

TAXAD 105 - (Individuals) - Comprehensive Outline

- Domain 1: Preliminary Work with Taxpayer Data – 17%
- Domain 2: Income and Assets – 21%
- Domain 3: Deductions and Credits – 21%
- Domain 4: Taxation and Advice – 18%
- Domain 5: Specialized Returns for Individuals – 13%
- Domain 6: Completion of the Filing Process – 10%

Domain 1: Preliminary Work with Taxpayer Data (17%)

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 (2024 for reference – exam often uses general rules, not a specific year):

- **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 over 65 changes threshold.
- **Married Filing Separately (MFS):** must file if **any gross income**.
- **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 \$1,300 (2024) or earned income + \$450, but not above standard deduction for single.

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).
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3. Exam Focus Points

- **Threshold traps:**
 - MFS → must file if **any gross income**, no threshold.
 - Self-employed → must file if **net earnings \geq \$400**.
 - Dependents → 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 → partially taxable depending on provisional income.
 - Alimony → only taxable/deductible for **pre-2019 agreements**.
 - Cancelled debt → income unless exception applies (bankruptcy, insolvency, etc.).
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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 2024**, since their income is below the \$14,600 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.
 - $\$4,500 < \$4,900$ → not required, but may want to file for refund.
 4. **SE income \$600 net. Must file?**
 - Yes, $> \$400$ threshold.
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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 third-party network payments (PayPal, Venmo, credit card processors).
- **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; broker must also issue **Form 8949** for transactions.
 - **Supporting Records:**
 - Brokerage statements.
 - Trade confirmations.
 - Proof of cost basis (purchase records, reinvested dividends, stock splits).
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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.
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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.
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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.
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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.
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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.
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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.
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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 (§6654).

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.
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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).
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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.
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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**.
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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).
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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.
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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.
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10. Practice Questions

1. **TP made \$3,000 of estimated tax payments in 2024 and had \$4,000 of withholding on W-2. What is the total applied to 2024 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 2024.
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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 (21%)

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)

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).

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).**
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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)).
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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.
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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 (\$126500 for 2024) 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%, 50%, or 15% 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.
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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).
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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:

Gain (or Loss) = Amount Realized – Adjusted Basis

3. Capital Gains and Losses

- **Short-term:** Held \leq 1 year → taxed at ordinary rates.
 - **Long-term:** Held > 1 year → 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.
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4. Special Property Transactions

A. Principal Residence (§121)

- Exclude up to \$250,000 gain (\$500,000 MFJ) if:
 - Owned ≥ 2 years, and
 - Used as principal residence ≥ 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 ≥ 5 years and meets QSBS rules.
 - **Collectibles:** Long-term capital gain taxed at max 28%.
 - **Qualified dividends:** Taxed at same rates as long-term capital gains.
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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).
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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 \rightarrow 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 \rightarrow \$6,000 ordinary.
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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 (21%)

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 (QBID §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 \$10,000)
 - 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** (2024) 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 (2024): \$4,150 self-only, \$8,300 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 \$69,000 in 2024).
-

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 (2024): \$7,000 (\$8,00 if 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 begins at MAGI \$75,000 (single) / \$155,000 (MFJ) (2024 figures).
- 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?**
 - o \$300 (max limit).
2. **TP earns \$80,000 SE income, pays \$11,304 SE tax. How much deductible above the line?**
 - o $\$11,304 \times 50\% = \$5,652$.
3. **TP pays \$2,600 student loan interest, MAGI \$60,000, single. How much deductible?**
 - o \$2,500 (max).
4. **TP divorced in 2016, pays \$12,000 alimony. Deductible?**
 - o Yes, \$12,000 (pre-2019).
5. **TP has family HDHP, age 56, contributes \$8,750 to HSA. How much deductible?**
 - o $\$7,750 + \$1,000$ catch-up = \$8,750 (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:**
 - o Moving expenses (military only).
 - o Roth IRA contributions not deductible.
 - o Student loan interest deduction not allowed for MFS or dependents.

Standard vs. Itemized Deductions

1. Standard Deduction (IRC §63(c))

Basic Amounts (2024 – exam uses rules, not exact dollar figures):

- **Single:** \$14,600
- **Married Filing Jointly (MFJ):** \$29,200
- **Head of Household (HOH):** \$21,900
- **Married Filing Separately (MFS):** \$14,600
- **Qualifying Widow(er):** \$29,200

Additional Standard Deduction:

- Age 65+ or blind → additional \$1,500 each (MFJ, QW) or \$1,850 each (Single, HOH).

Limitations:

- **Dependents:** Standard deduction limited to greater of \$1,250 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)

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)

- Deduction limited to **\$10,000 (\$5,000 MFS)** for state & local taxes (SALT):
 - 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:** \$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 $\$10,000 + \$5,000 = \$15,000$ 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

- 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 (2024)** 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 threshold (~\$11,500 in 2024).
 - 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 \$ 16,810 per child (2024).
 - 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 = \$4,000. 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 and Advice (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 (\$2,600 in 2024) 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 (2024): \$ 85,700 single / \$ 133,300 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 (\$168,600 for 2024).
 - 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?**
 - \$1,250 standard deduction for dependents.
 - \$1,250 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 (2024 values for reference – exam focuses on rules, not dollar figures)

- **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.
- **2024 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 (2024 figures)

- **Social Security portion:** 12.4% up to wage base (\$160,200 in 2024).
- **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:

Net SE Income \times 92.35% = 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 = \$160,200?**
 - All \$100,000 (since $< \$160,200$).
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.

Taxpayer Advice

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 2024).
- 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% per month × 5 months = 25% × \$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 5: 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 \geq 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).
 - $COGS = \text{Beginning Inventory} + \text{Purchases} - \text{Ending Inventory}$.
 - 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** (2024 = 67¢/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 → 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 (\$2,700 in 2024 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).
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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.

Domain 6: Completion of the Filing Process (10%)

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 → liability \$9,000 → 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 → 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 → \$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 = \$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 ≠ 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 → 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 ≥ 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).

Pontis Community Services