions (SALT, mortgage, charity, casualty).
5. Tax credits (EIC, CTC, AOTC, LLC, Dependent Care).
6. Tax computation (SE tax, NIIT, kiddie tax, LTCG rates, AMT).
7. Property transactions (basis, gain/loss, §121, §1031, §1033).
8. Rental property & passive loss rules.
9. Business & farm income (Schedule C & F, hobby loss rules).
10. Compliance issues (due dates, SOL, refund claims, recordkeeping, preparer due diligence).

## Procedural Topics

### 1. Filing Requirements

Who must file (§6012): Based on filing status, gross income thresholds, dependency status, and self-employment income  $\geq$  \$400.

When to file: April 15 (next business day if weekend/holiday).

Where to file: e-file (preferred) or paper (mailing address depends on state/payment).

Extensions: Form 4868  $\rightarrow$  6-month extension to file, not to pay.

### 2. Signatures (§6061, §6062)

Paper returns: taxpayer must sign; MFJ requires both signatures.

E-file: use PIN (Form 8879).

Exceptions: POA (Form 2848), surviving spouse, executor, or court-appointed representative.

Paid preparers: must sign, date, and include PTIN.

### 3. Recordkeeping (§6001)

Must keep records to substantiate income/deductions.

#### Retention:

- 3 years standard,
- 6 years if >25% of gross income omitted,
- 7 years for bad debts/worthless securities,
- Indefinitely for property basis/fraud/no return.

### 4. Payments & Refunds

Payments: Withholding, estimated tax (Form 1040-ES), extension payments.

Safe harbor (§6654): Avoid estimated penalty if 90% current year or 100% (110% if AGI > \$150k) of prior year paid.

Refunds (§6402, §6511): Refund claim due within 3 years of return filed or 2 years of payment (later of the two).

Offsets: Refunds can be reduced for federal/state debts, child support, student loans.

## 5. Penalties and Interest

Failure-to-file (§6651(a)(1)): 5% per month (max 25%).

Failure-to-pay (§6651(a)(2)): 0.5% per month (max 25%).

Accuracy-related penalty (§6662): 20%.

Fraud penalty (§6663): 75%.

Estimated tax penalty (§6654).

Interest (§6601): from due date until paid (can't be abated).

## 6. Statutes of Limitations (SOL)

### Assessment:

- 3 years after filing (normal).
- 6 years if >25% of gross income omitted.
- No limit for fraud or no return.
- Refund claim: 3 years from filing or 2 years from payment, whichever is later.

## 7. IRS Compliance & Due Diligence

Due diligence (§6695(g)): Preparer must complete Form 8867 for EIC, CTC/ACTC/ODC, AOTC, HOH. \$600 penalty per failure.

Preparer requirements: PTIN, signature, compliance with Circular 230.

E-file mandate: Preparers who file  $\geq 11$  returns must e-file.

## 8. Special Procedural Rules

Combat zone relief: 180-day extension after leaving combat zone.

Abroad filing: automatic 2-month extension to June 15 for U.S. citizens/residents abroad.

Disaster relief: IRS grants extended deadlines for federally declared disasters.

Identity Protection PIN (IP PIN): required if issued; return rejected without it.

## 9. EA Exam Hot Spots

- Filing thresholds & April 15 deadline.
- Extension to file vs. extension to pay.
- Statute of limitations (3 years, 6 years, no limit).
- Penalty amounts (failure-to-file vs. failure-to-pay).
- Refund claim time limits.
- Preparer due diligence & penalties (Form 8867).
- Combat zone & abroad filing extensions.
- Household employment taxes (Schedule H filing).
- Preparer PTIN & e-file mandate.

## 10. Examples (EA Style) 1. TP files 2 years late, shows refund due. Can refund be issued?

- Yes, within 3-year window from original due date, if within refund statute.

### 2. TP owes \$5,000, files 4 months late. Penalties?

- Failure-to-file =  $5\% \times 4 = 20\% = \$1,000$ .
- Failure-to-pay =  $0.5\% \times 4 = 2\% = \$100$ .
- Total =  $\$1,100 + \text{interest}$ .

### 3. TP omits \$60,000 income from \$200,000 return. How long does IRS have to assess?

- 6 years (>25% omission).

### 4. Preparer fails to complete Form 8867 for AOTC. Penalty? \$600 per failure. 5. TP is in Afghanistan combat zone, leaves April 1. Return due?

- Extended 180 days after April 1, plus remaining time.

## Summary for EA Exam

- Procedural topics = “nuts and bolts” of compliance.
- Filing deadlines & requirements (Form 4868 extension).
- Signatures (taxpayer, spouse, preparer with PTIN).
- Recordkeeping (3/6/7/indefinite years).
- Payments & refunds (safe harbor, refund statute, offsets).
- Penalties (5% late file vs. 0.5% late pay).
- Statutes of limitation (3/6/indefinite).
- Preparer due diligence (Form 8867, \$600 penalty).
- Special relief (combat zone, abroad, disaster).

## 2026 Current-Year Source Basis

- IRS SEE guidance: 2026 SEE questions are based on tax law, forms, and publications as amended through December 31, 2025; unless otherwise stated, current year means 2025.
- IRS Enrolled Agent News: beginning March 1, 2026, PSI Services administers the IRS Special Enrollment Examination.
- IRS OBBBA individual provisions: 2025 standard deduction amounts, Schedule 1-A deductions for tips, overtime, vehicle loan interest, and enhanced senior deduction.
- IRS Publication 969 (2025): HSA contribution limits and age 55+ catch-up rules.
- IRS Publication 970 (2025): student loan interest deduction amount and phaseout ranges.