



Federal Taxation of Individuals

Area III — Acronyms & Notes

**SUMMIT
CPA REVIEW**





M1: Filing Requirements and Filing Status

Page A — Calculations, Acronym Key & Thresholds

Acronym Key

Qualifying Child - CARES - Taxpayers provide more than half of the support

1. C - Close relative
 - a. Son, daughter, stepson, stepdaughter, brother, sister, step brother, stepsister or descendent of those.
2. A - Age limit
 - a. Younger than a taxpayer
 - b. 19 years old OR
 - c. 24 years old if full time student (attends an educational institution at least 5 months)
 - d. No age limit if the individual is permanently disabled at any time during the tax year
3. R - Residency and filing requirements
 - a. Lives with taxpayers more than half the year
 - b. Exception: Dorms
4. E - Eliminate gross income test
5. S - Support test

Qualifying Relative - SUPPORT

1. S - Support test (over 50%)
2. U - Under a specified amount of gross income test
 - a. <5200
3. P - Precludes dependent filing a joint tax return test
4. O - Only citizens (US/Canada + Mexico)
5. Relative test OR Taxpayer lives with an individual for whole year
 - a. R - Relative
 - i. Children + descendants
 - ii. Siblings + descendants
 - iii. Parents + ancestors
 - iv. Aunts + Uncles
 - v. In laws
 - b. T - Taxpayer lives with an individual for a whole year
 - i. Taxpayer's broke bestie can become their dependent



Page B — Notes

Notes

Single:

1. Applies if taxpayers are unmarried, divorced, or legally separated under a final decree by the last day of the tax year
2. Standard deduction is lower than MFJ or HOH
3. Commonly tested because it's the default status if no other applies

Married Filing Jointly

1. Married couples filing one return combining income and deductions
2. Both spouses are jointly and severally liable for tax
3. Offers the lowest tax rates and highest standard deduction
4. Can file jointly even if one spouse has no income
5. If spouse dies during the year, MFJ can still be used

Married Filing Separately (MFS)

1. Married but choose to file separate returns
2. Each spouse reports their own income, deductions, and credits

Qualifying Surviving Spouse **with Dependent Child** – same benefits as MFJ

1. Spouse Dies Year 1, Can claim Year 1, 2, AND 3
2. The taxpayer has a child who can be claimed as a dependent
3. The taxpayer paid over half the cost of keeping up a home for the child
4. The taxpayer could have filed a joint return in the year the spouse died
5. **Principal Residence For Dependent:** Entire Year

Head Of Household

1. Taxpayer must be unmarried on the last day of the tax year
2. Must have paid more than half the cost of maintaining a home for the tax year
3. **Principal Residence For Dependent:** Half Year

Qualifying Child – CARES - Taxpayers provide more than half of the support

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 - a. Son, daughter, stepson, stepdaughter, brother, sister, step brother, stepsister or descendent of those.
7. A - Age limit
 - a. Younger than a taxpayer



- b. 19 years old OR
 - c. 24 years old if full time student (attends an educational institution at least 5 months)
 - d. No age limit if the individual is permanently disabled at any time during the tax year
- 8. R - Residency and filing requirements
 - a. Lives with taxpayers more than half the year
 - b. Exception: Dorms
- 9. E - Eliminate gross income test
- 10. S - Support test

Qualifying Relative - SUPPORT

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 - i. Children + descendants
 - ii. Siblings + descendants
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 - b. T - Taxpayer lives with an individual for a whole year
 - i. Taxpayer's broke bestie can become their dependent

Taxpayers must know if their income is equal or greater than

- 1. Standard deduction
- 2. Additional standard deduction for taxpayers age 65 and older

Extension

- 1. Automatic Six-month extension to October 15: Available for those taxpayers who are unable to file by April 15 due date
 - a. Not an extension for the payment of any taxes owed
- 2. Payment of tax: even with an extension, the due date for payment remains April 15

Multiple Support Agreements: two or more taxpayers together contribute more than 50 percent to the support of a person but none of them individually contributes more than 50 percent

- 1. Must be qualifying relatives
 - a. Relationship



- b. Provided >50%
 - c. Gross Income test
- 2. Or lived the entire year with the individual
- 3. **More** than 10 percent
- 4. Required to file a multiple support declaration
- 5. No single person can contribute more than 0% support under this agreement

Children of Divorced Parents

- 1. Only the parent with custody qualify to use child as dependent
- 2. Determined by time test, not divorce decree
- 3. It doesn't matter which parent provided more support
- 4. If parents have equal custody
 - a. Parents with higher AGI will claim tax benefits

Individual Income Tax Formula

- 1. Adjustments FOR AGI - **ASSHATMEDS**
- 2. Standard deduction (15k single, 30k married)/Itemized deduction - **MTICCO**
- 3. QBI Deduction
- 4. = Taxable Income



II: Gross Income: Part 1

Page A — Calculations, Acronym Key & Thresholds

Acronym Key

Exceptions - **HIM DEAD TED (makes withdrawal as taxable income)**

1. **H - Homebuyer** (Distribution used toward the purchase of a first home within 120 days of distribution (10k maximum exclusion)
2. **I - Insurance** (medical if unemployed and with 12 consecutive weeks of unemployment compensation)
3. **M - Medical Expenses** (in excess of percentage of AGI)
4. **D - Disability**
5. **E - Education:** College tuition, fees, books, etc.
6. **A - Adoption** (5k max)
7. **D - Disaster** (22k per disaster)
8. **T - Terminal** illness or death
9. **E - Emergency** Expenses (1000/yr)
10. **D - Domestic** Abuse Victims (lesser of 10,300 or 50 percent)



Page B — Notes

Notes

Gross Income: All Income from whatever source derived, unless specifically excluded.

In order to be taxable, the gain must be realized and recognized.

1. **Realization:** Realization requires the accrual or receipt of cash, property, or services, or a change in the form or the nature of the investment (a sale or exchange).
2. **Recognition:** Recognition means the realized gain must be included on the tax return.

Timing of Revenue Recognition

1. **Accrual Method:** Recognition occurs according to the rules of GAAP (with some exceptions); that is, revenue is taxable when earned.
2. **Cash Method:** Under the cash method, recognition occurs in the period the revenue is actually or constructively received in cash or fair market value of property

Taxpayers

1. Cash basis taxpayers should report gross income for the year in which income is either actually or constructively received, whether in cash or in property.
2. Accrual basis taxpayers: income and expenses are generally recognized when they are earned or incurred, regardless of when cash is actually received or paid.

Accruable expense: Services have been received/performed but not have been paid for by the end of the recording period

Nontaxable Fringe Benefits

1. Life insurance coverage – Up to 50,000
2. Accident, Medical, and Health insurance (Employer-Paid): Amounts paid out to employee and not paid directly are still taxable
3. De Minimis Fringe Benefits
4. Meals and Lodging: (Lodging only if a condition of employment)
5. Employer Payment of Employee's Educational Expenses (Up to 5,250) – Applies to both graduate and undergraduate degrees
6. Employee Adoption Assistance Program
7. Dependent Care Assistance
8. Qualified Tuition Reduction
 - a. Undergraduate: May exclude tuition reduction



- b. Graduate: May exclude tuition reduction only if they are engaged in teaching or research activities, and only if the tuition reduction is in addition to the pay for the teaching or research.
 - c. Tuition Reductions must be done on a non-discriminatory basis
- 9. Qualified Employee Discounts
 - a. Merchandise Discounts
 - b. Service Discounts
- 10. Employer-Provided Parking (Up to 325/ month)
- 11. Transit Passes (Up to 325/ month)
- 12. Qualified Non-Roth Retirement Plans
 - a. Contributions Made by Employer (Nontaxable)
 - b. Contributions Made by Employee (Nontaxable)
 - c. Benefits Received (Taxable)
- 13. Flexible Spending Arrangements
 - a. Pretax Deposits into Employee's Account
 - b. Forfeit funds not used within 2 ½ months after year end

Taxable Employee fringe benefit: Provided by an employer to an employee that is considered part of the employee's taxable income

- 1. Moving expenses
- 2. Company car
- 3. Group-term life insurance (<50k)
- 4. Graduate school tuition and fees (<5250)
- 5. Expenses for parking garage near work (325/month)
- 6. Lodging (Only excluded if provided for convenience not requirement)

Taxable Miscellaneous Income

- 1. **Prizes and awards:** FMV is taxable income (only if the taxpayer entered into the contest)
- 2. **Gambling Winnings and Losses:** Losses deductible for itemized deductions ONLY up to the amount won.
- 3. **Damages Awards:** If it's in lieu of wages then it would be income
- 4. **Punitive Damages (Punishment Damages):** Always taxable since it's meant to punish the other party.
- 5. **Compensatory Damages (Funds to make a person whole again):** Compensates them for personal injury and is always taxable for slander or loss of personal reputation
- 6. **Cancellation of Debt (COD) Income**
 - a. Not taxable if the following:
 - i. Debt is discharged through insolvency
 - ii. Taxpayer is insolvent when the debt is cancelled
 - iii. Cancellation of debt as a gift, bequest, devise, or inheritance



- iv. Cancellation of nonrecourse secured loan, including foreclosure on personal residence (treated as a sale of the forfeited secured property)
- v. Student loans forgiven by lender are not included in borrower's taxable income (2021-2025)

Qualified Educational Expenses

- 1. Tuition
- 2. Fees required for enrollment or attendance
- 3. Books required for courses

Not Taxable payment

- 1. Property settlements
- 2. Child support

Qualified ROTH IRA distributions are nontaxable

- 1. Made at least five years after taxpayer made first contribution
- 2. Taxpayer at least 59.5 when received distribution

Tax Treatment of Early Withdrawal from

Deductible Traditional IRA

Age Rule: Withdrawals before age 59 ½ are generally subject to a 10% early withdrawal penalty unless an exception applies

Taxation: Entire withdrawal amount is taxable as ordinary income if contributions were deductible

Exceptions - **HIM DEAD TED (makes withdrawal as taxable income)**

- 11. **H - Homebuyer** (Distribution used toward the purchase of a first home within 120 days of distribution (10k maximum exclusion))
- 12. **I - Insurance** (medical if unemployed and with 12 consecutive weeks of unemployment compensation)
- 13. **M - Medical Expenses** (in excess of percentage of AGI)
- 14. **D - Disability**
- 15. **E - Education:** College tuition, fees, books, etc.
- 16. **A - Adoption** (5k max)
- 17. **D - Disaster** (22k per disaster)
- 18. **T - Terminal** illness or death
- 19. **E - Emergency** Expenses (1000/yr)
- 20. **D - Domestic** Abuse Victims (lesser of 10,300 or 50 percent)



State and Local Tax Refunds

1. Receipt of a state or local income tax refund in a subsequent year is not taxable if the taxes paid did not result in a tax benefit in the prior year
 - a. Itemized in prior year = state or local refund is taxable
 - b. Standard deduction used in prior year = state or local refund is nontaxable

Tax Exempt Interest Income (Reportable but not Taxable)

1. State and Local Government Bonds/Obligations
2. Bonds of a U.S. Possession
3. U.S. Series EE Savings Bonds (issued after 1989)
 - a. **Ownership:** Purchaser of the bonds must be the sole owner (or joint owner with their spouse). The bonds cannot be purchased in the name of a dependent or someone else.
 - b. **Age:** Owner must be at least 24 years old at the time the bonds are issued
 - c. **Use of proceeds:** Redemption proceeds must be used to pay qualified higher education expenses (tuition and fees) for the taxpayer, their spouse, or dependent
 - d. **Qualified Expenses Reduced By Scholarships:** Expenses must be reduced by any tax-free scholarships
 - e. **Bonds Issued After 1989**
 - f. **Filing status:** Married taxpayers must file jointly
 - g. **Phase Out Limits**
 - i. Single: 99,500-114,500
 - ii. Married filing joint: 149,250-179,250

Dividend Income

Source Determines Taxability

1. Corporate earnings and profits -> taxable dividend
2. No earnings and profits and taxpayer have basis in stock -> nontaxable and reduces basis of stock
3. No earnings and profits and no stock basis -> taxable capital gain income

Taxable Dividend

1. All dividends that represent distributions of a corporation's earnings and profits (similar to retained earnings) are includable in gross income
2. **Taxable Amount (to Recipient Shareholder)**
 - a. Cash = amount received
 - b. Property = fair market value



Preferential Tax Rate for Qualified Dividends

1. Qualified Dividends Holding Period: To be qualified dividends, the stock must be held for more than 60 days during the 120-day period that begins 60 days before the ex-dividend date
2. Nonqualified Dividends
 - a. Employer stock held by an employee stock ownership plan (ESOP)
 - b. Amounts taken into account as investment income (for purposes of the limitation on investment expenses)
 - c. Short sale positions
 - d. Certain foreign corporations
 - e. Dividends paid by credit unions, mutual savings banks, building and loan associations, mutual insurance companies, and farmer's cooperatives

Alimony Requirements

1. Payment must be in cash or its equivalent
2. Payments cannot extend beyond the death of the spouse
3. Payments must be legally required pursuant to a written divorce agreement
4. Payment cannot be made to members of the same household
5. Payments must not be designated as anything other than alimony
6. The spouses may not file a joint tax return

Examples of Property Settlements (Nontaxable)

1. Cash payments
2. Real estate
3. Personal property
4. Retirement accounts
5. Business interests
6. Use of property
7. Other tangible or intangible assets jointly owned during the marriage

Annuities

Fixed period annuities

Example: 100k investment now = Benefit of: 12k annually for 10 yrs

1. Identify the total investment in the annuity: 100k
2. Determine the fixed payment period: 10
3. Calculate the nontaxable return of capital = $100k/10 = 10k$
4. Note the annual annuity payment amount: 12K
5. Calculate the taxable portion of each payment: $12k - 10k = 2k$



Modified Adjusted Gross Income

1. Income excluded because of the foreign-earning income exclusion
2. Exclusion/deduction claimed for foreign housing
3. Any interest income from series EE bonds utilized for higher education
4. Deduction claimed for student loan or qualified tuition related expenses
5. Any employer paid adoption expense
6. Any deduction claimed from an annual contribution to tradition IRA

Common Testable Items Not Included in Gross Income

1. State tax refunds
2. Inheritance
3. Proceeds from a lawsuit for physical injuries
4. Loans Received
5. Workers' Compensation for job-related injury
6. Interest on state and local government bonds (municipal bonds)
7. Interest on obligations of the U.S. Possessions (Puerto Rico Bonds)
8. Gifts and bequests

Social Security Benefits

Payments received from the Social Security Administration, typically for retirement, disability, or survivors.

Modified Adjusted Gross Income for Social Security:

$MAGI = AGI + \text{Tax-Exempt interest} + 50\% * \text{Social Security Benefits}$

Tiers are as follows

1. Lower than 25k single, 32k MFJ: \$0 Taxable
2. Middle: Single filer: 25k-34k, Married filing Jointly: 32k-44k: 50% Taxable

Higher than 34k single, 44k MFJ: **Up to 85% of Social Security Benefits Included in Gross Income**



Premiums for Group Term Life Insurance provided by an employer

1. First \$50,000 of coverage is nontaxable to the employee.
2. Any coverage above \$50,000 is taxable. Calculated using the IRS-established uniform cost of insurance per \$1,000 coverage
3. **Calculation**
 - a. Coverage: \$200,000
 - b. Subtract: \$50,000
 - c. Taxable coverage: \$150,000
 - d. IRS Established: \$9/\$1000 coverage
 - e. Taxable Units: $150,000 / 1,000 = 150$
 - f. Excess coverage: $150 * 9 = 1350$
 - g. Taxable Premium: 1350

Home Sale Exclusion: When selling your primary residence you can exclude up to 250k (single), 500k (married filing jointly) of the capital gains from your taxable income.

1. Owned home for 2 years during the 5 year period ending on the date of sale
2. You used the home as your principal residence at least 2 years during the same five year period

Exclusion Reduction

1. **Nonqualified use:** Any period I own the home but do not use it as my principal residence BEFORE the last time I lived there.
 - a. IRS gives a grace period
2. **Proportional Reduction:** Based on the ratio of nonqualified use to total ownership

Example

Owned home for years 1-5

Lived in home: Years 1-2

Rented it for years 3-5

Sold at Year 5

Rental period is AFTER the last time I lived there so NO reduction applies



M3: Gross Income: Part 2

Page A — Calculations, Acronym Key & Thresholds

Acronym Key

- (No acronyms detected in module text.)

Page B — Notes

Notes

Gross Income

1. Cash = amount received (cash basis)
2. Property = fair market value
3. Cancellation of debt

Included on Schedule C (Deductible Business Expenses)

1. Gross business revenue
2. Rent expense
3. Wages paid to employees
4. Payroll taxes for employees
5. Supplies expense
6. Insurance expense
7. Depreciation expense
8. Business meals @ 50%
9. Health insurance expense only for employees
10. State and local business taxes
11. Ordinary and necessary business expenses
12. Trap: Self Employment tax is not a deductible business expense on Schedule C, It is a FOR AGI deduction on Form 1040

Guaranteed Payments to Partners

Definition: Payments made to a partner for services rendered or use of capital, regardless of partnership income

Tax Treatment:

1. Treated as earned compensation
2. Subject to self-employment tax



3. Deductible by the partnership as a business expense

Income From Hobbies

1. Income inclusion
2. No expense deductions
3. Report all hobby income, no deductions will be considered

Self-Employment Tax (50 Percent)

Definition: A tax consisting of Social Security and Medicare taxes primarily for individuals who work for themselves

Why? It applies to net earnings from self-employment and is separate from federal income tax

1. Self-employed taxpayers with net business income are subject to two taxes: income tax and self-employment (Social Security and Medicare) tax.
2. Fifty percent of the self-employment tax is deducted to arrive at an adjusted gross income.

S Corporation

Definition: Income passed through to Shareholders from an S corporation

Tax treatment

1. Included in shareholder's gross income
2. Not subject to self-employment tax
3. S corporation income is taxed differently than partnership income for self-employment tax purposes

Partnership Income and Self-Employment Tax

1. Income from a partner is subject to self-employment tax only if received by a general partner
2. Limited partners generally do NOT pay self-employment tax
3. Example
 - a. Guaranteed payment from services rendered to a partnership

Taxation of Barter Transactions and Noncash Income

1. Fair market value of property or services received in exchange for services or goods

Prepaid Interest Deduction Rules

1. Must be allocated over to the period to which the interest relates
2. Applies to both cash basis and accrual basis taxpayers



Residence Leasing – Taxation and Deductions

Personal/Rental Residence Classification

Rented 15 days or more

Personal Use > 14 days or 10% of rental days

Rental Income Reporting

1. Must be included in gross income if rented more than 14 days
2. Rental income and expenses go on Schedule E (Supplemental Income and Loss)
3. No reporting required for fewer than 15 days

Deductible Expenses

1. Real estate taxes and mortgage interest
 - a. Deductible regardless of rental or personal use status
 - b. Allocated between rental and personal use if mixed use
2. Utilities and maintenance
 - a. Deductible only for the rental portion on Schedule E
3. Depreciation
 - a. Deductible only for rental portion on Schedule E

Rental Income Calculation

+ Gross rental income

+ Prepaid rental income

+ Rent cancellation payment

+ Improvement in lieu of rents

- (rental expenses)

= Net Rental Income (Loss)

Trap: Security Deposits are NOT taxable



IV: Adjustments

Page A — Calculations, Acronym Key & Thresholds

Acronym Key

Grace's For AGI – ASS HAT MEDS

Begins with: Ordinary net income determined from Schedule C that gets added into AGI

1. Alimony (pre 2019)
2. Student Loan interest deduction (Max: 2,500)
3. Self employed health insurance deduction (100% deductible)
4. Health saving account deduction (Up to annual limits)
5. Attorney fees ONLY FOR discrimination/whistle blower
6. Traditional IRA contribution deduction (7,000/person + 1,000 catch up if 50 or older)
 - a. Deduction phases out if:
 - i. Taxpayer is an active participant in an employer-sponsored retirement plan AND
 - ii. AGI exceeds certain thresholds
7. Moving Expenses (Only as an active member of the Armed forces)
8. Educator Expenses – As the teacher (Max: 300/ educator)
9. Deductible part of self-employment tax: (50% of self-employment tax paid) 92.35%
10. Self-employed retirement plan contributions (Limits depend on type of plan)



Page B — Notes

Notes

Retirement Savings Contribution Credit: Eligible taxpayers may also be entitled to a tax credit for contributions to either a traditional IRA or a Roth IRA, subject to certain limitations

Traditional IRA Contributions

Definition: Contributions made to a traditional individual retirement account

Tax treatment: Deductible as an adjustment for AGI on the tax return

Deduction Limits

1. Maximum contribution limit is 7k (Including catch up if age 50+)
2. Deduction amount is limited to the lesser of the contribution or earned income
3. Minimum distributions are required to be taken by April 1 of the year following the year in which the taxpayer reaches age 73
4. Earnings on deductible traditional IRA contributions accumulate tax free until withdrawn
5. **The adjustment is allowed for a year only if the contribution is made by the due date for Individuals (April 15)**

Participation In Employee Sponsored Retirement Plan

Filing Status	2025 AGI Phase out
Single	79000-89000
Married filing jointly	126000-146000

Traditional IRA Calculation

1. Determine the total account balance at the time of distributions
2. Identify the total contributions made to the IRA, separating deductible and nondeductible contributions
 1. **Deductible**
 2. **Nondeductible**
3. Calculate the earnings in the IRA: Total account balance – Total contributions (deductible and nondeductible)
4. Taxable portion of the IRA: Deductible contributions + Earnings
5. Taxable percentage= Taxable portion/ Total account balance
6. Taxable amount: Distribution x Taxable percentage



Nonworking Spouse + Working Spouse in Employee Sponsored Retirement Plan Chart

	Spouse 1 has earned income		Spouse 2: 0 Income
2025 Modified AGI Phase Out	In employee sponsored retirement plan	Can IRA be deducted	Can IRA be deducted
N/A	No	Yes	yes
<126k	Yes	Yes	Yes
126k-146k	Yes	Yes (IRA deduction Phases out)	Yes
146,k-236k	Yes	No	
236k-246k	Yes	No	Yes (IRA deduction phases out)
>246k	Yes	No	No

Roth IRA contributions

Definition: Contributions made to a Roth IRA, a retirement account funded with after-tax dollars

Tax Treatment: Contributions are never deductible

Why does it matter?

1. Roth IRA contributions do not reduce taxable income in contributions year
2. Qualified distributions in retirement are tax free

Phase Out:

MFJ: 236k-246k: If above limit, no Roth IRA contributions are allowed

Single: 150k-165k: If above limit, no Roth IRA contributions

Roth IRA Taxable Portion Calculation

1. Identify the total distribution amount
2. Determine if distribution is qualified or nonqualified
 1. **Qualified:**
 1. Roth IRA has been open for at least 5 years
 2. Taxpayer is age 59 ½ or over/ HIMDEADTED
 2. **Nonqualified:** If these conditions are not met
3. Apply the ordering rules for ROTH IRA distributions
 1. Contributions – nontaxable
 2. Then conversions if any
 3. Earnings (taxable only if distributions is nonqualified)
4. **Qualified = nontaxable**



5. Nonqualified = taxable earnings only

Student Loan Interest Deduction Overview

Above the line deduction FOR AGI

Maximum deduction: 2500/yr

Eligibility Requirements

1. Qualified Loan: Pay education expenses
2. Filing status: Available to taxpayers who are not dependents on another person's tax return
3. Income Limits
 - a. Single: Phase out begins: 85k
 - b. MFJ: Phase Out begins: 170k
4. Payment requirement: Interest must be actually paid during tax year

IRA Contributions

	Under Age 50	Age 50 and Over
Unmarried	7000 or earned income	8000 or Earned Income
Married	14000 (7000 each) or earned income of married couple	16000 or Earned Income

Phase Out - Active participant

1. Lower
2. Medium: Single: 77k-87k, 123k-143k (both active participants)
3. Higher:

Phase Out: Spouse Not Active Participant

1. Lower
2. Medium: 230k-240k



3. Higher

Phase Out Married Filing Separate: 0-10k

Form 1040

Schedule C

Reports business income and expenses for a sole proprietor

1. Gross receipts or sales
2. Business expenses
3. COGS
4. Business interest expense
5. Depreciation related to business assets
6. Business taxes
7. Net profit or loss from the business

Schedule SE

Calculates self-employment tax (Social Security and Medicare) on net self-employment income

1. Net Earnings from self-employment (from Schedule C or Schedule K-1)
2. Calculation of total self-employment tax owed
3. 50% of self-employment tax is deductible as an adjustment on Form 1040



V: Itemized Deductions

Page A — Calculations, Acronym Key & Thresholds

Acronym Key

Itemized Deductions – MTICCO

7. M - Medical expenses
 1. Burial expenses does not count
 2. Allowed if primarily for medical care
 3. Includes: Doctors, hospitals, prescription drugs, medical schools for disabled children, repairs/maintenance of medical equipment
 4. Reduce by 7.5% of AGI threshold
 5. **Individuals:** Filing taxpayer, spouse, dependent who receives >50% support
 6. **Only for expenses paid during the year**
8. T - Taxes: State, local, and real estate taxes paid (SALT deduction) **Cap 10k**
 1. Real estate taxes on your **personal residence (primary AND Vacation)** are deductible
 2. Personal property taxes on your **automobile (car)** are deductible
 3. State and local taxes are deductible + your withholdings
 4. Self-employment tax = NOT itemized (50% is an above the line adjustment)
9. I - Interest: Home mortgage interest
 1. Qualified Home mortgage interest is deductible (up to 750k debt) - pre-2018
 1. 1M debt now (MFJ)
 2. Qualified mortgage interest paid
 2. Deduction allowed only if debt is acquisition debt
 1. Buy, build, or substantially improve the home
 2. Net Investment Income (interest, dividends, royalties, short-term capital gains)
 3. Excess can be carried forward indefinitely
10. C - Charity: Charitable contributions
 1. Contributions to qualified orgs + Contributions from a Schedule K-1
11. C- Casualty: Casualty and theft losses
 1. Only if in federally declared disaster area
 1. Steps
 1. Smaller of damages or decreased FMV
 2. Subtract insurance reimbursement
 3. Subtract 100/ event
 4. Subtract 10% of AGI
12. O - Other Deductions: Gambling Losses
 1. Deductible only up to **Gambling** Winnings



Page B — Critically Important AGI Floors

Medical Expenses: Deductible only to the extent they exceed 7.5% of AGI (Adjusted Gross Income)

Defining Principal:

1. Medical expenses must be for the **diagnosis, cure, mitigation, treatment, or prevention of disease**, or for affecting any part or function of the body
2. Supplies or equipment that are necessary **because of a medical condition** qualify.
3. **The medical necessity or direct condition**

Examples

1. Cost of wigs used due to hair loss from chemotherapy
2. Building a steam room or swimming pool at home if prescribed by a doctor (must reduce the expense by any increase in home value)
3. Repair and maintenance of a motorized wheelchair
4. Annual exams
5. Dental implants
6. Hearing aid batteries
7. Transportation costs

Casualty and Theft Losses Floor: Deductible only for losses exceeding \$100 per casualty event (Could be multiple tornados in one year if you live in Oklahoma) and then only 10% of AGI are deductible (same if there's 1 tornado or 10000 tornados). Only for personal-use property losses in federally declared disaster areas.

1. Home
2. Car
3. Furniture
4. Etc.



Home Mortgage Interest

Home Equity Indebtedness: A loan secured by your first or second home but not used to purchase, build, or substantially improve that home. This is only deductible if the loan proceeds are used to acquire, construct, or substantially improve the residence that secures the loan.

Limit:

1. Married filing jointly; 750,000
2. Married Filing Separate or Single: 375,000

Requirements

1. Incurred in buying, constructing, or substantially improving the taxpayer's principal and second home
2. Secured by the home

Points: Prepaid interest you pay upfront when taking out a loan, usually a mortgage. Each point equals 1% of the loan amount. (EX: 200k loan, one point = 2k)

1. **Points paid to purchase or improve your main residence:** Generally deductible in full in the year you pay them as mortgage interest
2. **Points paid to refinance a mortgage:** Not deductible immediately. They must be capitalized and amortized over the life of the loan.

Charity AGI Limitations – **DO NOT** Get these confused with Corporation's 10% Charity Limitation

(percentages are of AGI)	Public Charities (Salvation Army)	Private Operating Foundations (Family foundation that runs their own scholarship program or medical research facility)	Private Nonoperating Foundation (Makes grants to other charitable organizations rather than directly operating programs themselves.)
Cash (Cash, Charity Items paid – Fair value of things received)	60%	60%	30%
Ordinary Income Property (Used furniture, Clothes to salvation army with valuation receipt)	50%	50%	30%
Long-Term Capital Gain Property (Land @ Fair value)	30%	30%	20%



Page C — Notes

Notes

Additional Standard Deduction for Age 65 or Older and/or Blindness

	Unmarried	Married
One qualified taxpayer		
65 or blind	2000	1600
65 AND blind	4000	3200
Two Qualified Taxpayers		
Each 65 OR blind		3200
Both 65 AND blind		6400



Investment Interest Expense

Definition: Interest paid on money borrowed to purchase taxable investments is called investment interest expense

1. The investment interest deduction for individuals is limited to net taxable investment income
2. Interest
3. Dividends
4. Short term capital gains
5. Royalties (in excess of expenses)
6. Net long -term capital gains and qualified dividends (only if the taxpayer elects not to claim the reduced capital gains tax rate)

Stockholders' Derivative Suit: Definition and Purpose

1. Derivative Suit: A lawsuit filed by a stockholder in the name of the corporation to enforce a right or recover damages on behalf of the corporation
2. Used when the corporation fails or refuses to enforce its own rights
3. Commonly brought against directors or officers who have breached their duties

When

1. To recover damages from corporate management for wrongful acts
2. Ultra vires act: acts by directors or officers outside their authority or scope of power

Schedule E: Report **Passive** Income or loss from rental real estate, royalties, partnerships, S corporations, estates, trusts, and residual interests in REMICs.

Purpose: Calculate the net income (loss) from these sources which then flows into AGI

1. Rental Real Estate Income
2. Rental Real Estate Expenses
3. Royalties

Income (loss) from Partnerships, S Corporations, Estates, and Trusts



Medical Itemized Deductions Example

Medical insurance premiums paid	\$ 8,000
Deductible paid for medical insurance	1,000
Hospital costs for emergency room visit	2,000
Vitamins for general health (Easy to get = doesn't count)	–
Prescription eyeglasses	200
Visits to the doctor and dentist	700
Health club dues for general health (Easy to get = doesn't count, too general)	–
Insurance co-pays for prescription drugs	300
Transportation to doctor's office for required medical care	100
Insurance reimbursement for hospital visit	(1,500)
Total net qualified medical expenses	\$ 10,800
Less: percentage of AGI floor:	
AGI	\$ 80,000
Times 7.5%	<u>× 7.5%</u>
	6,000
	(6,000)
Total deductible medical expenses on Schedule A	<u><u>\$ 4,800</u></u>



VI: Section 199A Qualified Business Income Deduction

Page A — Calculations, Acronym Key & Thresholds

Acronym Key

- (No acronyms detected in module text.)

Page B — Notes

Notes

Basic Calculation

Lesser of

1. 20% of Qualified Business Income (Qualified Trade or Business)
2. 20% of Taxable Income

Deduction Type and Placement

1. From AGI deduction (below the line)
 1. Taken after adjusted gross income
2. Separate from the standard or itemized deductions

QBI Income Limitation Calculation

1. Start with gross income
2. Subtract above-the-line adjustments to get AGI
3. From AGI, subtract either the standard deduction or itemized deductions to get taxable income before the QBI deduction
4. This taxable income before the QBI deduction is the amount used to determine the QBI phase-out limitation category

Income Thresholds and Limitations

1. Below certain thresholds
 1. Single filers: 197,300
 2. Single filers: >247,300, NOT eligible for the QBI deduction on income from specified service trade or business (SSTB)
2. Above thresholds, the deduction may be limited or phased out
 1. Service trades or businesses



Specified Service Trade or Business (SSTB) Rules

1. Taxable Income exceeds the thresholds, no QBI deduction is allowed for SSTB income
 1. Consulting
 2. Law
 3. Health services
 4. Accounting firm
2. Below the threshold, SSTBs are treated the same as qualified trades or businesses

NEITHER an SSTB or QTB: The business is NOT conducted within the US

Wage and Property Limitations (For High-Income Taxpayers OVER the QBI Income Limit)

Apply this on a case-by-case basis for EACH business

1. Income thresholds about the deduction is limited to the lesser of
 1. 20% QBI or
 2. Greater of
 1. 50% of w-2 wages paid by the business
 2. 25% of w-2 wages plus 2.5% of the unadjusted basis of qualified property

Overall Deduction Limit: Cannot exceed 20% of taxable income minus net capital gains

Things included in Qualified Business Income

1. Net Ordinary Business Income
2. Gain
3. Deduction
4. Loss

Excludes

1. Wages or salary earned as an employee
2. Guaranteed Payments to Partners
3. Capital Gains or Losses
4. Dividends
5. Interest Income (unless it is properly allocable to the business)
6. Certain other investment income



From AGI Deductions

1. Standard deduction
2. Itemized deduction
3. QBI deductions

**Form 1040 (Example)**

Line	Description	Amount
1	Wages, Salaries, and tips	0
2	Taxable Interest	2,500
3	Ordinary Dividends	5,000
4	IRA distributions (taxable amount)	0
5	Pensions and Annuities (taxable amount)	0
6	Social Security Benefits (taxable amount)	0
7	Capital Gain or (loss)	25,000
8	Other Income from Schedule 1, Line 10	150,000
9	Total Income. Add lines 1 through 8	182,500
10	Adjustments to Income from Schedule 1, Line 26	9,537
11	Adjusted Gross Income. Subtract Line 10 from Line 9.	172,963
12	Standard deduction or itemized deduction	26,000
13	Qualified Business Income deduction	0
14	Add lines 12 and 13	26,000
15	Taxable Income> Subtract Line 14 from line 11	146,963

**QBI vs SSTB Deduction Calculation (Example)**

	QTB (Qualified Trade or Business) or SSTB (Specialized Trade or Business)	QBI Deduction for Each Business	Taxable Income
Taxable Income before QBI Deduction			250,000
QBI deduction for Each Business:			
Bravo partners	QTB	10,000	
Delta Company LLC	QTB	2,000	
Foxtrot Consulting	SSTB	11,000	
Total Section 199A QBI Deduction			23,000
Taxable Income After QBI Deduction			227,000

**Limitations On Taxable Income Level**

Filing Status	
Single and all other	197,300-247,300
Married Filing Jointly	394,600-494,600

Or greater of

1. 50% of W-2 wages for business
2. 25% of W-2 Wages for business plus 2.5% of the unadjusted basis immediately after acquisition of all qualified property

Then, Lesser of

1. Above
2. 20% of QBI



VII: Tax Computations & Credits

Page A — Calculations, Acronym Key & Thresholds

Acronym Key

Page B — Notes

Types of Tax credits

1. Refundable credits: Can reduce tax liability below zero
 1. Earned Income Credit (EIC)
 2. Child Tax Credit (Partially refundable)
 3. Excess Social Security Tax Withheld
 4. Federal Income tax withheld
 5. American Opportunity Credit (40%)
2. Refundable Credits: can reduce tax liability to zero but no refund beyond that
 1. Lifetime learning credit
 2. Retirement saving contribution credit
 3. Credit for the elderly or permanently disabled
 4. Child and dependent care credit: (Under 13) 20 percent to 35 percent of work related expenses to care for qualifying persons
 1. One dependent 3k
 2. Two or more dependents 6k
 3. Identify Qualified Children for the credit
 1. Becky is 10 years old (under 13) qualified
 2. Matt is 14 years old (not under 13) does not qualify
 4. Determine total eligible expenses
 1. Spent 5k for each child so 10k total
 2. Only Becky's 5k qualifies because Matt is too old
 5. Apply the maximum eligible expense limit per child
 1. Maximum eligible expenses for one child is 3k
 2. So, eligible expenses are limited to 3k
 6. Limit expenses by the lower earned income of the two spouses
 1. Frank earns 60k
 2. Mary 2.5K
 3. Eligible expenses are limited to lower earned income 2.5k
 7. Determine the applicable credit percentage based on combined income
 1. Their combined income is 62.5k
 2. For AGI over 43k, the credit rate is 20%



Adoption Tax Credit

Purpose: Provides a tax credit to taxpayers who incur qualified expenses related to adopting a child

Qualifying expenses

1. Legal fees
2. Agency Fees

Non-qualifying expenses

1. Medical expenses for the child

Credit limitations

1. 16,810/per child

Nonrefundable Credit:

2. Adoption credit is nonrefundable meaning it can reduce your tax liability to zero but will not generate a refund beyond that
3. Carry forward the unused credit for up to 5 years
4. Common Nonrefundable tax credits
 1. Retirement Saving Contribution Credit (Saver's Credit)
 1. Traditional IRA, Roth IRA, or qualified employer-sponsored retirement plan
 2. Credit is based on contributions of up to 2k per taxpayer
 3. Why it matters: Often confused with refundable credits

Phase-Out Based on Income

1. The credit begins to phase out when Modified Adjusted Gross Income (MAGI) exceeds 252,150
2. Completely phased out at 292,150

Employer Adoption Assistance:

1. Employer provides adoption, can exclude up to 16,810 of those payments from your income
2. Cannot double dip by claiming both

Tax Credits vs. Tax Deductions

1. Credits reduce tax liability dollar for dollar
2. Deductions reduce taxable income



Foreign Tax Credit

1. Taxpayers may claim a credit for foreign income taxes paid to a foreign country or United States possession.
2. Allowable Credit
3. There is no limit on foreign taxes used as a deduction; however, foreign tax credits are limited to the lesser of:
 1. Foreign taxes paid
 2. $(\text{Taxable Income from all operations} / \text{Total taxable worldwide income}) \times \text{U.S. tax} = \text{foreign tax credit limit}$
 3. As a credit against federal income taxes due

Carryover of Excess (Disallowed) Credit

1. Any disallowed foreign tax credit may be carried over as follows:
 1. Carry back one year
 2. Carry forward 10 years

General Business Credit: Included

1. Investment credit
2. Work opportunity tax credit
3. Alternative fuels credit
4. Increased research credit (generally 20 percent of the increase in qualified research expenditures over the base amount for the year)
5. Low-income housing credit
6. Qualified Child care expenditures
7. Welfare to work credit
8. Employer provided child care credit
9. Small employer retirement plan start-up costs credit
10. Alternative motor vehicle credit
11. Other Infrequent (on exam) credits

Net Investment Income Tax

1. 3.8 percent to certain net investment income of individuals who have income above statutory thresholds AGI amounts
2. Statutory threshold amounts are 250k for a filing status of married filing jointly, and 200k for taxpayers with a single or head of household filing status
3. 3.8 percent tax is imposed on the lesser of net investment income or the excess AGI over the threshold amount



Kiddie Tax

The kiddie tax applies to the net unearned income of a dependent child under age 18 and taxes it at the parents' marginal rate

1. This prevents parents from shifting investment income to children in lower tax brackets to reduce family liability
1. Under 18 years of age/full time student until 24

2025 Child's Unearned Income	Tax Rate
0-\$1350	0%
1351-2700	Child's rate
Over 2700	Parent's rate

Kiddie Tax

Chris, age 5, has 3k in interest income with no earned income this year. The standard deduction for dependents unearned income is 1350.

1. First 1350 taxed at 0%
2. Second 1350 taxed at child's marginal rate
3. Anything above 2700 is taxed at Parents' Marginal rate



Earned Income Credit

A refundable tax credit designed to help low to moderate income working individuals and families

Encourages Work by low-to-moderate income taxpayers

Refundable credit: can reduce tax liability below zero, resulting in a refund even if no income tax is owed

One of the few credits that can generate a refund without any tax liability

Carryback/Carryforward: None needed, excess credit paid out immediately

Eligibility

1. Must have earned income from wages, salaries, tips, or self-employment
2. Must meet income limits (phase-out thresholds vary by filing status and number of qualifying children)
3. Must be at least age 19 if there are no qualifying children
4. If married, the taxpayer **MUST** generally file a joint return with their spouse (**Married filing separate disqualifies a taxpayer from claiming EIC**)
5. Must have a valid Social Security Number
6. Must be a U.S. Citizen or resident for more than half the year
7. Cannot have investment income exceeding 11,950 in 2025

Tests for Child

1. Qualifying Relationship Test
 1. Child must be related to the taxpayer by blood, marriage, or law
 2. Must be in the same generation or a later generation of the taxpayer
 3. A foster child qualifies if officially placed with taxpayer by agency
2. Age Test
 1. Under 19 at end of tax year
 2. Under 24 and a full-time student
 3. Permanently and totally disabled at any age
3. **Dependent Primary Residence:** Half-Year



If below than Phase Out Start: **Lesser of**

1. Phase In Credit = Earned Income x Credit Rate
2. Max Credit for each

If above the Phase Out Start, it goes as follows:

1. Single Earned Income: 12,000
2. Max Credit: 649
3. Credit Rate: 7.65%
4. Phase-Out threshold: 10,620
5. Phase Out Rate: 7.65%

Credit for the Elderly or Permanently Disabled

Provides tax relief for taxpayers age 65+ or permanently disabled

Refundability: Nonrefundable

Carryback/carryforward: Not Allowed

Limitation:

1. 5000 single or one spouse qualified
2. 7500 if both spouses qualify
3. 3750 if married filing separately

Reduced by

1. Social security and other excludable pensions
2. 50% of AGI exceeding thresholds
 1. 7500 single + MFS
 2. 10000 MFJ

Foreign Tax Credit

Prevents double taxation on income taxed by a foreign country and the U.S.

Treated as a credit against federal income taxes due.

Calculation: Lesser of foreign taxes paid on U.S. tax on foreign item (Limited by ratio of foreign income to worldwide income)

Carryback: 1 Year

Carryforward: 10 Years



Child and Dependent Care Credit

Offsets the costs of child or dependent care while the taxpayer works.

Refundability: Nonrefundable

Carryback/carryforward: Not Allowed

Limitations: Maximum qualifying expenses: 3,000 for one dependent, 6,000 for two or more

Credit Rate: 20% to 35% of qualifying expenses, phased down as AGI increases

Eligibility

1. Under age 13 or a disabled dependent/spouse
2. Both spouses must have earned income
3. Capped at Lower earner

Grace is warning you: Use it or lose it

Child Tax Credit

2000 tax credit for each qualifying child, but the refundable amount is lesser

Refundable

1. Excess of the child tax credit over tax liability
2. 15% of your earned income over 2500
3. 1700 per qualifying child

Phase out: Must reduce by \$50 for each \$1000 by which AGI exceeds the following:

1. 400,000 for MFJ
2. 200,000 for Single
3. 200,000 for MFS



American Opportunity Tax Credit - only for Undergraduate education

Available for the first four years of postsecondary undergraduate education

1. 100% of the first 2k qualified expenses
2. 25% of the next 2k
3. Making the max 2500 per student per year

Refundable: Up to 40% of the credit (2500×0.4) = 1k

Enrollment Term: Must be enrolled at least half-time for at least one academic period during the year.

Lifetime Learning Credit (20% of 10k) - 2000 MAX/ tax year NOT 2000 per student

A nonrefundable education tax credit that reduces your tax liability dollar-for-dollar based on qualified tuition and related expenses

1. Students enrolled in eligible educational institutions
2. All years of post-secondary education
3. Includes undergraduate, graduate, and professional degree courses

Lifetime Learning Credit - Example

Grace only enrolled in one quarter of her MBA because she is lazy. This costed her \$4,250. She can deduct 20% of this and wants to because she thinks school is dumb. $4,250 \times 0.2 = 850$. She wishes it was more because she's dropping out to work at McDonalds instead.

Disclosure: BOTH American Opportunity Credit + Lifetime Learning Credit can be claimed on the same return, but NOT for the same student.



Coverdell Education Savings Account

A tax-advantage savings account designed to pay for qualified education expenses

Tax Treatment of earnings are as follows

1. Accumulate tax-free inside the account
2. Distributions are tax free if used for qualified education expenses

Reporting

1. Not taxable and thus do not appear on the tax return

Retirement Savings Contribution Credit (Saver's Credit)

A nonrefundable tax credit designed to encourage low and moderate-income taxpayers to save for retirement by contributing to retirement accounts

Eligible Contributions

1. Traditional IRAs and Roth IRAs
2. Maximum credit is based on up to 2,000 per taxpayer per year
3. Must be at least 18 years old
4. Cannot be a full-time student
5. Cannot be claimed as a dependent

Credit Rate	Single or MFS	Head of House	MFJ	Max Credit
50%	0-23,750	0-35,625	0-47,500	$2000 \times 0.5 = 1000$
20%	23,571-25,500	35,626-38,250	47,501-51,000	$2000 \times 0.2 = 400$
10%	25,501-39,500	38,251-59,250	51,001-79,000	$2000 \times 0.1 = 200$
0%	>39,500	>59,250	>79,000	$2000 \times 0 = 0$



Social Security Tax Over withholding - Excess FICA withheld

Excess Social Security Paid

Single Employer

1. Employee cannot claim a credit on tax return
2. Must claim refund or adjust for excess withholding

Refundable!

Multiple Employers

1. May claim the excess as a credit against their income tax
2. The excess as a credit against income tax, if that excess resulted from correct withholding by two or more employers

No reimbursement from employers

Estimated Taxes (Required Minimum)

1. Estimated quarterly payment with the following conditions
2. 1,000 or more tax liability
3. Inadequate tax estimates
 1. Withholding is less than
 1. 90 percent of current year tax
 2. 100 percent of last year tax

TRAP: It still applies if an individual files a return with zero tax liability last year. This, however, does not apply to corporations.

Exception: AGI > 150k (MFJ), 75k (S) in prior year, 110 percent of the prior year's tax liability is used to compute safe harbor

Married Filing Jointly: 150,000

Single: 75,000

1. Withholding is less than

1. 90 percent of current year tax
2. 110 percent of last year tax



Penalty For Underpayment of Estimated Taxes

Penalty imposed when a taxpayer does not pay enough tax throughout the year via withholding or estimated tax payments

Key Rule: 1,000 or less

Calculation example:

Owes: 16,500 in tax

Employer withheld: 16,000

Pays: 300 with extension

Unpaid Balance: $16,500 - 16,300 = 200$

$200 < 1000$ no underpayment penalty

Penalty Rate

1. 0.5% per month (or part of a month) on the amount of underpayment
2. Max 25% of the unpaid tax amount

Avoid tax return preparer penalty

1. Complete and submit a Paid Preparer's Due Diligence Checklist
2. Document the earned income credit calculation, including the method and information used to make the computation
3. Make reasonable inquiries if the information furnished to the preparer appears incorrect

Estimated Taxes (Required Minimum)

1. A taxpayer is required to make estimated quarterly tax payments if both the following conditions are met
 1. 1000 or more tax liability
 1. One condition is met if the amount of taxes owed (excess of tax liability over withholding) is expected to be 1k or more
 2. Inadequate tax estimated
 1. 90 percent of the current year's tax
 2. 100 percent of last year's tax

Applies if zero tax liability prior year