NYS Training for Tax Preparers

Common Federal Schedules

Get Started

Overview

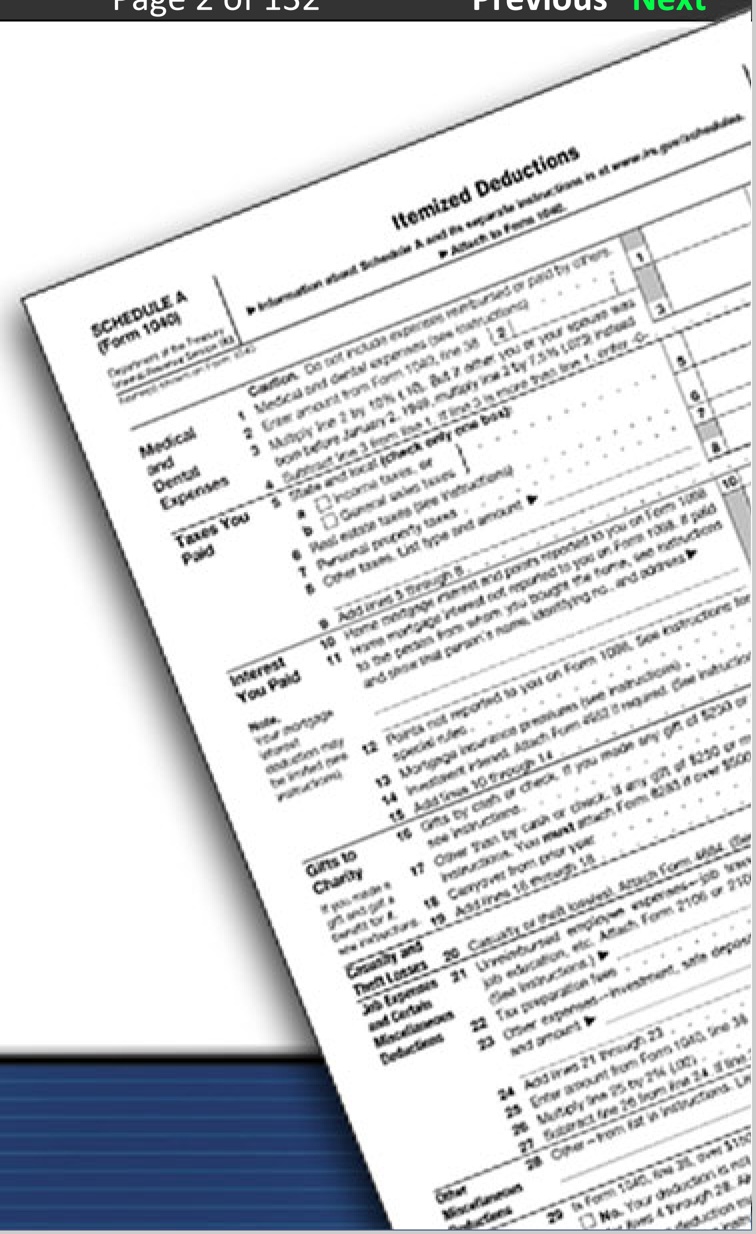
During this presentation we'll discuss the following federal schedules:

- Schedule A, *Itemized Deductions*
- Schedule B, *Interest and Ordinary Dividends*
- Schedule C, *Profits or Loss from Business*
- Schedule D, *Capital Gains/Losses*
- Schedule E, *Supplemental Income and Loss*

Section 1

Schedule A

Itemized Deductions


SCHEDULE A (Form 1040)

Itemized Deductions

Medical and Dental Expenses

Taxes You Paid

Interest You Paid

Gifts to Charity

Casualty and Theft Losses

Job Expenses and Certain Miscellaneous Deductions

Other Miscellaneous Deductions

Schedule A: Itemized Deductions

To arrive at their taxable income, taxpayers may either deduct the standard deduction from federal adjusted gross income or itemize deductions.

Taxpayers who elect to itemize their deductions, do so by filing Schedule A along with their federal tax return.

- If spouses file separately, they must both take either the standard or the itemized deduction.
- Taxpayers with a Federal Adjusted Gross Income (FAGI) of more than a certain amount have limitations on some of their itemized deductions when calculating Schedule A.
- Whose income is $150,000 or greater may be subject to a limitation on the amount of itemized deductions they can claim. Use the Itemized Deductions Worksheet to determine the amount of any limitation.

Schedule A: Itemized Deductions

To arrive at their taxable income, taxpayers may either deduct the standard deduction from federal adjusted gross income or itemize deductions.

Taxpayers who elect to itemize their deductions, do so by filing Schedule A along with their federal tax return.

- If spouses file separately, they must both take either the standard or the itemized deduction.
- Taxpayers with a Federal Adjusted Gross Income (FAGI) of more than a certain amount have limitations on some of their itemized deductions when calculating Schedule A.
  - Married Filing Jointly or Qualifying Widow(er) – Limited if FAGI more than $300,000.
  - Head of Household – Limited if more than $275,000.
  - Single – Limited if more than $250,000.
  - Married Filing Separately - Limited if more than $150,000

Schedule A: Itemized Deductions

Some examples of itemized deductions are:

- Medical expenses
- Taxes paid
- Interests paid
- Gifts to charity
- Casualty and theft loss
- Job expenses and certain miscellaneous deductions (subject to the 2% limit)
- Miscellaneous deductions (**not** subject to the 2% limit)

Medical Expenses

Taxpayers may deduct medical expenses for themselves, their spouse, or their dependents if those expenses are not compensated by insurance.

Qualifying Medical Expenses

Almost all medical expenses can be deducted on Schedule A, such as:

- Medical care expenses
  - expenses incurred for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body
- Transportation primarily for medical care
  - standard mileage is $0.235
  - lodging is $50 a night per person

Qualifying Medical Expenses

- Prescription drugs or biologicals which require a prescription from a physician for its use by an individual.
- Long-term care service
- Health savings account

Examples of Medical Expenses

Remember, these items are only deductible if they were **not** covered by insurance.

- bandages
- birth control pills prescribed by a doctor
- body scan
- braille books
- breast pump and supplies
- capital expenses for equipment or improvements to the taxpayer's home needed for medical care (see the worksheet in Publication 502)
- diagnostic devices
- expenses of an organ donor
- eye surgery (to promote the correct function of the eye, not cosmetic)

Examples of Medical Expenses (continued)

Remember, these items are only deductible if they were not covered by insurance.

- certain enhancement procedures
- guide dogs or other animals aiding the blind, deaf, and disabled
- hospital services fees (lab work, therapy, nursing services, surgery, etc.)
- lead-based paint removal
- legal abortion
- legal operation to prevent having children such as a vasectomy or tubal ligation
- long-term care contracts, qualified
- meals and lodging provided by a hospital during medical treatment
- medical services fees (from doctors, dentists, surgeons, specialists, and other medical practitioners)

Examples of Medical Expenses (continued)

Remember, these items are only deductible if they were not covered by insurance.

- Medicare Part D premiums
- medical and hospital insurance premiums
- nursing services
- oxygen equipment and oxygen
- part of life-care fee paid to retirement home designated for medical care
- physical examination
- pregnancy test kit
- prescription medicines (prescribed by a doctor) and insulin
- psychiatric and psychological treatment

Examples of Medical Expenses (continued)

Remember, these items are only deductible if they were not covered by insurance.

- Social security tax, Medicare tax, FUTA, and state employment tax for worker providing medical care (see *Wages for nursing services*, below)
- special items (artificial limbs, false teeth, eye-glasses, contact lenses, hearing aids, crutches, wheelchair, etc.)
- special education for mentally or physically disabled persons (only if recommended by Dr.)
- stop-smoking programs
- transportation for needed medical care
- treatment at a drug or alcohol center (includes meals and lodging provided by the center)
- wages for nursing services
- weight-loss, certain expenses for obesity

Limitation on Medical Expenses

Beginning in 2013:

To be deductible, the total of taxpayers' medical expenses must exceed 10% of their federal adjusted gross income (FAGI). Furthermore, taxpayers can only deduct the amount that exceeds 10%.

For medical expenses paid for in 2013, 2014, 2015 and 2016, substitute 7.5% of the federal AGI if the taxpayer (or the taxpayer's spouse) has attained the age of 65 before the close of such tax year.

Prior to 2013:

The threshold for expenses to be deducted was 7.5 percent of FAGI in prior years.

Common Mistakes

The following expenses are not deductible on Schedule A:

- Drugs and medications **not prescribed** by a doctor

  - Medicines or drugs that can be purchased without a prescription are not qualifying medical expenses.

- General health expenses

  - Therapeutic vacations
  - Gym memberships

Common Mistakes (continued)

The following expenses are not deductible on Schedule A:

- Pre-tax medical premium payroll deduction
  - The taxpayer received a tax benefit when the payroll deduction occurs.
  - A second deduction is not allowed.
- Amounts reported on box 12, code DD, of the wages and tax statement
  - This amount is the amount paid by the employer towards health insurance premiums.

For further information, see IRS Publication 502, *Medical and Dental Expenses* and IRS Tax Tip 2014-21.

Knowledge Check

Which of these expenses is not a qualified medical expense?

- ○ copays
- ○ over the counter medication
- ○ lead-based paint removal
- ○ treatment at a drug or alcohol center

Knowledge Check

Which of these expenses is not a qualified medical expense?

- ( ) copays
- (•) over the counter medication
- ( ) lead-based paint removal
- ( ) treatment at a drug or alcohol center

A taxpayer incurred qualifying medical expenses totaling $6,000. The taxpayer is 66 years old during the 2014 tax year, and his FAGI is $75,000. If the taxpayer itemized his deductions in 2014, what is the medical expenses deduction?

- ( ) $6,000
- ( ) $0
- ( ) $375
- ( ) more information is needed to answer

Knowledge Check

Which of these expenses is not a qualified medical expense?

- ( ) copays
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- ( ) $6,000
- ( ) $0
- (•) $375
- ( ) more information is needed to answer

Taxes Paid

A deduction can be taken on Schedule A for certain taxes paid during the tax year. Deductible taxes include:

- State, local, and foreign real property taxes
- State and local personal property taxes
- State, local, and foreign income taxes, or state and local sales taxes*
- Generation skipping tax imposed on income distributions
- Qualified motor vehicle taxes

Income Taxes (State, Local, and Foreign)

State and local taxes are deductible to the extent they are imposed on income, war profits, or excess profits.

- Reported on line 5 of Schedule A
- Taxpayers may elect to deduct state and local **sales** taxes in lieu of state and local income taxes.

General Sales Tax

- A general sales tax is imposed at one rate on the retail sale of a broad range of items.
  - In order to be deductible, the sales tax must be stated separately on the invoice or receipt.
- Substantiation requirements
  - Taxpayers may use the optional sales tax tables to compute their deduction. If they use this method, no substantiation is required.
  - Taxpayers who do not use the optional sales tax tables must keep the actual receipts showing the amount of general sales taxes paid.

Real Property Taxes (State, Local, and Foreign)

Real property taxes are taxes imposed on interests in real property. They are levied for the general public welfare by the proper taxing authorities of a state. They are imposed at a consistent rate against all property in the territory over which the taxing authority has jurisdiction.

Real Property Taxes (State, Local, and Foreign)

Real property taxes are reported on line 6 of Schedule A and must satisfy three tests to qualify for the deduction:

1. They must be imposed or triggered by the ownership of real property and not on the exercise of one or more of the incidents of property ownership, such as the use or disposition of the property.
2. They must be measured by the value of the real property itself and not by any other value, such as the value of a renter's use of the property.
3. They must be imposed on the property itself, and not solely as a personal tax. For instance, an excise tax on the use of property is not a real property tax.

Personal Property Taxes (State, Local, and Foreign)

Personal property taxes are reported on line 7 of Schedule A. To be deductible, the tax must be:

- ad valorem; that is, substantially proportionate to the value of the personal property; and
- imposed on an annual basis, even if it is collected more or less frequently, and
- imposed on personal property. A tax meets this requirement even if in form it is imposed on the exercise of a privilege.

Common Mistakes

- Property taxes deducted in the wrong year
  - Property taxes paid in January 2014 are reported on the 2014 income tax return, which is due April 15, 2015. These taxes should not be not deducted on the 2013 income tax return, which is due April 15, 2014.(deduct in year paid, not assessed)
- Car registration and other fees.
  - These amounts are sometimes reported as personal property taxes. Car registration fees and other fees are not taxes based on the value of the property, ad valorem.

Knowledge Check

During the 2014 tax year, a taxpayer pays $6,000 in income taxes withheld, $7,000 in real estate taxes, and $2,000 in general sales taxes. Assuming the taxpayer wants to maximize their tax benefit, what is the amount of the deduction for taxes paid?

- ○ $15,000
- ○ $9,000
- ○ $8,000
- ○ $13,000

Knowledge Check

During the 2014 tax year, a taxpayer pays $6,000 in income taxes withheld, $7,000 in real estate taxes, and $2,000 in general sales taxes. Assuming the taxpayer wants to maximize their tax benefit, what is the amount of the deduction for taxes paid?

- ○ $15,000
- ○ $9,000
- ○ $8,000
- ◉ $13,000

Interest Paid

Taxpayers may deduct interest paid on:

- Home mortgage interest, including certain points and mortgage insurance premiums.
- Investment interest. (IRC § 163(a))
  - Individual taxpayers cannot deduct personal interest (IRC§163(h)(1)) on Schedule A.

For further information see

- Publication 936, *Home Mortgage Interest Deduction*
- Publication 550, *Investment Income and Expenses*

Mortgage Interest

Any indebtedness that is incurred in acquiring, constructing, or substantially improving any qualified residence of the taxpayer and that is secured by such residence is deductible. This applies to the main home or second home only.

- Only interest on loans up to $1,000,000 is deductible ($500,000 if MFS).
- If the interest it is paid to an individual, report it on line 10 or 11of Schedule A.
- Points paid on a mortgage not reported on Form 1098 are reported on line 12 of Schedule A.

Home Equity Indebtedness

Homeowners are also allowed to deduct the interest on a home equity loan.

The term “home equity indebtedness” means any indebtedness (other than acquisition indebtedness) secured by a qualified residence to the extent the aggregate amount of such indebtedness does not exceed:

- the fair market value of such qualified residence, reduced by
- the amount of acquisition indebtedness with respect to such residence.

The amount treated for home equity indebtedness for any period shall not exceed $100,000 ($50,000 if married filing separately).

Mortgage Insurance Premium

Premiums paid for qualified mortgage insurance by a taxpayer during the tax year in connection with acquisition indebtedness with respect to a qualified residence shall be treated as qualified residence interest. This amount is reported on line 13 of Schedule A.

For each $1,000 or fraction thereof ($500 if filing separately) that the taxpayer's adjusted gross income for the tax year exceeds $100,000 ($50,000 if filing separately) the deduction is reduced 10%.

The premium is only deductible for premiums paid between January 1, 2007 and December 31, 2013.

Investment Interest

Interest that is paid on indebtedness properly allocable to property held for investment is deductible, but the deduction cannot exceed the amount of investment income reported.

The amounts not allowed as a deduction for any tax year, because of the investment income limitation, shall be treated as investment interest paid by the taxpayer in the succeeding tax year.

Qualified Residence Interest

Also deductible are:

- interest paid during the tax year on acquisition indebtedness with respect to any qualified residence of the taxpayer; and
- interest paid during the tax year on home equity indebtedness with respect to any qualified residence of the taxpayer.

Common Mistakes

Homeowners' or hazard insurance are not deductible as mortgage insurance premiums.

Interest on car loans, credit cards, or personal loans is also non-deductible.

Knowledge Check

Which of the following interest payments made during the 2014 tax year are deductible on an individual taxpayer's return?

- ○ homeowners' insurance
- ○ mortgage insurance premiums
- ○ investment interest of $1,000, with investment interest $0
- ○ mortgage interest paid on acquisition indebtedness less than $1,000,000

Knowledge Check

Which of the following interest payments made during the 2014 tax year are deductible on an individual taxpayer's return?

- ○ homeowners' insurance
- ○ mortgage insurance premiums
- ○ investment interest of $1,000, with investment interest $0
- ◉ mortgage interest paid on acquisition indebtedness less than $1,000,000

Gifts to Charity

A deduction is allowed for charitable contributions made within the tax year. The amount of the deduction is limited to 50% of the taxpayer's FAGI.

- Certain contributions are limited to 30% of FAGI. IRC § 170(b)(1)(B).
- Charitable contributions not allowed, due to exceeding the limits, can be carried forward for five years. IRC § 170(d)(1)(A).

Gifts to Charity

Other reporting requirements:

- Cash donations are reported on line 16.
- Non-cash donations are reported on line 17.
- Carry forwards are reported on line 18.
- Taxpayers who deduct non-cash donations over $500 must attach Form 8283.

Charitable Contributions

Contributions or gifts (or the use of) to the following entities are tax deductible:

- a State, a possession of the United States, or any political subdivision of any of the foregoing, or the United States or the District of Columbia -- but only if the contribution or gift is made for exclusively public purposes

- a corporation, trust, community chest, fund, or foundation created or organized in the United States as long as all of the following are true:

  - the entity is organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals;

  - no part of the net earnings of which inures to the benefit of any private shareholder or individual; and

  - the entity is not disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office (IRC§170(c)).

Substantiation

Cash Donations, Treasury Regulations §1.170A-15

Contributions up to $250 must provide a bank record or letter from the charitable organization that shows:

- the name and address of the organization that received the donation;
- the date of the contribution; and
- the amount of the contribution.

Contributions of $250 or more require the above documentation, plus a contemporaneous written acknowledgment (as described in 170(f)(8) and 1.170A-13(f)).

Substantiation

Non-Cash Donations, Treasury Regulation §1.170A-16

Contributions up to $250 require a receipt showing:

- the name and address of the organization that received the donation;
- the date of the contribution;
- detailed description of the property donated, including value

If impractical to obtain receipt, reliable written records are sufficient.

Contributions from $251 - $500 require the above receipt, plus a contemporaneous written acknowledgment (as described in 170(f)(8) and 1.170A-13(f)).

Substantiation

Non-Cash Donations, Treasury Regulation §1.170A-16 (cont.)

Contributions from $501 - $5,000 require:

- contemporaneous written acknowledgment (as described in 170(f)(8) and 1.170A-13(f))
- completed Form 8283

Contributions greater than $5,000 require the above, plus a qualified appraisal (as defined in §1.170A-17(a)(1)).

Common Mistakes

- Donations made to a non-qualifying organization are **not** deductible. In order to qualify for a deduction, the donations must be made to an organization that qualifies under IRC §170(c).
    - Donations to individuals are not deductible.
- Deducting incorrect amount
    - If goods or services were provided in consideration of the donation, the amount deductible is the amount of the donation less the fair market value of goods or services received.

Knowledge Check

Taxpayer donated $10,000 to his church, $2,000 to a political campaign, $300 to various homeless people, $1,000 for a fundraising dinner (FMV of dinner was $200) for animal abuse prevention, and $2,000 to his son. Assuming the taxpayer has all required documentation, and his FAGI for the tax year is $30,000, how much should his gifts to charity deduction be?

- ○ $10,800
- ○ $15,300
- ○ $15,000
- ○ $15,100

Knowledge Check

Taxpayer donated $10,000 to his church, $2,000 to a political campaign, $300 to various homeless people, $1,000 for a fundraising dinner (FMV of dinner was $200) for animal abuse prevention, and $2,000 to his son. Assuming the taxpayer has all required documentation, and his FAGI for the tax year is $30,000, how much should his gifts to charity deduction be?

- (x) $10,800
- ( ) $15,300
- ( ) $15,000
- ( ) $15,100

Casualty and Theft Losses

A casualty loss is a loss of property arising from fire, storm, shipwreck, or other casualty. A casualty loss may arise from a disaster, auto accident, hurricane, or flood. It requires an event of a sudden, unexpected, or unusual nature.

Casualty losses are reported on line 20 of Schedule A.

- Losses arising from theft are also reported on line 20.
- When claiming a casualty or theft loss, taxpayers must complete Form 4684.

Casualty losses are generally deductible the year they occur. When the losses occur within a designated disaster area, they may be deducted the year immediately preceding the year they occurred.

Theft losses must be illegal under the law of the state where it occurred and it must have been done with criminal intent. They are deducted in the year of discovery.

- For more information see Publication 547, *Casualties, Disasters, and Thefts.*

Deduction Limits

The amount deductible for each casualty and theft loss is the actual amount of the loss (less any amount reimbursed by insurance) in excess of $100 ($500 for tax years beginning before December 31, 2009).

The aggregate amount of all casualty and theft loss is reduced by 10% of the taxpayers' adjusted gross income.

Example of Deduction Calculation

The taxpayer has two casualty losses in 2014. The amount of the first loss is $2,000 for which the taxpayer was reimbursed $500 by the insurance company. The amount of the second loss is $5,000, for which the taxpayer was reimbursed $2,000 by the insurance company. The taxpayer's FAGI is $30,000.

First Loss: ($2,000 - $500) - $100 = $1,400

Second Loss: ($5,000 - $2,000) - $100 = $2,900

Deductible Amount: ($1,400+$2,900) – ($30,000 x 10%) = $4,300 - $3,000 = **$1,300**

Common Mistakes

- Fair market value vs. adjusted basis
  - Use the adjusted basis when computing the loss.
- Insurance reimbursement and salvage value
  - When computing the amount of the loss, any insurance reimbursements and/or salvage values must be subtracted out.
- Loss is not sudden, unexpected, or unusual
  - An example of a sudden or unexpected loss is a loss caused by bug infestation (termites, ants, etc.).

Knowledge Check

Taxpayer's FAGI for 2014 is $75,000. During 2014, the taxpayer purchased a car for $20,000, and during the same year the car was in an accident, and it was totaled. The insurance company paid the taxpayer $15,000. If the taxpayer itemizes his deductions, how much can the taxpayer report for casualty loss?

- ○ $20,000
- ○ $0
- ○ $5,000
- ○ $4,900

Knowledge Check

Taxpayer's FAGI for 2014 is $75,000. During 2014, the taxpayer purchased a car for $20,000, and during the same year the car was in an accident, and it was totaled. The insurance company paid the taxpayer $15,000. If the taxpayer itemizes his deductions, how much can the taxpayer report for casualty loss?

- ○ $20,000
- ◉ $0 ✓
- ○ $5,000
- ○ $4,900

Job Expenses and Certain Misc. Deductions; 2% Limit

Taxpayers may deduct the aggregate of all deductible job expenses to the extent that they exceed 2% of the taxpayers' adjusted gross income. This includes:

- unreimbursed employee expenses
- tax preparation fees
- other expenses

Unreimbursed Employee Expenses

Unreimbursed employee expenses are deductible only if they were:

- paid or incurred during the tax year;
- for carrying on the taxpayer's trade or business of being an employee; and
- **ordinary** expenses common and accepted in the trade or business; and
- **necessary** expenses appropriate and helpful to the business.

These expenses are reported on line 21 of Schedule A. Form 2106 or 2106-EZ must be attached

Unreimbursed Employee Expenses

Examples of unreimbursed employee expenses:

- business bad debt of an employee
- business liability insurance premiums
- damages paid to a former employer for breach of an employment contract
- depreciation on a computer required by an employer to use for work
- dues to a chamber of commerce if membership helps the taxpayer do his or her job
- dues to professional societies
- educator expenses
- home office or part of a home used regularly and exclusively in your work. (must be for the convenience of the employer)
- job search expenses in the taxpayer's present occupation

Unreimbursed Employee Expenses

Examples of unreimbursed employee expenses (cont.):

- job search expenses in the taxpayer's present occupation
- laboratory breakage fees
- legal fees related to the taxpayer's job
- licenses and regulatory fees
- malpractice insurance premiums
- medical examinations required by an employer
- occupational taxes
- passport for a business trip
- repayment of an income aid payment received under an employer's plan

Unreimbursed Employee Expenses

Examples of unreimbursed employee expenses (cont.):

- research expenses of a college professor
- rural mail carriers' vehicle expenses
- subscriptions to professional journals and trade magazines related to the taxpayer's work
- tools and supplies used in the taxpayer's work
- travel, transportation, meals, entertainment, gifts, and local lodging related to the taxpayer's work
- union dues and expenses
- work clothes and uniforms if required and not suitable for everyday use
- work-related education

Educator Expenses

Up to $250 of educator expenses are reported as an adjustment to gross income. If expenses could not be deducted as an adjustment to income, they can be deducted as an itemized deduction on Schedule A, submitted to the 2% limit.

These expenses include those paid in connection with books, supplies, equipment (including computer equipment, software, and services), and other materials used in the classroom that relate to the taxpayer's job or business.

Home Office Expenses

If a taxpayer uses part of his or her home for business purposes, a part of the operating expenses and depreciation of the home may be deductible.

This deduction may be claimed only if that part of the home was regularly and exclusively used:

- as the principal place of business for any trade or business,
  - The regular and exclusive business use must be for the convenience of the taxpayer's employer and not just appropriate and helpful to the taxpayer.
- as a place to meet or deal with patients, clients, or customers in the normal course of trade or business, or
- in the case of a separate structure not attached to the taxpayer's home, in connection with the taxpayer's trade or business.

For more information, see IRS FAQs - *Simplified Method for Home Office Deduction*

Travel Expenses

Travel expenses are those incurred while traveling away from home for an employer. Taxpayers can deduct travel expenses paid or incurred in connection with a temporary work assignment. Generally, a taxpayer cannot deduct travel expenses paid or incurred in connection with an indefinite work assignment.

Travel expenses include:

- the cost of getting to and from the business destination (air, rail, bus, car, etc.),
- meals and lodging while away from home,
- taxi fares,
- baggage charges, and
- cleaning and laundry expenses.

Temporary Work Assignment

If an assignment or job away from home in a single location is realistically expected to last (and does in fact last) for one year or less, it is temporary, unless there are facts and circumstances that indicate it is not.

Indefinite Work Assignment

If an assignment or job away from home in a single location is realistically expected to last for more than one year, it is indefinite, whether or not it actually lasts for more than one year.

If an assignment or job away from home in a single location is realistically expected to last for one year or less, but at some later date it is realistically expected to exceed one year, it will be treated as temporary (in the absence of facts and circumstances indicating otherwise) until the date that the taxpayer's realistic expectation changes, at which point it will be treated as indefinite.

Local Transportation Expenses

Local transportation expenses are the expenses of getting from one workplace to another when not traveling away from home. They include the cost of transportation by air, rail, bus, taxi, and the cost of using a car.

Use the standard mileage rate to figure car expenses. The 2014 rate for business use of a vehicle is 56 cents per mile.

In general, the costs of commuting between a residence and a place of business are nondeductible. However, if a taxpayer works at two places in a day, whether or not for the same employer, they can generally deduct the expenses of getting from one workplace to the other.

Temporary Work Location

A taxpayer can deduct expenses incurred in going between the taxpayer's home and a temporary work location if at least one of the following applies:

- The work location is outside the metropolitan area where the taxpayer lives and normally works.
- The taxpayer has at least one regular work location (other than home) for the same trade or business. If this applies, the distance between home and the temporary work location does not matter.

Home Office

A taxpayer can deduct expenses incurred in going between home and a workplace if the home is their principal place of business for the same trade or business. In this situation, whether the other workplace is temporary or regular and its distance from the home do not matter.

Meals and Entertainment

Entertainment expenses (including entertainment-related meals) are deductible only if they are directly related to the active conduct of the taxpayer's trade or business.

Generally, 50% of the expenses are deductible.

Work Clothes and Uniforms

The cost and upkeep of work clothes is deductible if the following two requirements are met:

- The clothes must be worn as a condition of employment.
- The clothes must not be suitable for everyday wear.

Work-Related Education

Taxpayers can deduct expenses for education, even if the education may lead to a degree, if the education meets at least one of the following two tests:

- it maintains or improves skills required in the taxpayer's present work
- it is required by the taxpayer's employer or the law to keep the same salary, status, or job, and the requirement serves a business purpose of the taxpayer's employer

Taxpayers cannot deduct expenses for education, even though one or both of the preceding tests are met, if the education:

- is needed to meet the minimum educational requirements to qualify the taxpayer in his or her trade or business, or
- is part of a program of study that will lead to qualifying the taxpayer in a new trade or business.

Tax Preparation Fees

The taxpayer can usually deduct tax preparation fees on the return for the year in which they were paid. For example, on a taxpayer's 2013 return they can deduct fees paid in 2013 for preparing his or her 2012 return.

These fees include the cost of tax preparation software programs and tax publications. They also include any fee the taxpayer paid for electronically filing the return.

Other Expenses

Taxpayers can deduct certain other expenses as miscellaneous itemized deductions subject to the 2% of adjusted gross income limit. These expenses can be deducted even if they are not related to the trade or business of being an employee. Taxpayers can deduct the ordinary and necessary expenses paid:

- to produce or collect income that must be included in gross income,
- to manage, conserve, or maintain property held for producing such income, or
- to determine, contest, pay, or claim a refund of any tax.

Examples of Other Expenses Subject to the 2% Limit

- appraisal fees for a casualty loss or charitable contribution
- casualty and theft losses from property used in performing services as an employee
- clerical help and office rent in caring for investments
- depreciation on home computers used for investments
- excess deductions (including administrative expenses) allowed a beneficiary on termination of an estate or trust.
- fees to collect interest and dividends
- hobby expenses, but generally not more than hobby income
- indirect miscellaneous deductions from pass-through entities
- investment fees and expenses

Examples of Other Expenses Subject to the 2% Limit

- legal fees related to producing or collecting taxable income or getting tax advice
- loss on deposits in an insolvent or bankrupt financial institution
- loss on traditional IRAs or Roth IRAs, when all amounts have been distributed to the taxpayer
- repayments of income
- repayments of social security benefits
- safe deposit box rental, except for storing jewelry and other personal effects
- service charges on dividend reinvestment plans
- tax advice fees
- trustee's fees for an IRA, if separately billed and paid

Common Mistakes

- Claiming a deduction for work clothes that are suitable for general wear.
  - A shirt and tie are suitable for general wear and therefore not deductible.
  - This often applies to waiters/waitresses and home health aides.
- Claiming a deduction for maintaining professional appearance.
  - This often applies to security guards and sales representatives.
- Claiming reimbursable expenses
  - If the taxpayer is not reimbursed for employee expenses, but could have been reimbursed, i.e. fails to file expense report or chooses not to be reimbursed, the expenses are not deductible.
- Claiming expenses that are neither ordinary nor necessary
  - Extravagant and lavish expenses fall into this category.

Knowledge Check

Which of the following is not a deductible expense as Job Expenses and Certain Miscellaneous Deductions subject to the 2% limit on Schedule A?

- ○ travel expenses from home to a temporary work assignment
- ○ meals while away from home for work
- ○ tax preparation fees
- ○ legal fees in conjunction with a DWI charge

Knowledge Check

Which of the following is not a deductible expense as Job Expenses and Certain Miscellaneous Deductions subject to the 2% limit on Schedule A?

- ○ travel expenses from home to a temporary work assignment
- ○ meals while away from home for work
- ○ tax preparation fees
- ◉ legal fees in conjunction with a DWI charge

Miscellaneous Deductions; not subject to the 2% limit

Amortizable Premium on Taxable Bonds

- An amount in excess of bond price can be amortized for 15 years.

Casualty and Theft Loss on Income Producing Property

- If the damaged or stolen property was income-producing property, taxpayers can deduct a casualty or theft loss as a miscellaneous itemized deduction not subject to the 2% limit.

- Complete section B of Form 4684

Miscellaneous Deductions; not subject to the 2% limit

Federal Estate Tax on Income in Respect of a Decedent

Taxpayers can deduct the federal estate tax attributable to income in respect of a decedent that was included as a beneficiary include in his or her gross income.

Gambling Loss

Taxpayers can only deduct losses up to the reported amount of their winnings.

Miscellaneous Deductions; not subject to the 2% limit

Impairment-related Work Expenses

- Taxpayers who have a physical or mental disability that limits their employment, or substantially limits one or more of their major life activities, such as performing manual tasks, walking, speaking, breathing, learning, and working, they can deduct any impairment-related work expenses.
- Impairment-related work expenses are ordinary and necessary business expenses for attendant care services at a place of work and other expenses in connection with a place of work that are necessary for an individual to be able to work.

Loss from partnerships and other activities

- See Schedule K-1 (Form 1065-B), box 2

Miscellaneous Deductions; not subject to the 2% limit

Officials paid on a fee basis

- Taxpayers who are fee-basis officials, claim expenses in performing services in that job as an adjustment to income rather than as a miscellaneous itemized deduction.

Performing artists

- Taxpayer who are qualified performing artists, can deduct employee business expenses as an adjustment to income rather than as a miscellaneous itemized deduction.

- Complete Form 2106 or 2106-EZ if the taxpayer is an employee.

Miscellaneous Deductions; not subject to the 2% limit

Losses From Ponzi-type Investment Schemes

- These losses are deductible as theft losses of income-producing property on the tax return for the year the loss was discovered.
- Complete Section B of Form 4684 to figure the deductible loss.
- If taxpayer qualifies to use Revenue Procedure 2009-20 (as modified by Revenue Procedure 2011-58) and taxpayer chooses to follow the procedures in the guidance, complete Section C of Form 4684 before completing Section B.

Miscellaneous Deductions; not subject to the 2% limit

Repayments Under Claim of Right

If the taxpayer had to repay more than $3,000 that was included in income in an earlier year because at the time the taxpayer thought he had an unrestricted right to it, the taxpayer may be able to deduct the amount that was repaid, or take a credit against the tax.

- Unemployment received in one year and a portion of it repaid in a succeeding year is a common example.

Unrecovered Investment in Annuity

- A retiree who contributed to the cost of an annuity can exclude from income a part of each payment received as a tax-free return of the retiree's investment.
- If the retiree dies before the entire investment is recovered tax-free, any unrecovered investment can be deducted on the retiree's final income tax return.

Knowledge Check

Which of the following is a miscellaneous deduction not subject to the 2% Limit on Schedule A?

- ○ commuting expenses
- ○ gambling losses
- ○ lobbying expenses
- ○ professional accreditation fees

Knowledge Check

Which of the following is a miscellaneous deduction not subject to the 2% Limit on Schedule A?

- ○ commuting expenses
- ◉ gambling losses
- ○ lobbying expenses
- ○ professional accreditation fees

New York Itemized Deductions

Use the federal Schedule A as the starting point to compute New York itemized deductions.

Differences between federal and New York State tax laws make it necessary to make certain adjustments to your federal itemized deductions in computing your New York itemized deduction.

New York Itemized Deductions - Subtractions

To compute the amount of New York State itemized deductions, the following must be **subtracted from** federal itemized deductions:

- Additional state, local, and foreign taxes (or general sales tax, if applicable) from federal Schedule A, lines 5 and 8
- Ordinary and necessary expenses paid or incurred in connection with income or property held for the production of income that is exempt from New York income tax but only to the extent included in total federal itemized deductions
- Amortization of bond premium attributable to 2013 on any bond whose interest income is exempt from New York income tax, but only to the extent included in total federal itemized deductions
- Interest expense on money borrowed to purchase or carry bonds or securities whose interest is exempt from New York income tax, but only to the extent included in total federal itemized deductions.

New York Itemized Deductions - Subtractions (cont.)

To compute the amount of New York State itemized deductions, the following must be **subtracted from** federal itemized deductions:

- Long-term care premiums included on federal Schedule A, Line 29.
  - Premiums paid for long-term care insurance to the extent deducted in determining federal taxable income.(after 10% limitation)
- Shareholders of a federal S-Corp must subtract certain deductions they claim on their federal return.
  - If the taxpayer is a shareholder of a federal S corporation that could, but did not, elect to be a New York S corporation, the taxpayer must subtract any S corporation deductions included in the total federal itemized deductions.
  - If an S corporation short year is involved, the taxpayer must allocate those deductions.

Taxpayers with a Federal Adjusted Gross Income (FAGI) above certain levels, may need to use a worksheet to calculate the exact subtraction.

New York Itemized Deductions - Additions

To compute the amount of New York State itemized deductions, the following must be **added to** federal itemized deductions:

- **Interest expenses on income subject to New York tax**
  Interest expense on money borrowed to purchase or carry bonds or securities whose interest is subject to New York income tax, but exempt from federal income tax. Only include this amount if this interest expense was not deducted on the taxpayer's federal return or shown as a New York subtraction.

- **Ordinary and necessary expenses subject to New York tax**
  Expenses paid or incurred during 2013 in connection with income, or property held for the production of income, which is subject to New York income tax but exempt from federal income tax, if these expenses were not deducted on your federal return or shown as a New York subtraction.

- **Amortization interest income subject to New York tax**
  Amortization of bond premiums attributable to 2013 on any bond whose interest income is subject to New York income tax, but exempt from federal income tax. Only include this amount if the amortization was not deducted on the taxpayer's federal return or shown as a New York subtraction.

New York Itemized Deductions – Limitations

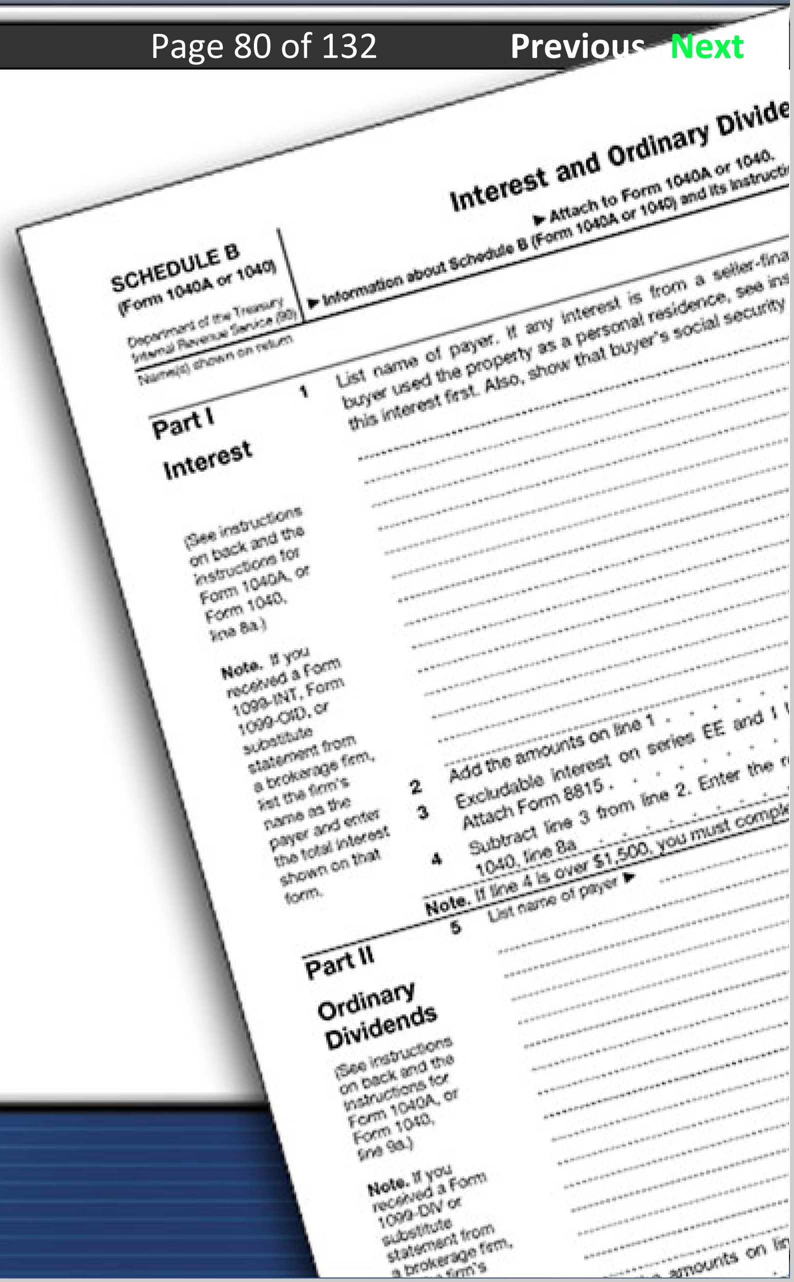
Taxpayers whose NYAGI (New York Adjusted Gross Income) is above $100,000 may be subject to a itemized deduction limitation with New York State, after already having their itemized deductions limited by the IRS.

- NYAGI more than $100,000 but not more than $475,000, must use Worksheet 3;
- NYAGI more than $475,000 but not more than $525,000, must use Worksheet 4;
- NYAGI more than $525,000 but not more than $1,000,000, must enter 50% of New York itemized deductions after additions and subtractions;
- NYAGI more than $1,000,000, but not more than $10,000,000, must use Worksheet 5; or
- NYAGI more than $10,000,000, must use Worksheet 6.

Section 2

Schedule B

Interest and Ordinary Dividends



Schedule B: Interest and Ordinary Dividends

- Schedule B is primarily used to report taxable income of over $1,500 in interest or ordinary dividend income.
- Not all file Schedule B and it is not as complex as other schedules that may be required.

The purposes of Schedule B are laid out in 3 different sections.

- Part I: Interest
- Part II: Ordinary Dividends
- Part III: Foreign Accounts and Trusts

Schedule B: Interest and Ordinary Dividends

Part I: Interest

- Report all taxable interest shown on your Forms 1099-INT, Forms 1099-OID, or substitute statements. Include interest from series EE, H, HH, and I U.S. savings bonds.

- List each payer's name and show the amount.

- Do not report on this line any *tax-exempt* interest from box 8 or box 9 of Form 1099-INT. Instead, report the amount from box 8 on line 8b of Form 1040A or 1040.

- Report interest received from a seller-financed mortgage where the buyer used the property as a personal residence.
  - Show the buyer's name, address, and SSN.

- List interest received as a nominee.*(in your name, but actually belonging to someone else)* Nominee interest is subtracted from your taxable interest on Part I.

Schedule B: Interest and Ordinary Dividends

Part I: Interest continued

- Accrued Interest – If bonds were purchased between interest payment dates and accrued interest was paid to the seller, this interest is taxable to the seller. The purchaser reports this interest, but it can be subtracted as "Accrued Interest."
- Original Issue Discount (OID) – Taxpayers that report interest that is less than shown on the 1099-OID, make subtraction and identify as "OID Adjustment."
- Amortizable Bond Premium – Taxpayers that reduce bond interest by the amortizable bond premium make the subtraction and identify it as "ABP Adjustment."
- Series EE or I Savings Bonds – If these bonds (issued after 1989) were cashed in but used to pay qualified higher education expenses for yourself, spouse, or dependent, you may exclude a portion of the interest. See Form 8815.

Schedule B: Interest and Ordinary Dividends

Part II: Ordinary Dividends

- Report all ordinary dividends shown on your Forms 1099-DIV or substitute statements.
- List each payer's name and show the amount.
- List ordinary dividends received as a nominee.*(in your name, but actually belonging to someone else)* Nominee dividends are subtracted from your taxable interest on Part II.
- Certain officers and directors may have to file Form 5471, *Information Return of U.S. Persons With Respect to Certain Foreign Corporations.*

Schedule B: Interest and Ordinary Dividends

Part III: Foreign Accounts and Trusts

- A taxpayer that has a financial interest in or signature authority over a financial account (such as a bank account, securities account, or brokerage account) located in a foreign country must disclose this in Part III.

The following forms may need to be filed.

- **Form 8938**, *Statement of Specified Foreign Financial Assets*
- **FinCEN Form 114**, *Report of Foreign Bank and Financial Accounts (FBAR).*
    - This is an online form filed with the Financial Crimes Enforcement Network (FinCEN) of the United States Treasury.

Knowledge Check

Which of the following taxpayers is not required to file Schedule B?

- ○ John received $1,501 of ordinary dividends.
- ○ Sue has $1,600 of taxable interest that she received as a nominee.
- ○ Mary received $801 of ordinary dividends and $700 in taxable interest.
- ○ Jake is the trustee of a foreign trust.

Knowledge Check

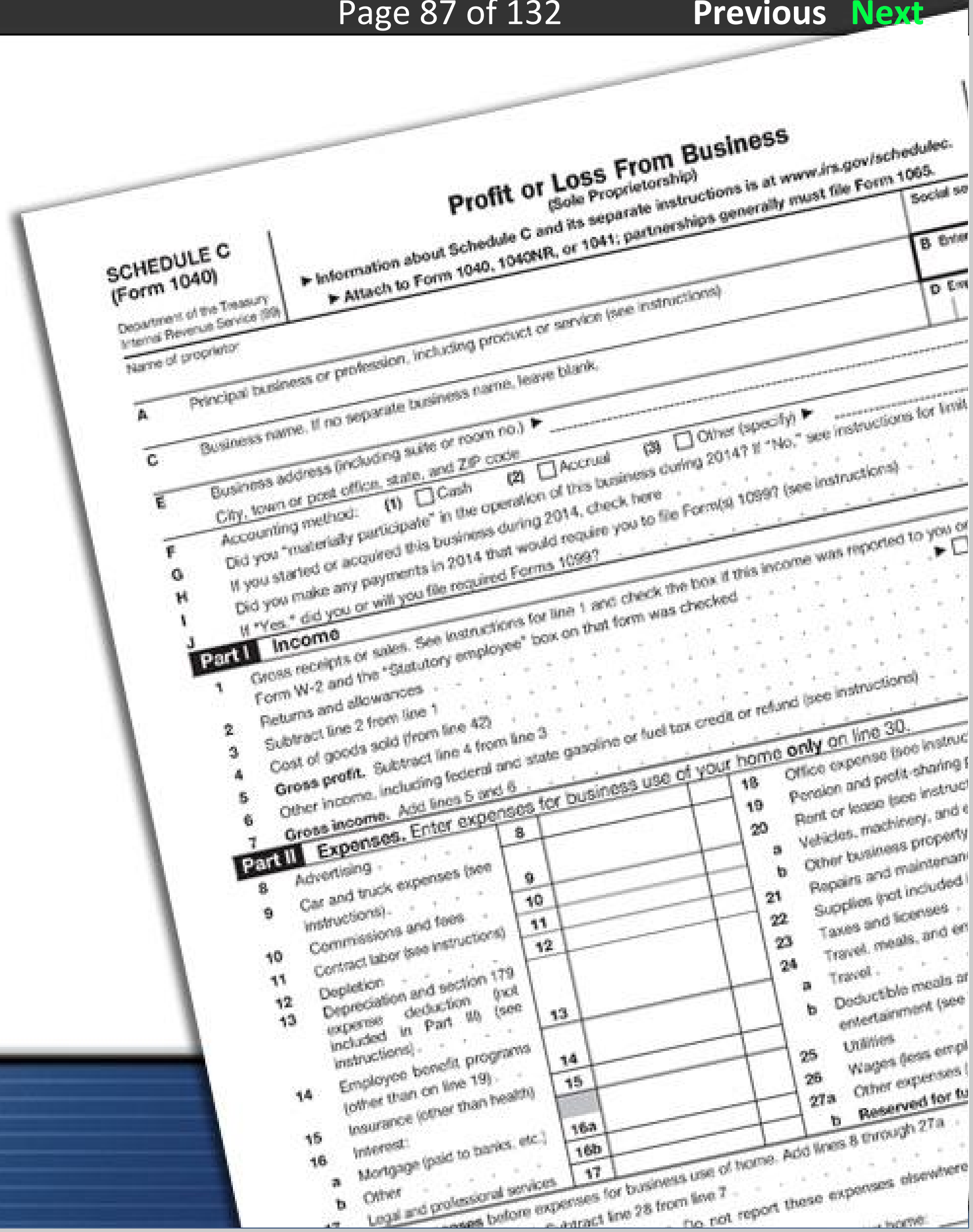
Which of the following taxpayers is not required to file Schedule B?

- ○ John received $1,501 of ordinary dividends.
- ○ Sue has $1,600 of taxable interest that she received as a nominee.
- ◉ Mary received $801 of ordinary dividends and $700 in taxable interest.
- ○ Jake is the trustee of a foreign trust.

Section 3

Schedule C

Profits or Loss From Business


SCHEDULE C
(Form 1040)
Department of the Treasury
Internal Revenue Service (99)
Profit or Loss From Business
(Sole Proprietorship)
▶ Information about Schedule C and its separate instructions is at www.irs.gov/schedulec.
▶ Attach to Form 1040, 1040NR, or 1041; partnerships generally must file Form 1065.
Name of proprietor
A Principal business or profession, including product or service (see instructions)
C Business name. If no separate business name, leave blank.
E Business address (including suite or room no.) ▶
City, town or post office, state, and ZIP code
F Accounting method: (1) ☐ Cash (2) ☐ Accrual (3) ☐ Other (specify) ▶
G Did you "materially participate" in the operation of this business during 2014? If "No," see instructions for limit
H If you started or acquired this business during 2014, check here
I Did you make any payments in 2014 that would require you to file Form(s) 1099? (see instructions)
J If "Yes," did you or will you file required Forms 1099?
Part I Income
1 Gross receipts or sales. See instructions for line 1 and check the box if this income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked
2 Returns and allowances
3 Subtract line 2 from line 1
4 Cost of goods sold (from line 42)
5 Gross profit. Subtract line 4 from line 3
6 Other income, including federal and state gasoline or fuel tax credit or refund (see instructions)
7 Gross income. Add lines 5 and 6
Part II Expenses. Enter expenses for business use of your home only on line 30.
8 Advertising
9 Car and truck expenses (see instructions)
10 Commissions and fees
11 Contract labor (see instructions)
12 Depletion
13 Depreciation and section 179 expense deduction (not included in Part III) (see instructions)
14 Employee benefit programs (other than on line 19)
15 Insurance (other than health)
16 Interest:
a Mortgage (paid to banks, etc.)
b Other
17 Legal and professional services
18 Office expense (see instructions)
19 Pension and profit-sharing plans
20 Rent or lease (see instructions)
a Vehicles, machinery, and equipment
b Other business property
21 Repairs and maintenance
22 Supplies (not included in Part III)
23 Taxes and licenses
24 Travel, meals, and entertainment:
a Travel
b Deductible meals and entertainment (see instructions)
25 Utilities
26 Wages (less employment credits)
27a Other expenses
b Reserved for future use

Schedule C: Profits or Loss From Business

Income or loss from a business operated, or a profession practiced by the taxpayer as a sole proprietor, is reported on Schedule C.

A sole proprietor is someone who owns an unincorporated business by himself or herself.

Generally, when filing Schedule C, other forms and schedules should also be filed.

Schedule C: Profits or Loss From Business

Schedule C is comprised of five parts:

- Part I: Income
- Part II: Expenses
- Part III: Cost of Goods Sold
- Part IV: Information on Your Vehicle
- Part V: Other Expenses

Part I: Income

Line 1: Gross Receipts or Sales

Gross receipts are the total amounts the organization received from all sources during its annual accounting period, without subtracting any costs or expenses.

- Self-employment
  - Enter gross receipts from the trade or business.
  - Include amounts received in the trade or business that were property shown on Forms 1099-MISC.
- Statutory employee
  - If "Statutory employee" is checked in box 13 of Form W-2, then put a check in the box above line 1, and enter on line 1 the amount reported in box 1 of Form W-2.

If both forms of income were received, file **two** Forms Schedule C.

Part I: Income

Line 2: Returns and Allowances

Trade discounts, cash discounts, and sales returns and allowances are to be included on line 2 of Schedule C.

Line 4: Cost of Goods Sold

The direct costs attributable to the production of the goods sold by a company.

- This amount includes the cost of the materials used in creating the good along with the direct labor costs used to produce the good.
- It excludes indirect expenses such as distribution costs and sales force costs.
- This amount is computed on Schedule C Part III: Cost of Goods Sold.

Part I: Income

Line 7: Gross Income

In order to arrive at the gross income, subtract the amounts reported in returns and allowances and cost of goods sold from the gross receipts and sales.

Part II: Expenses

Taxpayers may deduct all the ordinary and necessary expenses paid during the tax year in carrying on any trade or business.

Part II: Expenses

Specific deductible expenses associated with the trade or business are reported on lines 8 through 26. These include common expenses such as:

- advertising
- car and truck expenses
- commissions and fees
- contract labor
- depletion
- depreciation and section 179 (not included in Part III)
- employee benefit program (not included in line19)
- insurance (other than health)
- interest
- legal and professional services

Part II: Expenses

Specific deductible expenses associated with the trade or business are reported on lines 8 through 26. These include common expenses such as:

- office expenses
- pension and profit-sharing plans
- rent and lease
- repairs and maintenance
- supplies
- taxes and licenses
- travel, meals and entertainment
- utilities
- wages

Part II: Expenses

To claim a deduction for the business use of the home, that part of the home must be regularly and exclusively used in connection with a trade or business.

Additionally, it needs to meet one of the following conditions:

- is the principal place of business;
- is a meeting place for clients, patients, or customers; or
- it is a separate structure.

Form 8829 is used to compute the amount to be reported on line 30 of Schedule C.

Part III: Cost of Goods Sold

This refers to the direct costs attributable to the production of the goods sold by a company.

This amount includes the cost of the materials used in creating the goods along with the direct labor costs used to produce the goods.

It excludes indirect expenses such as distribution costs and sales force costs.

Part III: Cost of Goods Sold

To Compute the Cost of Goods Sold

- Start with the beginning-of-the-year inventory balance (line 35).
  - If this amount is different from the prior year ending balance, a statement must be attached.
- Add:
  - the purchases for the year (line 36);
  - cost of labor, not including amounts the taxpayers paid to themselves (line 37);
  - materials and supplies (line 38); and
  - any other direct costs (line 39).
- Subtract the end-of-year inventory balance (line 41).
- The total cost of goods sold is totaled on line 42 and must be reported on line 4 of Schedule C.

Part IV: Information on Your Vehicle

The taxpayer must complete Part IV of the Schedule C only if an expense is reported on line 9, *Car and truck expenses*. The taxpayer may skip this section if they are required to file Form 4562, *Depreciation and Amortization* for the vehicle.

Part V: Other Expenses

Expenses not specifically listed in Part II of Schedule C can be itemized here. The aggregate total of these miscellaneous expenses is reported on line 27.

Schedule SE

When filing Schedule C, the taxpayer must also file Schedule SE, *Self-Employment tax*.

Schedule SE is used to determine the amount of self-employment tax to be reported, as well as the amount of the self-employment tax adjustment to gross income.

Common Mistakes on Schedule C

- Computing commuting miles as vehicle expenses.
- Deducting the same expense in more than one place (double dipping). For example: the taxpayer reports utilities on line 25, and then reports it again when computing the business use of the home expense.

Knowledge Check

Which of the following is not part of computing the cost of goods sold?

- ○ subtract purchases
- ○ add materials
- ○ subtract end of year inventory balance
- ○ add cost of labor

Knowledge Check

Which of the following is not part of computing the cost of goods sold?

- (selected) subtract purchases
- add materials
- subtract end of year inventory balance
- add cost of labor

A taxpayer received the following income: $10,000 non-statutory wages; $10,000 1099-MISC income, and $2,000 gambling winnings. How many forms Schedule C should the taxpayer file?

- none
- one
- two

Knowledge Check

Which of the following is not part of computing the cost of goods sold?

- (●) subtract purchases ✓
- ( ) add materials
- ( ) subtract end of year inventory balance
- ( ) add cost of labor

A taxpayer received the following income: $10,000 non-statutory wages; $10,000 1099-MISC income, and $2,000 gambling winnings. How many forms Schedule C should the taxpayer file?

- ( ) none
- (●) one ✓
- ( ) two

Which of the following expenses is reported on Part V: Other Expenses?

- ( ) taxes and licenses
- ( ) amortization on intangible
- ( ) rents or leases
- ( ) interest

Knowledge Check

Which of the following is not part of computing the cost of goods sold?

- (●) subtract purchases
- ( ) add materials
- ( ) subtract end of year inventory balance
- ( ) add cost of labor

A taxpayer received the following income: $10,000 non-statutory wages; $10,000 1099-MISC income, and $2,000 gambling winnings. How many forms Schedule C should the taxpayer file?

- ( ) none
- (●) one
- ( ) two

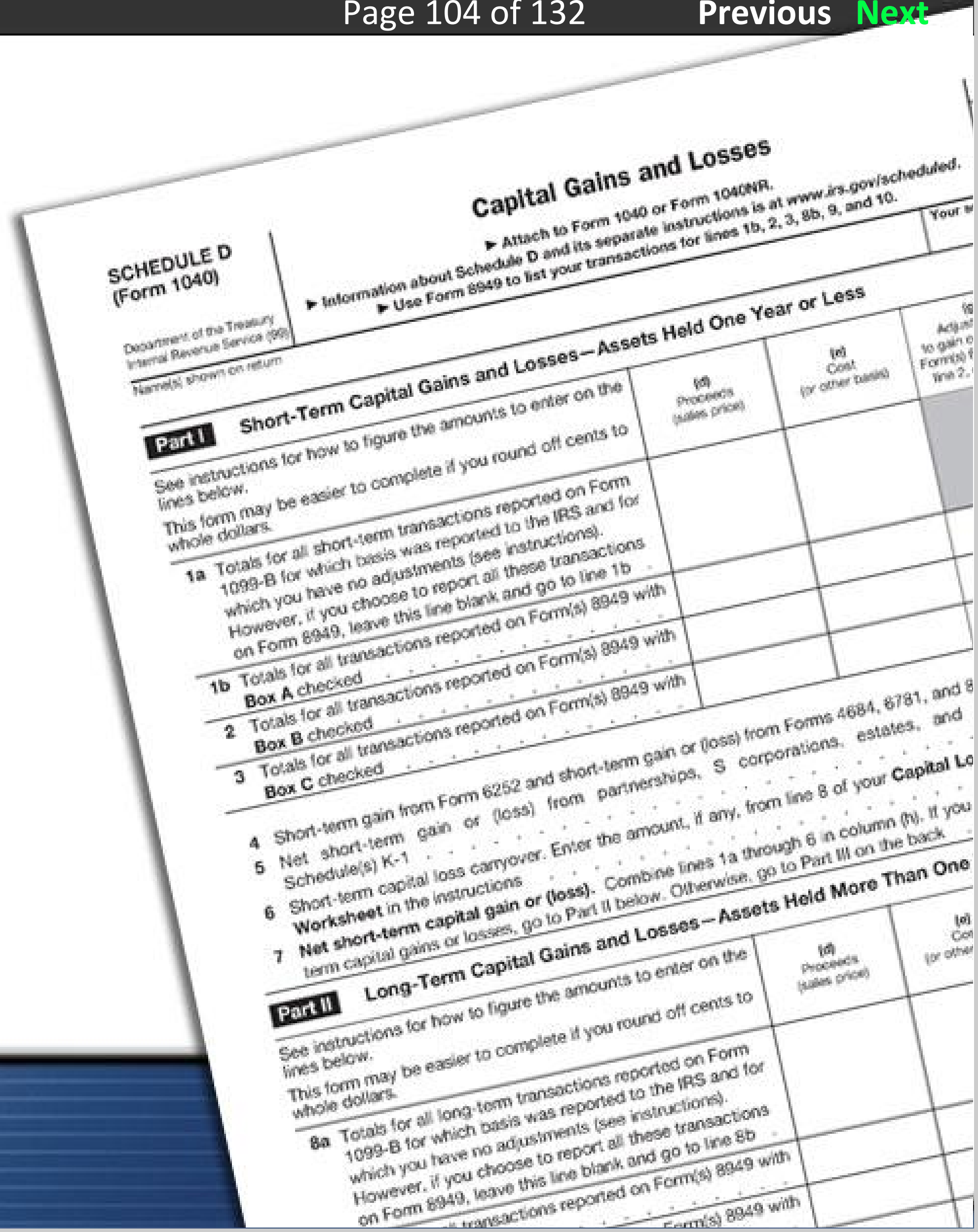
Which of the following expenses is reported on Part V: Other Expenses?

- ( ) taxes and licenses
- (●) amortization on intangible
- ( ) rents or leases
- ( ) interest

Section 4

Schedule D

Capital Gains / Losses



SCHEDULE D (Form 1040)

Department of the Treasury Internal Revenue Service (99)

Capital Gains and Losses

► Attach to Form 1040 or Form 1040NR.

► Information about Schedule D and its separate instructions is at www.irs.gov/scheduled.

► Use Form 8949 to list your transactions for lines 1b, 2, 3, 8b, 9, and 10.

Name(s) shown on return

Your s

Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less

See instructions for how to figure the amounts to enter on the lines below.

This form may be easier to complete if you round off cents to whole dollars.

(d) Proceeds (sales price)

(e) Cost (or other basis)

(g) Adjust to gain o Form(s) 8 line 2,

1a Totals for all short-term transactions reported on Form 1099-B for which basis was reported to the IRS and for which you have no adjustments (see instructions). However, if you choose to report all these transactions on Form 8949, leave this line blank and go to line 1b

1b Totals for all transactions reported on Form(s) 8949 with Box A checked

2 Totals for all transactions reported on Form(s) 8949 with Box B checked

3 Totals for all transactions reported on Form(s) 8949 with Box C checked

4 Short-term gain from Form 6252 and short-term gain or (loss) from Forms 4684, 6781, and 8

5 Net short-term gain or (loss) from partnerships, S corporations, estates, and Schedule(s) K-1

6 Short-term capital loss carryover. Enter the amount, if any, from line 8 of your Capital Lo Worksheet in the instructions

7 Net short-term capital gain or (loss). Combine lines 1a through 6 in column (h). If you term capital gains or losses, go to Part II below. Otherwise, go to Part III on the back

Part II Long-Term Capital Gains and Losses—Assets Held More Than One

See instructions for how to figure the amounts to enter on the lines below.

This form may be easier to complete if you round off cents to whole dollars.

(d) Proceeds (sales price)

(e) Co (or other

8a Totals for all long-term transactions reported on Form 1099-B for which basis was reported to the IRS and for which you have no adjustments (see instructions). However, if you choose to report all these transactions on Form 8949, leave this line blank and go to line 8b

transactions reported on Form(s) 8949 with

Form(s) 8949 with

Schedule D: Capital Gains and Losses

Schedule D is used to report:

- The sale or exchange of a capital asset not reported on another form or schedule
- Gains from involuntary conversions (other than from casualty or theft) of capital assets not held for business or profit
- Capital gain distributions not reported directly on Form 1040 (or effectively connected capital gain distributions not reported directly on Form 1040NR)
- Non-business bad debts

Capital Assets

For individuals, a *capital asset* is generally anything the individual owns for personal or investment purposes, including:

- house and furnishings
- automobiles
- stocks and bonds

Schedule D: Capital Gains and Losses

Schedule D is comprised of three parts:

- Part I: Short-Term Capital Gains and Losses
- Part II: Long-Term Capital Gains and Losses
- Part III: Summary

Capital Gains and Losses

Capital gains are taxed differently than ordinary income with the IRS.

- Based on the income level, capital gains are taxed at either 5% or 15 %.
- Qualified dividends are taxed at 20% for some taxpayers.
- Collectibles are taxed at 28%.
  - Collectibles include art, jewelry, antiques, precious metals, etc.
- Unrecaptured real estate depreciation is taxed at 25%.
- The Schedule D Tax Worksheet is used to determine the total tax on all income using the various rates.

Capital Gains and Losses (cont.)

When the proceeds of a sale or exchange are greater than the basis of a capital asset, the taxpayer realized a gain. However, when the proceeds are less, the taxpayer realized a loss. Capital losses can be used to offset capital gains.

Excess loss can be reported for a maximum of $3,000 each year against ordinary income.

Excess losses exceeding $3,000 cannot be carried back, but can be carried forward indefinitely. The loss retains its character of either long or short-term loss.

Part I: Short-Term Capital Gains and Losses

A short-term capital gain or loss is a gain or loss realized by the sale or exchange of a capital asset that has been held for **exactly one year or less**.

Complete Part I by reporting all short-term gains or losses from:

- Form 8949, *Sales and Other Disposition of Capital Assets*;
- Form 6252, *Installment Sales*;
- Form 4684, *Casualty and Theft*;
- Form 6781, Section 1256 *Gains and Losses, Contracts and Straddles*;
- Form 8824, *Like-Kind Exchange*;
- Schedules K-1; and
- carry forward losses.

Net short-term capital gain or loss is reported on line 7.

Part II: Long-Term Capital Gains and Losses

A long-term capital gain or loss is a gain or loss realized by the sale or exchange of a capital asset that has been held for more than one year.

Complete Part II by reporting all long-term gains or losses from:

- Form 8949, *Sales and Other Disposition of Capital Assets*;
- Form 4797, *Sales of Business Property*;
- Form 2439, *Notice of shareholder Undistributed Long-Term Capital Gain*;
- Form 6252, *Installment Sales*;
- Form 4684, *Casualty and Theft*;
- Form 6781, *Section 1256 Gains and Losses, Contracts and Straddles*;
- Form 8824, *Like-Kind Exchange*;
- Schedules K-1; and
- carry forward losses.

Net long-term capital gain or loss is reported on line 15.

Part III: Summary

- Net short-term and long-term capital gains or losses are combined on line 16 to arrive at the amount to be reported on Form 1040 line 13.
- If the long-term gains or loss includes “collectibles,” the 28% Rate Gain Worksheet* should be completed, and the result reported on line 18 of Schedule D.
- If the long-term gain includes Section 1250 gain, *depreciation on business or investment real estate*, the Unrecaptured Section 1250 Worksheet* should be completed, and reported in line 19 of Schedule D.
- Schedule D Tax Worksheet* is used to compute the total tax due to be reported on Form 1040 line 44.

* found in the Schedule D instructions

Part III: Summary – New York State taxation

- New York State does not have a different method of taxing capital gains.
- The amount reported on Form 1040 line 13, consisting of net short-term and long-term capital gains or losses combined, is taxed as ordinary income to New York.

Knowledge Check

Which of the following is a short-term gain?

- ○ $100 gain on the sale of stock held for 3 years
- ○ $2,000 gain on the sale of a painting purchased 10 years ago
- ○ $30,000 gain on the sale of a building purchased 1 year ago
- ○ $1,000 gain on the sale of a car purchased 15 months ago

Knowledge Check

Which of the following is a short-term gain?

- $100 gain on the sale of stock held for 3 years
- $2,000 gain on the sale of a painting purchased 10 years ago
- $30,000 gain on the sale of a building purchased 1 year ago
- $1,000 gain on the sale of a car purchased 15 months ago

A taxpayer has net short-term capital losses of $10,000 and net long-term capital gains of $3,500. What amount is reported on the taxpayers Form 1040 line 13?

- $10,000
- $3,500
- $6,500
- $3,000

Knowledge Check

Which of the following is a short-term gain?

- ○ $100 gain on the sale of stock held for 3 years
- ○ $2,000 gain on the sale of a painting purchased 10 years ago
- ◉ $30,000 gain on the sale of a building purchased 1 year ago
- ○ $1,000 gain on the sale of a car purchased 15 months ago

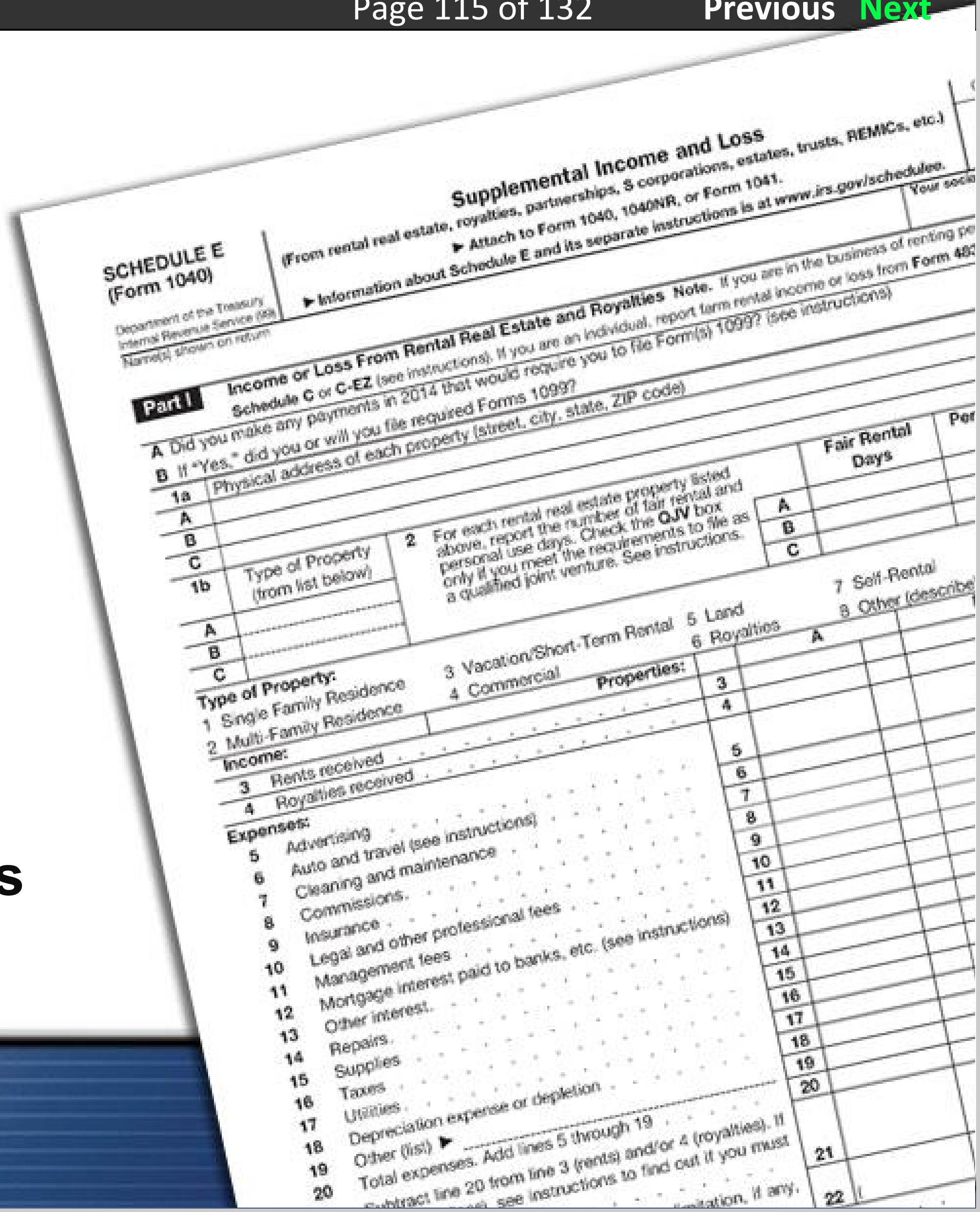
A taxpayer has net short-term capital losses of $10,000 and net long-term capital gains of $3,500. What amount is reported on the taxpayers Form 1040 line 13?

- ○ $10,000
- ○ $3,500
- ○ $6,500
- ◉ $3,000

Section 5

Schedule E

Supplemental Income and Loss



Schedule E: Supplemental Income and Loss

Schedule E is used to report income or loss from:

- Rental real estate;
- Royalties;
- Partnerships;
- S corporations;
- Estates;
- Trusts; and
- Residual interests in REMICs.

Schedule E: Supplemental Income and Loss

Schedule E is comprised of five parts:

- Part I: Income or Loss From Rental Real Estate and Royalties
- Part II: Income or Loss From Partnerships and S Corporations
- Part III: Income or Loss From Estates and Trusts
- Part IV: Income or Loss From Real Estate Mortgage Investment Conduits (REMICs)
- Part V: Summary

Part I: Income or Loss from Rental Real Estate and Royalties

Rental Property Information

- Physical address of the properties
  - Up to three properties can be reported on Schedule E (lines 1a A-C).
  - Additional Schedule E forms can be filed if more than three rental properties are being reported.
- The types of property that can be reported on Schedule E (line 1b A-C) include single family, multi-family, vacation, commercial, land, royalties, self-rental, or other.
- Report the number of fair rent and personal use days (line 2).

Part I: Income or Loss from Rental Real Estate and Royalties

Income

- Report all rents received (line 3)
  - If rent is received for a dwelling unit used by the taxpayer and rented for less than 15 days, neither the income or expenses have to be reported.
- Report all royalties received (line 4)
  - This includes oil, gas, mineral properties, copyrights, and patents.

Part I: Income or Loss from Rental Real Estate and Royalties

Expenses (reported on lines 5 through 19)

- advertising
- auto and travel
- cleaning and maintenance
- commissions
- insurance
- legal and professional services
- management fees
- mortgage interest paid to banks
- other interests
- repairs
- supplies
- taxes
- utilities
- depreciation and depletion
- other expenses

Part I: Income or Loss from Rental Real Estate and Royalties

Losses

- If the expenses are greater than the income, the taxpayer realized a loss.
- Rental income and losses are used to calculate passive income.
  - Passive losses are used to reduce passive income.
  - Excess passive losses are carried forward indefinitely.
- Form 8582 , *Passive Activity Loss Limitations,* is used to determine the amount of the loss limitation.

Part I: Income or Loss from Rental Real Estate and Royalties

Real Estate Professional

If the taxpayer qualifies as a real estate professional, the real estate activity is not considered passive and therefore not subject to the passive loss limitations. As a real estate professional, the taxpayer will file Schedule C, rather than Schedule E.

A test is used to determine if a taxpayer qualifies as a real estate professional.

Part I: Income or Loss from Rental Real Estate and Royalties

Real Estate Professional Test

To be considered a real estate professional, the taxpayer must meet all three criteria:

- The taxpayer owns at least one interest in rental real estate.
- More than one-half of the personal services the taxpayer performs in trades or businesses during the tax year are performed in real property trades or businesses in which the taxpayer materially participates.
- The taxpayer performs more than 750 hours of service during the tax year in real property trades or businesses in which the taxpayer materially participates.

Part II: Income or Loss from Partnerships and S Corporations

Partnerships and S Corporations are entities that file their own income tax returns, Forms 1065, and 1120 respectively. However, the entities themselves do not pay income taxes. Instead, the taxes are paid by the partners or shareholders on their own income tax returns. The income of the entities is allocated to each partner or shareholder based on their ownership interest using a Schedule K1.

Income and losses can either be passive or non-passive.

Part II: Income or Loss from Rental Real Estate and Royalties

Passive Activity

The term “passive activity” means any activity involving the conduct of any trade or business in which the taxpayer does not materially participate.

Generally, passive activity losses can only be used to reduce passive activity income. Any excess loss can be carried forward indefinitely.

Part II: Income or Loss from Rental Real Estate and Royalties

Passive Activity **(cont.)**

Passive activity losses deriving from rental activity in which the taxpayer actively participated can be used to offset ordinary income up to a maximum of $25,000.

The maximum is phased-out by 50% of the amount by which the adjusted gross income exceeds $100,000.

For example, if a taxpayer's FAGI is $130,000, the maximum rental activity loss that can be used to offset ordinary income is $10,000

($25,000) - $30,000/2) = $10,000

Part III: Income or Loss from Estates and Trust

Taxpayers who are beneficiaries of an estate or trust, report income on Part III. The taxpayer would receive a Schedule K-1 identifying their portion of income or loss.

Part IV: Income or Loss from Real Estate Mortgage Investment Conduits

A real estate mortgage investment conduit is an entity that holds a fixed pool of mortgages and issues multiple classes of investments to the investors.

- If the taxpayer is a holder of a residual interest in a real estate mortgage investment conduit, the income or losses are reported on Part IV.
- The taxpayer would receive Schedule Q showing their portion of income or loss.

Part V: Summary

The totals from parts I-IV are added together and entered on line 41 of Schedule E. This amount is then reported on line 17 of Form 1040.

Income from farming, fishing, and professional real estate services is reported here as well.

Knowledge Check

Which of the following is not part of the real estate professional test?

- owning at least one interest in rental real estate
- no other activities were materially participated in
- more than one-half of the personal services are performed in real property trades or businesses
- more than 750 hours of service

Knowledge Check

Which of the following is not part of the real estate professional test?

- ○ owning at least one interest in rental real estate
- ◉ no other activities were materially participated in
- ○ more than one-half of the personal services are performed in real property trades or businesses
- ○ more than 750 hours of service

Taxpayer has total rental income of $20,000, and total rental expenses of $55,000. No other activities are reported on Schedule E. How much would the taxpayer report on line 17 of Form 1040?

- ○ $20,000
- ○ $35,000
- ○ $55,000
- ○ $25,000

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- ◉ $25,000

Which of the following income or loss is not reported on Schedule E?

- ○ royalties
- ○ partnership income of a partner
- ○ rental income as a real estate professional
- ○ interest from real estate mortgage investment conduits

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Which of the following is not part of the real estate professional test?

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