

EA Exam Preparation 2025

Part 1: Individuals

VIDEO 2:

INCOME

PRESENTER: TOM NORTON CPA, EA

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What We'll Cover

- Types of income
- Wages and employee compensation
- Injury and illness income
- Interest
- Dividends
- Other income

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Separate Videos

- Capital Gains
 - Asset basis
 - Sales of property
 - Capital gains
- Retirement Plans and Social Security
 - Distributions from and contributions to IRAs and other retirement plans
 - Social security income
- Specialized Topics and Returns
 - Foreign income and accounts

Free Resources (irs.gov)

- **Publication 17, *Your Federal Income Tax***
- **Forms 1040 and 1040-SR, and their instructions**
- **Publication 525, *Taxable and Nontaxable Income***
- Publication 550, *Investment Income and Expenses*
- Publication 504, *Divorced or Separated Individuals*
- Publication 517, *Social Security and Other Information for Members of the Clergy and Religious Workers*
- Publication 4681, *Canceled Debts, Foreclosures, Repossessions, & Abandonments*
- Publication 3, *Armed Forces' Tax Guide*

Flow of the Tax Return

START:	Gross income
LESS:	Adjustments to income
EQUALS:	Adjusted gross income (AGI)
LESS:	Deductions (Standard or Itemized, QBI)
EQUALS:	Taxable income
APPLY:	Tax tables/Schedules
EQUALS:	Income tax
LESS:	Credits
PLUS:	Other taxes
EQUALS:	Total tax
LESS:	Payments
EQUALS:	Amount Due/Overpayment (Refund)

Types of Income

Taxable vs. Nontaxable Income

- Taxable income must always be reported
 - Even if no 1099 or other form received
- Nontaxable income usually does not have to be reported, though there are exceptions

Is It Taxable?

- Yes, unless specifically excluded by law
- US Constitution, 16th Amendment, Enacted in 1913:
 - **"ARTICLE XVI.** The Congress shall have the power to lay and collect taxes on incomes, **from whatever source derived**, without apportionment among the several States, and without regard to any census or enumeration."
- Includes illegally obtained as well as legal income
 - Al Capone

Earned vs. Unearned Income

- **Earned income:** Income from working or performing services, such as wages, salaries, tips, professional fees, self-employment income.
- **Unearned income:** Not directly from current work or performance of services, such as interest, dividends, capital gains, retirement income, life insurance proceeds.
- Generally, earned income is subject to Social Security and Medicare tax, unearned income is not.

Investment ("Portfolio") Income

- Interest (Schedule B)
- Dividends (Schedule B)
- Capital gains (Schedule D)
- Rents (Schedule E)
- Royalties (Schedule E)
- Publication 550, *Investment Income and Expenses*

Active vs. Passive Income

- **Active income** is generated by an activity engaged in for profit in which you materially participate.
 - Material participation means you are involved in the operation of the activity on a regular, continuous, and substantial basis.
- **Passive income** is generated by an activity engaged in for profit in which you do not materially participate, or by rental property.
- Losses from passive activities generally cannot be deducted against nonpassive income. For this purpose, portfolio income is not considered passive.

Cash vs. Accrual Accounting

- **Cash method:** Income is recognized when received, and expenses are recognized when paid
 - Virtually all individuals follow this method
 - Many small businesses also follow this method
- **Accrual method:** Income is recognized when earned, rather than when actually received, and expenses are recognized when incurred, rather than when actually paid
 - Many businesses use this method
 - Technically the "correct" method for business accounting purposes

Constructive Receipt

- Applies to cash method taxpayers, including individuals
- Generally, you constructively receive income when it is credited to your account or set apart in any way that makes it available to you. You don't need to have physical possession of it.
 - **Example:** Your employer prepares a paycheck for you on 12/29/24, but you don't pick it up and deposit it in the bank until January 2, 2025. It is considered received in 2024.
 - **Example:** Per a court order, your employer garnishes \$100 from your paycheck to be handed over to the court. You constructively received the \$100.

Wages and Employee Compensation

Employee Compensation

- If you receive compensation for working, you must report it (assuming you meet requirements for filing a return)
- Usually receive a W-2
 - Wages/tips
 - Income tax withheld
 - Social Security/Medicare tax withheld
 - Other info
- Even if you don't receive a W-2, it is still taxable
 - e.g. household employees who make less than \$2,800
 - Independent contractor- 1099

Employee vs. Independent Contractor

- Employee vs. independent contractor is controversial
- Employer saves employment taxes (Social Security, Medicare, Unemployment) by designating a worker as an independent contractor
- Independent contractor is in business for themselves, and files a Sch. C, and pays self-employment tax (in place of SS and Medicare)
- Will cover in Part 2 when we discuss businesses
- For now:
 - Receive a W-2: Employee
 - Receive a 1099: Independent contractor

Independent Contractor 1099s

- **1099-NEC:** Non-Employee Compensation
 - Most common for independent contractors
 - Came back into use in 2020
 - For payments of more than \$600 per year
- **1099-MISC:** Miscellaneous
 - Used for various purposes, most commonly Rents
 - Prior to 2020, was used for independent contractors, too
 - For payments of more than \$600 per year

Independent Contractor 1099s

- **1099-K:** Payments from credit card processors and online apps
 - Credit card companies- When your customers pay with a credit card and you get the proceeds
 - Gig economy- Uber, Doordash, Instacart, etc.
 - Payment apps for business (Paypal, Venmo, etc.)
- Must issue a 1099-K if more than \$5,000 paid during 2024
 - \$2,500 in 2025
 - \$600 in 2026
- Should not get both a 1099-NEC and a 1099-K for same income
- For any kind of 1099, if you file your return and are later issued a corrected form, you may need to file an amended tax return (1040-X)

Employee Compensation

- Included in income in year received:
 - Advance commissions
 - Back pay awards
 - Bonus or award
 - Exception for certain length of service and safety awards
 - Differential wage payments (e.g. military reservist)
 - Severance pay
 - Accrued leave pay
 - Sick pay
- Expense reimbursement generally not taxable

Fringe Benefits

- Included in income in year received, unless excluded by law
- Generally excluded by law:
 - Accident and Health insurance premiums
 - Long-term care insurance premiums
 - Archer MSA contributions
 - Health Flexible Spending Account salary reductions up to \$3,200 and any employer reimbursements
 - Health reimbursement plan payments
 - Health savings account contributions (subject to limits) and employer contributions (unless to partners or 2% S corp shareholders)

Fringe Benefits

- Generally excluded by law:
 - Adoption assistance. See Form 8839, *Qualified Adoption Expenses*
 - De Minimis benefits (e.g. discount in cafeteria, cab ride home when working late)
 - Non-cash holiday gift of nominal value (turkey, ham, etc.)
 - Educational assistance up to \$5,250 (within guidelines)
 - Qualifying student loan payments up to \$5,250
 - Group term life insurance up to \$50,000. Amounts over \$50,000 reported on W-2 according to an IRS formula

Fringe Benefits

- Generally excluded by law:
 - Retirement planning services provided by qualified retirement plan
 - Does not include tax preparation, accounting, legal or brokerage services.
 - Qualified transportation benefit
 - Transportation in a commuter vehicle (e.g. van) between home and work (up to \$315 per month)
 - Transit pass (up to \$315 per month), or
 - Qualified parking (up to \$315 per month)

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Child and Dependent Care Benefits

- Amounts received for dependent care can be excluded. The amount excluded is the lesser of:
 - \$5,000 (\$2,500 MFS and not considered unmarried)
 - Actual qualified expenses incurred in 2024, regardless of when paid
 - Taxpayer's earned income
 - Spouse's earned income
- Amounts are reported on W-2, and excess amounts are included in income
- Form 2441 to compute

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Retirement Plan Contributions

- Employer's contributions to a qualified retirement plan aren't included in income at the time contributed
- If plan is not qualified, the contributions are included in income
- Elective deferrals (within limits) to a qualified retirement plan (other than a Roth) are excluded from income
 - 401(k)
 - 403(b)
 - Thrift Savings Plan (federal employees)
 - Etc.

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Incentive Stock Options (ISOs)

- Statutory stock options
 - No income until you sell or exchange the stock
 - Taxed at capital gains rates
 - Must meet certain rules to be "statutory"
 - Employer will know and will send Form 3921 to report amounts
- Nonstatutory stock options
 - Generally income when received, if fair market value (FMV) can be determined
 - If FMV can't be determined when received, then taxable when exercised or sold
 - Capital gains rates

Special Rules for Clergy

- Report salary like anyone else
 - Considered "employee" for income tax purposes
 - Considered "self employed" for Self Employment Tax
 - Can request an exemption from IRS
 - May have FICA withheld for non "ministerial" services
- Also include offerings and fees received for marriages, baptisms, funerals, masses, etc.
 - Unless offering is made to the religious institution
- If give earnings to a religious institution, still include in income. Can take charitable contribution deduction
- Pension or retirement pay is treated like anyone else

Special Rules for Clergy

- Housing
 - Don't include in income the FMV of housing (including utilities) provided by the church for income tax purposes
 - Includes housing allowance
 - Must be reasonable based on services provided
 - Value is included for SE tax purposes
- Publication 517, *Social Security and Other Information for Members of the Clergy and Religious Workers*

Members of Religious Orders

- Vow of poverty
 - All income turned over to the Order
- If working for the order or an institution associated with the order (e.g. hospital, school), do not include salary in income
- If an employee of an unrelated third party, include salary in income
 - Even if directed to do so by the order and the work is the type of work typically done by the order

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Foreign Employer

- Refers to a foreign government or international organization
- US Citizen- Include salary in income. Also pay SE tax, even though not self employed
- Non-citizen who works for international organization: Not taxable
- Non-citizen who works for foreign government: Not taxable if:
 - Your work is like the work done by US citizens in foreign countries
 - The foreign government gives an equal exemption for US citizens working there

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Military

- Salary taxed like anyone else
- Retirement pay taxed as a pension
- Differential pay included in income

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Veterans Benefits: Not Income

- Education, training and subsistence allowances
- Disability compensation
- Grants for homes designed for wheelchairs
- Grants for motor vehicles for veterans who lost sight or limbs
- Veterans' insurance proceeds and dividends, including endowment policy paid before death
- Interest on insurance proceeds on deposit with VA
- Dependent care assistance benefits
- Death gratuity paid to survivor
- Compensation under work therapy program
- Bonus for working in a combat zone

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Volunteers

- Peace Corps
 - Living allowances for housing, utilities, etc. excluded from income
 - Some allowances are taxable, however:
 - Allowances paid to spouse or children while you're a volunteer leader training in the US
 - Living allowances designated as "basic compensation" for:
 - Domestic help
 - Laundry and clothing
 - Entertainment and recreation
 - Transportation
 - Etc.
 - Readjustment allowances or termination payments

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Volunteers

- Volunteers in Service to America (VISTA)
 - Allowances for meals and lodging are **included** in income as wages
- National Senior Services Corps programs
 - Do not include in income amounts received from:
 - Retired Senior Volunteer Program (RSVP)
 - Foster Grandparent Program
 - Senior Companion Program

Volunteers

- Volunteer tax counseling
 - Tax Counseling for the Elderly (TCE)- Do not include expense reimbursements in income
 - Volunteer Income Tax Assistance (VITA) program- Can deduct unreimbursed expenses as a charitable contribution
- Volunteer firefighters and emergency medical responders
 - Do not include payments received up to \$50 per month
 - Do not include rebates or reductions in property taxes

Injury and Illness Income

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Disability Pensions

- If you retired on disability, include pension received under a plan paid for by your employer
 - Report as wages until retirement age, then
 - Report as pension once at retirement age
- Military Disability Pension
 - Exclude if based on a service-connected disability
 - Include if based on years of service
 - If mix of disability and years of service, include only the portion based on years of service

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Long-Term Care Insurance Proceeds

- Exclude up to \$410 per day (decrease of \$10 from 2023)
- Form 8853, *Archer MSAs and Long-Term Care Insurance Contracts*.

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Workers' Compensation

- Exclude payments received for an occupational sickness or injury
- Exclusion doesn't apply to retirement plan benefits based on age, length of service, or prior contributions, even if retired due to illness or injury
- If return to work, salary received for performing light duties are taxable as wages

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Other Injury or Illness Compensation

- Exclude payments received for:
 - Compensatory damages for illness or injury, whether lump sum or periodic
 - Benefits received under accident or health insurance policy which either you paid for, or your employer included in your income
 - Disability benefits for loss of income or earning capacity under a no-fault car insurance policy
 - Compensation for permanent loss or loss of use of a part or function of your body, or for permanent disfigurement.
 - Must be based only on injury and not the period of absence from work
 - Not taxable even if employer pays for the policy
 - Reimbursement for medical care

Interest Income

Interest Income

- In general, any interest you receive or that is credited to your account and can be withdrawn is taxable income (including foreign source interest)
- Often reported on 1099-INT (but doesn't have to be)
- Interest received as beneficiary of a trust is taxable (K-1)
- Property you give to a child under the Model Gifts of Securities to Minors Act, the Uniform Gifts to Minors Act or similar laws becomes the child's property and any income is taxable to the child.

Interest Income

- Some interest is not federally taxable, such as:
 - Interest on municipal bonds
 - Dividends received from a mutual fund that holds muni bonds
 - Interest on VA dividends left on deposit with the VA
 - Interest inside IRAs, both regular and Roth

Taxable Interest

- Interest from banks, loans you make to others, and other sources
- So called “dividends” from credit unions, savings and loans, etc. are actually interest and will be reported on 1099-INT
 - Dividends from money market funds, such as with mutual funds, are taxed as dividends
- Interest on Certificates of Deposit (CDs) are taxable when received, or when available without a substantial penalty
- Gifts for opening an account are treated as interest
 - Non-cash gifts of more than \$10 are reportable for deposits of less than \$5,000. For deposits of \$5,000 and up, the limit is \$20.

Taxable Interest

- Interest on insurance dividends left on deposit with the insurance company
- Interest on US bonds/obligations
- Interest on tax refunds
- Interest on condemnation award
- Interest portion of installment sale payments received
- Interest on an annuity contract
- Interest on frozen deposits (e.g. bank failure)
- Below market loans
 - If you lend for little or no interest, you may have to impute interest in line with market rates

US Savings Bonds

- Generally, include in income in year interest is received
- Series HH bonds: Pay interest twice a year, plus a deferred portion
- Series EE and I bonds: Interest pays when bonds redeemed. Sold at a discount, and difference between purchase price and redemption price is interest.
 - Can elect to report and pay tax on the increased value each year rather than reporting all in the year redeemed.
- If transfer ownership before redemption, you include in income all the interest that accrued to that point

Education Savings Bond Program

- You may be able to exclude interest from certain savings bonds if you pay qualified higher education expenses during the year of redemption
- Interest on Series EE bonds issued after 1989, and Series I bonds if:
 - Issued in your name or your and your spouse's name
 - You must be at least 24 years old before the bond's issue date
 - **Example:** Bob bought a Series EE bond in 1998, when he was 30, and had the bond issued in the name of his daughter, Emily, who was 2 years old at the time. The bond was redeemed in 2024, and the proceeds were used to help pay for Emily's college costs. Neither Bob nor Emily qualify for the exclusion, because the bonds were issued in Emily's name.

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US Treasury Bills, Notes And Bonds

- Interest is taxable for federal income tax, but not for state and local income tax
- Bonds sold between interest dates
 - Seller treats part of the sales price as interest income
 - Buyer does not have to include the accrued interest as income when interest is received

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State or Local Government Obligations

- Interest on bonds issued by a state, the District of Columbia, a possession of the US, or any of their political subdivisions is not taxable at the federal level
- Interest on bonds issued after 1982 by an Indian tribal government is generally not taxable
- If you file a tax return, you must report this interest even though it is not taxable

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Interest on Life Insurance Proceeds

- Life insurance proceeds are generally not taxable
- If receive in installments, however, the interest portion is taxable
- If you buy an annuity with life insurance proceeds, the annuity payments are taxed as pension and annuity income from a nonqualified plan, not as interest income

Original Issue Discount (OID)

- When a debt instrument is issued at one price, and the redemption price is higher, this is considered OID
- OID is generally considered interest, and must be paid as it accrues each year, even though no interest is actually received
- **Example:** A company issues a zero-coupon bond with an issue price of \$800. The bond's face value is \$1,000, which will be paid at maturity 5 years from the date of issue. There is \$200 of OID that must be partially recognized in each of the 5 years (e.g. \$40 per year).

Original Issue Discount (OID)

- Does not apply to:
 - Tax exempt obligations
 - US savings bonds
 - Short-term debt instruments with a maturity of 1 year or less from date of issue
 - Loans between individuals if all the following are true:
 - Not made in the course of the trade or business of the lender
 - The amount of the loan, including any other loans between the individuals, is not more than \$10,000
 - Avoiding federal tax is not one of the principal purposes of the loan
 - A debt instrument purchased at a premium

Original Issue Discount (OID)

- Usually receive 1099-OID, if \$10 or more
- De minimis OID:
 - You can ignore the discount if it is less than one-fourth of 1% (.0025) of the stated redemption price at maturity multiplied by the number of full years from the date of original issue to maturity
 - **Example:** Roberto bought a 10-year bond with a stated redemption price at maturity of \$1,000, issued at \$980 with OID of \$20. $\$1,000 \times .0025 \times 10 = \25 , therefore the OID is treated as zero. If Roberto holds the bond to maturity, he will recognize \$20 of capital gain.

Reporting Interest Income

- Report on line 2b of 1040 or 1040-SR
- Also complete Schedule B, if any of the following apply:
 1. Taxable interest and dividends is greater than \$1,500
 2. Claiming interest exclusion under the Education Savings Bond Program
 3. Received interest from a seller-financed mortgage
 4. Received Form 1099-INT for US savings bond interest that includes amounts you reported in a previous tax year
 5. Received, as nominee, interest that belongs to someone else
 6. Received 1099-INT for interest on frozen deposits
 7. Received a 1099-INT for interest on a bond bought between interest payment dates
 8. Reporting OID in an amount less than the amount shown on 1099-OID
 9. Reduce interest income from bonds by amortizable bond premium
 10. Received distribution, directly or indirectly, from a foreign account.

Dividends

Dividends

- Usually, distributions from a corporation to its stockholders or a mutual fund to its owners
- Reported to taxpayer on Form 1099-DIV
- Can also be found on some K-1s from partnerships and S corporations
- Report on Sch. B if more than \$1,500, or received as nominee for someone else

Ordinary Dividends

- Most dividends are ordinary dividends
- Taxed at ordinary income tax rates
- Assume dividends are ordinary unless reported to you as being "qualified dividends"

Qualified Dividends

- “Qualified dividends” are taxed at the lower, capital gains rate
- Must be paid by a US corporation or a qualified foreign corp
- Cannot be of a type deemed not qualified
- Holding period of the stock must be met

Not Qualified

- The following are deemed not qualified
 - Capital gain distributions
 - Dividends that are really interest, such as those paid by credit unions, mutual savings banks, etc.
 - Dividends from a tax-exempt organization or farmer's cooperative
 - Dividends paid on shares held by an employee stock ownership plan (ESOP)
 - Dividends on any share of stock to the extent you are obligated to make related payments for positions in substantially similar or related property
 - Payments in lieu of dividends, if you know or have reason to know they are not qualified
 - Payments shown on 1099-DIV as qualified if from a foreign corporation you know or have reason to know are not qualified

Qualified Dividends

- Holding period of the stock to be qualified:
 - You must have held the stock for more than 60 days during the 121-day period that begins 60 days before the ex-dividend date. The ex-dividend date is the first date following the declaration of a dividend on which the buyer of a stock is not entitled to receive the next dividend payment.
 - Preferred stock: You must have held the stock more than 90 days during the 181-day period that begins 90 days before the ex-dividend date if the dividends are due to periods totaling more than 366 days. If the preferred dividends are due to periods totaling less than 367 days, the holding period in the previous paragraph applies.

Dividend Reinvestment Plans

- Some corporations and mutual funds will let you use dividends to purchase more stock, rather than receiving them as cash
- These dividends must still be reported as income (because you could have received the cash, but chose not to)
- IRS treats this as if you received the cash and turned around and used it to buy more shares

Stock Dividends

- Sometimes a corporation distributes stock or stock options instead of cash
- Generally, these are not taxable
 - Exceptions if you have the choice to receive stock or cash, and on some preferred stock distributions and other scenarios

Constructive Dividends

- A distribution from a corporation to a shareholder that is not intended to be a dividend, but is considered to be a dividend to tax purposes
- Results in dividend income to the shareholder, and no deduction for the corporation
- Examples:
 - Paying personal expenses with a business check/credit card
 - Corporate owned property used for personal purposes
 - Corporation pays off personal debts
 - Excessive compensation to a shareholder or family member
 - Purchase or rental of asset from shareholder at higher than FMV

Other Income

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Business Income

- Income from a sole proprietorship is reported on Schedule C.
- Income of a self-employed farmer is reported on Schedule F.
- Income from rental real estate is reported on Schedule E.
- These will be covered in Part 2- Businesses.

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Partnership and S Corp Income

- Partnerships and S corporations are generally not taxable entities. The income and deductions pass through to the partners/shareholders based on ownership percentage
- Will receive a K-1 showing the amounts to report
 - Ordinary business income is reported on Schedule E (page 2)
 - Some items are "separately stated" on the K-1, such as:
 - Charitable contributions
 - Section 179 deduction
 - May also include items affecting basis, and amounts eligible for the Qualified Business Income Deduction

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Estate And Trust Income

- Unlike a partnership, an estate or trust may have to pay tax
- The beneficiary may have to pay tax on an item, or the trust may have to pay tax on it, but there is no double taxation
- If you're the beneficiary of a trust that is required to distribute all its current income, you must include your share in taxable income even if you don't actually receive it
- Otherwise, you pay tax on whatever amounts are distributed or credited to your account
- Losses are not deductible by the beneficiaries
- Will receive a K-1 with applicable amounts to be reported. Sch. E

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Royalties

- Royalty income typically comes from
 - Oil, gas, or mineral properties
 - Copyrights
 - Patents
- May be reported on 1099-MISC or Schedule K-1
- Report on Schedule E
- If received by someone in business as a self-employed artist, writer, inventor, etc., then it is a business and reported on Schedule C.

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Rents From Personal Property

- If you rent out personal property, such as equipment or vehicles, then:
 - If you are in the business of renting property, it is reported on Sch. C
 - If it is not a business, report on Sch. 1 as Other Income

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Bartering

- Bartering is an exchange of property or services
- You must include in income the value of property or services you receive
 - If you both agree on the value ahead of time, that will be accepted
- Form 1099-B: If you exchanged property or services through a barter exchange, you should receive a 1099-B, showing the value of property or services you received during the year.
- Generally, the income is reported on Sch. C, Profit or Loss From Business

Bartering

- **Example 1.** You're a self-employed attorney who performs legal services for a client, a small corporation. The corporation gives you shares of its stock as payment for your services. You must include the fair market value of the shares in your income on Schedule C (Form 1040) in the year you receive them.

Bartering

▪ **Example 2.** You're self-employed and a member of a barter club. The club uses "credit units" as a means of exchange. It adds credit units to your account for goods or services you provide to members, which you can use to purchase goods or services offered by other members of the barter club. The club subtracts credit units from your account when you receive goods or services from other members. You must include in your income the value of the credit units that are added to your account, even though you may not actually receive goods or services from other members until a later tax year.

Canceled Debts

- Generally, if a debt you owe is forgiven, other than as a gift, you must include the canceled amount in your income
- If it is a non-business debt, report the canceled amount on Sch. 1, line 8c.
- If it is a business debt, report the amount on Sch. C (or F if you are a farmer)
- 1099-C: If a federal government agency or financial institution cancels or forgives a debt of \$600 or more, you will receive a 1099-C
 - **Example:** If you restructure your credit card debt and the bank agrees to forgive part of it.

Canceled Debts- Exceptions

- Do not include these canceled debts in income:
 - Student loans
 - Debt discharged in bankruptcy or when you're insolvent
 - Qualified farm debt
 - Qualified real property business debt
 - Cancellation is intended as a gift
 - Qualified principal residence indebtedness
- Note: These categories have exceptions and qualifiers

Host

- If you host a party at which sales are made, any gift or gratuity you receive for hosting is income at its FMV
- Can deduct 50% of reasonable cost of meals provided

Life Insurance Proceeds

- Generally, life insurance proceeds are not taxable
- If receive in installments, some may be interest, which is taxable
- If you cash in a cash-value policy, you include in income any amount in excess of what you paid in
 - Should receive a 1099-R
- Accelerated Death Benefits: If terminally or chronically ill and choose to receive insurance while still living, generally exclude from income. Includes a viatical settlement.

Recoveries

- A recovery is a return of an amount you deducted or took a credit for in an earlier year
- Most common are refunds, reimbursements, and rebates of deductions itemized on Schedule A
- You may also have recoveries of nonitemized deductions, such as payments on previously deducted bad debts, and recoveries of items for which you previously claimed a tax credit
- If the payment and recovery happen in the same year, the deduction and recovery offset, and nothing is reported on your tax return

Recoveries

- **Example 1:** In 2023, you itemized deductions, including state income tax payments of \$8,000. In April 2024, you prepared your 2023 state income tax return, and as a result received a state income tax refund of \$500. You have \$500 of taxable income in 2024.
- **Example 2:** Same facts as Example 1, except in 2023 you took the standard deduction. The \$500 refund is not included in income.
- **Note:** Federal income tax payments are not deductible, and therefore any federal tax refund is not taxable

Unemployment Benefits

- Unemployment benefits received are taxable income
- Should receive a 1099-G
- No longer a Covid exception (2020 only)

Welfare And Other Public Assistance

- Government payments received based on need are not taxable and not included in income
- If payments are compensation for services performed, they are taxable
- If payments are fraudulently received, they are taxable
- Disaster Relief: Do not include in income amounts received as a victim of a federally declared disaster or terrorist act

Certain Disaster Payments

- Certain relief payments received by those affected by the East Palestine, OH train derailment are not taxable.
- Qualified wildfire relief payments are not taxable.
- New for 2024.

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Activity Not For Profit (Hobby)

- Any income from a hobby or activity you do not operate as a business must be reported as income on Schedule 1
- Deductions are limited to the amount of income, and can only be taken if you itemize deductions
- **Example:** Cheryl grows tomatoes in her garden at home primarily for recreation and personal use. In 2024, she had a bumper crop, and sold some of the tomatoes to neighbors and friends. The income received is taxable as Other Income. Since Cheryl takes the standard deduction, no expenses involved in growing or selling the tomatoes are deductible.

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Alimony

- For divorces with alimony (spousal support) payments entered into or modified after 2018, alimony is not included in income (nor deductible by the payer)
- For divorces prior to 2019, alimony generally is included in income (and deductible by the payer)
- Child support is never included in income
- Publication 504, *Divorced or Separated Individuals*

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Court Awards And Damages

- Whether or not a court award is taxable depends on what it is intended to compensate for
- Generally, not taxable if compensating for physical injury or sickness
 - Includes emotional distress due to physical injury or illness
- Generally, if compensation for anything other than physical injury or sickness, it is taxable
 - e.g. lost wages, punitive damages, breach of contract, emotional distress not related to physical injury or illness

Gambling Winnings

- Must include in income
- Losses can only be deducted if you itemize deductions, and then only up to the amount of gambling income
- Also include amounts from lotteries and raffles. Non-cash items included at FMV
- May receive a Form W-2G
- If a professional gambler, file Schedule C

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Scholarships And Fellowships

- Scholarships and fellowships for tuition and fees at an educational institution are not taxable
- Scholarships for room and board are taxable
- Payments for services performed are taxable
- Allowances paid by Department of Veteran affairs are not taxable

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Included In Income

- Alaska Permanent Fund dividend
- Bribes
- Credit card insurance (makes payments if disabled/unemployed)
- Fees for services, e.g. corporate director, notary public. Usually Schedule C
- Found property is taxable to you at its fair market value
- Free tour received for organizing a group of tourists

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Included In Income

- Income from illegal activities, e.g. drug dealing, blackmail
- Jury duty pay
- Kickbacks, side commissions and similar payments
- Prizes and awards (e.g. television game show, beauty contest)
- Rewards (e.g. for turning in a criminal, returning lost property)
- Stolen property

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Not Included In Income

- Campaign contributions
- Carpool amounts from passengers (unless a business)
- Cash rebates from purchases
- Casualty insurance and other reimbursements
- Child support payments
- Downpayment assistance on home
- Employment agency fees paid by employer
- Energy conservation subsidies

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Not Included In Income

- Payments received for being a foster care provider
- Gifts and inheritances
- Utility rebates
- Payments from qualified tuition programs (e.g. 529 plan) if used for qualified expenses

Net Operating Loss (NOL)

- A net operating loss (NOL) is when losses from a business, rental property, casualty and theft, and/or deductible moving expenses, are greater than income for the year.
- In computing the NOL, do not include:
 - Capital losses in excess of capital gains
 - Section 1202 exclusion on gain from sale of qualified small business stock
 - Nonbusiness deductions to the extent they exceed nonbusiness income
 - Any NOL carryover
 - Qualified business income deduction
 - Domestic production activities deduction

Net Operating Loss (NOL) Carryforwards

- NOLs generated after 2020, can no longer be carried back to previous years
 - Exceptions for certain farmers and insurance companies, other than life insurance companies, who can carry back losses 2 years
- NOLs can be carried forward indefinitely
- Can only be used to offset 80% of taxable income without respect to any NOL carryforward, the QBID, and global intangible low-taxed income deduction.
- Reported as a negative amount in "Other income" on Sch. 1

NOL Carryforward Example

- **Example:** In 2023, Ginny had a loss from Schedule C from operating her used clothing shop, resulting in a net operating loss of \$40,000 on her Form 1040. In 2024, Ginny's taxable income, without regard to the NOL or QBID, was \$30,000. Ginny can take a NOL deduction of \$24,000 (80% of \$30,000), resulting in taxable income of \$6,000 before the QBID. She has a remaining NOL carryover of \$16,000 (\$40,000 - \$24,000) to use in future years.

End of Video 2. See you in Video 3!