

Miscellaneous Income

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October 18, 2016



Miscellaneous Income

- While most people are aware they must include wages, salaries, interest, dividends, tips and commissions as income on their tax returns, many don't realize that they must also report most other income, such as: cash earned from side jobs, barter exchanges of goods or services, awards, prizes, contest winnings and gambling proceeds
- The tax gap, or the amount of taxes that go unpaid each year, results from taxpayers underreporting their taxable income
- This seminar will explore what is taxable and how it is reported by the individual

?Income Not Income?

- We will look at issues that can be income sometimes and in other instances they are not income
- Facts and circumstances may need to be addressed

Tip Income

- All tips received are income and are subject to federal income tax
- The client must include in gross income all tips received directly, charged tips paid to and the share of any tips received under a tip-splitting or tip-pooling arrangement
- The value of noncash tips, such as tickets, passes, or other items of value, is also income and subject to tax
- Reporting tip income correctly isn't difficult.
- The client must do three things:
 - 1. Keep a daily tip record
 - 2. Report tips to the employer
 - 3. Report all tips on the income tax return

Keeping a Daily Tip Record

- The client should keep the daily tip record
- If they keep a tip diary, they can use Form 4070A, Employee's Daily Record of Tips
- Pub. 1244 includes a 1-year supply of Form 4070A

Form 4070 A

Form 4070A (Rev. August 2005) Department of the Treasury Internal Revenue Service		Employee's Daily Record of Tips This is a voluntary form provided for your convenience. See instructions for records you must keep.		OMB No. 1545-0074	
Employee's name and address		Employer's name	Month and year		
		Establishment name (if different)			
Date tips rec'd	Date of entry	a. Tips received directly from customers and other employees	b. Credit and debit card tips received	c. Tips paid out to other employees	d. Names of employees to whom you paid tips
1					
2					
3					
4					
5					
Subtotals					

For Paperwork Reduction Act Notice, see Instructions on the back of Form 4070. Page 1

Tip Income

- Cash tips the taxpayer gets directly from customers or from other employees
- Tips from credit and debit card charge customers that the employer pays to the employee
- The value of any noncash tips, such as tickets, passes, or other items of value

Tip Income

- Form 4137 is used to figure social security and Medicare taxes and/or Form 8959 is used to figure Additional Medicare Tax
- Tax reported on Form 1040

Service Charges

- The client should not record any service charge that the employer adds to a customer's bill and then pays to the employee and is treated wages

Example

- Good Food Restaurant adds an 18% charge to the bill for parties of 6 or more customers
- Jane's bill for food and beverages for her party of 8 includes an amount on the tip line equal to 18% of the charges for food and beverages, and the total includes this amount
- Because Jane didn't have an unrestricted right to determine the amount on the "tip line," the 18% charge is considered a service charge
- Service charges that are paid to the client are considered wages, not tips

When to Report Tips to the Employer

- Your client must provide the report for each month to the employer by the 10th of the next month
- If the 10th falls on a Saturday, Sunday, or legal holiday, give the employer the report by the next day that isn't a Saturday, Sunday, or legal holiday

Keeping the Daily Tip Log

- If the client didn't keep a daily tip record as required and an amount is shown on the Form W-2, Box 8 the client has Allocated Tips

Allocated Tips

- Although allocated tips are shown on the Form W-2, they are not included in Box 1 on that form and no tax is withheld from these tips
- Therefore they are added into Form 4137

Form 4137

Form 4137 Social Security and Medicare Tax on Unreported Tip Income

OMB No. 1545-0074

2016

Attachment Sequence No. 24

Department of the Treasury
Internal Revenue Service (IRS)

Information about Form 4137 and its instructions is at www.irs.gov/form4137.
 Attach to Form 1040, Form 1040NR, Form 1040NR-EZ, Form 1040-SS, or Form 1040-PR.

Name of person who received tips. If married, complete a separate Form 4137 for each spouse with unreported tips.

1	(a) Name of employer to whom you were required to, but did not, report all your tips (see instructions)	(b) Employer identification number (see instructions)	(c) Total cash and charge tips you received (including unreported tips) (see instructions)	(d) Total cash and charge tips you reported to your employer
A				
B				
C				
D				
E				
2	Total cash and charge tips you received in 2016. Add the amounts from line 1, column (c).			
3	Total cash and charge tips you reported to your employer(s) in 2016. Add the amounts from line 1, column (d).			
4	Subtract line 3 from line 2. This amount is due to you and is included in the total on Form 1040, line 7; Form 1040NR, line 6; or Form 1040NR-EZ, line 3.			
5	Cash and charge tips you received but did not report to your employer because the total was less than \$20 in a calendar month (see instructions).			
6	Unreported tips subject to Medicare tax. Subtract line 5 from line 4.			
7	Maximum amount of wages (including tips) subject to social security tax.			
8	Total social security wages and social security tips (total of lines 3 and 7 shown on your Form(s) W-2 and railroad retirement (RRTP) compensation subject to 6.2% rate) (see instructions).			
9	Subtract line 8 from line 7. If line 8 is more than line 7, enter -0-			
10	Unreported tips subject to social security tax. Enter the smaller of line 6 or line 9. If you received tips as a federal, state, or local government employee, see instructions.			
11	Multiply line 10 by 0.062 (social security tax rate).			
12	Multiply line 8 by 0.0945 (Medicare tax rate).			
13	Add lines 11 and 12. Enter the result here and on Form 1040, line 5b; Form 1040NR, line 5b; or Form 1040NR-EZ, line 10 (Form 1040-SS and 1040-PR filers, see instructions).			

Form 4137

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 Attach to Form 1040, Form 1040NR, Form 1040NR-EZ, Form 1040-SS, or Form 1040-PR.

Name of person who received tips. If married, complete a separate Form 4137 for each spouse with unreported tips.

Social security number

1	(a) Name of employer to whom you were required to, but did not, report all your tips (see instructions)	(b) Employer identification number (see instructions)	(c) Total cash and charge tips you received (including unreported tips) (see instructions)	(d) Total cash and charge tips you reported to your employer
A				
B				
C				
D				
E				

Tips

- If the tips were not enough to cover taxes, the client may have given the employer additional amounts needed
- The Form W-2 will include the tips reported to the employer and the taxes withheld
- If there was not enough money to cover the social security and Medicare tax (or railroad retirement tax), the Form W-2 will also show the uncollected tax due in Box 12 with codes A and B

Form W-2 Codes

- A—Uncollected social security or RRTA tax on tips
- B—Uncollected Medicare tax on tips

Tips

- If the client kept a daily tip record and reported tips to the employer as required, add the following tips to the amount on the Form W-2, Box 1
 - Cash and charge tips the client received that totaled less than \$20 for any month
 - The value of noncash tips, such as tickets, passes, or other items of value

Form 4137

2 Total cash and charge tips you received in 2016. Add the amounts from line 1, column (c)	2				
3 Total cash and charge tips you reported to your employer(s) in 2016. Add the amounts from line 1, column (d)	3				
4 Subtract line 3 from line 2. This amount is income you must include in the total on Form 1040, line 7; Form 1040NR, line 8; or Form 1040NR-EZ, line 3	4				
5 Cash and charge tips you received but did not report to your employer because the total was less than \$20 in a calendar month (see instructions)	5				

Form 4137

6 Unreported tips subject to Medicare tax. Subtract line 5 from line 4	6				
7 Maximum amount of wages (including tips) subject to social security tax	7	118,500	00		
8 Total social security wages and social security tips (total of boxes 3 and 7 shown on your Form(s) W-2) and railroad retirement (RRTA) compensation (subject to 6.2% rate) (see instructions)	8				
9 Subtract line 8 from line 7. If line 8 is more than line 7, enter -0-	9				
10 Unreported tips subject to social security tax. Enter the smaller of line 6 or line 9. If you received tips as a federal, state, or local government employee, see instructions	10				

Completing Form 4137

- Complete a separate line for each employer
- If the client had more than five employers in 2016, attach a statement that contains all of the information (and in a similar format) as required on Form 4137, line 1, or complete and attach line 1 of additional Form(s) 4137
- Complete lines 2 through 13 on only one Form 4137
- The line 2 and line 3 amounts on that Form 4137 should be the combined totals of all Forms 4137 and attached statements

Completing Form 4137

- Include the name, social security number, and calendar year (2016) on the top of any attachment
- Column (a) Enter the employer's name exactly as shown on the Form W-2
- Column (b) For each employer's name entered in column (a), enter the employer identification number (EIN) or the words "Applied For" exactly as shown on the Form W-2

Completing Form 4137

- Column (c) Include all cash and charge tips received
- This includes the following tips:
 - Total tips reported to the employer on time
 - Tips the client did not report to the employer on time or did not report at all (include any allocated tips shown in Box 8 on Form(s) W-2 unless the client can prove that the unreported tips are less than the amount in Box 8)
 - Tips received that were not required to report to the employer because they totaled less than \$20 during the month
 - Allocated tips that must be reported as income

Line 5 and Line 8

- Line 5
 - Enter only the tips the client was not required to report to the employer because the total received was less than \$20 in a calendar month
 - These tips are not subject to social security and Medicare tax
- Line 8
 - For railroad retirement (RRTA) compensation, do not include an amount greater than \$118,500, which is the amount subject to the 6.2% rate for 2016

Line 10 and 11

- Line 10
 - If line 6 includes tips received for work the client did as a federal, state, or local government employee and the pay was subject only to the 1.45% Medicare tax, subtract the amount of those tips from the line 6 amount only for the purpose of comparing lines 6 and 9
 - Do not reduce the actual entry on line 6
 - Enter “1.45% tips” and the amount you subtracted on the dotted line next to line 10
- Line 11
 - Multiply the amount on line 10 by 0.062 (the social security rate for 2016)

Form 1040

Other Taxes	57	Self-employment tax. Attach Schedule SE	57	
	58	Unreported social security and Medicare tax from Form: a <input type="checkbox"/> 4137 b <input type="checkbox"/> 8919	58	
	59	Additional tax on IRAs, other qualified retirement plans, etc. Attach Form 5329 if required	59	
	60a	Household employment taxes from Schedule H	60a	
	60b	First-time homebuyer credit repayment. Attach Form 5405 if required	60b	
	61	Health care: individual responsibility (see instructions) Full-year coverage <input type="checkbox"/>	61	
	62	Taxes from: a <input type="checkbox"/> Form 8859 b <input type="checkbox"/> Form 8960 c <input type="checkbox"/> Instructions; enter code(s)	62	
	63	Add lines 56 through 62. This is your total tax	63	

Bartering



What is Bartering?

- Generally a noncash transaction bartering or trading one product or service for another
- The barter can also be a direct exchange but could also be part cash
- The barter could be an item of inventory
- The barter could also be through a barter exchange company

Why Are We Discussing the Issue?

- Bartering or trading is a taxable event
- Regardless of what form of compensation the business is paid in, there is income
- The business benefits from the transaction
- The IRS interview at the beginning of an audit addresses whether the business barter or trades

Advantages of Bartering or Trading

- Bartering may be a useful way to acquire a product or service the business needs if they have little cash and a ton of inventory to trade
- But, they may not be able to write off the services or product exchanged
- The fair market value of a product or service might be less than expected which means they end up saving a bit on taxes
- Bartering may be a way to avoid transactional costs or costs they have to pay to third parties if they didn't barter
- Bartering can be a nice way to setup new business relationships
- Bartering can be a way to give an employee a bonus or compensation

Disadvantages of Bartering or Trading

- For one, the client needs to find someone who has what they want and is willing to trade it for what the client has
- And they have to agree on how much of each is fair
- Direct barter trades can be unequal

IRS View

- When they receive a service in lieu of revenue the business must recognize the service as income
- The IRS taxes barter transactions in dollars and cents, even though no money changes hands
- The client must keep track of trades made and keep good records of them so they can be properly taxed
- The IRS measures bartered exchanges by using the market price of the goods or services someone receives
- In a swap, both parties have to list the market value of what they received as taxable income

Tax Implications of Bartering

- Income from bartering is taxable in the year it is performed
- Bartering may result in liabilities for income tax, self-employment tax, employment tax or excise tax
- The barter activities may result in ordinary business income, capital gains or capital losses, or they may have a nondeductible personal loss

Examples

- The business trades \$1,000 worth of accounting services for \$1,000 worth of computer repairs
- A small craft business could exchange a quilt for a piece of pottery
- The quilt could be exchanged for bookkeeping services
- The options for bartering and trading is numerous

Examples of Bartering

- The client is a self-employed attorney who performs legal services for a client, a small corporation
- The corporation gives the client shares of its stock as payment for services
- The client must include the fair market value of the shares in income on Schedule C or Schedule C-EZ (Form 1040) in the year they receive them
- The income claimed then becomes the basis in the stock

Examples of Bartering

- You are a self-employed accountant
- In return for accounting services you provided, a house painter painted your home
- You must report as income on Schedule C or Schedule C-EZ (Form 1040) the fair market value of the house painting services received
- The house painter must include in income the fair market value of the accounting services provided

Examples of Bartering

- You own a small apartment building
- In return for 6 months rent-free use of an apartment, an artist gives you a work of art she created
- You must report as rental income on Schedule E (Form 1040) the fair market value of the artwork, and the artist must report as income on Schedule C or Schedule C-EZ (Form 1040) the fair rental value of the apartment

Look Simple “Right”

- Barter Income can be a Bookkeeping Challenge for a Business
 - Suppose the client exchanges a service worth \$1,000 for another service worth \$1,000
 - Technically, they have \$1,000 of income, and can’t claim as a deduction the value of the service exchanged

Looks Simple “Right”

- Apart from service swaps, even simple trades of goods can trigger multiple tax rules
- Let’s look at a personally owned asset, not a business
 - Suppose the client swaps 100 shares of stock with a FMV of \$3,500 for 500 shares of ABC stock
 - The client considers it an even swap and not a tax event
- Sorry, they may still have income
- The trade is two separate transactions, producing gain or loss depending on the basis in the stock

Looks Simple “Right”

- The client originally purchased the stock for \$1,000, for a gain of \$2,500
- It might be long term capital gain, but that depends on the facts and how long the client owned the stock
- If they received it within the past year, the gain is short term and taxed up to the top 39.6% rate
- In the IRS’s view, they sold the stock so you should pay tax

Compensation

- The fair market value of what the employee receives must be accounted for because it is subject to federal income tax withholding and social security and Medicare and is included on Form W-2
 - Many companies conduct barter bonus or sales incentive programs, using everything from restaurant certificates to resort trips
- If the worker is an independent contractor, then their 1099 must reflect the value of services or products given

What if the Issue is not a Service but an Asset?

- Two companies agree to swap fax machines. The features of each are similar but better meet the needs of each different company
- Company A's fax machine has a book value of \$750.00 (Cost of \$1,000 - \$250.00 of depreciation)
- Company B's fax machine has a book value of \$1,000 (Cost of \$1,500 - \$500 of depreciation)
- Both fax machines have a FMV of \$500
- The substance of the transaction is equal and is accounted for at book value
- As a result of the trade, Company A has the following unrecognized gain:
 - Cost value of Company A fax machine given to Company B = \$1,000
 - Book value of Company A fax machine given to Company B = \$ 750
 - Total gain (unrecognized) = \$ 250

What if the Issue is not a Service but an Asset?

- Company A elects to depreciate its newly acquired fax machine over five years under MACRS
- The unrecognized gain on the transaction is actually being recognized through ongoing reduced depreciation
- If the substance of the transaction were not equal, the gain would be required to be recognized

Inventory Example

- The business is an online retail web site that sells gourmet food products to restaurants and specialty shops
- The client provides \$2,000 worth of products (FMV) to a local restaurant in return for 100# of lobster tail with a cost of \$2,000
- The client must include the fair market value of the lobster received in income on the business income schedule of the tax return
- They will also increase the cost of goods sold by decreasing the inventory for the cost or other basis gourmet food given up
- The restaurant will handle recordkeeping the same way if both maintain inventories
- Both the client and the restaurant owner will report the income of \$2,000

Is it a Wash Sale?

- Be sure to use a reasonable fair market value for the property or services received in a barter transaction to include in income
- **The transaction is not a "wash" if you report the fair market value of the property received that is greater than the cost or basis in the property given up**
- **In our example the restaurant purchased the lobster for \$2,000 that is their cost for them it will be a wash as the FMV of the property received is \$2,000**
- But the gourmet food given up has a cost basis of \$500, there is a \$1500 gross profit on the transaction since the fair market value of the lobster \$2,000
- Simply put, identify the transaction in the records and report the income and any related business deductions and cost of goods sold on the business income and expense schedule of the tax return

A Little Bit More

- If the client provides services to pay a business expense, the amount they can deduct is limited to the out-of-pocket costs
- They cannot deduct the cost of their own labor
- Similarly, if you pay a business expense in goods or other property, they can deduct only what the property costs
- **If these costs are included in the cost of goods sold, do not deduct them as a business expense**

Summary

- When a taxpayer engages in a barter transaction, the transaction should be treated as if the taxpayer sold its own product or services at fair market value and then paid fair market value for the product or services of the other party
- Thus, the recognition of income gives the taxpayer a cost basis in the services or product received equal to the amount of income recognized
- The memo cites several court cases in support of its position, including the landmark tax court case, *United States v. General Shoe Corp.*, 282 F.2d 9, 12 (6th Cir. 1960), cert. denied 365 U.S. 843 (1961)

Other Types of Income



Medical Reimbursement in a Later Year

- If the client is reimbursed in a later year for medical expenses they deducted in an earlier year, they generally must report the reimbursement as income up to the amount they previously deducted as medical expenses
- However, don't report as income the amount of reimbursement received up to the amount of the medical deductions that didn't reduce tax for the earlier year

Free Tour

- If the client received a free tour from a travel agency for organizing a group of tourists, they must include its value in income
- Report the fair market value of the tour on Form 1040, line 21, if they are not in the trade or business of organizing tours
- They cannot deduct expenses in serving as the voluntary leader of the group at the group's request
- If they organize tours as a trade or business, report the tour's value on Schedule C or Schedule C-EZ (Form 1040)

Activity Not for Profit

- The client must include in income from an activity from which they do not expect to make a profit
- An example of this type of activity is a hobby or a farm they operate mostly for recreation and pleasure
- Enter this income on Form 1040, line 21
- Deductions for expenses related to the activity are limited
- They cannot total more than the income reported and can be taken only if they itemize deductions on Schedule A (Form 1040)

Car Pools

- Do not include in income amounts received from the passengers for driving a car in a car pool to and from work
- These amounts are considered reimbursement for expenses
- However, this rule does not apply if they have developed car pool arrangements into a profit-making business of transporting workers for hire

Cash Rebates

- A cash rebate received from a dealer or manufacturer of an item the client buys is not income, but they must reduce the basis by the amount of the rebate

Court Awards and Damages

- To determine if settlement amounts received by compromise or judgment must be included in income, the client must consider the item that the settlement replaces
- The character of the income as ordinary income or capital gain depends on the nature of the underlying claim
- Include the following as ordinary income
 - 1. Interest on any award
 - 2. Compensation for lost wages or lost profits in most cases
 - 3. Punitive damages, in most cases
 - It does not matter if they relate to a physical injury or physical sickness
 - 4. Amounts received in settlement of pension rights (if the taxpayer did not contribute to the plan)

Court Awards and Damages

- 5. Damages for
 - a. Patent or copyright infringement
 - b. Breach of contract, or
 - c. Interference with business operations
- 6. Back pay and damages for emotional distress received to satisfy a claim under title VII of the Civil Rights Act of 1964
- 7. Attorney fees and costs (including contingent fees) where the underlying recovery is included in gross income

Compensatory Damages

- Do not include in income compensatory damages for personal physical injury or physical sickness (whether received in a lump sum or installments)

Emotional Distress

- Emotional distress itself is not a physical injury or physical sickness, but damages received for emotional distress due to a physical injury or sickness are treated as received for the physical injury or sickness
- Do not include them in income
- If the emotional distress is due to a personal injury that is not due to a physical injury or sickness (for example, employment discrimination or injury to reputation), the client must include the damages in income, except for any damages that are not more than amounts paid for medical care due to that emotional distress
- Emotional distress includes physical symptoms that result from emotional distress, such as headaches, insomnia, and stomach disorders

Credit Card Insurance

- In most cases, if the client receives benefits under a credit card disability or unemployment insurance plan, the benefits are taxable
- These plans make the minimum monthly payment on the credit card account if the taxpayer cannot make the payment due to injury, illness, disability, or unemployment
- Report on Form 1040, line 21, the amount of benefits received during the year that is more than the amount of the premiums paid during the year

Down Payment Assistance

- If the client purchased a home and receive assistance from a nonprofit corporation to make the down payment, that assistance is not included in income
- If the corporation qualifies as a tax-exempt charitable organization, the assistance is treated as a gift and is included in the basis of the house
- If the corporation does not qualify, the assistance is treated as a rebate or reduction of the purchase price and is not included in the basis

Employment Agency Fees

- If the client gets a job through an employment agency, and the fee is paid by the employer, the fee is not includible in the clients income if they are not liable for it
- However, if the client pays the fee and the employer reimburses them for it, it is includible in income

Fees for Services

- Include all fees for services in income
- Examples of these fees are amounts received for services performed as:
 - A corporate director
 - An executor, administrator, or personal representative of an estate
 - A manager of a trade or business the client operated before declaring Chapter 11 bankruptcy
 - A notary public or
 - An election precinct official

Nonemployee Compensation

- If the client is not an employee and the fees for their services from a single payer in the course of the payer's trade or business total \$600 or more for the year, the payer should send them a Form 1099-MISC
- They may need to report the fees as self-employment income

Corporate Director

- Corporate director fees are self-employment income
- Report these payments on Schedule C or Schedule C-EZ (Form 1040)

Personal Representatives

- All personal representatives must include in their gross income fees paid to them from an estate
- If they are not in the trade or business of being an executor (for instance, the client is an executor of a friend's or relative's estate), report these fees on Form 1040, line 21
- If they are in the trade or business of being an executor, report these fees as self-employment income on Schedule C or Schedule C-EZ (Form 1040)
- The fee is not includible in income if it is waived

Manager of Trade or Business for Bankruptcy Estate

- Include in income all payments received from the bankruptcy estate for managing or operating a trade or business that the taxpayer operated before they filed for bankruptcy
- Report this income on Form 1040, line 21

Notary Public

- Report payments for these services on Schedule C or Schedule C-EZ (Form 1040)
- These payments are not subject to self-employment tax

Election Precinct Official

- The client should receive a Form W-2 showing payments for services performed as an election official or election worker
- Report these payments on line 7 of Form 1040 or Form 1040A or on line 1 of Form 1040EZ

Foster Care Providers

- Generally, payments received from a state, political subdivision, or a qualified foster care placement agency for caring for a qualified foster individual in the home is excluded from income
- However, the client must include in income payments to the extent it is received for the care of more than 5 qualified foster individuals age 19 years or older
- A qualified foster individual is a person who:
 1. Is living in a foster family home, and
 2. Was placed there by:
 - a. An agency of a state or one of its political subdivisions, or
 - b. A qualified foster care placement agency

Lotteries and Raffles

- Winnings from lotteries and raffles are gambling winnings
- In addition to cash winnings, the client must include in income the fair market value of bonds, cars, houses, and other noncash prizes

Gambling Winnings

- The client must include gambling winnings in income on Form 1040, line 21
- If they itemize deductions on Schedule A (Form 1040), they can deduct gambling losses they had during the year, but only up to the amount of the winnings
- If they are in the trade or business of gambling, use Schedule C

Gifts and Inheritances

- In most cases, property received as a gift, bequest, or inheritance is not included in income
- However, if property received this way later produces income such as interest, dividends, or rents, that income is taxable
- If property is given to a trust and the income from it is paid, credited, or distributed, that income is also taxable
- If the gift, bequest, or inheritance is the income from the property, that income is taxable

Illegal Activities

- Income from illegal activities, such as money from dealing illegal drugs, must be included in income on Form 1040, line 21, or on Schedule C or Schedule C-EZ (Form 1040) if from self-employment activity

Interest on Frozen Deposits

- In general, exclude from income the amount of interest earned on a frozen deposit

Interest on Qualified Savings Bonds

- A client may be able to exclude from income the interest from qualified U.S. savings bonds redeemed if they are used to pay qualified higher education expenses in the same year

Jury Duty

- Jury duty pay received must be included in income on Form 1040, line 21
- If the client gave any of the jury duty pay to the employer because the employer continued to pay the client while they served jury duty, include the amount the client gave the employer as an income adjustment on Form 1040, line 36

Kickbacks

- The client must include kickbacks, side commissions, push money, or similar payments received in income on Form 1040, line 21
- Or on Schedule C or Schedule C-EZ (Form 1040), if from self-employment activity
- Example
 - The client sells cars and helps arrange car insurance for buyers
 - Insurance brokers pay back part of their commissions for referring customers to them
 - This amount must be included in income

Medical Savings Accounts (MSAs)

- In most cases, the client does not include in income amounts withdrawn from Archer MSA or Medicare Advantage MSA if they use the money to pay for qualified medical expenses
- Generally, qualified medical expenses are those they can deduct on Schedule A (Form 1040), Itemized Deductions

Prizes and Awards

- If the client wins a prize in a lucky number drawing, television or radio quiz program, beauty contest, or other event, they must include it in income
- The amount must be reported on Form 1040, line 21
- If the client refuses to accept a prize, do not include its value in income
- Prizes and awards in goods or services must be included in income at their fair market value

Employee Awards or Bonuses

- Cash awards or bonuses given to the client by the employer for good work or suggestions generally must be included in income as wages
- However, certain noncash employee achievement awards can be excluded from income

Qualified Tuition Programs (QTPs)

- A qualified tuition program (also known as a 529 program) is a program set up to allow the client to either prepay or contribute to an account established for paying a student's qualified higher education expenses at an eligible educational institution
- A program can be established and maintained by a state, an agency or instrumentality of a state, or an eligible educational institution
- The part of a distribution representing the amount paid or contributed to a QTP is not included in income
- This is a return of the investment in the program
- In most cases, the beneficiary does not include in income any earnings distributed from a QTP if the total distribution is less than or equal to adjusted qualified higher education expenses

Rewards

- If the client receives a reward for providing information, include it in income

Sale of Personal Items

- If the client sold an item owned for personal use, such as a car, refrigerator, furniture, stereo, jewelry, or silverware, the gain is taxable as a capital gain
- No losses can be deducted
- However, if the client sold an item held for investment, such as gold or silver bullion, coins, or gems, any gain is taxable as a capital gain and any loss is deductible as a capital loss

Scholarships and Fellowships

- A candidate for a degree can exclude amounts received as a qualified scholarship or fellowship
- A qualified scholarship or fellowship is any amount received that is for:
 - Tuition and fees to enroll at or attend an educational institution; or
 - Fees, books, supplies, and equipment required for courses at the educational institution.
- Amounts used for room and board do not qualify for the exclusion

VA Payments

- Allowances paid by the Department of Veterans Affairs are not included in income
- These allowances are not considered scholarship or fellowship grants

Scholarship Prizes

- Scholarship prizes won in a contest are not scholarships or fellowships if the taxpayer does not have to use the prizes for educational purposes
- The client must include these amounts in income on Form 1040, line 21, whether or not the amounts are used for educational purposes

Stolen Property

- If the client steals property, they must report its fair market value in income in the year they stole it unless in the same year, they returned it to the rightful owner

Strike and Lockout Benefits

- Benefits paid to the client by a union as strike or lockout benefits, including both cash and the fair market value of other property, are usually included in income as compensation
- They can exclude these benefits from income only when the facts clearly show that the union intended them as gifts

Utility Rebates

- If the client is a customer of an electric utility company and they participate in the utility's energy conservation program, they may receive on their monthly electric bill either:
 - A reduction in the purchase price of electricity furnished to them (rate reduction), or
 - A nonrefundable credit against the purchase price of the electricity
- The amount of the rate reduction or nonrefundable credit is not included in income

Recoveries

- A recovery is a return of an amount the client deducted or took a credit for in an earlier year
- The most common recoveries are refunds, reimbursements, and rebates of deductions itemized on Schedule A (Form 1040)
- They also may have recoveries of non-itemized deductions (such as payments on previously deducted bad debts) and recoveries of items for which they previously claimed a tax credit

Tax Benefit Rule

- The client must include a recovery in income in the year they received it up to the amount by which the deduction or credit they took for the recovered amount reduced tax in the earlier year
- For this purpose, any increase to an amount carried over to the current year that resulted from the deduction or credit is considered to have reduced tax in the earlier year

Federal Income Tax Refund

- Refunds of federal income taxes are not included in income because they are never allowed as a deduction from income

State Tax Refund

- If the client received a state or local income tax refund (or credit or offset) in 2016, they generally must include it in income if they deducted the tax in an earlier year
- The payer should send Form 1099-G, Certain Government Payments, to them by January 31, 2017
- The IRS also will receive a copy of the Form 1099-G
- Use the State and Local Income Tax Refund Worksheet to determine any taxable amount

State Tax Refund

- If they can choose to deduct for a tax year either:
 - State and local income taxes, or
 - State and local general sales taxes
- Then the maximum refund that they may have to include in income is limited to the excess of the tax they chose to deduct for that year over the tax they did not choose to deduct for that year

Mortgage Interest Refund

- If the client received a refund or credit in 2016 of mortgage interest paid in an earlier year, the amount should be shown in box 3 of the Form 1098, Mortgage Interest Statement
- Do not subtract the refund amount from the interest paid in 2016
- The client may have to include it in income under the recovery rules

Interest on Recovery

- Interest on any of the amounts recovered must be reported as interest income in the year received

Recovery and Expense in Same Year

- If the refund or other recovery and the expense occur in the same year, the recovery reduces the deduction or credit and is not reported as income

Recovery for 2 or More Years

- If the client received a refund or other recovery that is for amounts paid in 2 or more separate years, they must allocate, on a pro rata basis, the recovered amount between the years in which they paid it
- This allocation is necessary to determine the amount of recovery from any earlier years and to determine the amount, if any, of the allowable deduction for this item for the current year

Itemized Deduction Recoveries

- If they recover any amount that was deducted in an earlier year on Schedule A (Form 1040), they generally must include the full amount of the recovery in the income in the year they receive it.
- Where to report
- Enter the state or local income tax refund on Form 1040, line 10, and the total of all other recoveries as other income on Form 1040, line 21
- The client cannot use Forms 1040A or Form 1040EZ

Standard Deduction Limit

- The client is generally allowed to claim the standard deduction if they do not itemize deductions
- Only the itemized deductions that are more than the standard deduction are subject to the recovery rule
- (unless the taxpayer was required to itemize deductions)
- If the total deductions on the earlier year return were not more than income for that year, include in income this year the lesser of:
 - Recoveries, or
 - The amount by which the itemized deductions exceeded the standard deduction

Recovery Limited to Deduction

- Do not include in income any amount of the recovery that is more than the amount deducted in the earlier year
- The amount to include in income is limited to the smaller of:
 - The amount deducted on Schedule A (Form 1040), or
 - The amount recovered

CALT Website

<http://www.calt.iastate.edu/>



Tour of the CALT Website



Fall Tax Schools

- Though they are named the Farm and Urban Tax Schools the schools cover more than farm issues
- Common return issues for all kinds of returns are covered
- All kinds of business entities
- Problematic issues
- Sometimes we even get into to issues that you many encounter only once or twice a year or tax season
- The Tax Schools are a blend of diverse topics of interest to all tax professionals
- This year: New instructors with diverse backgrounds
- Your adventure awaits at Iowa State's Center for Agricultural Law and Taxation

Farm and Urban Tax Schools 2016

- November 2, 2016 to December 13, 2016
- 8 Locations in Iowa and Online Webinar
- Save the Date for the 2016 Annual Farm and Urban Income Tax Schools
- The program is intended for tax professionals and is designed to provide up-to-date training on current tax law and regulations
 - November 2-3: Maquoketa
 - November 7-8: Red Oak
 - November 9-10: Sheldon
 - November 14-15: Mason City
 - November 17-18: Ottumwa
 - November 21-22: Waterloo
 - December 5-6: Denison
 - December 12-13: Ames and Live Webinar

Winter Webinars

- Tax law Update: New Developments
- Monthly Ethics Classes

The Scoop

- Throughout the filing season two Scoops will be held on Scoop Dates
 - 8:00 – 8:30 am Central time
 - 12:00 – 12:30 Central time
- This assists with accommodating our west coast practitioners
- The same information will be shared at both sessions
- You have the option of registering for whatever session suits your schedule
- <https://www.calt.iastate.edu/calendar-node-field-seminar-date/month>

Future Scoop Dates

- October 19, 2016
- November 16, 2016
- December 14, 2016
- <http://www.calt.iastate.edu/calendar-node-field-seminar-date/month>

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