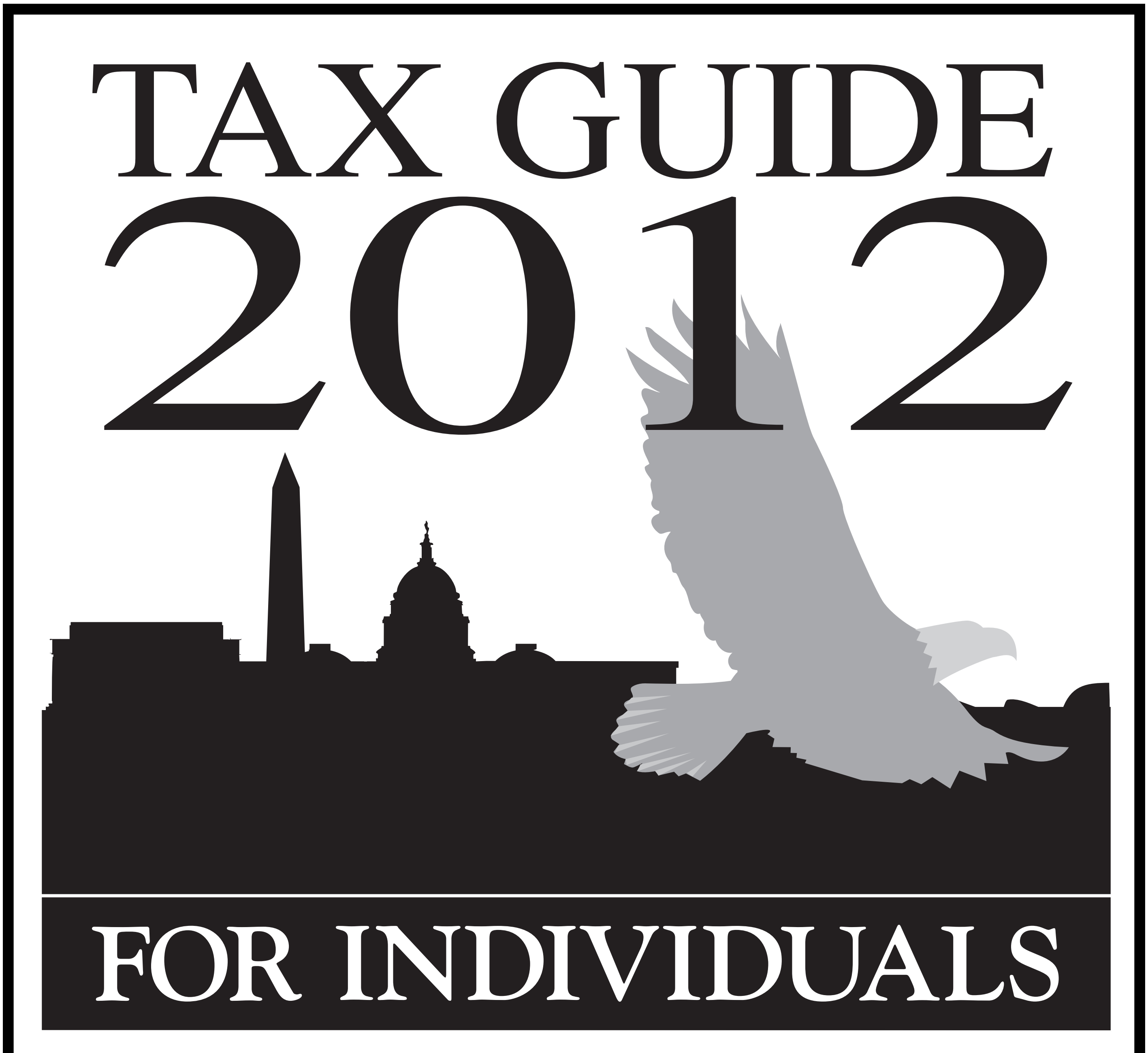
Department of the Treasury
Internal Revenue Service

Your Federal Income Tax

For Individuals

Publication 17
Catalog Number 10311G

For use in preparing
2012 Returns



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Jan 31, 2013

Department of the Treasury

Internal Revenue Service

Your Federal Income Tax

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Contents

The explanations and examples in this publication reflect the interpretation by the Internal Revenue Service (IRS) of:

- Tax laws enacted by Congress,
- Treasury regulations, and
- Court decisions.

However, the information given does not cover every situation and is not intended to replace the law or change its meaning.

This publication covers some subjects on which a court may have made a decision more favorable to taxpayers than the interpretation by the IRS. Until these differing interpretations are resolved by higher court decisions or in some other way, this publication will continue to present the interpretations by the IRS.

All taxpayers have important rights when working with the IRS. These rights are described in *Your Rights as a Taxpayer* in the back of this publication.

What's New

This section summarizes important tax changes that took effect in 2012. Most of these changes are discussed in more detail throughout this publication.

Future developments. For the latest information about the tax law topics covered in this publication, including information about any tax legislation, go to *www.irs.gov/pub17*.

Tax benefits extended. Several temporary tax benefits have been extended through 2013, including the following.

- Deduction for educator expenses. See chapter 19.
- Tuition and fees deduction. See chapter 19.
- Credit for nonbusiness energy property. See chapter 36.
- Election to deduct state and local general sales taxes instead of state and local income taxes. See chapter 22.
- Deduction for mortgage insurance premiums. See chapter 23.
- Exclusion from income of qualified charitable distributions. See chapter 17.

Standard mileage rates. The 2012 rate for business use of your car remains 55½ cents a mile. See chapter 26.

The 2012 rate for use of your car to get medical care is decreased to 23 cents a mile. See chapter 21.

The 2012 rate for use of your car to move is decreased to 23 cents a mile. See Publication 521, Moving Expenses.

Exemption amount. The amount you can deduct for each exemption has increased. It was $3,700 for 2011. It is $3,800 for 2012. See chapter 3.

Roth IRAs. If you converted or rolled over an amount to a Roth IRA in 2010 and did not elect to report the taxable amount on your 2010 return, you generally must report half of it on your 2011 return and the rest on your 2012 return. See Publication 575 for details.

Designated Roth accounts. If you rolled over an amount from a 401(k) or 403(b) plan to a designated Roth account in 2010 and did not elect to report the taxable amount on your 2010 return, you generally must report half of it on your 2011 return and the rest on your 2012 return. See Publication 575 for details.

Schedule 8812. Use Schedule 8812 (Form 1040A or 1040) to figure your additional child tax credit for 2012. Schedule 8812 is new for 2012. Form 8812 is no longer in use. See chapter 33.

Identity Protection Personal Identification Number (Identity Protection PIN or IP PIN). If we sent you an Identity Protection PIN, see chapter 1 to find out how to use it.

Mailing your return. If you are filing a paper return, you may be mailing it to a different address this year because the IRS has changed the filing location for several areas. See *Where To File* near the end of this publication for a list of IRS addresses.

Reminders

Listed below are important reminders and other items that may help you file your 2012 tax return. Many of these items are explained in more detail later in this publication.

Enter your social security number (SSN). Enter your SSN in the space provided on your tax form. If you filed a joint return for 2011 and are filing a joint return for 2012 with the same spouse, enter your names and SSNs in the same order as on your 2011 return. See chapter 1.

Secure your tax records from identity theft. Identity theft occurs when someone uses your personal information such as your name, SSN, or other identifying information, without your permission, to commit fraud or other crimes. An identity thief may use your SSN to get a job or may file a tax return using your SSN to receive a refund. For more information about identity theft and how to reduce your risk from it, see chapter 1.

Taxpayer identification numbers. You must provide the taxpayer identification number for each person for whom you claim certain tax benefits. This applies even if the person was born in 2012. Generally, this number is the person's social security number (SSN). See chapter 1.

Foreign source income. If you are a U.S. citizen with income from sources outside the United States (foreign income), you must report all such income on your tax return unless it is exempt by U.S. law. This is true whether you live inside or outside the United States and whether or not you receive a Form W-2 or Form 1099 from the foreign payer. This applies to earned income (such as wages and tips) as well as unearned income (such as interest, dividends, capital gains, pensions, rents and royalties).

If you live outside the United States, you may be able to exclude part or all of your foreign source earned income. For details, see Publication 54, Tax Guide for U.S. Citizens and Resident Aliens Abroad.

Foreign financial assets. If you had foreign financial assets in 2012, you may have to file Form 8938 with your return. Check *www.IRS.gov/form8938* for details.

Automatic 6-month extension to file tax return. You can use Form 4868, Application for Automatic Extension of Time To File U.S. Individual Income Tax Return, to obtain an automatic 6-month extension of time to file your tax return. See chapter 1.

Include your phone number on your return. To promptly resolve any questions we have in processing your tax return, we would like to be able to call you. Please enter your daytime telephone number on your tax form next to your signature.

Payment of taxes. You can pay your taxes online or by phone. You can make a direct transfer from your bank account or use a credit or debit card. If you *e-file*, you can schedule an electronic payment. See chapter 1.

Faster ways to file your return. The IRS offers fast, accurate ways to file your tax return information without filing a paper tax return. You can use IRS *e-file* (electronic filing). See chapter 1.

Free electronic filing. You may be able to file your 2012 taxes online for free thanks to an electronic filing agreement. See chapter 1.

Change of address. If you change your address, you should notify the IRS. See *Change of Address* in chapter 1.

Refund on a late filed return. If you were due a refund but you did not file a return, you generally must file your return within 3 years from the date the return was due (including extensions) to get that refund. See chapter 1.

Frivolous tax submissions. The IRS has published a list of positions that are identified as frivolous. The penalty for filing a frivolous tax return is $5,000. See chapter 1.

Filing erroneous claim for refund or credit. You may have to pay a penalty if you file an erroneous claim for refund or credit. See chapter 1.

Privacy Act and paperwork reduction information. The IRS Restructuring and Reform Act of 1998, the Privacy Act of 1974, and the Paperwork Reduction Act of 1980 require that when we ask you for information we must first tell you what our legal right is to ask for the information, why we are asking for it, how it will be used, what could happen if we do not receive it, and whether your response is voluntary, required to obtain a benefit, or mandatory under the law. A complete statement on this subject can be found in your tax form instructions.

Customer service for taxpayers. You can set up a personal appointment at the most convenient Taxpayer Assistance Center, on the most convenient business day. See *How To Get Tax Help* in the back of this publication.

Preparer *e-file* mandate. Most paid preparers must *e-file* returns they prepare and file. Your preparer may make you aware of this requirement and the options available to you.

Treasury Inspector General for Tax Administration. If you want to confidentially report misconduct, waste, fraud, or abuse by an IRS employee, you can call 1-800-366-4484 (call 1-800-877-8339 if you are deaf, hard of hearing, or have a speech disability, and are using TTY/TDD equipment). You can remain anonymous.

Photographs of missing children. The Internal Revenue Service is a proud partner with the National Center for Missing and Exploited Children. Photographs of missing children selected by the Center may appear in this publication on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling 1-800-THE-LOST (1-800-843-5678) if you recognize a child.

Introduction

This publication covers the general rules for filing a federal income tax return. It supplements the information contained in your tax form instructions. It explains the tax law to make sure you pay only the tax you owe and no more.

How this publication is arranged. This publication closely follows Form 1040, U.S. Individual Income Tax Return. It is divided into six parts which cover different sections of Form 1040. Each part is further divided into chapters which generally discuss one line of the form. Do not worry if you file Form 1040A or Form 1040EZ. Anything included on a line of either of these forms is also included on Form 1040.

The table of contents inside the front cover and the index in the back of the publication are useful tools to help you find the information you need.

What is in this publication. The publication begins with the rules for filing a tax return. It explains:

1. Who must file a return,
2. Which tax form to use,
3. When the return is due,
4. How to *e-file* your return, and
5. Other general information.

It will help you identify which filing status you qualify for, whether you can claim any dependents, and whether the income you receive is taxable. The publication goes on to explain the standard deduction, the kinds of expenses you may be able to deduct, and the various kinds of credits you may be able to take to reduce your tax.

Throughout the publication are examples showing how the tax law applies in typical situations. Also throughout the publication are flowcharts and tables that present tax information in an easy-to-understand manner.

Many of the subjects discussed in this publication are discussed in greater detail in other IRS publications. References to those other publications are provided for your information.

Icons. Small graphic symbols, or icons, are used to draw your attention to special information. See Table 1 below for an explanation of each icon used in this publication.

What is not covered in this publication. Some material that you may find helpful is not included in this publication but can be found in your tax form instruction booklet. This includes lists of:

- Where to report certain items shown on information documents, and
- Recorded tax information topics (TeleTax).

If you operate your own business or have other self-employment income, such as from babysitting or selling crafts, see the following publications for more information.

- Publication 334, Tax Guide for Small Business (For Individuals Who Use Schedule C or C-EZ).
- Publication 535, Business Expenses.
- Publication 587, Business Use of Your Home (Including Use by Daycare Providers).

Help from the IRS. There are many ways you can get help from the IRS. These are explained under *How To Get Tax Help* in the back of this publication.

Comments and suggestions. We welcome your comments about this publication and your suggestions for future editions.

You can write to us at the following address:

Internal Revenue Service
Individual Forms and
Publications Branch
SE:W:CAR:MP:T:I
1111 Constitution Ave. NW,
IR-6526
Washington, DC 20224

We respond to many letters by telephone. Therefore, it would be helpful if you would include your daytime phone number, including the area code, in your correspondence.

You can email us at *taxforms@irs.gov*. Please put "Publications Comment" on the subject line. You can also send us comments from *www.irs.gov/formspubs/*. Select "More Information" and then "Comment on Tax Forms and Publications."

Although we cannot respond individually to each comment received, we do appreciate your feedback and will consider your comments as we revise our tax forms and publications.

Ordering forms and publications. Visit *www.irs.gov/formspubs/* to download forms and publications, call 1-800-TAX-FORM (1-800-829-3676) to order forms and publications, or write to the address below and receive a response within 10 days after your request is received.

Internal Revenue Service
1201 N. Mitsubishi Motorway
Bloomington, IL 61705-6613

Tax questions. If you have a tax question, check the information available on IRS.gov or call 1-800-829-1040. We cannot answer tax questions sent to either of the above addresses.

IRS mission. Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

Table 1. **Legend of Icons**

Icon	Explanation
CAUTION	Items that may cause you particular problems, or an alert about pending legislation that may be enacted after this publication goes to print.
	An Internet site or an email address.
	An address you may need.
RECORDS	Items you should keep in your personal records.
	Items you may need to figure or a worksheet you may need to complete.
	An important phone number.
TIP	Helpful information you may need.

Part One.

The Income Tax Return

The four chapters in this part provide basic information on the tax system. They take you through the first steps of filling out a tax return—such as deciding what your filing status is, how many exemptions you can take, and what form to file. They also discuss recordkeeping requirements, IRS e-file *(electronic filing), certain penalties, and the two methods used to pay tax during the year: withholding and estimated tax.*

1.

Filing Information

What's New

Who must file. Generally, the amount of income you can receive before you must file a return has been increased. See Table 1-1, Table 1-2, and Table 1-3 for the specific amounts.

Mailing your return. If you file a paper return, you may be mailing it to a different address this year because the IRS has changed the filing location for several areas. See *Where Do I File*, later in this chapter.

Reminders

File online. Rather than filing a return on paper, you may be able to file electronically using IRS *e-file*. Create your own personal identification number (PIN) and file a completely paperless tax return. For more information, see *Does My Return Have To Be on Paper*, later.

Change of address. If you change your address, you should notify the IRS. See *Change of Address*, later, under *What Happens After I File*.

Enter your social security number. You must enter your social security number (SSN) in the spaces provided on your tax return. If you file a joint return, enter the SSNs in the same order as the names.

Direct deposit of refund. Instead of getting a paper check, you may be able to have your refund deposited directly into your account at a bank or other financial institution. See *Direct Deposit* under *Refunds*, later. If you choose direct deposit of your refund, you may be able to split the refund among two or three accounts.

Pay online or by phone. If you owe additional tax, you may be able to pay online or by phone. See *How To Pay*, later.

Installment agreement. If you cannot pay the full amount due with your return, you may ask to make monthly installment payments. See *Installment Agreement*, later, under *Amount You Owe*. You may be able to apply online for a payment agreement if you owe federal tax, interest, and penalties.

Automatic 6-month extension. You can get an automatic 6-month extension to file your tax return if, no later than the date your return is due, you file Form 4868, Application for Automatic Extension of Time To File U.S. Individual Income Tax Return. See *Automatic Extension*, later.

Service in combat zone. You are allowed extra time to take care of your tax matters if you are a member of the Armed Forces who served in a combat zone, or if you served in the combat zone in support of the Armed Forces. See *Individuals Serving in Combat Zone*, later, under *When Do I Have To File*.

Adoption taxpayer identification number. If a child has been placed in your home for purposes of legal adoption and you will not be able to get a social security number for the child in time to file your return, you may be able to get an adoption taxpayer identification number (ATIN). For more information, see *Social Security Number (SSN)*, later.

Taxpayer identification number for aliens. If you or your dependent is a nonresident or resident alien who does not have and is not eligible to get a social security number, file Form W-7, Application for IRS Individual Taxpayer Identification Number, with the IRS. For more information, see *Social Security Number (SSN)*, later.

Frivolous tax submissions. The IRS has published a list of positions that are identified as frivolous. The penalty for filing a frivolous tax return is $5,000. Also, the $5,000 penalty will apply to other specified frivolous submissions. For more information, see *Civil Penalties*, later.

Introduction

This chapter discusses the following topics.

- Whether you have to file a return.
- Which form to use.
- How to file electronically.
- When, how, and where to file your return.
- What happens if you pay too little or too much tax.
- What records you should keep and how long you should keep them.
- How you can change a return you have already filed.

Do I Have To File a Return?

You must file a federal income tax return if you are a citizen or resident of the United States or a resident of Puerto Rico and you meet the filing requirements for any of the following categories that apply to you.

1. Individuals in general. (There are special rules for surviving spouses, executors, administrators, legal representatives, U.S. citizens and residents living outside the United States, residents of Puerto Rico, and individuals with income from U.S. possessions.)
2. Dependents.
3. Certain children under age 19 or full-time students.
4. Self-employed persons.
5. Aliens.

The filing requirements for each category are explained in this chapter.

The filing requirements apply even if you do not owe tax.

TIP *Even if you do not have to file a return, it may be to your advantage to do so. See* Who Should File, *later.*

CAUTION *File only one federal income tax return for the year regardless of how many jobs you had, how many Forms W-2 you received, or how many states you lived in during the year. Do not file more than one original return for the same year, even if you have not gotten your refund or have not heard from the IRS since you filed.*

Individuals—In General

If you are a U.S. citizen or resident, whether you must file a return depends on three factors:

1. Your gross income,
2. Your filing status, and
3. Your age.

To find out whether you must file, see Table 1-1, Table 1-2, and Table 1-3. Even if no table shows that you must file, you may need to file to get money back. (See *Who Should File*, later.)

Gross income. This includes all income you receive in the form of money, goods, property, and services that is not exempt from tax. It also includes income from sources outside the United States or from the sale of your main home (even if you can exclude all or part of it). Include part of your social security benefits if:

1. You were married, filing a separate return, and you lived with your spouse at any time during 2012; or
2. Half of your social security benefits plus your other gross income and any tax-exempt interest is more than $25,000 ($32,000 if married filing jointly).

If either (1) or (2) applies, see the instructions for Form 1040 or 1040A, or Publication 915, Social Security and Equivalent Railroad Retirement Benefits, to figure the social security benefits you must include in gross income.

Common types of income are discussed in *Part Two* of this publication.

Community income. If you are married and your permanent home is in a community property state, half of any income described by state law as community income may be considered yours. This affects your federal taxes, including whether you must file if you do not file a joint return with your spouse. See Publication 555, Community Property, for more information.

Nevada, Washington, and California domestic partners. A registered domestic partner in Nevada, Washington, or California (or a person in California who is married to a person of the same sex) generally must report half the combined community income of the individual and his or her domestic partner (or California same-sex spouse). See Publication 555.

Self-employed individuals. If you are self-employed, your gross income includes the amount on line 7 of Schedule C (Form 1040), Profit or Loss From Business; line 1 of Schedule C-EZ (Form 1040), Net Profit From Business; and line 9 of Schedule F (Form 1040), Profit or Loss From Farming. See *Self-Employed Persons*, later, for more information about your filing requirements.

CAUTION *If you do not report all of your self-employment income, your social security benefits may be lower when you retire.*

Filing status. Your filing status depends on whether you are single or married and on your family situation. Your filing status is determined on the last day of your tax year, which is December 31 for most taxpayers. See chapter 2 for an explanation of each filing status.

Age. If you are 65 or older at the end of the year, you generally can have a higher amount of gross income than other taxpayers before you must file. See Table 1-1. You are considered 65 on the day before your 65th birthday. For example, if your 65th birthday is on January 1, 2013, you are considered 65 for 2012.

Surviving Spouses, Executors, Administrators, and Legal Representatives

You must file a final return for a decedent (a person who died) if both of the following are true.

- You are the surviving spouse, executor, administrator, or legal representative.
- The decedent met the filing requirements at the date of death.

For more information on rules for filing a decedent's final return, see Publication 559, Survivors, Executors, and Administrators.

U.S. Citizens and Resident Aliens Living Abroad

To determine whether you must file a return, include in your gross income any income you received abroad, including any income you can exclude under the foreign earned income exclusion. For information on special tax rules that may apply to you, see Publication 54, Tax Guide for U.S. Citizens and Resident Aliens Abroad. It is available online and at most U.S. embassies and consulates. See *How To Get Tax Help* in the back of this publication.

Residents of Puerto Rico

If you are a U.S. citizen and also a bona fide resident of Puerto Rico, you generally must file a U.S. income tax return for any year in which you meet the income requirements. This is in addition to any legal requirement you may have to file an income tax return with Puerto Rico.

If you are a bona fide resident of Puerto Rico for the entire year, your U.S. gross income does not include income from sources within Puerto Rico. It does, however, include any income you received for your services as an employee of the United States or a U.S. agency. If you receive income from Puerto Rican sources that is not subject to U.S. tax, you must reduce your standard deduction. As a result, the amount of income you must have before you are required to file a U.S. income tax return is lower than the applicable amount in Table 1-1 or Table 1-2. For more information, see Publication 570, Tax Guide for Individuals With Income From U.S. Possessions.

Individuals With Income From U.S. Possessions

If you had income from Guam, the Commonwealth of the Northern Mariana Islands, American Samoa, or the U.S. Virgin Islands, special rules may apply when determining whether you must file a U.S. federal income tax return. In addition, you may have to file a return with the individual island government. See Publication 570 for more information.

Dependents

If you are a dependent (one who meets the dependency tests in chapter 3), see Table 1-2 to find whether you must file a return. You also

Table 1-1. **2012 Filing Requirements for Most Taxpayers**

IF your filing status is...	AND at the end of 2012 you were...*	THEN file a return if your gross income was at least...**
single	under 65	$ 9,750
	65 or older	$11,200
married filing jointly***	under 65 (both spouses)	$19,500
	65 or older (one spouse)	$20,650
	65 or older (both spouses)	$21,800
married filing separately	any age	$ 3,800
head of household	under 65	$12,500
	65 or older	$13,950
qualifying widow(er) with dependent child	under 65	$15,700
	65 or older	$16,850

* If you were born on January 1, 1948, you are considered to be age 65 at the end of 2012.

** Gross income means all income you received in the form of money, goods, property, and services that is not exempt from tax, including any income from sources outside the United States or from the sale of your main home (even if you can exclude part or all of it). Do not include any social security benefits unless (a) you are married filing a separate return and you lived with your spouse at any time during 2012 or (b) one-half of your social security benefits plus your other gross income and any tax-exempt interest is more than $25,000 ($32,000 if married filing jointly). If (a) or (b) applies, see the instructions for Form 1040 or 1040A or Publication 915 to figure the taxable part of social security benefits you must include in gross income. Gross income includes gains, but not losses, reported on Form 8949 or Schedule D. Gross income from a business means, for example, the amount on Schedule C, line 7, or Schedule F, line 9. But, in figuring gross income, do not reduce your income by any losses, including any loss on Schedule C, line 7, or Schedule F, line 9.

*** If you did not live with your spouse at the end of 2012 (or on the date your spouse died) and your gross income was at least $3,800, you must file a return regardless of your age.

Table 1-2. **2012 Filing Requirements for Dependents**

See chapter 3 to find out if someone can claim you as a dependent.

If your parents (or someone else) can claim you as a dependent, and any of the situations below apply to you, you must file a return. (See Table 1-3 for other situations when you must file.)

In this table, earned income includes salaries, wages, tips, and professional fees. It also includes taxable scholarship and fellowship grants. (See *Scholarships and fellowships* in chapter 12.) Unearned income includes investment-type income such as taxable interest, ordinary dividends, and capital gain distributions. It also includes unemployment compensation, taxable social security benefits, pensions, annuities, cancellation of debt, and distributions of unearned income from a trust. Gross income is the total of your earned and unearned income.

Single dependents—Were you **either** age 65 or older or blind?

☐ **No.** You must file a return if **any** of the following apply.
- Your unearned income was more than $950.
- Your earned income was more than $5,950.
- Your gross income was more than the **larger** of:
  - $950, or
  - Your earned income (up to $5,650) plus $300.

☐ **Yes.** You must file a return if **any** of the following apply.
- Your unearned income was more than $2,400 ($3,850 if 65 or older **and** blind).
- Your earned income was more than $7,400 ($8,850 if 65 or older **and** blind).
- Your gross income was more than the **larger** of:
  - $2,400 ($3,850 if 65 or older **and** blind), or
  - Your earned income (up to $5,650) plus $1,750 ($3,200 if 65 or older **and** blind).

Married dependents—Were you **either** age 65 or older or blind?

☐ **No.** You must file a return if **any** of the following apply.
- Your unearned income was more than $950.
- Your earned income was more than $5,950.
- Your gross income was at least $5 and your spouse files a separate return and itemizes deductions.
- Your gross income was more than the **larger** of:
  - $950, or
  - Your earned income (up to $5,650) plus $300.

☐ **Yes.** You must file a return if **any** of the following apply.
- Your unearned income was more than $2,100 ($3,250 if 65 or older **and** blind).
- Your earned income was more than $7,100 ($8,250 if 65 or older **and** blind).
- Your gross income was at least $5 and your spouse files a separate return and itemizes deductions.
- Your gross income was more than the **larger** of:
  - $2,100 ($3,250 if 65 or older **and** blind), or
  - Your earned income (up to $5,650) plus $1,450 ($2,600 if 65 or older **and** blind).

must file if your situation is described in Table 1-3.

Responsibility of parent. Generally, a child is responsible for filing his or her own tax return and for paying any tax on the return. If a dependent child must file an income tax return but cannot file due to age or any other reason, then a parent, guardian, or other legally responsible person must file it for the child. If the child cannot sign the return, the parent or guardian must sign the child's name followed by the words "By (your signature), parent for minor child."

Child's earnings. Amounts a child earns by performing services are included in his or her gross income and not the gross income of the parent. This is true even if under local law the child's parent has the right to the earnings and may actually have received them. But if the child does not pay the tax due on this income, the parent is liable for the tax.

Certain Children Under Age 19 or Full-Time Students

If a child's only income is interest and dividends (including capital gain distributions and Alaska Permanent Fund dividends), the child was under age 19 at the end of 2012 or was a full-time student under age 24 at the end of 2012, and certain other conditions are met, a parent can elect to include the child's income on the parent's return. If this election is made, the child does not have to file a return. See *Parent's Election To Report Child's Interest and Dividends* in chapter 30.

Self-Employed Persons

You are self-employed if you:

- Carry on a trade or business as a sole proprietor,
- Are an independent contractor,
- Are a member of a partnership, or
- Are in business for yourself in any other way.

Self-employment can include work in addition to your regular full-time business activities, such as certain part-time work you do at home or in addition to your regular job.

You must file a return if your gross income is at least as much as the filing requirement amount for your filing status and age (shown in Table 1-1). Also, you must file Form 1040 and Schedule SE (Form 1040), Self-Employment Tax, if:

1. Your net earnings from self-employment (excluding church employee income) were $400 or more, or
2. You had church employee income of $108.28 or more. (See Table 1-3.)

Use Schedule SE (Form 1040) to figure your self-employment tax. Self-employment tax is comparable to the social security and Medicare tax withheld from an employee's wages. For more information about this tax, see Publication 334, Tax Guide for Small Business.

Employees of foreign governments or international organizations. If you are a U.S. citizen who works in the United States for an international organization, a foreign government, or a wholly owned instrumentality of a foreign government, and your employer is not required to withhold social security and Medicare taxes from your wages, you must include your earnings from services performed in the United States when figuring your net earnings from self-employment.

Ministers. You must include income from services you performed as a minister when figuring your net earnings from self-employment, unless you have an exemption from self-employment tax. This also applies to Christian Science practitioners and members of a religious order who have not taken a vow of poverty. For more information, see Publication 517, Social Security and Other Information for Members of the Clergy and Religious Workers.

Aliens

Your status as an alien—resident, nonresident, or dual-status—determines whether and how you must file an income tax return.

The rules used to determine your alien status are discussed in Publication 519, U.S. Tax Guide for Aliens.

Resident alien. If you are a resident alien for the entire year, you must file a tax return following the same rules that apply to U.S. citizens. Use the forms discussed in this publication.

Nonresident alien. If you are a nonresident alien, the rules and tax forms that apply to you are different from those that apply to U.S. citizens and resident aliens. See Publication 519 to find out if U.S. income tax laws apply to you and which forms you should file.

Dual-status taxpayer. If you are a resident alien for part of the tax year and a nonresident alien for the rest of the year, you are a dual-status taxpayer. Different rules apply for each part of the year. For information on dual-status taxpayers, see Publication 519.

Who Should File

Even if you do not have to file, you should file a federal income tax return to get money back if any of the following conditions apply.

1. You had federal income tax withheld or made estimated tax payments.
2. You qualify for the earned income credit. See chapter 35 for more information.

Table 1-3. **Other Situations When You Must File a 2012 Return**

You must file a return if any of the four conditions below apply for 2012.
1. You owe any special taxes, including any of the following. **a.** Alternative minimum tax. **b.** Additional tax on a qualified plan, including an individual retirement arrangement (IRA), or other tax-favored account. But if you are filing a return only because you owe this tax, you can file **Form 5329** by itself. **c.** Household employment taxes. But if you are filing a return only because you owe this tax, you can file **Schedule H** by itself. **d.** Social security and Medicare tax on tips you did not report to your employer or on wages you received from an employer who did not withhold these taxes. **e.** Recapture of first-time homebuyer credit. **f.** Write-in taxes, including uncollected social security and Medicare or RRTA tax on tips you reported to your employer or on group-term life insurance and additional taxes on health savings accounts. **g.** Recapture taxes.
2. You (or your spouse, if filing jointly) received HSA, Archer MSA, or Medicare Advantage MSA distributions.
3. You had net earnings from self-employment of at least $400.
4. You had wages of $108.28 or more from a church or qualified church-controlled organization that is exempt from employer social security and Medicare taxes.

3. You qualify for the additional child tax credit. See chapter 33 for more information.
4. You qualify for the health coverage tax credit. See chapter 36 for more information.
5. You qualify for the refundable credit for prior year minimum tax.
6. You qualify for the American opportunity credit. See chapter 34 for more information.
7. You qualify for the credit for federal tax on fuels. See chapter 36 for more information.

Which Form Should I Use?

You must use one of three forms to file your return: Form 1040EZ, Form 1040A, or Form 1040. (But also see *Does My Return Have To Be on Paper*, later.)

TIP *See the discussion under Form 1040 for when you must use that form.*

Form 1040EZ

Form 1040EZ is the simplest form to use.

You can use Form 1040EZ if all of the following apply.

1. Your filing status is single or married filing jointly. If you were a nonresident alien at any time in 2012, your filing status must be married filing jointly.
2. You (and your spouse if married filing a joint return) were under age 65 and not blind at the end of 2012. If you were born on January 1, 1948, you are considered to be age 65 at the end of 2012.
3. You do not claim any dependents.
4. Your taxable income is less than $100,000.
5. Your income is only from wages, salaries, tips, unemployment compensation, Alaska Permanent Fund dividends, taxable scholarship and fellowship grants, and taxable interest of $1,500 or less.
6. You do not claim any adjustments to income, such as a deduction for IRA contributions or student loan interest.
7. You do not claim any credits other than the earned income credit.
8. You do not owe any household employment taxes on wages you paid to a household employee.
9. If you earned tips, they are included in boxes 5 and 7 of your Form W-2.
10. You are not a debtor in a chapter 11 bankruptcy case filed after October 16, 2005.

You must meet all of these requirements to use Form 1040EZ. If you do not, you must use Form 1040A or Form 1040.

Figuring tax. On Form 1040EZ, you can use only the tax table to figure your income tax. You cannot use Form 1040EZ to report any other tax.

Form 1040A

If you do not qualify to use Form 1040EZ, you may be able to use Form 1040A.

You can use Form 1040A if all of the following apply.

1. Your income is only from:
   a. Wages, salaries, and tips,
   b. Interest,
   c. Ordinary dividends (including Alaska Permanent Fund dividends),
   d. Capital gain distributions,
   e. IRA distributions,
   f. Pensions and annuities,
   g. Unemployment compensation,
   h. Taxable social security and railroad retirement benefits, and
   i. Taxable scholarship and fellowship grants.

   If you receive a capital gain distribution that includes unrecaptured section 1250 gain, section 1202 gain, or collectibles (28%) gain, you cannot use Form 1040A. You must use Form 1040.
2. Your taxable income is less than $100,000.
3. Your adjustments to income are for only the following items.
   a. Educator expenses.
   b. IRA deduction.
   c. Student loan interest deduction.
   d. Tuition and fees.
4. You do not itemize your deductions.
5. You claim only the following tax credits.
   a. The credit for child and dependent care expenses. (See chapter 31.)
   b. The credit for the elderly or the disabled. (See chapter 32.)
   c. The education credits. (See chapter 34.)
   d. The retirement savings contribution credit. (See chapter 36.)
   e. The child tax credit. (See chapter 33.)
   f. The earned income credit. (See chapter 35.)
   g. The additional child tax credit. (See chapter 33.)

6. You did not have an alternative minimum tax adjustment on stock you acquired from the exercise of an incentive stock option. (See Publication 525, Taxable and Nontaxable Income.)

You can also use Form 1040A if you received employer-provided dependent care benefits or if you owe tax from the recapture of an education credit or the alternative minimum tax.

You must meet all of the above requirements to use Form 1040A. If you do not, you must use Form 1040.

Form 1040

If you cannot use Form 1040EZ or Form 1040A, you must use Form 1040. You can use Form 1040 to report all types of income, deductions, and credits.

You may pay less tax by filing Form 1040 because you can take itemized deductions, some adjustments to income, and credits you cannot take on Form 1040A or Form 1040EZ.

You must use Form 1040 if any of the following apply.

1. Your taxable income is $100,000 or more.
2. You itemize your deductions on Schedule A.
3. You had income that cannot be reported on Form 1040EZ or Form 1040A, including tax-exempt interest from private activity bonds issued after August 7, 1986.
4. You claim any adjustments to gross income other than the adjustments listed earlier under *Form 1040A*.
5. Your Form W-2, box 12, shows uncollected employee tax (social security and Medicare tax) on tips (see chapter 6) or group-term life insurance (see chapter 5).
6. You received $20 or more in tips in any 1 month and did not report all of them to your employer. (See chapter 6.)
7. You were a bona fide resident of Puerto Rico and exclude income from sources in Puerto Rico.
8. You claim any credits other than the credits listed earlier under *Form 1040A*.
9. You owe the excise tax on insider stock compensation from an expatriated corporation.
10. Your Form W-2 shows an amount in box 12 with a code Z.
11. You had a qualified health savings account funding distribution from your IRA.
12. You are an employee and your employer did not withhold social security and Medicare tax.
13. You have to file other forms with your return to report certain exclusions, taxes, or transactions.
14. You are a debtor in a bankruptcy case filed after October 16, 2005.
15. You must repay the first-time homebuyer credit.

Does My Return Have To Be on Paper?

You may be able to file a paperless return using IRS *e-file* (electronic filing). If your 2012 adjusted gross income (AGI) is $57,000 or less, you are eligible for Free File. If you do not qualify for Free File, then you should check out IRS.gov for low-cost *e-file* options or Free File Fillable Forms.

IRS *e-file*

Table 1-4 lists the benefits of IRS *e-file*. IRS *e-file* uses automation to replace most of the manual steps needed to process paper returns. As a result, the processing of *e-file* returns is faster and more accurate than the processing of paper returns. However, as with a paper return, you are responsible for making sure your return contains accurate information and is filed on time.

Using *e-file* does not affect your chances of an IRS examination of your return.

Free File Fillable Forms. If you do not need the help of a tax preparer, then Free File Fillable Forms may be for you. These forms:

- Do not have an income requirement so everyone is eligible,
- Are easy to use,
- Perform basic math calculations,
- Are available only at IRS.gov, and
- Apply only to a federal tax return.

Electronic return signatures. To file your return electronically, you must sign the return electronically using a personal identification number (PIN). If you are filing online, you must use a Self-Select PIN. If you are filing electronically using a tax practitioner, you can use a Self-Select PIN or a Practitioner PIN.

Self-Select PIN. The Self-Select PIN method allows you to create your own PIN. If you are married filing jointly, you and your spouse will each need to create a PIN and enter these PINs as your electronic signatures.

A PIN is any combination of five digits you choose except five zeros. If you use a PIN, there is nothing to sign and nothing to mail—not even your Forms W-2.

To verify your identity, you will be prompted to enter your adjusted gross income (AGI) from your originally filed 2011 federal income tax return, if applicable. Do not use your AGI from an amended return (Form 1040X) or a math error correction made by the IRS. AGI is the amount shown on your 2011 Form 1040, line 38; Form 1040A, line 22; or Form 1040EZ, line 4. If you do not have your 2011 income tax return, you can quickly request a transcript by using our automated self-service tool. Visit us at IRS.gov and click on "Order a Return or Account Transcript" or call 1-800-908-9946 to get a free transcript of your return. (If you filed electronically last year, you may use your prior year PIN to verify your identity instead of your prior year AGI. The prior year PIN is the five digit PIN you used to electronically sign your 2011 return.) You will also be prompted to enter your date of birth.

CAUTION *You cannot use the Self-Select PIN method if you are a first-time filer under age 16 at the end of 2012.*

TIP *If you cannot locate your prior year AGI or prior year PIN, use the Electronic Filing PIN Request. This can be found at IRS.gov. Click on "Request an Electronic Filing PIN." Or you can call 1-866-704-7388.*

Practitioner PIN. The Practitioner PIN method allows you to authorize your tax practitioner to enter or generate your PIN. The practitioner can provide you with details.

Form 8453. You must send in a paper Form 8453 if you have to attach certain forms or other documents that cannot be electronically filed. For details, see Form 8453.

For more details, visit *www.irs.gov/efile* and click on "*Individual Taxpayers.*"

Identity Protection PIN. If the IRS gave you an identity protection personal identification number (PIN) because you were a victim of identity theft, enter it in the spaces provided on your tax form. If the IRS has not given you this

Table 1-4. **Benefits of IRS *e-file***

- Free File allows qualified taxpayers to prepare and *e-file* their own tax returns for free.
- Free File is available in English and Spanish.
- Free File is available online 24 hours a day, 7 days a week.
- Get your refund faster by *e-filing* using Direct Deposit.
- Sign electronically with a secure self-selected PIN and file a completely paperless return.
- Receive an acknowledgement that your return was received and accepted.
- If you owe, you can *e-file* and authorize an electronic funds withdrawal or pay by credit or debit card. You can also file a return early and pay the amount you owe by the due date of your return.
- Save time by preparing and e-filing federal and state returns together.
- IRS computers quickly and automatically check for errors or other missing information.
- Help the environment, use less paper, and save taxpayer money—it costs less to process an e-filed return than a paper return.

type of number, leave these spaces blank. For more information, see the Instructions for Form 1040A or Form 1040.

Power of attorney. If an agent is signing your return for you, a power of attorney (POA) must be filed. Attach the POA to Form 8453 and file it using that form's instructions. See Signatures, later, for more information on POAs.

State returns. In most states, you can file an electronic state return simultaneously with your federal return. For more information, check with your local IRS office, state tax agency, tax professional, or the IRS website at www.irs.gov/efile.

Refunds. You can have a refund check mailed to you, or you can have your refund deposited directly to your checking or savings account or split among two or three accounts. With *e-file*, your refund will be issued faster than if you filed on paper.

As with a paper return, you may not get all of your refund if you owe certain past-due amounts, such as federal tax, state income tax, state unemployment compensation debts, child support, spousal support, or certain other federal nontax debts, such as student loans. See Offset against debts under *Refunds*, later.

Refund inquiries. You can go online to check the status of your refund 24 hours after the IRS receives your e-filed return. See Refund Information, later.

Amount you owe. To avoid late-payment penalties and interest, pay your taxes in full by April 15, 2013. See How To Pay, later, for information on how to pay the amount you owe.

Using Your Personal Computer

You can file your tax return in a fast, easy, and convenient way using your personal computer. A computer with Internet access and tax preparation software are all you need. Best of all, you can *e-file* from the comfort of your home 24 hours a day, 7 days a week.

IRS approved tax preparation software is available for online use on the Internet, for download from the Internet, and in retail stores.

For information, visit www.irs.gov/efile.

Through Employers and Financial Institutions

Some businesses offer free *e-file* to their employees, members, or customers. Others offer it for a fee. Ask your employer or financial institution if they offer IRS *e-file* as an employee, member, or customer benefit.

Free Help With Your Return

Free help in preparing your return is available nationwide from IRS-trained volunteers. The Volunteer Income Tax Assistance (VITA) program is designed to help low to moderate income taxpayers and the Tax Counseling for the Elderly (TCE) program is designed to assist taxpayers age 60 or older with their tax returns. Many VITA sites offer free electronic filing and all volunteers will let you know about the credits and deductions you may be entitled to claim. To find a site near you, call 1-800-906-9887. Or to find the nearest AARP TaxAide site, visit AARP's website at www.aarp.org/taxaide or call 1-888-227-7669. For more information on these programs, go to IRS.gov and enter keyword "VITA" in the upper right-hand corner.

Using a Tax Professional

Many tax professionals electronically file tax returns for their clients. You may personally enter your PIN or complete Form 8879, IRS *e-file* Signature Authorization, to authorize the tax professional to enter your PIN on your return.

Note. Tax professionals may charge a fee for IRS *e-file*. Fees can vary depending on the professional and the specific services rendered.

When Do I Have To File?

April 15, 2013, is the due date for filing your 2012 income tax return if you use the calendar year. For a quick view of due dates for filing a return with or without an extension of time to file (discussed later), see Table 1-5.

If you use a fiscal year (a year ending on the last day of any month except December, or a 52-53-week year), your income tax return is due by the 15th day of the 4th month after the close of your fiscal year.

When the due date for doing any act for tax purposes—filing a return, paying taxes, etc.—falls on a Saturday, Sunday, or legal holiday, the due date is delayed until the next business day.

Filing paper returns on time. Your paper return is filed on time if it is mailed in an envelope that is properly addressed, has enough postage, and is postmarked by the due date. If you send your return by registered mail, the date of the registration is the postmark date. The registration is evidence that the return was delivered. If you send a return by certified mail and have your receipt postmarked by a postal employee, the date on the receipt is the postmark date. The postmarked certified mail receipt is evidence that the return was delivered.

Private delivery services. If you use a private delivery service designated by the IRS to send your return, the postmark date generally is the date the private delivery service records in its database or marks on the mailing label. The private delivery service can tell you how to get written proof of this date.

For the IRS mailing address to use if you are using a private delivery service, go to IRS.gov and enter "private delivery service" in the search box.

The following are designated private delivery services.

- DHL Express (DHL): Same Day Service.
- Federal Express (FedEx): FedEx Priority Overnight, FedEx Standard Overnight, FedEx 2Day, FedEx International Priority, and FedEx International First.
- United Parcel Service (UPS): UPS Next Day Air, UPS Next Day Air Saver, UPS 2nd Day Air, UPS 2nd Day Air A.M., UPS Worldwide Express Plus, and UPS Worldwide Express.

Filing electronic returns on time. If you use IRS *e-file*, your return is considered filed on time if the authorized electronic return transmitter postmarks the transmission by the due date. An authorized electronic return transmitter is a participant in the IRS *e-file* program that transmits electronic tax return information directly to the IRS.

The electronic postmark is a record of when the authorized electronic return transmitter received the transmission of your electronically filed return on its host system. The date and time in your time zone controls whether your electronically filed return is timely.

Filing late. If you do not file your return by the due date, you may have to pay a failure-to-file penalty and interest. For more information, see Penalties, later. Also see Interest under *Amount You Owe*.

If you were due a refund but you did not file a return, you generally must file within 3 years from the date the return was due (including extensions) to get that refund.

Nonresident alien. If you are a nonresident alien and earn wages subject to U.S. income tax withholding, your 2012 U.S. income tax return (Form 1040NR or Form 1040NR-EZ) is due by:

- April 15, 2013, if you use a calendar year, or
- The 15th day of the 4th month after the end of your fiscal year if you use a fiscal year.

If you do not earn wages subject to U.S. income tax withholding, your return is due by:

- June 17, 2013, if you use a calendar year, or
- The 15th day of the 6th month after the end of your fiscal year, if you use a fiscal year.

See Publication 519 for more filing information.

Filing for a decedent. If you must file a final income tax return for a taxpayer who died

Table 1-5. **When To File Your 2012 Return**

For U.S. citizens and residents who file returns on a calendar year.

	For Most Taxpayers	For Certain Taxpayers Outside the U.S.
No extension requested	April 15, 2013	June 17, 2013
Automatic extension	October 15, 2013	October 15, 2013

during the year (a decedent), the return is due by the 15th day of the 4th month after the end of the decedent's normal tax year. See Publication 559.

Extensions of Time To File

You may be able to get an extension of time to file your return. There are three types of situations where you may qualify for an extension:

- Automatic extensions,
- You are outside the United States, or
- You are serving in a combat zone.

Automatic Extension

If you cannot file your 2012 return by the due date, you may be able to get an automatic 6-month extension of time to file.

Example. If your return is due on April 15, 2013, you will have until October 15, 2013, to file.

CAUTION *If you do not pay the tax due by the regular due date (generally, April 15), you will owe interest. You may also be charged penalties, discussed later.*

How to get the automatic extension. You can get the automatic extension by:

1. Using IRS *e-file* (electronic filing), or
2. Filing a paper form.

E-file options. There are two ways you can use *e-file* to get an extension of time to file. Complete Form 4868, Application for Automatic Extension of Time To File U.S. Individual Income Tax Return, to use as a worksheet. If you think you may owe tax when you file your return, use *Part II* of the form to estimate your balance due. If you *e-file* Form 4868 to the IRS, do not also send a paper Form 4868.

E-file using your personal computer or a tax professional. You can use a tax software package with your personal computer or a tax professional to file Form 4868 electronically. You will need to provide certain information from your tax return for 2011. If you wish to make a payment by electronic funds withdrawal, see Pay online, under *How To Pay*, later in this chapter.

E-file and pay by credit or debit card or by using the Electronic Federal Tax Payment System (EFTPS). You can get an extension by paying part or all of your estimate of tax due by using a credit or debit card or by using EFTPS. You can do this by phone or over the Internet. You do not file Form 4868. See Pay online, under *How To Pay*, later in this chapter.

Filing a paper Form 4868. You can get an extension of time to file by filing a paper Form 4868. Mail it to the address shown in the form instructions.

If you want to make a payment with the form, make your check or money order payable to "United States Treasury." Write your SSN, daytime phone number, and "2012 Form 4868" on your check or money order.

When to file. You must request the automatic extension by the due date for your return. You can file your return any time before the 6-month extension period ends.

When you file your return. Enter any payment you made related to the extension of time to file on Form 1040, line 68. If you file Form 1040EZ or Form 1040A, include that payment in your total payments on Form 1040EZ, line 9, or Form 1040A, line 41. Also enter "Form 4868" and the amount paid in the space to the left of line 9 or line 41.

Individuals Outside the United States

You are allowed an automatic 2-month extension, without filing Form 4868, (until June 15, 2013, if you use the calendar year) to file your 2012 return and pay any federal income tax due if:

1. You are a U.S. citizen or resident, and
2. On the due date of your return:
   a. You are living outside the United States and Puerto Rico, and your main place of business or post of duty is outside the United States and Puerto Rico, or
   b. You are in military or naval service on duty outside the United States and Puerto Rico.

However, if you pay the tax due after the regular due date (generally, April 15), interest will be charged from that date until the date the tax is paid.

If you served in a combat zone or qualified hazardous duty area, you may be eligible for a longer extension of time to file. See *Individuals Serving in Combat Zone*, later, for special rules that apply to you.

Married taxpayers. If you file a joint return, only one spouse has to qualify for this automatic extension. If you and your spouse file separate returns, this automatic extension applies only to the spouse who qualifies.

How to get the extension. To use this automatic extension, you must attach a statement to your return explaining what situation qualified you for the extension. (See the situations listed under (2), earlier.)

Extensions beyond 2 months. If you cannot file your return within the automatic 2-month extension period, you may be able to get an additional 4-month extension, for a total of 6 months. File Form 4868 and check the box on line 8.

No further extension. An extension of more than 6 months will generally not be granted. However, if you are outside the United States and meet certain tests, you may be granted a longer extension. For more information, see *When To File and Pay* in Publication 54.

Individuals Serving in Combat Zone

The deadline for filing your tax return, paying any tax you may owe, and filing a claim for refund is automatically extended if you serve in a combat zone. This applies to members of the Armed Forces, as well as merchant marines serving aboard vessels under the operational control of the Department of Defense, Red Cross personnel, accredited correspondents, and civilians under the direction of the Armed Forces in support of the Armed Forces.

Combat zone. For purposes of the automatic extension, the term "combat zone" includes the following areas.

1. The Persian Gulf area, effective January 17, 1991.
2. The qualified hazardous duty area of the Federal Republic of Yugoslavia (Serbia/ Montenegro), Albania, the Adriatic Sea, and the Ionian Sea north of the 39th parallel, effective March 24, 1999.
3. Afghanistan, effective September 19, 2001.

See Publication 3, Armed Forces' Tax Guide, for information about other tax benefits available to military personnel serving in a combat zone.

Extension period. The deadline for filing your return, paying any tax due, and filing a claim for refund is extended for at least 180 days after the later of:

1. The last day you are in a combat zone or the last day the area qualifies as a combat zone, or
2. The last day of any continuous qualified hospitalization for injury from service in the combat zone.

In addition to the 180 days, your deadline is also extended by the number of days you had left to take action with the IRS when you entered the combat zone. For example, you have $3^1/_2$ months (January 1 – April 15) to file your tax return. Any days left in this period when you entered the combat zone (or the entire $3^1/_2$ months if you entered it before the beginning of the year) are added to the 180 days. See *Extension of Deadlines* in Publication 3 for more information.

The above rules on the extension for filing your return also apply when you are deployed outside the United States (away from your permanent duty station) while participating in a designated contingency operation.

How Do I Prepare My Return?

This section explains how to get ready to fill in your tax return and when to report your income and expenses. It also explains how to complete certain sections of the form. You may find Table 1-6 helpful when you prepare your paper return.

Table 1-6. **Six Steps for Preparing Your Paper Return**

1 —	Get your records together for income and expenses.
2 —	Get the forms, schedules, and publications you need.
3 —	Fill in your return.
4 —	Check your return to make sure it is correct.
5 —	Sign and date your return.
6 —	Attach all required forms and schedules.

Electronic returns. For information you may find useful in preparing a paperless return, see *Does My Return Have To Be on Paper*, earlier.

Substitute tax forms. You cannot use your own version of a tax form unless it meets the requirements explained in Publication 1167, General Rules and Specifications for Substitute Forms and Schedules.

Form W-2. If you were an employee, you should receive Form W-2 from your employer. You will need the information from this form to prepare your return. See *Form W-2* under *Credit for Withholding and Estimated Tax* in chapter 4.

Your employer is required to provide or send Form W-2 to you no later than January 31, 2013. If it is mailed, you should allow adequate time to receive it before contacting your employer. If you still do not get the form by February 15, the IRS can help you by requesting the form from your employer. When you request IRS help, be prepared to provide the following information.

- Your name, address (including ZIP code), and phone number.
- Your SSN.
- Your dates of employment.
- Your employer's name, address (including ZIP code), and phone number.

Form 1099. If you received certain types of income, you may receive a Form 1099. For example, if you received taxable interest of $10 or more, the payer is required to provide or send Form 1099 to you no later than January 31, 2013 (or by February 15, 2013, if furnished by a broker). If it is mailed, you should allow adequate time to receive it before contacting the payer. If you still do not get the form by February 15 (or by March 5, 2013, if furnished by a broker), call the IRS for help.

When Do I Report My Income and Expenses?

You must figure your taxable income on the basis of a tax year. A "tax year" is an annual accounting period used for keeping records and reporting income and expenses. You must account for your income and expenses in a way that clearly shows your taxable income. The way you do this is called an accounting method. This section explains which accounting periods and methods you can use.

Accounting Periods

Most individual tax returns cover a calendar year—the 12 months from January 1 through December 31. If you do not use a calendar year, your accounting period is a fiscal year. A regular fiscal year is a 12-month period that ends on the last day of any month except December. A 52-53-week fiscal year varies from 52 to 53 weeks and always ends on the same day of the week.

You choose your accounting period (tax year) when you file your first income tax return. It cannot be longer than 12 months.

More information. For more information on accounting periods, including how to change your accounting period, see Publication 538, Accounting Periods and Methods.

Accounting Methods

Your accounting method is the way you account for your income and expenses. Most taxpayers use either the cash method or an accrual method. You choose a method when you file your first income tax return. If you want to change your accounting method after that, you generally must get IRS approval.

Cash method. If you use this method, report all items of income in the year in which you actually or constructively receive them. Generally, you deduct all expenses in the year you actually pay them. This is the method most individual taxpayers use.

Constructive receipt. 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 do not need to have physical possession of it. For example, interest credited to your bank account on December 31, 2012, is taxable income to you in 2012 if you could have withdrawn it in 2012 (even if the amount is not entered in your passbook or withdrawn until 2013).

Garnisheed wages. If your employer uses your wages to pay your debts, or if your wages are attached or garnisheed, the full amount is constructively received by you. You must include these wages in income for the year you would have received them.

Debts paid for you. If another person cancels or pays your debts (but not as a gift or loan), you have constructively received the amount and generally must include it in your gross income for the year. See *Canceled Debts* in chapter 12 for more information.

Payment to third party. If a third party is paid income from property you own, you have constructively received the income. It is the same as if you had actually received the income and paid it to the third party.

Payment to an agent. Income an agent receives for you is income you constructively received in the year the agent receives it. If you indicate in a contract that your income is to be paid to another person, you must include the amount in your gross income when the other person receives it.

Check received or available. A valid check that was made available to you before the end of the tax year is constructively received by you in that year. A check that was "made available to you" includes a check you have already received, but not cashed or deposited. It also includes, for example, your last paycheck of the year that your employer made available for you to pick up at the office before the end of the year. It is constructively received by you in that year whether or not you pick it up before the end of the year or wait to receive it by mail after the end of the year.

No constructive receipt. There may be facts to show that you did not constructively receive income.

Example. Alice Johnson, a teacher, agreed to her school board's condition that, in her absence, she would receive only the difference between her regular salary and the salary of a substitute teacher hired by the school board. Therefore, Alice did not constructively receive the amount by which her salary was reduced to pay the substitute teacher.

Accrual method. If you use an accrual method, you generally report income when you earn it, rather than when you receive it. You generally deduct your expenses when you incur them, rather than when you pay them.

Income paid in advance. An advance payment of income is generally included in gross income in the year you receive it. Your method of accounting does not matter as long as the income is available to you. An advance payment may include rent or interest you receive in advance and pay for services you will perform later.

A limited deferral until the next tax year may be allowed for certain advance payments. See Publication 538 for specific information.

Additional information. For more information on accounting methods, including how to change your accounting method, see Publication 538.

Social Security Number (SSN)

You must enter your SSN on your return. If you are married, enter the SSNs for both you and your spouse, whether you file jointly or separately.

If you are filing a joint return, include the SSNs in the same order as the names. Use this same order in submitting other forms and documents to the IRS.

Check that both the name and SSN on your Form 1040, W-2, and 1099 agree with your social security card. If they do not, certain deductions and credits on your Form 1040 may be reduced or disallowed and you may not receive credit for your social security earnings. If your Form W-2 shows an incorrect SSN or name, notify your employer or the form-issuing agent as soon as possible to make sure your earnings are credited to your social security record. If the name or SSN on your social security card is incorrect, call the SSA at 1-800-772-1213.

Name change. If you changed your name because of marriage, divorce, etc., be sure to report the change to your local Social Security Administration (SSA) office before filing your return. This prevents delays in processing your return and issuing refunds. It also safeguards your future social security benefits.

Dependent's SSN. You must provide the SSN of each dependent you claim, regardless of the dependent's age. This requirement applies to all dependents (not just your children) claimed on your tax return.

Exception. If your child was born and died in 2012 and did not have an SSN, enter “DIED” in column (2) of line 6c (Form 1040 or 1040A) and include a copy of the child's birth certificate, death certificate, or hospital records. The document must show that the child was born alive.

No SSN. File Form SS-5, Application for a Social Security Card, with your local SSA office to get an SSN for yourself or your dependent. It usually takes about 2 weeks to get an SSN. If you or your dependent is not eligible for an SSN, see *Individual taxpayer identification number (ITIN)*, later.

If you are a U.S. citizen or resident alien, you must show proof of age, identity, and citizenship or alien status with your Form SS-5. If you are 12 or older and have never been assigned an SSN, you must appear in person with this proof at an SSA office.

Form SS-5 is available at any SSA office, on the Internet at *www.socialsecurity.gov*, or by calling 1-800-772-1213. If you have any questions about which documents you can use as proof of age, identity, or citizenship, contact your SSA office.

If your dependent does not have an SSN by the time your return is due, you may want to ask for an extension of time to file, as explained earlier under *When Do I Have To File*.

If you do not provide a required SSN or if you provide an incorrect SSN, your tax may be increased and any refund may be reduced.

Adoption taxpayer identification number (ATIN). If you are in the process of adopting a child who is a U.S. citizen or resident and cannot get an SSN for the child until the adoption is final, you can apply for an ATIN to use instead of an SSN.

File Form W-7A, Application for Taxpayer Identification Number for Pending U.S. Adoptions, with the IRS to get an ATIN if all of the following are true.

- You have a child living with you who was placed in your home for legal adoption.
- You cannot get the child's existing SSN even though you have made a reasonable attempt to get it from the birth parents, the placement agency, and other persons.
- You cannot get an SSN for the child from the SSA because, for example, the adoption is not final.
- You are eligible to claim the child as a dependent on your tax return.

After the adoption is final, you must apply for an SSN for the child. You cannot continue using the ATIN.

See Form W-7A for more information.

Nonresident alien spouse. If your spouse is a nonresident alien, your spouse must have either an SSN or an ITIN if:

- You file a joint return,
- You file a separate return and claim an exemption for your spouse, or
- Your spouse is filing a separate return.

If your spouse is not eligible for an SSN, see the next discussion.

Individual taxpayer identification number (ITIN). The IRS will issue you an ITIN if you are a nonresident or resident alien and you do not have and are not eligible to get an SSN. This also applies to an alien spouse or dependent. To apply for an ITIN, file Form W-7 with the IRS. It usually takes about 6 to 10 weeks to get an ITIN. Enter the ITIN on your tax return wherever an SSN is requested.

TIP *If you are applying for an ITIN for yourself, your spouse, or a dependent in order to file your tax return, attach your completed tax return to your Form W-7. See the Form W-7 instructions for how and where to file.*

CAUTION *You cannot electronically file (e-file) a return using an ITIN in the calendar year the ITIN is issued; however, you can e-file returns in the following years.*

ITIN for tax use only. An ITIN is for tax use only. It does not entitle you or your dependent to social security benefits or change the employment or immigration status of either of you under U.S. law.

Penalty for not providing social security number. If you do not include your SSN or the SSN of your spouse or dependent as required, you may have to pay a penalty. See the discussion on *Penalties*, later, for more information.

SSN on correspondence. If you write to the IRS about your tax account, be sure to include your SSN (and the name and SSN of your spouse, if you filed a joint return) in your correspondence. Because your SSN is used to identify your account, this helps the IRS respond to your correspondence promptly.

Presidential Election Campaign Fund

This fund helps pay for Presidential election campaigns. The fund reduces candidates' dependence on large contributions from individuals and groups and places candidates on an equal financial footing in the general election. If you want $3 to go to this fund, check the box. If you are filing a joint return, your spouse can also have $3 go to the fund. If you check a box, your tax or refund will not change.

Computations

The following information may be useful in making the return easier to complete.

Rounding off dollars. You may round off cents to whole dollars on your return and schedules. If you do round to whole dollars, you must round all amounts. To round, drop amounts under 50 cents and increase amounts from 50 to 99 cents to the next dollar. For example, $1.39 becomes $1 and $2.50 becomes $3.

If you have to add two or more amounts to figure the amount to enter on a line, include cents when adding the amounts and round off only the total.

Example. You receive two Forms W-2: one showing wages of $5,000.55 and one showing wages of $18,500.73. On Form 1040, line 7, you would enter $23,501 ($5,000.55 + $18,500.73 = $23,501.28), not $23,502 ($5,001 + $18,501).

Equal amounts. If you are asked to enter the smaller or larger of two equal amounts, enter that amount.

Example. Line 1 is $500. Line 3 is $500. Line 5 asks you to enter the smaller of line 1 or 3. Enter $500 on line 5.

Negative amounts. If you file a paper return and you need to enter a negative amount, put the amount in parentheses rather than using a minus sign. To combine positive and negative amounts, add all the positive amounts together and then subtract the negative amounts.

Attachments

Depending on the form you file and the items reported on your return, you may have to complete additional schedules and forms and attach them to your return.

TIP *You may be able to file a paperless return using IRS* e-file*. There's nothing to attach or mail, not even your Forms W-2. See* Does My Return Have To Be on Paper*, earlier.*

Form W-2. Form W-2 is a statement from your employer of wages and other compensation paid to you and taxes withheld from your pay. You should have a Form W-2 from each employer. If you file a paper return, be sure to attach a copy of Form W-2 in the place indicated on the front page of your return. Attach it to the front page of your return, not to any attachments. For more information, see *Form W-2* in chapter 4.

If you received a Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc., showing federal income tax withheld, and you file a paper return, attach a copy of that form in the place indicated on the front page of your return.

Form 1040EZ. There are no additional schedules to file with Form 1040EZ.

Form 1040A. If you file a paper return, attach any forms and schedules behind Form 1040A in order of the “Attachment Sequence Number” shown in the upper right corner of the form or schedule. Then arrange all other statements or attachments in the same order as the forms and schedules they relate to and attach them last. Do not attach items unless required to do so.

Form 1040. If you file a paper return, attach any forms and schedules behind Form 1040 in order of the "Attachment Sequence Number" shown in the upper right corner of the form or schedule. Then arrange all other statements or attachments in the same order as the forms and schedules they relate to and attach them last. Do not attach items unless required to do so.

Third Party Designee

You can authorize the IRS to discuss your return with your preparer, a friend, family member, or any other person you choose. If you check the "Yes" box in the *Third party designee* area of your 2012 tax return and provide the information required, you are authorizing:

1. The IRS to call the designee to answer any questions that arise during the processing of your return, and
2. The designee to:
   a. Give information that is missing from your return to the IRS,
   b. Call the IRS for information about the processing of your return or the status of your refund or payments,
   c. Receive copies of notices or transcripts related to your return, upon request, and
   d. Respond to certain IRS notices about math errors, offsets (see Refunds, later), and return preparation.

The authorization will automatically end no later than the due date (without any extensions) for filing your 2013 tax return. This is April 15, 2014, for most people.

See your form instructions for more information.

Signatures

You must sign and date your return. If you file a joint return, both you and your spouse must sign the return, even if only one of you had income.

CAUTION *If you file a joint return, both spouses are generally liable for the tax, and the entire tax liability may be assessed against either spouse. See chapter 2.*

TIP *If you* e-file *your return, you can use an electronic signature to sign your return. See* Does My Return Have To Be on Paper, *earlier.*

If you are due a refund, it cannot be issued unless you have signed your return.

Enter your occupation. If you file a joint return, enter both your occupation and your spouse's occupation. Entering your daytime phone number may help speed the processing of your return.

When someone can sign for you. You can appoint an agent to sign your return if you are:

1. Unable to sign the return because of disease or injury,
2. Absent from the United States for a continuous period of at least 60 days before the due date for filing your return, or
3. Given permission to do so by the IRS office in your area.

Power of attorney. A return signed by an agent in any of these cases must have a power of attorney (POA) attached that authorizes the agent to sign for you. You can use a POA that states that the agent is granted authority to sign the return, or you can use Form 2848, Power of Attorney and Declaration of Representative. Part I of Form 2848 must state that the agent is granted authority to sign the return.

Court-appointed, conservator, or other fiduciary. If you are a court-appointed conservator, guardian, or other fiduciary for a mentally or physically incompetent individual who has to file a tax return, sign your name for the individual. File Form 56.

Unable to sign. If the taxpayer is mentally competent but physically unable to sign the return or POA, a valid "signature" is defined under state law. It can be anything that clearly indicates the taxpayer's intent to sign. For example, the taxpayer's "X" with the signatures of two witnesses might be considered a valid signature under a state's law.

Spouse unable to sign. If your spouse is unable to sign for any reason, see Signing a joint return in chapter 2.

Child's return. If a child has to file a tax return but cannot sign the return, the child's parent, guardian, or another legally responsible person must sign the child's name, followed by the words "By (your signature), parent for minor child."

Paid Preparer

Generally, anyone you pay to prepare, assist in preparing, or review your tax return must sign it and fill in the other blanks, including their Preparer Tax Identification Number (PTIN), in the paid preparer's area of your return.

Many preparers are required to e-file the tax returns they prepare. They sign these e-filed returns using their tax preparation software. However, you can choose to have your return completed on paper if you prefer. In that case, the paid preparer can sign the paper return manually or use a rubber stamp or mechanical device. The preparer is personally responsible for affixing his or her signature to the return.

If the preparer is self-employed (that is, not employed by any person or business to prepare the return), he or she should check the self-employed box in the *Paid Preparer Use Only* space on the return.

The preparer must give you a copy of your return in addition to the copy filed with the IRS.

If you prepare your own return, leave this area blank. If another person prepares your return and does not charge you, that person should not sign your return.

If you have questions about whether a preparer must sign your return, contact any IRS office.

Refunds

When you complete your return, you will determine if you paid more income tax than you owed. If so, you can get a refund of the amount you overpaid or, if you file Form 1040 or Form 1040A, you can choose to apply all or part of the overpayment to your next year's (2013) estimated tax. You cannot have your overpayment applied to your 2013 estimated tax if you file Form 1040EZ.

CAUTION *If you choose to have a 2012 overpayment applied to your 2013 estimated tax, you cannot change your mind and have any of it refunded to you after the due date (without extensions) of your 2012 return.*

Follow the form instructions to complete the entries to claim your refund and/or to apply your overpayment to your 2013 estimated tax.

TIP *If your refund for 2012 is large, you may want to decrease the amount of income tax withheld from your pay in 2013. See chapter 4 for more information.*

DIRECT DEPOSIT Simple. Safe. Secure. Instead of getting a paper check, you may be able to have your refund deposited directly into your checking or savings account, including an individual retirement arrangement. Follow the form instructions to request direct deposit.

If the direct deposit cannot be done, the IRS will send a check instead.

TreasuryDirect®. You can request a deposit of your refund to a TreasuryDirect® online account to buy U.S. Treasury marketable securities and savings bonds. For more information, go to www.treasurydirect.gov.

Split refunds. If you choose direct deposit, you may be able to split the refund and have it deposited among two or three accounts or buy up to $5,000 in paper series I savings bonds. Complete Form 8888, Allocation of Refund (Including Savings Bond Purchases), and attach it to your return.

Overpayment less than one dollar. If your overpayment is less than one dollar, you will not get a refund unless you ask for it in writing.

Cashing your refund check. Cash your tax refund check soon after you receive it. Checks expire the last business day of the 12th month of issue.

If your check has expired, you can apply to the IRS to have it reissued.

Refund more or less than expected. If you receive a check for a refund you are not entitled to, or for an overpayment that should have been credited to estimated tax, do not cash the check. Call the IRS.

If you receive a check for more than the refund you claimed, do not cash the check until you receive a notice explaining the difference.

If your refund check is for less than you claimed, it should be accompanied by a notice explaining the difference. Cashing the check does not stop you from claiming an additional amount of refund.

If you did not receive a notice and you have any questions about the amount of your refund, you should wait 2 weeks. If you still have not received a notice, call the IRS.

Offset against debts. If you are due a refund but have not paid certain amounts you owe, all or part of your refund may be used to pay all or part of the past-due amount. This includes past-due federal income tax, other federal debts (such as student loans), state income tax, child and spousal support payments, and state unemployment compensation debt. You will be notified if the refund you claimed has been offset against your debts.

Joint return and injured spouse. When a joint return is filed and only one spouse owes a past-due amount, the other spouse can be considered an injured spouse. An injured spouse should file Form 8379, Injured Spouse Allocation, if both of the following apply and the spouse wants a refund of his or her share of the overpayment shown on the joint return.

1. You are not legally obligated to pay the past-due amount.
2. You made and reported tax payments (such as federal income tax withheld from your wages or estimated tax payments), or claimed a refundable tax credit (see the credits listed under Who Should File, earlier).

Note. If the injured spouse's residence was in a community property state at any time during the tax year, special rules may apply. See the Instructions for Form 8379.

If you have not filed your joint return and you know that your joint refund will be offset, file Form 8379 with your return. You should receive your refund within 14 weeks from the date the paper return is filed or within 11 weeks from the date the return is filed electronically.

If you filed your joint return and your joint refund was offset, file Form 8379 by itself. When filed after offset, it can take up to 8 weeks to receive your refund. Do not attach the previously filed tax return, but do include copies of all Forms W-2 and W-2G for both spouses and any Forms 1099 that show income tax withheld. The processing of Form 8379 may be delayed if these forms are not attached, or if the form is incomplete when filed.

A separate Form 8379 must be filed for each tax year to be considered.

CAUTION

An injured spouse claim is different from an innocent spouse relief request. An injured spouse uses Form 8379 to request the division of the tax overpayment attributed to each spouse. An innocent spouse uses Form 8857, Request for Innocent Spouse Relief, to request relief from joint liability for tax, interest, and penalties on a joint return for items of the other spouse (or former spouse) that were incorrectly reported on the joint return. For information on innocent spouses, see Relief from joint responsibility under Filing a Joint Return *in chapter 2.*

Amount You Owe

When you complete your return, you will determine if you have paid the full amount of tax that you owe. If you owe additional tax, you should pay it with your return.

TIP

You do not have to pay if the amount you owe is under $1.

If the IRS figures your tax for you, you will receive a bill for any tax that is due. You should pay this bill within 30 days (or by the due date of your return, if later). See *Tax Figured by IRS* in chapter 29.

CAUTION

If you do not pay your tax when due, you may have to pay a failure-to-pay penalty. See Penalties*, later. For more information about your balance due, see Publication 594, The IRS Collection Process.*

TIP

If the amount you owe for 2012 is large, you may want to increase the amount of income tax withheld from your pay or make estimated tax payments for 2013. See chapter 4 *for more information.*

How To Pay

You can pay online, by phone, or by check or money order. Do not include any estimated tax payment for 2013 in this payment. Instead, make the estimated tax payment separately.

Bad check or payment. The penalty for writing a bad check to the IRS is $25 or 2% of the check, whichever is more. This penalty also applies to other forms of payment if the IRS does not receive the funds.

Pay online. Paying online is convenient and secure and helps make sure we get your payments on time.

You can pay using either of the following electronic payment methods.

- Direct transfer from your bank account.
- Credit or debit card.

To pay your taxes online or for more information, go to *www.irs.gov/e-pay*.

Pay by phone. Paying by phone is another safe and secure method of paying electronically. Use one of the following methods.

- Direct transfer from your bank account.
- Credit or debit card.

To pay by direct transfer from your bank account, call 1-800-555-4477 (English) or 1-800-244-4829 (Espanol). People who are deaf, hard of hearing, or have a speech disability and have access to TTY/TDD equipment can call 1-800-733-4829.

To pay using a credit or debit card, you can call one of the following service providers. There is a convenience fee charged by these providers that varies by provider, card type, and payment amount.

Official Payments Corporation
1-888-UPAY-TAX™ (1-888-872-9829)
www.officialpayments.com

Link2Gov Corporation
1-888-PAY-1040™ (1-888-729-1040)
www.PAY1040.com

WorldPay
1-888-9-PAY-TAX™ (1-888-972-9829)
www.payUSAtax.com

For the latest details on how to pay by phone, go to *www.irs.gov/e-pay*.

Pay by check or money order. Make your check or money order payable to "United States Treasury" for the full amount due. Do not send cash. Do not attach the payment to your return. Show your correct name, address, SSN, daytime phone number, and the tax year and form number on the front of your check or money order. If you are filing a joint return, enter the SSN shown first on your tax return.

Estimated tax payments. Do not include any 2013 estimated tax payment in the payment for your 2012 income tax return. See *chapter 4* for information on how to pay estimated tax.

Interest

Interest is charged on tax you do not pay by the due date of your return. Interest is charged even if you get an extension of time for filing.

TIP

If the IRS figures your tax for you, to avoid interest for late payment, you must pay the bill within 30 days of the date of the bill or by the due date of your return, whichever is later. For information, see Tax Figured by IRS *in chapter 29.*

Interest on penalties. Interest is charged on the failure-to-file penalty, the accuracy-related penalty, and the fraud penalty from the due date of the return (including extensions) to the date of payment. Interest on other penalties starts on the date of notice and demand, but is not charged on penalties paid within 21 calendar days from the date of the notice (or within 10 business days if the notice is for $100,000 or more).

Interest due to IRS error or delay. All or part of any interest you were charged can be forgiven if the interest is due to an unreasonable error or delay by an officer or employee of the IRS in performing a ministerial or managerial act.

A ministerial act is a procedural or mechanical act that occurs during the processing of your case. A managerial act includes personnel transfers and extended personnel training. A decision concerning the proper application of federal tax law is not a ministerial or managerial act.

The interest can be forgiven only if you are not responsible in any important way for the error or delay and the IRS has notified you in writing of the deficiency or payment. For more information, see Publication 556, Examination of Returns, Appeal Rights, and Claims for Refund.

Interest and certain penalties may also be suspended for a limited period if you filed your return by the due date (including extensions) and the IRS does not provide you with a notice specifically stating your liability and the basis for it before the close of the 36-month period beginning on the later of:

- The date the return is filed, or
- The due date of the return without regard to extensions.

For more information, see Publication 556.

Installment Agreement

If you cannot pay the full amount due with your return, you can ask to make monthly installment payments for the full or a partial amount. However, you will be charged interest and may be charged a late payment penalty on the tax not paid by the date your return is due, even if your request to pay in installments is granted. If your request is granted, you must also pay a fee. To limit the interest and penalty charges, pay as much of the tax as possible with your return. But before requesting an installment agreement, you should consider other less costly alternatives, such as a bank loan or credit card payment.

To ask for an installment agreement, you can apply online or use Form 9465.

In addition to paying by check or money order, you can use a credit or debit card or direct payment from your bank account to make installment agreement payments. See *How To Pay*, earlier.

To apply online, go to IRS.gov and click on “Tools” and then “Online Payment Agreement.”

Gift To Reduce Debt Held by the Public

You can make a contribution (gift) to reduce debt held by the public. If you wish to do so, make a separate check payable to “Bureau of the Public Debt.”

Send your check to:

Bureau of the Public Debt
ATTN: Department G
P.O. Box 2188
Parkersburg, WV 26106-2188

Or, enclose your separate check in the envelope with your income tax return. Do not add this gift to any tax you owe.

Go to *www.publicdebt.treas.gov* for information on how to make this type of gift online.

You may be able to deduct this gift as a charitable contribution on next year's tax return if you itemize your deductions on Schedule A (Form 1040).

Name and Address

After you have completed your return, fill in your name and address in the appropriate area of the Form 1040, Form 1040A, or Form 1040EZ.

CAUTION *You must include your SSN in the correct place on your tax return.*

P.O. box. If your post office does not deliver mail to your street address and you have a P.O. box, enter your P.O. box number on the line for your present home address instead of your street address.

Foreign address. If your address is outside the United States or its possessions or territories, enter the city name on the appropriate line of your return. Do not enter any other information on that line, but also complete the line below showing:

1. Foreign country name,
2. Foreign province/state/county, and
3. Foreign postal code.

Follow the country's practice for entering the postal code and the name of the country, province, or state.

Where Do I File?

After you complete your return, you must send it to the IRS. You can mail it or you may be able to file it electronically. See *Does My Return Have To Be on Paper*, earlier.

Mailing your return. Mail your paper return to the address shown in your instructions. The filing addresses are also shown near the end of this publication.

What Happens After I File?

After you send your return to the IRS, you may have some questions. This section discusses concerns you may have about recordkeeping, your refund, and what to do if you move.

What Records Should I Keep?

This part discusses why you should keep records, what kinds of records you should keep, and how long you should keep them.

You probably already keep records in your daily routine. This includes keeping receipts for purchases and recording information in your checkbook. Use this to determine if you need to keep additional information in your records.

RECORDS You must keep records so that you can prepare a complete and accurate income tax return. The law does not require any special form of records. However, you should keep all receipts, canceled checks or other proof of payment, and any other records to support any deductions or credits you claim.

If you file a claim for refund, you must be able to prove by your records that you have overpaid your tax.

This part does not discuss the records you should keep when operating a business. For information on business records, see Publication 583, Starting a Business and Keeping Records.

Why Keep Records?

There are many reasons to keep records. In addition to tax purposes, you may need to keep records for warranty or insurance purposes or for getting a loan. Good records will help you:

- **Identify sources of income.** You may receive money or property from a variety of sources. Your records can identify the sources of your income. You need this information to separate business from nonbusiness income and taxable from nontaxable income.
- **Keep track of expenses.** You may forget an expense unless you record it when it occurs. You can use your records to identify expenses for which you can claim a deduction. This will help you determine if you can itemize deductions on your tax return.
- **Keep track of the basis of property.** You need to keep records that show the basis of your property. This includes the original cost or other basis of the property and any improvements you made.
- **Prepare tax returns.** You need records to prepare your tax return. Good records help you to file quickly and accurately.
- **Support items reported on tax returns.** You must keep records in case the IRS has a question about an item on your return. If the IRS examines your tax return, you may be asked to explain the items reported. Good records will help you explain any item and arrive at the correct tax with a minimum of effort. If you do not have records, you may have to spend time getting statements and receipts from various sources. If you cannot produce the correct documents, you may have to pay additional tax and be subject to penalties.

Kinds of Records to Keep

The IRS does not require you to keep your records in a particular way. Keep them in a manner that allows you and the IRS to determine your correct tax.

You can use your checkbook to keep a record of your income and expenses. In your checkbook you should record amounts, sources of deposits, and types of expenses. You also need to keep documents, such as receipts and sales slips, that can help prove a deduction.

You should keep your records in an orderly fashion and in a safe place. Keep them by year and type of income or expense. One method is to keep all records related to a particular item in a designated envelope.

In this section you will find guidance about basic records that everyone should keep. The section also provides guidance about specific records you should keep for certain items.

Electronic records. All requirements that apply to hard copy books and records also apply to electronic storage systems that maintain tax books and records. When you replace hard copy books and records, you must maintain the electronic storage systems for as long as they are material to the administration of tax law.

An electronic storage system is any system for preparing or keeping your records either by electronic imaging or by transfer to an electronic storage medium. The electronic storage system must index, store, preserve, retrieve, and reproduce the electronically stored books and records in a legible, readable format. All electronic storage systems must provide a complete and accurate record of your data that is accessible to the IRS. Electronic storage systems are also subject to the same controls and retention guidelines as those imposed on your original hard copy books and records.

The original hard copy books and records may be destroyed provided that the electronic storage system has been tested to establish that the hard copy books and records are being reproduced in compliance with IRS requirements for an electronic storage system and procedures are established to ensure continued compliance with all applicable rules and regulations. You still have the responsibility of retaining any other books and records that are required to be retained.

The IRS may test your electronic storage system, including the equipment used, indexing methodology, software and retrieval capabilities. This test is not considered an examination and the results must be shared with you. If your electronic storage system meets the requirements mentioned earlier, you will be in compliance. If not, you may be subject to penalties for noncompliance, unless you continue to maintain your original hard copy books and records in a manner that allows you and the IRS to determine your correct tax.

For details on electronic storage system requirements, see Rev. Proc. 97-22, which is on page 9 of Internal Revenue Bulletin 1997-13 at *www.irs.gov/pub/irs-irbs/irb97-13.pdf*.

Copies of tax returns. You should keep copies of your tax returns as part of your tax records. They can help you prepare future tax returns, and you will need them if you file an amended return or are audited. Copies of your returns and other records can be helpful to your survivor or the executor or administrator of your estate.

If necessary, you can request a copy of a return and all attachments (including Form W-2) from the IRS by using Form 4506, Request for Copy of Tax Return. There is a charge for a copy of a return. For information on the cost and where to file, see the Form 4506 instructions.

If you just need information from your return, you can order a transcript in one of the following ways.

- Visit IRS.gov and click on "Order a Return or Account Transcript."
- Call 1-800-908-9946.
- Use Form 4506-T, Request for Transcript of Tax Return, or Form 4506T-EZ, Short Form Request for Individual Tax Return Transcript.

There is no fee for a transcript. For more information, see Form 4506-T.

Basic Records

Basic records are documents that everybody should keep. These are the records that prove your income and expenses. If you own a home or investments, your basic records should contain documents related to those items. Table 1-7 lists documents you should keep as basic records. Following Table 1-7 are examples of information you can get from these records.

Table 1-7. **Proof of Income and Expenses**

FOR items concerning your...	KEEP as basic records...
Income	• Form(s) W-2 • Form(s) 1098 • Form(s) 1099 • Bank statements • Brokerage statements • Form(s) K-1
Expenses	• Sales slips • Invoices • Receipts • Canceled checks or other proof of payment • Written communications from qualified charities
Home	• Closing statements • Purchase and sales invoices • Proof of payment • Insurance records • Receipts for improvement costs
Investments	• Brokerage statements • Mutual fund statements • Form(s) 1099 • Form(s) 2439 • Receipts for collectibles

Income. Your basic records prove the amounts you report as income on your tax return. Your income may include wages, dividends, interest, and partnership or S corporation distributions. Your records also can prove that certain amounts are not taxable, such as tax-exempt interest.

Note. If you receive a Form W-2, keep Copy C until you begin receiving social security benefits. This will help protect your benefits in case there is a question about your work record or earnings in a particular year.

Expenses. Your basic records prove the expenses for which you claim a deduction (or credit) on your tax return. Your deductions may include alimony, charitable contributions, mortgage interest, and real estate taxes. You also may have child care expenses for which you can claim a credit.

Home. Your basic records should enable you to determine the basis or adjusted basis of your home. You need this information to determine if you have a gain or loss when you sell your home or to figure depreciation if you use part of your home for business purposes or for rent. Your records should show the purchase price, settlement or closing costs, and the cost of any improvements. They also may show any casualty losses deducted and insurance reimbursements for casualty losses. Your records also should include a copy of Form 2119, Sale of Your Home, if you sold your previous home before May 7, 1997, and postponed tax on the gain from that sale.

For detailed information on basis, including which settlement or closing costs are included in the basis of your home, see chapter 13.

When you sell your home, your records should show the sales price and any selling expenses, such as commissions. For information on selling your home, see chapter 15.

Investments. Your basic records should enable you to determine your basis in an investment and whether you have a gain or loss when you sell it. Investments include stocks, bonds, and mutual funds. Your records should show the purchase price, sales price, and commissions. They may also show any reinvested dividends, stock splits and dividends, load charges, and original issue discount (OID).

For information on stocks, bonds, and mutual funds, see chapters 8, 13, 14, and 16.

Proof of Payment

One of your basic records is proof of payment. You should keep these records to support certain amounts shown on your tax return. Proof of payment alone is not proof that the item claimed on your return is allowable. You also should keep other documents that will help prove that the item is allowable.

Generally, you prove payment with a cash receipt, financial account statement, credit card statement, canceled check, or substitute check. If you make payments in cash, you should get a dated and signed receipt showing the amount and the reason for the payment.

If you make payments by electronic funds transfer, you may be able to prove payment with an account statement.

Table 1-8. **Proof of Payment**

IF payment is by...	THEN the statement must show the...
Cash	• Amount • Payee's name • Transaction date
Check	• Check number • Amount • Payee's name • Date the check amount was posted to the account by the financial institution
Debit or credit card	• Amount charged • Payee's name • Transaction date
Electronic funds transfer	• Amount transferred • Payee's name • Date the transfer was posted to the account by the financial institution
Payroll deduction	• Amount • Payee code • Transaction date

Account statements. You may be able to prove payment with a legible financial account statement prepared by your bank or other financial institution. These statements are accepted as proof of payment if they show the items reflected in Table 1-8.

Pay statements. You may have deductible expenses withheld from your paycheck, such as union dues or medical insurance premiums. You should keep your year-end or final pay statements as proof of payment of these expenses.

How Long to Keep Records

You must keep your records as long as they may be needed for the administration of any provision of the Internal Revenue Code. Generally, this means you must keep records that support items shown on your return until the period of limitations for that return runs out.

The period of limitations is the period of time in which you can amend your return to claim a credit or refund or the IRS can assess additional tax. Table 1-9 contains the periods of limitations that apply to income tax returns. Unless otherwise stated, the years refer to the period beginning after the return was filed. Returns filed before the due date are treated as being filed on the due date.

Table 1-9. **Period of Limitations**

IF you...	THEN the period is...
1 Owe additional tax and (2), (3), and (4) do not apply to you	3 years
2 Do not report income that you should and it is more than 25% of the gross income shown on your return	6 years
3 File a fraudulent return	No limit
4 Do not file a return	No limit
5 File a claim for credit or refund after you filed your return	The later of 3 years or 2 years after tax was paid.
6 File a claim for a loss from worthless securities	7 years

Property. Keep records relating to property until the period of limitations expires for the year in which you dispose of the property in a taxable disposition. You must keep these records to figure your basis for computing gain or loss when you sell or otherwise dispose of the property.

Generally, if you received property in a nontaxable exchange, your basis in that property is the same as the basis of the property you gave up. You must keep the records on the old property, as well as the new property, until the period of limitations expires for the year in which you dispose of the new property in a taxable disposition.

Keeping records for nontax purposes. When your records are no longer needed for tax purposes, do not discard them until you check to see if they should be kept longer for other purposes. Your insurance company or creditors may require you to keep certain records longer than the IRS does.

Refund Information

You can go online to check the status of your 2012 refund 24 hours after the IRS receives your e-filed return, or 4 weeks after you mail a paper return. If you filed Form 8379 with your return, allow 14 weeks (11 weeks if you filed electronically) before checking your refund status. Be sure to have a copy of your 2012 tax return handy because you will need to know the filing status, the first SSN shown on the return, and the exact whole-dollar amount of the refund. To check on your refund, do one of the following.

- Go to IRS.gov, and click on "Where's My Refund."
- Download the free IRS2GO app by visiting the iTunes app store or the Android Marketplace.
- Call 1-800-829-4477 24 hours a day, 7 days a week for automated refund information.

Interest on Refunds

If you are due a refund, you may get interest on it. The interest rates are adjusted quarterly.

If the refund is made within 45 days after the due date of your return, no interest will be paid. If you file your return after the due date (including extensions), no interest will be paid if the refund is made within 45 days after the date you filed. If the refund is not made within this 45-day period, interest will be paid from the due date of the return or from the date you filed, whichever is later.

Accepting a refund check does not change your right to claim an additional refund and interest. File your claim within the period of time that applies. See *Amended Returns and Claims for Refund*, later. If you do not accept a refund check, no more interest will be paid on the overpayment included in the check.

Interest on erroneous refund. All or part of any interest you were charged on an erroneous refund generally will be forgiven. Any interest charged for the period before demand for repayment was made will be forgiven unless:

1. You, or a person related to you, caused the erroneous refund in any way, or
2. The refund is more than $50,000.

For example, if you claimed a refund of $100 on your return, but the IRS made an error and sent you $1,000, you would not be charged interest for the time you held the $900 difference. You must, however, repay the $900 when the IRS asks.

Change of Address

If you have moved, file your return using your new address.

If you move after you filed your return, you should give the IRS clear and concise notification of your change of address. The notification may be written, electronic, or oral. Send written notification to the Internal Revenue Service Center serving your old address. You can use Form 8822, Change of Address. If you are expecting a refund, also notify the post office serving your old address. This will help in forwarding your check to your new address (unless you chose direct deposit of your refund). For more information, see Revenue Procedure 2010-16, 2010-19 I.R.B. 664, available at *www.irs.gov/irb/2010-19_IRB/ar07.html*.

Be sure to include your SSN (and the name and SSN of your spouse, if you filed a joint return) in any correspondence with the IRS.

What If I Made a Mistake?

Errors may delay your refund or result in notices being sent to you. If you discover an error, you can file an amended return or claim for refund.

Amended Returns and Claims for Refund

You should correct your return if, after you have filed it, you find that:

1. You did not report some income,
2. You claimed deductions or credits you should not have claimed,
3. You did not claim deductions or credits you could have claimed, or
4. You should have claimed a different filing status. (Once you file a joint return, you cannot choose to file separate returns for that year after the due date of the return. However, an executor may be able to make this change for a deceased spouse.)

If you need a copy of your return, see *Copies of tax returns* under *What Records Should I Keep*, earlier in this chapter.

Form 1040X. Use Form 1040X, Amended U.S. Individual Income Tax Return, to correct a return you have already filed. An amended tax return cannot be filed electronically.

Completing Form 1040X. On Form 1040X, enter your income, deductions, and credits as you originally reported them on your return, the changes you are making, and the corrected amounts. Then figure the tax on the corrected amount of taxable income and the amount you owe or your refund.

If you owe tax, pay the full amount with Form 1040X. The tax owed will not be subtracted from any amount you had credited to your estimated tax.

If you cannot pay the full amount due with your return, you can ask to make monthly installment payments. See *Installment Agreement*, earlier.

If you overpaid tax, you can have all or part of the overpayment refunded to you, or you can apply all or part of it to your estimated tax. If you choose to get a refund, it will be sent separately from any refund shown on your original return.

Filing Form 1040X. After you finish your Form 1040X, check it to be sure that it is complete. Do not forget to show the year of your original return and explain all changes you made. Be sure to attach any forms or schedules needed to explain your changes. Mail your Form 1040X to the Internal Revenue Service Center serving the area where you now live (as shown in the instructions to the form). However, if you are filing Form 1040X in response to a notice you received from the IRS, mail it to the address shown on the notice.

File a separate form for each tax year involved.

Time for filing a claim for refund. Generally, you must file your claim for a credit or refund within 3 years after the date you filed your original return or within 2 years after the date you paid the tax, whichever is later. Returns filed before the due date (without regard to extensions) are considered filed on the due date (even if the due date was a Saturday, Sunday, or legal holiday). These time periods are suspended while you are financially disabled, discussed later.

If the last day for claiming a credit or refund is a Saturday, Sunday, or legal holiday, you can file the claim on the next business day.

If you do not file a claim within this period, you may not be entitled to a credit or a refund.

Protective claim for refund. Generally, a protective claim is a formal claim or amended return for credit or refund normally based on current litigation or expected changes in tax law or other legislation. You file a protective claim when your right to a refund is contingent on future events and may not be determinable until after the statute of limitations expires. A valid protective claim does not have to list a particular dollar amount or demand an immediate refund. However, a valid protective claim must:

- Be in writing and signed,
- Include your name, address, SSN or ITIN, and other contact information,
- Identify and describe the contingencies affecting the claim,
- Clearly alert the IRS to the essential nature of the claim, and
- Identify the specific year(s) for which a refund is sought.

Mail your protective claim for refund to the address listed in the instructions for Form 1040X, under *Where To File*.

Generally, the IRS will delay action on the protective claim until the contingency is resolved.

Limit on amount of refund. If you file your claim within 3 years after the date you filed your return, the credit or refund cannot be more than the part of the tax paid within the 3-year period (plus any extension of time for filing your return) immediately before you filed the claim. This time period is suspended while you are financially disabled, discussed later.

Tax paid. Payments, including estimated tax payments, made before the due date (without regard to extensions) of the original return are considered paid on the due date. For example, income tax withheld during the year is considered paid on the due date of the return, April 15 for most taxpayers.

Example 1. You made estimated tax payments of $500 and got an automatic extension of time to October 15, 2009, to file your 2008 income tax return. When you filed your return on that date, you paid an additional $200 tax. On October 17, 2012, you filed an amended return and claimed a refund of $700. Because you filed your claim within 3 years after you filed your original return, you can get a refund of up to $700, the tax paid within the 3 years plus the 6-month extension period immediately before you filed the claim.

Example 2. The situation is the same as in *Example 1*, except you filed your return on October 30, 2009, 2 weeks after the extension period ended. You paid an additional $200 on that date. On October 31, 2012, you filed an amended return and claimed a refund of $700. Although you filed your claim within 3 years from the date you filed your original return, the refund was limited to $200, the tax paid within the 3 years plus the 6-month extension period immediately before you filed the claim. The estimated tax of $500 paid before that period cannot be refunded or credited.

If you file a claim more than 3 years after you file your return, the credit or refund cannot be more than the tax you paid within the 2 years immediately before you file the claim.

Example. You filed your 2008 tax return on April 15, 2009. You paid taxes of $500. On November 5, 2010, after an examination of your 2008 return, you had to pay an additional tax of $200. On May 12, 2012, you file a claim for a refund of $300. However, because you filed your claim more than 3 years after you filed your return, your refund will be limited to the $200 you paid during the 2 years immediately before you filed your claim.

Financially disabled. The time periods for claiming a refund are suspended for the period in which you are financially disabled. For a joint income tax return, only one spouse has to be financially disabled for the time period to be suspended. You are financially disabled if you are unable to manage your financial affairs because of a medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months. However, you are not treated as financially disabled during any period your spouse or any other person is authorized to act on your behalf in financial matters.

To claim that you are financially disabled, you must send in the following written statements with your claim for refund.

1. A statement from your qualified physician that includes:
   a. The name and a description of your physical or mental impairment,
   b. The physician's medical opinion that the impairment prevented you from managing your financial affairs,
   c. The physician's medical opinion that the impairment was or can be expected to result in death, or that its duration has lasted, or can be expected to last, at least 12 months,
   d. The specific time period (to the best of the physician's knowledge), and
   e. The following certification signed by the physician: “I hereby certify that, to the best of my knowledge and belief, the above representations are true, correct, and complete.”

2. A statement made by the person signing the claim for credit or refund that no person, including your spouse, was authorized to act on your behalf in financial matters during the period of disability (or the exact dates that a person was authorized to act for you).

Exceptions for special types of refunds. If you file a claim for one of the items listed below, the dates and limits discussed earlier may not apply. These items, and where to get more information, are as follows.

- Bad debt. (See *Nonbusiness Bad Debts* in chapter 14.)
- Worthless security. (See *Worthless securities* in chapter 14.)
- Foreign tax paid or accrued. (See Publication 514, Foreign Tax Credit for Individuals.)
- Net operating loss carryback. (See Publication 536, Net Operating Losses (NOLs) for Individuals, Estates, and Trusts.)
- Carryback of certain business tax credits. (See Form 3800, General Business Credit.)
- Claim based on an agreement with the IRS extending the period for assessment of tax.

Processing claims for refund. Claims are usually processed 8-12 weeks after they are filed. Your claim may be accepted as filed, disallowed, or subject to examination. If a claim is examined, the procedures are the same as in the examination of a tax return.

If your claim is disallowed, you will receive an explanation of why it was disallowed.

Taking your claim to court. You can sue for a refund in court, but you must first file a timely claim with the IRS. If the IRS disallows your claim or does not act on your claim within 6 months after you file it, you can then take your claim to court. For information on the burden of proof in a court proceeding, see Publication 556.

The IRS provides a direct method to move your claim to court if:

- You are filing a claim for a credit or refund based solely on contested income tax or on estate tax or gift tax issues considered in your previously examined returns, and
- You want to take your case to court instead of appealing it within the IRS.

When you file your claim with the IRS, you get the direct method by requesting in writing that your claim be immediately rejected. A notice of claim disallowance will be sent to you.

You have 2 years from the date of mailing of the notice of claim disallowance to file a refund suit in the United States District Court having jurisdiction or in the United States Court of Federal Claims.

Interest on refund. If you receive a refund because of your amended return, interest will be paid on it from the due date of your original return or the date you filed your original return, whichever is later, to the date you filed the amended return. However, if the refund is not made within 45 days after you file the amended return, interest will be paid up to the date the refund is paid.

Reduced refund. Your refund may be reduced by an additional tax liability that has been assessed against you.

Also, your refund may be reduced by amounts you owe for past-due federal tax, state income tax, state unemployment compensation debts, child support, spousal support, or certain other federal nontax debts, such as student loans. If your spouse owes these debts, see *Offset against debts*, under *Refunds*, earlier, for the correct refund procedures to follow.

Effect on state tax liability. If your return is changed for any reason, it may affect your state income tax liability. This includes changes made as a result of an examination of your return by the IRS. Contact your state tax agency for more information.

Penalties

The law provides penalties for failure to file returns or pay taxes as required.

Civil Penalties

If you do not file your return and pay your tax by the due date, you may have to pay a penalty. You may also have to pay a penalty if you substantially understate your tax, understate a reportable transaction, file an erroneous claim for refund or credit, file a frivolous tax submission, or fail to supply your SSN or individual taxpayer identification number. If you provide fraudulent information on your return, you may have to pay a civil fraud penalty.

Filing late. If you do not file your return by the due date (including extensions), you may have to pay a failure-to-file penalty. The penalty is usually 5% for each month or part of a month that a return is late, but not more than 25%. The penalty is based on the tax not paid by the due date (without regard to extensions).

Fraud. If your failure to file is due to fraud, the penalty is 15% for each month or part of a month that your return is late, up to a maximum of 75%.

Return over 60 days late. If you file your return more than 60 days after the due date or extended due date, the minimum penalty is the smaller of $135 or 100% of the unpaid tax.

Exception. You will not have to pay the penalty if you show that you failed to file on time because of reasonable cause and not because of willful neglect.

Paying tax late. You will have to pay a failure-to-pay penalty of 1/2 of 1% (.50%) of your unpaid taxes for each month, or part of a month, after the due date that the tax is not paid. This penalty does not apply during the automatic 6-month extension of time to file period if you paid at least 90% of your actual tax liability on or before the due date of your return and pay the balance when you file the return.

The monthly rate of the failure-to-pay penalty is half the usual rate (.25% instead of .50%) if an installment agreement is in effect for that month. You must have filed your return by the due date (including extensions) to qualify for this reduced penalty.

If a notice of intent to levy is issued, the rate will increase to 1% at the start of the first month beginning at least 10 days after the day that the notice is issued. If a notice and demand for immediate payment is issued, the rate will increase to 1% at the start of the first month beginning after the day that the notice and demand is issued.

This penalty cannot be more than 25% of your unpaid tax. You will not have to pay the penalty if you can show that you had a good reason for not paying your tax on time.

Combined penalties. If both the failure-to-file penalty and the failure-to-pay penalty (discussed earlier) apply in any month, the 5% (or 15%) failure-to-file penalty is reduced by the failure-to-pay penalty. However, if you file your return more than 60 days after the due date or extended due date, the minimum penalty is the smaller of $135 or 100% of the unpaid tax.

Accuracy-related penalty. You may have to pay an accuracy-related penalty if you underpay your tax because:

1. You show negligence or disregard of the rules or regulations,
2. You substantially understate your income tax,
3. You claim tax benefits for a transaction that lacks economic substance, or
4. You fail to disclose a foreign financial asset.

The penalty is equal to 20% of the underpayment. The penalty is 40% of any portion of the underpayment that is attributable to an undisclosed noneconomic substance transaction or an undisclosed foreign financial asset transaction. The penalty will not be figured on any part of an underpayment on which the fraud penalty (discussed later) is charged.

Negligence or disregard. The term "negligence" includes a failure to make a reasonable attempt to comply with the tax law or to exercise ordinary and reasonable care in preparing a return. Negligence also includes failure to keep adequate books and records. You will not have to pay a negligence penalty if you have a reasonable basis for a position you took.

The term "disregard" includes any careless, reckless, or intentional disregard.

Adequate disclosure. You can avoid the penalty for disregard of rules or regulations if you adequately disclose on your return a position that has at least a reasonable basis. See *Disclosure statement*, later.

This exception will not apply to an item that is attributable to a tax shelter. In addition, it will not apply if you fail to keep adequate books and records, or substantiate items properly.

Substantial understatement of income tax. You understate your tax if the tax shown on your return is less than the correct tax. The understatement is substantial if it is more than the larger of 10% of the correct tax or $5,000. However, the amount of the understatement may be reduced to the extent the understatement is due to:

1. Substantial authority, or
2. Adequate disclosure and a reasonable basis.

If an item on your return is attributable to a tax shelter, there is no reduction for an adequate disclosure. However, there is a reduction for a position with substantial authority, but only if you reasonably believed that your tax treatment was more likely than not the proper treatment.

Substantial authority. Whether there is or was substantial authority for the tax treatment of an item depends on the facts and circumstances. Some of the items that may be considered are court opinions, Treasury regulations, revenue rulings, revenue procedures, and notices and announcements issued by the IRS and published in the Internal Revenue Bulletin that involve the same or similar circumstances as yours.

Disclosure statement. To adequately disclose the relevant facts about your tax treatment of an item, use Form 8275, Disclosure Statement. You must also have a reasonable basis for treating the item the way you did.

In cases of substantial understatement only, items that meet the requirements of Revenue Procedure 2012-15 (or later update) are considered adequately disclosed on your return without filing Form 8275.

Use Form 8275-R, Regulation Disclosure Statement, to disclose items or positions contrary to regulations.

Transaction lacking economic substance. For more information on economic substance, see section 7701(o).

Foreign financial asset. For more information on undisclosed foreign financial assets, see section 6662(j).

Reasonable cause. You will not have to pay a penalty if you show a good reason (reasonable cause) for the way you treated an item. You must also show that you acted in good faith. This does not apply to a transaction that lacks economic substance.

Filing erroneous claim for refund or credit. You may have to pay a penalty if you file an erroneous claim for refund or credit. The penalty is equal to 20% of the disallowed amount of the claim, unless you can show a reasonable basis for the way you treated an item. However, any disallowed amount due to a transaction that lacks economic substance will not be treated as having a reasonable basis. The penalty will not be figured on any part of the disallowed amount of the claim that relates to the earned income credit or on which the accuracy-related or fraud penalties are charged.

Frivolous tax submission. You may have to pay a penalty of $5,000 if you file a frivolous tax return or other frivolous submissions. A frivolous tax return is one that does not include enough information to figure the correct tax or that contains information clearly showing that the tax you reported is substantially incorrect. For more information on frivolous returns, frivolous submissions, and a list of positions that are identified as frivolous, see Notice 2010-33, 2010-17 I.R.B. 609, available at *www.irs.gov/irb/2010-17_IRB/ar13.html*.

You will have to pay the penalty if you filed this kind of return or submission based on a frivolous position or a desire to delay or interfere with the administration of federal tax laws. This includes altering or striking out the preprinted language above the space provided for your signature.

This penalty is added to any other penalty provided by law.

Fraud. If there is any underpayment of tax on your return due to fraud, a penalty of 75% of the underpayment due to fraud will be added to your tax.

Joint return. The fraud penalty on a joint return does not apply to a spouse unless some part of the underpayment is due to the fraud of that spouse.

Failure to supply SSN. If you do not include your SSN or the SSN of another person where required on a return, statement, or other document, you will be subject to a penalty of $50 for each failure. You will also be subject to a penalty of $50 if you do not give your SSN to another person when it is required on a return, statement, or other document.

For example, if you have a bank account that earns interest, you must give your SSN to the bank. The number must be shown on the Form 1099-INT or other statement the bank sends you. If you do not give the bank your SSN, you will be subject to the $50 penalty. (You also may be subject to "backup" withholding of income tax. See *chapter 4*.)

You will not have to pay the penalty if you are able to show that the failure was due to reasonable cause and not willful neglect.

Criminal Penalties

You may be subject to criminal prosecution (brought to trial) for actions such as:

1. Tax evasion,
2. Willful failure to file a return, supply information, or pay any tax due,
3. Fraud and false statements,
4. Preparing and filing a fraudulent return, or
5. Identity theft.

Identity Theft

Identity theft occurs when someone uses your personal information such as your name, SSN, or other identifying information, without your permission, to commit fraud or other crimes. An identity thief may use your SSN to get a job or may file a tax return using your SSN to receive a refund.

To reduce your risk:

- Protect your SSN,
- Ensure your employer is protecting your SSN, and
- Be careful when choosing a tax preparer.

If your tax records are affected by identity theft and you receive a notice from the IRS, respond right away to the name and phone number printed on the IRS notice or letter.

If your tax records are not currently affected by identity theft but you think you are at risk due to a lost or stolen purse or wallet, questionable credit card activity or credit report, etc., contact the IRS Identity Protection Specialized Unit at 1-800-908-4490 or submit Form 14039.

For more information, see Publication 4535, Identity Theft Prevention and Victim Assistance.

Victims of identity theft who are experiencing economic harm or a systemic problem, or are seeking help in resolving tax problems that have not been resolved through normal channels, may be eligible for Taxpayer Advocate Service (TAS) assistance. You can reach TAS by calling the National Taxpayer Advocate helpline at 1-877-777-4778 or TTY/TDD 1-800-829-4059. Deaf or hard-of-hearing individuals can also contact the IRS through relay services such as the Federal Relay Service available at *www.gsa.gov/fedrelay*.

Protect yourself from suspicious emails or phishing schemes. Phishing is the creation and use of email and websites designed to mimic legitimate business emails and websites. The most common form is the act of sending an email to a user falsely claiming to be an established legitimate enterprise in an attempt to scam the user into surrendering private information that will be used for identity theft.

The IRS does not initiate contacts with taxpayers via emails. Also, the IRS does not request detailed personal information through email or ask taxpayers for the PIN numbers, passwords, or similar secret access information for their credit card, bank, or other financial accounts.

If you receive an unsolicited email claiming to be from the IRS, forward the message to: *phishing@irs.gov*. You may also report misuse of the IRS name, logo, forms or other IRS property to the Treasury Inspector General for Tax Administration toll-free at 1-800-366-4484. You can forward suspicious emails to the Federal Trade Commission at: *spam@uce.gov* or contact them at *www.ftc.gov/idtheft* or 1-877-ID-THEFT (1-877-438-4338).

Visit IRS.gov and enter "identity theft" in the search box to learn more about identity theft and how to reduce your risk.

2.

Filing Status

Introduction

This chapter helps you determine which filing status to use. There are five filing statuses.

- Single.
- Married Filing Jointly.
- Married Filing Separately.
- Head of Household.

- Qualifying Widow(er) With Dependent Child.

TIP *If more than one filing status applies to you, choose the one that will give you the lowest tax.*

You must determine your filing status before you can determine your filing requirements (chapter 1), standard deduction (chapter 20), and tax (chapter 29). You also use your filing status to determine whether you are eligible to claim certain deductions and credits.

Useful Items

You may want to see:

Publication

- ❑ **501** Exemptions, Standard Deduction, and Filing Information
- ❑ **519** U.S. Tax Guide for Aliens
- ❑ **555** Community Property

Marital Status

In general, your filing status depends on whether you are considered unmarried or married. For federal tax purposes, a marriage means only a legal union between a man and a woman as husband and wife. The word "spouse" means a person of the opposite sex who is a husband or a wife.

Unmarried persons. You are considered unmarried for the whole year if, on the last day of your tax year, you are unmarried or legally separated from your spouse under a divorce or separate maintenance decree. State law governs whether you are married or legally separated under a divorce or separate maintenance decree.

Divorced persons. If you are divorced under a final decree by the last day of the year, you are considered unmarried for the whole year.

Divorce and remarriage. If you obtain a divorce for the sole purpose of filing tax returns as unmarried individuals, and at the time of divorce you intend to and do, in fact remarry each other in the next tax year, you and your spouse must file as married individuals in both years.

Annulled marriages. If you obtain a court decree of annulment, which holds that no valid marriage ever existed, you are considered unmarried even if you filed joint returns for earlier years. You must file Form 1040X, Amended U.S. Individual Income Tax Return, claiming single or head of household status for all tax years that are affected by the annulment and are not closed by the statute of limitations for filing a tax return. Generally, for a credit or refund, you must file Form 1040X within 3 years (including extensions) after the date you filed your original return or within 2 years after the date you paid the tax, whichever is later. If you filed your original return early (for example, March 1), your return is considered filed on the due date (generally April 15). However, if you had an extension to file (for example, until October 15) but you filed earlier and we received it July 1, your return is considered filed on July 1.

Head of household or qualifying widow(er) with dependent child. If you are considered unmarried, you may be able to file as a head of household or as a qualifying widow(er) with a dependent child. See *Head of Household* and *Qualifying Widow(er) With Dependent Child* to see if you qualify.

Married persons. If you are considered married, you and your spouse can file a joint return or separate returns.

Considered married. You are considered married for the whole year if on the last day of your tax year you and your spouse meet any one of the following tests.

1. You are married and living together as husband and wife.
2. You are living together in a common law marriage recognized in the state where you now live or in the state where the common law marriage began.
3. You are married and living apart, but not legally separated under a decree of divorce or separate maintenance.
4. You are separated under an interlocutory (not final) decree of divorce.

Spouse died during the year. If your spouse died during the year, you are considered married for the whole year for filing status purposes.

If you did not remarry before the end of the tax year, you can file a joint return for yourself and your deceased spouse. For the next 2 years, you may be entitled to the special benefits described later under *Qualifying Widow(er) With Dependent Child*.

If you remarried before the end of the tax year, you can file a joint return with your new spouse. Your deceased spouse's filing status is married filing separately for that year.

Married persons living apart. If you live apart from your spouse and meet certain tests, you may be able to file as head of household even if you are not divorced or legally separated. If you qualify to file as head of household instead of as married filing separately, your standard deduction will be higher. Also, your tax may be lower, and you may be able to claim the earned income credit. See *Head of Household*, later.

Single

Your filing status is single if, you are considered unmarried, and you do not qualify for another filing status. To determine your marital status, see *Marital Status*, earlier.

Widow(er). Your filing status may be single if you were widowed before January 1, 2012, and did not remarry before the end of 2012. You may, however be able to use another filing status that will give you a lower tax. See *Head of Household* and *Qualifying Widow(er) With Dependent Child*, later, to see if you qualify.

How to file. You can file Form 1040A, or Form 1040. If you have no dependents, and are under 65 and not blind, and meet other requirements, you can file Form 1040-EZ. If you file Form 1040A or Form 1040, show your filing status as single by checking the box on line 1. Use the *Single* column of the Tax Table or Section A of the Tax Computation Worksheet to figure your tax.

Married Filing Jointly

You can choose married filing jointly as your filing status if you are considered married and both you and your spouse agree to file a joint return. On a joint return, you and your spouse report your combined income and deduct your combined allowable expenses. You can file a joint return even if one of you had no income or deductions.

If you and your spouse decide to file a joint return, your tax may be lower than your combined tax for the other filing statuses. Also, your standard deduction (if you do not itemize deductions) may be higher, and you may qualify for tax benefits that do not apply to other filing statuses.

TIP *If you and your spouse each have income, you may want to figure your tax both on a joint return and on separate returns (using the filing status of married filing separately). You can choose the method that gives the two of you the lower combined tax.*

How to file. If you file as married filing jointly, you can use Form 1040 or Form 1040A. If you and your spouse have no dependents, are both under 65 and not blind, and meet other requirements, you can file Form 1040EZ. If you file Form 1040 or Form 1040A, show this filing status by checking the box on line 2. Use the *Married filing jointly* column of the Tax Table or Section B of the Tax Computation Worksheet to figure your tax.

Spouse died. If your spouse died during the year, you are considered married for the whole year and can choose married filing jointly as your filing status. See *Spouse died during the year* under *Marital Status*, earlier, for more information.

If your spouse died in 2013 before filing a 2012 return, you can choose married filing jointly as your filing status on your 2012 return.

Divorced persons. If you are divorced under a final decree by the last day of the year, you are considered unmarried for the whole year and you cannot choose married filing jointly as your filing status.

Filing a Joint Return

Both you and your spouse must include all of your income, exemptions, and deductions on your joint return.

Accounting period. Both of you must use the same accounting period, but you can use different accounting methods. See *Accounting Periods* and *Accounting Methods* in chapter 1.

Joint responsibility. Both of you may be held responsible, jointly and individually, for the tax and any interest or penalty due on your joint return. This means that if one spouse does not pay the tax due, the other may have to. Or, if one spouse does not report the correct tax, both spouses may be responsible for any additional taxes assessed by the IRS. One spouse may be held responsible for all the tax due even if all the income was earned by the other spouse.

You may want to file separately if:

- You believe your spouse is not reporting all of his or her income, or
- You do not want to be responsible for any taxes due if your spouse does not have enough tax withheld or does not pay enough estimated tax.

Divorced taxpayer. You may be held jointly and individually responsible for any tax, interest, and penalties due on a joint return filed before your divorce. This responsibility may apply even if your divorce decree states that your former spouse will be responsible for any amounts due on previously filed joint returns.

Relief from joint responsibility. In some cases, one spouse may be relieved of joint responsibility for tax, interest, and penalties on a joint return for items of the other spouse that were incorrectly reported on the joint return. You can ask for relief no matter how small the liability.

There are three types of relief available.

1. Innocent spouse relief.
2. Separation of liability, (available only to joint filers who are divorced, widowed, legally separated, or have not lived together for the 12 months ending on the date the election for this relief is filed).
3. Equitable relief.

You must file Form 8857, Request for Innocent Spouse Relief, to request relief from joint responsibility. Publication 971, Innocent Spouse Relief, explains these kinds of relief and who may qualify for them.

Signing a joint return. For a return to be considered a joint return, both husband and wife generally must sign the return.

Spouse died before signing. If your spouse died before signing the return, the executor or administrator must sign the return for your spouse. If neither you nor anyone else has yet been appointed as executor or administrator, you can sign the return for your spouse and enter "Filing as surviving spouse" in the area where you sign the return.

Spouse away from home. If your spouse is away from home, you should prepare the return, sign it, and send it to your spouse to sign so that it can be filed on time.

Injury or disease prevents signing. If your spouse cannot sign because of disease or injury and tells you to sign, you can sign your spouse's name in the proper space on the return followed by the words "By (your name), Husband (or Wife)." Be sure to also sign in the space provided for your signature. Attach a dated statement, signed by you, to the return. The statement should include the form number of the return you are filing, the tax year, and the reason your spouse cannot sign, and should state that your spouse has agreed to your signing for him or her.

Signing as guardian of spouse. If you are the guardian of your spouse who is mentally incompetent, you can sign the return for your spouse as guardian.

Spouse in combat zone. You can sign a joint return for your spouse if your spouse cannot sign because he or she is serving in a combat zone (such as the Persian Gulf Area, Serbia, Montenegro, Albania, or Afghanistan), even if you do not have a power of attorney or other statement. Attach a signed statement to your return explaining that your spouse is serving in a combat zone. For more information on special tax rules for persons who are serving in a combat zone, or who are in missing status as a result of serving in a combat zone, see Publication 3, Armed Forces' Tax Guide.

Other reasons spouse cannot sign. If your spouse cannot sign the joint return for any other reason, you can sign for your spouse only if you are given a valid power of attorney (a legal document giving you permission to act for your spouse). Attach the power of attorney (or a copy of it) to your tax return. You can use Form 2848, Power of Attorney and Declaration of Representative.

Nonresident alien or dual-status alien. Generally, a husband and wife cannot file a joint return if either one is a nonresident alien at any time during the tax year. However, if one spouse was a nonresident alien or dual-status alien who was married to a U.S. citizen or resident alien at the end of the year, the spouses can choose to file a joint return. If you do file a joint return, you and your spouse are both treated as U.S. residents for the entire tax year. See chapter 1 of Publication 519.

Married Filing Separately

You can choose married filing separately as your filing status if you are married. This filing status may benefit you if you want to be responsible only for your own tax or if it results in less tax than filing a joint return.

If you and your spouse do not agree to file a joint return, you may have to use this filing status unless you qualify for head of household status, discussed later.

You may be able to choose head of household filing status if you are considered unmarried because you live apart from your spouse and meet certain tests (explained later, under *Head of Household*). This can apply to you even if you are not divorced or legally separated. If you qualify to file as head of household, instead of as married filing separately, your tax may be lower; you may be able to claim the earned income credit and certain other credits; and your standard deduction will be higher. The head of household filing status allows you to choose the standard deduction even if your spouse chooses to itemize deductions. See *Head of Household*, later, for more information.

TIP *You will generally pay more combined tax on separate returns than you would on a joint return for the reasons listed under* Special Rules, *later. However, unless you are required to file separately, you should figure your tax both ways (on a joint return and on separate returns). This way you can make sure you are using the filing status that results in the lowest combined tax. When figuring the combined tax of husband and wife, you may want to consider state taxes as well as federal taxes.*

How to file. If you file a separate return, you generally report only your own income, exemptions, credits, and deductions. You can claim an exemption for your spouse only if your spouse had no gross income, is not filing a return, and was not the dependent of another person.

If you file as married filing separately, you can use Form 1040A or Form 1040. Select this filing status by checking the box on line 3 of either form. You also must enter your spouse's full name in the space provided and must enter your spouse's SSN or ITIN in the space provided unless your spouse does not have and is not required to have an SSN or ITIN. If your spouse does not have and is not required to have an SSN or ITIN, enter "NRA" in the space for your spouse's SSN. Use the *Married filing separately* column of the Tax Table or Section C of the Tax Computation Worksheet to figure your tax.

Special Rules

If you choose married filing separately as your filing status, the following special rules apply. Because of these special rules, you usually pay more tax on a separate return than if you use another filing status that you qualify for.

1. Your tax rate generally is higher than on a joint return.
2. Your exemption amount for figuring the alternative minimum tax is half that allowed on a joint return.
3. You cannot take the credit for child and dependent care expenses in most cases, and the amount you can exclude from income under an employer's dependent care assistance program is limited to $2,500 (instead of $5,000). If you are legally separated or living apart from your spouse, you may be able to file a separate return and still take the credit. For more information about these expenses, the credit, and the exclusion, see chapter 31.
4. You cannot take the earned income credit.
5. You cannot take the exclusion or credit for adoption expenses in most cases.
6. You cannot take the education credits (the American opportunity credit and lifetime learning credit), the deduction for student loan interest, or the tuition and fees deduction.
7. You cannot exclude any interest income from qualified U.S. savings bonds you used for higher education expenses.
8. If you lived with your spouse at any time during the tax year:
    a. You cannot claim the credit for the elderly or the disabled, and

b. You must include in income a greater percentage (up to 85%) of any social security or equivalent railroad retirement benefits you received.

9. The following credits are reduced at income levels half those for a joint return:

   a. The child tax credit, and

   b. The retirement savings contributions credit.

10. Your capital loss deduction limit is $1,500 (instead of $3,000 on a joint return).

11. If your spouse itemizes deductions, you cannot claim the standard deduction. If you can claim the standard deduction, your basic standard deduction is half the amount allowed on a joint return.

Adjusted gross income (AGI) limits. If your AGI on a separate return is lower than it would have been on a joint return, you may be able to deduct a larger amount for certain deductions that are limited by AGI, such as medical expenses.

Individual retirement arrangements (IRAs). You may not be able to deduct all or part of your contributions to a traditional IRA if you or your spouse were covered by an employee retirement plan at work during the year. Your deduction is reduced or eliminated if your income is more than a certain amount. This amount is much lower for married individuals who file separately and lived together at any time during the year. For more information, see *How Much Can You Deduct* in chapter 17.

Rental activity losses. If you actively participated in a passive rental real estate activity that produced a loss, you generally can deduct the loss from your nonpassive income, up to $25,000. This is called a special allowance. However, married persons filing separate returns who lived together at any time during the year cannot claim this special allowance. Married persons filing separate returns who lived apart at all times during the year are each allowed a $12,500 maximum special allowance for losses from passive real estate activities. See *Limits on Rental Losses* in chapter 9.

Community property states. If you live in Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, or Wisconsin and file separately, your income may be considered separate income or community income for income tax purposes. See Publication 555.

Joint Return After Separate Returns

You can change your filing status from a separate return to a joint return by filing an amended return using Form 1040X.

You generally can change to a joint return any time within 3 years from the due date of the separate return or returns. This does not include any extensions. A separate return includes a return filed by you or your spouse claiming married filing separately, single, or head of household filing status.

Separate Returns After Joint Return

Once you file a joint return, you cannot choose to file separate returns for that year after the due date of the return.

Exception. A personal representative for a decedent can change from a joint return elected by the surviving spouse to a separate return for the decedent. The personal representative has 1 year from the due date of the return (including extensions) to make the change. See Publication 559, Survivors, Executors, and Administrators, for more information on filing a return for a decedent.

Head of Household

You may be able to file as head of household if you meet all the following requirements.

1. You are unmarried or "considered unmarried" on the last day of the year. See *Marital Status*, earlier, and *Considered Unmarried*, later.

2. You paid more than half the cost of keeping up a home for the year.

3. A qualifying person lived with you in the home for more than half the year (except for temporary absences, such as school). However, if the qualifying person is your dependent parent, he or she does not have to live with you. See *Special rule for parent*, later, under *Qualifying Person*.

TIP *If you qualify to file as head of household, your tax rate usually will be lower than the rates for single or married filing separately. You will also receive a higher standard deduction than if you file as single or married filing separately.*

Kidnapped child. A child may qualify you to file as head of household even if the child has been kidnapped. For more information, see Publication 501.

How to file. If you file as head of household, you can use either Form 1040A or Form 1040. Indicate your choice of this filing status by checking the box on line 4 of either form. Use the *Head of a household* column of the Tax Table or Section D of the Tax Computation Worksheet to figure your tax.

Considered Unmarried

To qualify for head of household status, you must be either unmarried or considered unmarried on the last day of the year. You are considered unmarried on the last day of the tax year if you meet all the following tests.

1. You file a separate return (defined earlier under *Joint Return After Separate Returns*).

2. You paid more than half the cost of keeping up your home for the tax year.

3. Your spouse did not live in your home during the last 6 months of the tax year. Your spouse is considered to live in your home even if he or she is temporarily absent due to special circumstances. See *Temporary absences*, under *Qualifying Person*, later.

4. Your home was the main home of your child, stepchild, or foster child for more than half the year. (See *Home of qualifying person*, under *Qualifying Person*, later, for rules applying to a child's birth, death, or temporary absence during the year.)

5. You must be able to claim an exemption for the child. However, you meet this test if you cannot claim the exemption only because the noncustodial parent can claim the child using the rules described in *Children of divorced or separated parents (or parents who live apart)* under *Qualifying Child* in chapter 3, or in *Support Test for Children of Divorced or Separated Parents (or Parents Who Live Apart)* under *Qualifying Relative* in chapter 3. The general rules for claiming an exemption for a dependent are explained under *Exemptions for Dependents* in chapter 3.

CAUTION *If you were considered married for part of the year and lived in a community property state (listed earlier under* Married Filing Separately*), special rules may apply in determining your income and expenses. See Publication 555 for more information.*

Nonresident alien spouse. You are considered unmarried for head of household purposes if your spouse was a nonresident alien at any time during the year and you do not choose to treat your nonresident spouse as a resident alien. However, your spouse is not a qualifying person for head of household purposes. You must have another qualifying person and meet the other tests to be eligible to file as a head of household.

Choice to treat spouse as resident. You are considered married if you choose to treat your spouse as a resident alien. See Publication 519.

Keeping Up a Home

To qualify for head of household status, you must pay more than half of the cost of keeping up a home for the year. You can determine whether you paid more than half of the cost of keeping up a home by using Worksheet 2–1.

Costs you include. Include in the cost of keeping up a home expenses such as rent, mortgage interest, real estate taxes, insurance on the home, repairs, utilities, and food eaten in the home.

If you used payments you received under Temporary Assistance for Needy Families (TANF) or other public assistance programs to pay part of the cost of keeping up your home, you cannot count them as money you paid. However, you must include them in the total cost of keeping up your home to figure if you paid over half the cost.

Costs you do not include. Do not include the costs of clothing, education, medical treatment, vacations, life insurance, or transportation. Also, do not include the rental value of a home you own or the value of your services or those of a member of your household.

Qualifying Person

See Table 2-1 to see who is a qualifying person.

Any person not described in Table 2-1 is not a qualifying person.

Example 1—child. Your unmarried son lived with you all year and was 18 years old at the end of the year. He did not provide more than half of his own support and does not meet the tests to be a qualifying child of anyone else. As a result, he is your qualifying child (see Qualifying Child in chapter 3) and, because he is single, your qualifying person for you to claim head of household filing status.

Example 2—child who is not qualifying person. The facts are the same as in *Example 1* except your son was 25 years old at the end of the year and his gross income was $5,000. Because he does not meet the age test (explained under *Qualifying Child* in chapter 3), your son is not your qualifying child. Because he does not meet the gross income test (explained later under *Qualifying Relative* in chapter 3), he is not your qualifying relative. As a result, he is not your qualifying person for head of household purposes.

Example 3—girlfriend. Your girlfriend lived with you all year. Even though she may be your qualifying relative if the gross income and support tests (explained in chapter 3) are met, she is not your qualifying person for head of household purposes because she is not related to you in one of the ways listed under *Relatives who do not have to live with you* in chapter 3. See Table 2-1.

Example 4—girlfriend's child. The facts are the same as in *Example 3* except your girlfriend's 10-year-old son also lived with you all year. He is not your qualifying child and, because he is your girlfriend's qualifying child, he is not your qualifying relative (see *Not a Qualifying Child Test* in chapter 3). As a result, he is not your qualifying person for head of household purposes.

Home of qualifying person. Generally, the qualifying person must live with you for more than half of the year.

Special rule for parent. If your qualifying person is your father or mother, you may be eligible to file as head of household even if your father or mother does not live with you. However, you must be able to claim an exemption for your father or mother. Also, you must pay more than half the cost of keeping up a home that was the main home for the entire year for your father or mother. You are keeping up a main home for your father or mother if you pay more than half the cost of keeping your parent in a rest home or home for the elderly.

Death or birth. You may be eligible to file as head of household even if the individual who qualifies you for this filing status is born or dies during the year. You must have provided more than half of the cost of keeping up a home that was the individual's main home for more than half the part of the year he or she was alive.

Example. You are unmarried. Your mother, for whom you can claim an exemption, lived in an apartment by herself. She died on September 2. The cost of the upkeep of her apartment for the year until her death was $6,000. You paid $4,000 and your brother paid $2,000. Your brother made no other payments toward your mother's support. Your mother had no income. Because you paid more than half the cost of keeping up your mother's apartment from January 1 until her death, and you can claim an exemption for her, you can file as a head of household.

Temporary absences. You and your qualifying person are considered to live together even if one or both of you are temporarily absent from your home due to special circumstances such as illness, education, business, vacation, or military service. It must be reasonable to assume the absent person will return to the home after the temporary absence. You must continue to keep up the home during the absence.

Worksheet 2-1. **Cost of Keeping Up a Home**

Keep for Your Records

	Amount You Paid	Total Cost
Property taxes	$	$
Mortgage interest expense		
Rent		
Utility charges		
Repairs/maintenance		
Property insurance		
Food consumed on the premises		
Other household expenses		
Totals	$	$
Minus total **amount you paid**		(__________)
Amount others paid		$

If the total amount you paid is more than the amount others paid, you meet the requirement of paying more than half the cost of keeping up the home.

Qualifying Widow(er) With Dependent Child

If your spouse died in 2012, you can use married filing jointly as your filing status for 2012 if you otherwise qualify to use that status. The year of death is the last year for which you can file jointly with your deceased spouse. See *Married Filing Jointly*, earlier.

You may be eligible to use qualifying widow(er) with dependent child as your filing status for 2 years following the year your spouse died. For example, if your spouse died in 2011, and you have not remarried, you may be able to use this filing status for 2012 and 2013.

This filing status entitles you to use joint return tax rates and the highest standard deduction amount (if you do not itemize deductions). It does not entitle you to file a joint return.

How to file. If you file as qualifying widow(er) with dependent child, you can use either Form 1040A or Form 1040. Indicate your filing status by checking the box on line 5 of either form. Use the *Married filing jointly* column of the Tax Table or Section B of the Tax Computation Worksheet to figure your tax.

Eligibility rules. You are eligible to file your 2012 return as a qualifying widow(er) with dependent child if you meet all of the following tests.

- You were entitled to file a joint return with your spouse for the year your spouse died. It does not matter whether you actually filed a joint return.
- Your spouse died in 2010 or 2011 and you did not remarry before the end of 2012.
- You have a child or stepchild for whom you can claim an exemption. This does not include a foster child.
- This child lived in your home all year, except for temporary absences. See *Temporary absences*, earlier, under *Head of Household*. There are also exceptions, described later, for a child who was born or died during the year and for a kidnapped child.
- You paid more than half the cost of keeping up a home for the year. See *Keeping Up a Home*, earlier, under *Head of Household*.

Example. John Reed's wife died in 2010. John has not remarried. During 2011 and 2012, he continued to keep up a home for himself and his child, who lives with him and for whom he can claim an exemption. For 2010 he was entitled to file a joint return for himself and his deceased wife. For 2011 and 2012, he can file as qualifying widower with a dependent child. After 2012 he can file as head of household if he qualifies.

Table 2-1. **Who Is a Qualifying Person Qualifying You To File as Head of Household?**[1]

Caution. *See the text of this chapter for the other requirements you must meet to claim head of household filing status.*

IF the person is your . . .	AND . . .	THEN that person is . . .
qualifying child (such as a son, daughter, or grandchild who lived with you more than half the year and meets certain other tests)[2]	he or she is single	a qualifying person, whether or not you can claim an exemption for the person.
	he or she is married **and** you can claim an exemption for him or her	a qualifying person.
	he or she is married **and** you cannot claim an exemption for him or her	not a qualifying person.[3]
qualifying relative[4] who is your father or mother	you can claim an exemption for him or her[5]	a qualifying person.[6]
	you cannot claim an exemption for him or her	not a qualifying person.
qualifying relative[4] other than your father or mother (such as a grandparent, brother, or sister who meets certain tests)	he or she lived with you more than half the year, **and** he or she is related to you in one of the ways listed under *Relatives who do not have to live with you* in chapter 3 **and** you can claim an exemption for him or her[5]	a qualifying person.
	he or she did not live with you more than half the year	not a qualifying person.
	he or she is not related to you in one of the ways listed under *Relatives who do not have to live with you* in chapter 3 **and** is your qualifying relative only because he or she lived with you all year as a member of your household	not a qualifying person.
	you cannot claim an exemption for him or her	not a qualifying person.

[1]A person cannot qualify more than one taxpayer to use the head of household filing status for the year.

[2]The term "qualifying child" is defined in chapter 3. **Note.** If you are a noncustodial parent, the term "qualifying child" for head of household filing status does not include a child who is your qualifying child for exemption purposes only because of the rules described under *Children of divorced or separated parents (or parents who live apart)* under *Qualifying Child* in chapter 3. If you are the custodial parent and those rules apply, the child generally is your qualifying child for head of household filing status even though the child is not a qualifying child for whom you can claim an exemption.

[3]This person is a qualifying person if the only reason you cannot claim the exemption is that you can be claimed as a dependent on someone else's return.

[4]The term "*qualifying relative*" is defined in chapter 3.

[5]If you can claim an exemption for a person only because of a multiple support agreement, that person is not a qualifying person. See *Multiple Support Agreement* in chapter 3.

[6]See *Special rule for parent* for an additional requirement.

Death or birth. You may be eligible to file as a qualifying widow(er) with dependent child if the child who qualifies you for this filing status is born or dies during the year. You must have provided more than half of the cost of keeping up a home that was the child's main home during the entire part of the year he or she was alive.

Kidnapped child. A child may qualify you for qualifying widow(er) with dependent child, even if the child has been kidnapped. See Publication 501.

CAUTION *As mentioned earlier, this filing status is available for only 2 years following the year your spouse died.*

3.

Personal Exemptions and Dependents

What's New

Exemption amount. The amount you can deduct for each exemption has increased. It was $3,700 for 2011. It is $3,800 for 2012.

Introduction

This chapter discusses the following topics.

- Personal exemptions — You generally can take one for yourself and, if you are married, one for your spouse.
- Exemptions for dependents — You generally can take an exemption for each of your dependents. A dependent is your qualifying child or qualifying relative. If you are entitled to claim an exemption for a dependent, that dependent cannot claim a personal exemption on his or her own tax return.
- Social security number (SSN) requirement for dependents — You must list the SSN of any dependent for whom you claim an exemption.

Deduction. Exemptions reduce your taxable income. You can deduct $3,800 for each exemption you claim in 2012.

How to claim exemptions. How you claim an exemption on your tax return depends on which form you file.

If you file Form 1040EZ, the exemption amount is combined with the standard deduction amount and entered on line 5.

If you file Form 1040A, complete lines 6a through 6d. The total number of exemptions you can claim is the total in the box on line 6d. Also complete line 26.

If you file Form 1040, complete lines 6a through 6d. The total number of exemptions you can claim is the total in the box on line 6d. Also complete line 42.

Useful Items

You may want to see:

Publication

- ❑ **501** Exemptions, Standard Deduction, and Filing Information

Form (and Instructions)

- ❑ **2120** Multiple Support Declaration
- ❑ **8332** Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent

Exemptions

There are two types of exemptions you may be able to take:

- Personal exemptions for yourself and your spouse, and
- Exemptions for dependents (dependency exemptions).

While each is worth the same amount ($3,800 for 2012), different rules apply to each type.

Personal Exemptions

You are generally allowed one exemption for yourself. If you are married, you may be allowed one exemption for your spouse. These are called personal exemptions.

Your Own Exemption

You can take one exemption for yourself unless you can be claimed as a dependent by another taxpayer. If another taxpayer is entitled to claim you as a dependent, you cannot take an exemption for yourself even if the other taxpayer does not actually claim you as a dependent.

Your Spouse's Exemption

Your spouse is never considered your dependent.

Joint return. On a joint return you can claim one exemption for yourself and one for your spouse.

Separate return. If you file a separate return, you can claim an exemption for your spouse only if your spouse had no gross income, is not filing a return, and was not the dependent of another taxpayer. This is true even if the other taxpayer does not actually claim your spouse as a dependent. You can claim an exemption for your spouse even if he or she is a nonresident alien; in that case, your spouse must have no gross income for U.S. tax purposes, must not be filing a return, and must not be the dependent of another taxpayer.

Death of spouse. If your spouse died during the year and you file a joint return for yourself and your deceased spouse, you generally can claim your spouse's exemption under the rules just explained in *Joint return*. If you file a separate return for the year, you may be able to claim your spouse's exemption under the rules just described in *Separate return*.

If you remarried during the year, you cannot take an exemption for your deceased spouse.

If you are a surviving spouse without gross income and you remarry in the year your spouse died, you can be claimed as an exemption on both the final separate return of your deceased spouse and the separate return of your new spouse for that year. If you file a joint return with your new spouse, you can be claimed as an exemption only on that return.

Divorced or separated spouse. If you obtained a final decree of divorce or separate maintenance during the year, you cannot take your former spouse's exemption. This rule applies even if you provided all of your former spouse's support.

Exemptions for Dependents

You are allowed one exemption for each person you can claim as a dependent. You can claim an exemption for a dependent even if your dependent files a return.

The term "dependent" means:

- A qualifying child, or
- A qualifying relative.

The terms "*qualifying child*" and "*qualifying relative*" are defined later.

You can claim an exemption for a qualifying child or qualifying relative only if these three tests are met.

1. Dependent taxpayer test.
2. Joint return test.
3. Citizen or resident test.

These three tests are explained in detail later.

All the requirements for claiming an exemption for a dependent are summarized in Table 3-1.

CAUTION

Dependent not allowed a personal exemption. *If you can claim an exemption for your dependent, the dependent cannot claim his or her own personal exemption on his or her own tax return. This is true even if you do not claim the dependent's exemption on your return.*

Housekeepers, maids, or servants. If these people work for you, you cannot claim exemptions for them.

Child tax credit. You may be entitled to a child tax credit for each qualifying child who was under age 17 at the end of the year if you claimed an exemption for that child. For more information, see chapter 33.

Dependent Taxpayer Test

If you can be claimed as a dependent by another person, you cannot claim anyone else as a dependent. Even if you have a qualifying child or qualifying relative, you cannot claim that person as a dependent.

If you are filing a joint return and your spouse can be claimed as a dependent by someone else, you and your spouse cannot claim any dependents on your joint return.

Joint Return Test

You generally cannot claim a married person as a dependent if he or she files a joint return.

Exception. You can claim an exemption for a person who files a joint return if that person and

Table 3-1. **Overview of the Rules for Claiming an Exemption for a Dependent**

Caution. This table is only an overview of the rules. For details, see the rest of this chapter.

- You cannot claim any dependents if you, or your spouse if filing jointly, could be claimed as a dependent by another taxpayer.
- You cannot claim a married person who files a joint return as a dependent unless that joint return is filed only to claim a refund of withheld income tax or estimated tax paid.
- You cannot claim a person as a dependent unless that person is a U.S. citizen, U.S. resident alien, U.S. national, or a resident of Canada or Mexico.[1]
- You cannot claim a person as a dependent unless that person is your **qualifying child** or **qualifying relative.**

Tests To Be a Qualifying Child	Tests To Be a Qualifying Relative
1. The child must be your son, daughter, stepchild, foster child, brother, sister, half brother, half sister, stepbrother, stepsister, or a descendant of any of them.	1. The person cannot be your qualifying child or the qualifying child of any other taxpayer.
2. The child must be (a) under age 19 at the end of the year and younger than you (or your spouse, if filing jointly), (b) under age 24 at the end of the year, a student, and younger than you (or your spouse, if filing jointly), or (c) any age if permanently and totally disabled.	2. The person either (a) must be related to you in one of the ways listed under *Relatives who do not have to live with you*, or (b) must live with you all year as a member of your household[2] (and your relationship must not violate local law).
3. The child must have lived with you for more than half of the year.[2]	3. The person's gross income for the year must be less than $3,800.[3]
4. The child must not have provided more than half of his or her own support for the year.	4. You must provide more than half of the person's total support for the year.[4]
5. The child is not filing a joint return for the year (unless that return is filed only to get a refund of income tax withheld or estimated tax paid).	
If the child meets the rules to be a qualifying child of more than one person, only one person can actually treat the child as a qualifying child. See the *Special Rule for Qualifying Child of More Than One Person* to find out which person is the person entitled to claim the child as a qualifying child.	

[1]There is an exception for certain adopted children.

[2]There are exceptions for temporary absences, children who were born or died during the year, children of divorced or separated parents (or parents who live apart), and kidnapped children.

[3]There is an exception if the person is disabled and has income from a sheltered workshop.

[4]There are exceptions for multiple support agreements, children of divorced or separated parents (or parents who live apart), and kidnapped children.

his or her spouse file the joint return only to claim a refund of income tax withheld or estimated tax paid.

Example 1—child files joint return. You supported your 18-year-old daughter, and she lived with you all year while her husband was in the Armed Forces. The couple files a joint return. You cannot take an exemption for your daughter.

Example 2—child files joint return only as claim for refund of withheld tax. Your 18-year-old son and his 17-year-old wife had $800 of wages from part-time jobs and no other income. Neither is required to file a tax return. They do not have a child. Taxes were taken out of their pay so they filed a joint return only to get a refund of the withheld taxes. The exception to the joint return test applies, so you are not disqualified from claiming an exemption for each of them just because they file a joint return. You can claim exemptions for each of them if all the other tests to do so are met.

Example 3—child files joint return to claim American opportunity credit. The facts are the same as in Example 2 except no taxes were taken out of your son's pay. He and his wife are not required to file a tax return. However, they file a joint return to claim an American opportunity credit of $124 and get a refund of that amount. Because claiming the American opportunity credit is their reason for filing the return, they are not filing it only to get a refund of income tax withheld or estimated tax paid. The exception to the joint return test does not apply, so you cannot claim an exemption for either of them.

Citizen or Resident Test

You cannot claim a person as a dependent unless that person is a U.S. citizen, U.S. resident alien, U.S. national, or a resident of Canada or Mexico. However, there is an exception for certain adopted children, as explained next.

Exception for adopted child. If you are a U.S. citizen or U.S. national who has legally adopted a child who is not a U.S. citizen, U.S. resident alien, or U.S. national, this test is met if the child lived with you as a member of your household all year. This exception also applies if the child was lawfully placed with you for legal adoption.

Child's place of residence. Children usually are citizens or residents of the country of their parents.

If you were a U.S. citizen when your child was born, the child may be a U.S. citizen and meet this test even if the other parent was a nonresident alien and the child was born in a foreign country.

Foreign students' place of residence. Foreign students brought to this country under a qualified international education exchange program and placed in American homes for a temporary period generally are not U.S. residents and do not meet this test. You cannot claim an exemption for them. However, if you provided a home for a foreign student, you may be able to take a charitable contribution deduction. See Expenses Paid for Student Living With You in chapter 24.

U.S. national. A U.S. national is an individual who, although not a U.S. citizen, owes his or her allegiance to the United States. U.S. nationals include American Samoans and Northern Mariana Islanders who chose to become U.S. nationals instead of U.S. citizens.

Qualifying Child

Five tests must be met for a child to be your qualifying child. The five tests are:

1. Relationship,
2. Age,
3. Residency,
4. Support, and
5. Joint return.

These tests are explained next.

If a child meets the five tests to be the qualifying child of more than one person, a special rule applies to determine which person can actually treat the child as a qualifying child. See Special Rule for Qualifying Child of More Than One Person, later.

Relationship Test

To meet this test, a child must be:

- Your son, daughter, stepchild, foster child, or a descendant (for example, your grandchild) of any of them, or
- Your brother, sister, half brother, half sister, stepbrother, stepsister, or a descendant (for example, your niece or nephew) of any of them.

Adopted child. An adopted child is always treated as your own child. The term "adopted child" includes a child who was lawfully placed with you for legal adoption.

Foster child. A foster child is an individual who is placed with you by an authorized placement agency or by judgment, decree, or other order of any court of competent jurisdiction.

Age Test

To meet this test, a child must be:

- Under age 19 at the end of the year and younger than you (or your spouse, if filing jointly),
- A student under age 24 at the end of the year and younger than you (or your spouse, if filing jointly), or
- Permanently and totally disabled at any time during the year, regardless of age.

Example. Your son turned 19 on December 10. Unless he was permanently and totally disabled or a student, he does not meet the age test because, at the end of the year, he was not **under** age 19.

Child must be younger than you or spouse. To be your qualifying child, a child who is not permanently and totally disabled must be younger than you. However, if you are married filing jointly, the child must be younger than you or your spouse but does not have to be younger than both of you.

Example 1—child not younger than you or spouse. Your 23-year-old brother, who is a student and unmarried, lives with you and your spouse. He is not disabled. Both you and your spouse are 21 years old, and you file a joint return. Your brother is not your qualifying child because he is not younger than you or your spouse.

Example 2—child younger than your spouse but not younger than you. The facts are the same as in Example 1 except your spouse is 25 years old. Because your brother is younger than your spouse, and you and your spouse are filing a joint return, your brother is your qualifying child, even though he is not younger than you.

Student defined. To qualify as a student, your child must be, during some part of each of any 5 calendar months of the year:

1. A full-time student at a school that has a regular teaching staff, course of study, and a regularly enrolled student body at the school, or
2. A student taking a full-time, on-farm training course given by a school described in (1), or by a state, county, or local government agency.

The 5 calendar months do not have to be consecutive.

Full-time student. A full-time student is a student who is enrolled for the number of hours or courses the school considers to be full-time attendance.

School defined. A school can be an elementary school, junior or senior high school, college, university, or technical, trade, or mechanical school. However, an on-the-job training course, correspondence school, or school offering courses only through the Internet does not count as a school.

Vocational high school students. Students who work on "co-op" jobs in private industry as a part of a school's regular course of classroom and practical training are considered full-time students.

Permanently and totally disabled. Your child is permanently and totally disabled if both of the following apply.

- He or she cannot engage in any substantial gainful activity because of a physical or mental condition.
- A doctor determines the condition has lasted or can be expected to last continuously for at least a year or can lead to death.

Residency Test

To meet this test, your child must have lived with you for more than half the year. There are exceptions for temporary absences, children who were born or died during the year, kidnapped children, and children of divorced or separated parents.

Temporary absences. Your child is considered to have lived with you during periods of time when one of you, or both, are temporarily absent due to special circumstances such as:

- Illness,
- Education,
- Business,
- Vacation, or
- Military service.

Your child is also considered to have lived with you during any required hospital stay following birth, as long as the child would have lived with you during that time but for the hospitalization.

Death or birth of child. A child who was born or died during the year is treated as having lived with you more than half of the year if your home was the child's home more than half of the time he or she was alive during the year.

Child born alive. You may be able to claim an exemption for a child born alive during the year, even if the child lived only for a moment. State or local law must treat the child as having been born alive. There must be proof of a live birth shown by an official document, such as a birth certificate. The child must be your qualifying child or qualifying relative, and all the other tests to claim an exemption for a dependent must be met.

Stillborn child. You cannot claim an exemption for a stillborn child.

Kidnapped child. You may be able to treat your child as meeting the residency test even if the child has been kidnapped. See Publication 501 for details.

Children of divorced or separated parents (or parents who live apart). In most cases, because of the residency test, a child of divorced or separated parents is the qualifying child of the custodial parent. However, the child will be treated as the qualifying child of the noncustodial parent if all four of the following statements are true.

1. The parents:
   a. Are divorced or legally separated under a decree of divorce or separate maintenance,
   b. Are separated under a written separation agreement, or
   c. Lived apart at all times during the last 6 months of the year, whether or not they are or were married.
2. The child received over half of his or her support for the year from the parents.
3. The child is in the custody of one or both parents for more than half of the year.
4. Either of the following statements is true.
   a. The custodial parent signs a written declaration, discussed later, that he or she will not claim the child as a dependent for the year, and the noncustodial parent attaches this written declaration to his or her return. (If the decree or agreement went into effect after 1984 and before 2009, see *Post-1984 and pre-2009 divorce decree or separation agreement*, later. If the decree or agreement went into effect after 2008, see *Post-2008 divorce decree or separation agreement*, later.)
   b. A pre-1985 decree of divorce or separate maintenance or written separation agreement that applies to 2012 states that the noncustodial parent can claim the child as a dependent, the decree or agreement was not changed after 1984 to say the noncustodial parent cannot claim the child as a dependent, and the noncustodial parent provides at least $600 for the child's support during the year.

Custodial parent and noncustodial parent. The custodial parent is the parent with whom the child lived for the greater number of nights during the year. The other parent is the noncustodial parent.

If the parents divorced or separated during the year and the child lived with both parents before the separation, the custodial parent is the one with whom the child lived for the greater number of nights during the rest of the year.

A child is treated as living with a parent for a night if the child sleeps:

- At that parent's home, whether or not the parent is present, or
- In the company of the parent, when the child does not sleep at a parent's home (for example, the parent and child are on vacation together).

Equal number of nights. If the child lived with each parent for an equal number of nights during the year, the custodial parent is the parent with the higher adjusted gross income (AGI).

December 31. The night of December 31 is treated as part of the year in which it begins. For example, December 31, 2012, is treated as part of 2012.

Emancipated child. If a child is emancipated under state law, the child is treated as not living with either parent. See Examples 5 and 6.

Absences. If a child was not with either parent on a particular night (because, for example, the child was staying at a friend's house), the child is treated as living with the parent with whom the child normally would have lived for that night, except for the absence. But if it cannot be determined with which parent the child normally would have lived or if the child would not have lived with either parent that night, the child is treated as not living with either parent that night.

Parent works at night. If, due to a parent's nighttime work schedule, a child lives for a greater number of days, but not nights, with the parent who works at night, that parent is treated as the custodial parent. On a school day, the child is treated as living at the primary residence registered with the school.

Example 1—child lived with one parent greater number of nights. You and your child's other parent are divorced. In 2012, your child lived with you 210 nights and with the other parent 156 nights. You are the custodial parent.

Example 2—child is away at camp. In 2012, your daughter lives with each parent for alternate weeks. In the summer, she spends 6 weeks at summer camp. During the time she is at camp, she is treated as living with you for 3 weeks and with her other parent, your ex-spouse, for 3 weeks because this is how long she would have lived with each parent if she had not attended summer camp.

Example 3—child lived same number of nights with each parent. Your son lived with you 180 nights during the year and lived the same number of nights with his other parent, your ex-spouse. Your AGI is $40,000. Your ex-spouse's AGI is $25,000. You are treated as your son's custodial parent because you have the higher AGI.

Example 4—child is at parent's home but with other parent. Your son normally lives with you during the week and with his other parent, your ex-spouse, every other weekend. You become ill and are hospitalized. The other parent lives in your home with your son for 10 consecutive days while you are in the hospital. Your son is treated as living with you during this 10-day period because he was living in your home.

Example 5—child emancipated in May. When your son turned age 18 in May 2012, he became emancipated under the law of the state where he lives. As a result, he is not considered in the custody of his parents for more than half of the year. The special rule for children of divorced or separated parents does not apply.

Example 6—child emancipated in August. Your daughter lives with you from January 1, 2012, until May 31, 2012, and lives with her other parent, your ex-spouse, from June 1, 2012, through the end of the year. She turns 18 and is emancipated under state law on August 1, 2012. Because she is treated as not living with either parent beginning on August 1, she is treated as living with you the greater number of nights in 2012. You are the custodial parent.

Written declaration. The custodial parent may use either Form 8332 or a similar statement (containing the same information required by the form) to make the written declaration to release the exemption to the noncustodial parent. The noncustodial parent must attach a copy of the form or statement to his or her tax return.

The exemption can be released for 1 year, for a number of specified years (for example, alternate years), or for all future years, as specified in the declaration.

Post-1984 and pre-2009 divorce decree or separation agreement. If the divorce decree or separation agreement went into effect after 1984 and before 2009, the noncustodial parent may be able to attach certain pages from the decree or agreement instead of Form 8332. The decree or agreement must state all three of the following.

1. The noncustodial parent can claim the child as a dependent without regard to any condition, such as payment of support.
2. The custodial parent will not claim the child as a dependent for the year.
3. The years for which the noncustodial parent, rather than the custodial parent, can claim the child as a dependent.

The noncustodial parent must attach all of the following pages of the decree or agreement to his or her tax return.

- The cover page (write the other parent's social security number on this page).
- The pages that include all of the information identified in items (1) through (3) above.
- The signature page with the other parent's signature and the date of the agreement.

Post-2008 divorce decree or separation agreement. The noncustodial parent cannot attach pages from the decree or agreement instead of Form 8332 if the decree or agreement went into effect after 2008. The custodial parent must sign either Form 8332 or a similar statement whose only purpose is to release the custodial parent's claim to an exemption for a child, and the noncustodial parent must attach a copy to his or her return. The form or statement must release the custodial parent's claim to the child without any conditions. For example, the release must not depend on the noncustodial parent paying support.

CAUTION *The noncustodial parent must attach the required information even if it was filed with a return in an earlier year.*

Revocation of release of claim to an exemption. The custodial parent can revoke a release of claim to exemption that he or she previously released to the noncustodial parent on Form 8332 (or a similar statement). For the revocation to be effective for 2012, the custodial parent must have given (or made reasonable efforts to give) written notice of the revocation to the noncustodial parent in 2011 or earlier. The custodial parent can use Part III of Form 8332 for this purpose and must attach a copy of the revocation to his or her return for each tax year he or she claims the child as a dependent as a result of the revocation.

Remarried parent. If you remarry, the support provided by your new spouse is treated as provided by you.

Parents who never married. This special rule for divorced or separated parents also applies to parents who never married, and who lived apart at all times during the last 6 months of the year.

Support Test (To Be a Qualifying Child)

To meet this test, the child cannot have provided more than half of his or her own support for the year.

This test is different from the support test to be a qualifying relative, which is described later. However, to see what is or is not support, see *Support Test (To Be a Qualifying Relative)*, later. If you are not sure whether a child provided more than half of his or her own support, you may find Worksheet 3-1 helpful.

Example. You provided $4,000 toward your 16-year-old son's support for the year. He has a part-time job and provided $6,000 to his own support. He provided more than half of his own support for the year. He is not your qualifying child.

Foster care payments and expenses. Payments you receive for the support of a foster child from a child placement agency are considered support provided by the agency. Similarly, payments you receive for the support of a foster child from a state or county are considered support provided by the state or county.

If you are not in the trade or business of providing foster care and your unreimbursed out-of-pocket expenses in caring for a foster child were mainly to benefit an organization qualified to receive deductible charitable contributions, the expenses are deductible as charitable contributions but are not considered support you provided. For more information about the deduction for charitable contributions, see chapter 24. If your unreimbursed expenses are not deductible as charitable contributions, they may qualify as support you provided.

If you are in the trade or business of providing foster care, your unreimbursed expenses are not considered support provided by you.

Example 1. Lauren, a foster child, lived with Mr. and Mrs. Smith for the last 3 months of the year. The Smiths cared for Lauren because they wanted to adopt her (although she had not been placed with them for adoption). They did not care for her as a trade or business or to benefit the agency that placed her in their home. The Smiths' unreimbursed expenses are not deductible as charitable contributions but are considered support they provided for Lauren.

Example 2. You provided $3,000 toward your 10-year-old foster child's support for the year. The state government provided $4,000, which is considered support provided by the state, not by the child. See *Support provided by the state (welfare, food stamps, housing, etc.)*, later. Your foster child did not provide more than half of her own support for the year.

Scholarships. A scholarship received by a child who is a student is not taken into account in determining whether the child provided more than half of his or her own support.

Joint Return Test (To Be a Qualifying Child)

To meet this test, the child cannot file a joint return for the year.

Exception. An exception to the joint return test applies if your child and his or her spouse file a joint return only to claim a refund of income tax withheld or estimated tax paid.

Example 1—child files joint return. You supported your 18-year-old daughter, and she lived with you all year while her husband was in the Armed Forces. The couple files a joint return. Because your daughter and her husband file a joint return, she is not your qualifying child.

Example 2—child files joint return only as a claim for refund of withheld tax. Your 18-year-old son and his 17-year-old wife had $800 of wages from part-time jobs and no other income. Neither is required to file a tax return. They do not have a child. Taxes were taken out of their pay so they filed a joint return only to get a refund of the withheld taxes. The exception to the joint return test applies, so your son may be your qualifying child if all the other tests are met.

Example 3—child files joint return to claim American opportunity credit. The facts are the same as in Example 2 except no taxes were taken out of your son's pay. He and his wife were not required to file a tax return. However, they file a joint return to claim an American opportunity credit of $124 and get a refund of that amount. Because claiming the American opportunity credit is their reason for filing the return, they are not filing it only to get a refund of income tax withheld or estimated tax paid. The exception to the joint return test does not apply, so your son is not your qualifying child.

Special Rule for Qualifying Child of More Than One Person

TIP *If your qualifying child is not a qualifying child of anyone else, this special rule does not apply to you and you do not need to read about it. This is also true if your qualifying child is not a qualifying child of anyone else except your spouse with whom you file a joint return.*

CAUTION *If a child is treated as the qualifying child of the noncustodial parent under the rules for children of divorced or separated parents (or parents who live apart) described earlier, see Applying this special rule to divorced or separated parents (or parents who live apart), later.*

Sometimes, a child meets the relationship, age, residency, support, and joint return tests to be a qualifying child of more than one person. Although the child is a qualifying child of each of these persons, only one person can actually treat the child as a qualifying child to take all of the following tax benefits (provided the person is eligible for each benefit).

1. The exemption for the child.
2. The child tax credit.
3. Head of household filing status.
4. The credit for child and dependent care expenses.
5. The exclusion from income for dependent care benefits.
6. The earned income credit.

The other person cannot take any of these benefits based on this qualifying child. In other words, you and the other person cannot agree to divide these benefits between you. The other person cannot take any of these tax benefits for a child unless he or she has a different qualifying child.

Tiebreaker rules. To determine which person can treat the child as a qualifying child to claim these six tax benefits, the following tiebreaker rules apply.

- If only one of the persons is the child's parent, the child is treated as the qualifying child of the parent.
- If the parents do not file a joint return together but both parents claim the child as a qualifying child, the IRS will treat the child as the qualifying child of the parent with whom the child lived for the longer period of time during the year. If the child lived with each parent for the same amount of time, the IRS will treat the child as the qualifying child of the parent who had the higher adjusted gross income (AGI) for the year.
- If no parent can claim the child as a qualifying child, the child is treated as the qualifying child of the person who had the highest AGI for the year.
- If a parent can claim the child as a qualifying child but no parent does so claim the child, the child is treated as the qualifying child of the person who had the highest AGI for the year, but only if that person's AGI is higher than the highest AGI of any of the child's parents who can claim the child. If the child's parents file a joint return with each other, this rule can be applied by dividing the parents' combined AGI equally between the parents. See *Example 6*.

Subject to these tiebreaker rules, you and the other person may be able to choose which of you claims the child as a qualifying child.

Worksheet 3-1. **Worksheet for Determining Support** *Keep for Your Records*

Funds Belonging to the Person You Supported

1.	Enter the total funds belonging to the person you supported, including income received (taxable and nontaxable) and amounts borrowed during the year, plus the amount in savings and other accounts at the beginning of the year. Do not include funds provided by the state; include those amounts on line 23 instead	**1.**	
2.	Enter the amount on line 1 that was used for the person's support	**2.**	
3.	Enter the amount on line 1 that was used for other purposes	**3.**	
4.	Enter the total amount in the person's savings and other accounts at the end of the year	**4.**	
5.	Add lines 2 through 4. (This amount should equal line 1.)	**5.**	

Expenses for Entire Household (where the person you supported lived)

6.	Lodging (complete line 6a or 6b):		
	a. Enter the total rent paid	**6a.**	
	b. Enter the fair rental value of the home. If the person you supported owned the home, also include this amount in line 21	**6b.**	
7.	Enter the total food expenses	**7.**	
8.	Enter the total amount of utilities (heat, light, water, etc. not included in line 6a or 6b)	**8.**	
9.	Enter the total amount of repairs (not included in line 6a or 6b)	**9.**	
10.	Enter the total of other expenses. Do not include expenses of maintaining the home, such as mortgage interest, real estate taxes, and insurance	**10.**	
11.	Add lines 6a through 10. These are the total household expenses	**11.**	
12.	Enter total number of persons who lived in the household	**12.**	

Expenses for the Person You Supported

13.	Divide line 11 by line 12. This is the person's share of the household expenses	**13.**	
14.	Enter the person's total clothing expenses	**14.**	
15.	Enter the person's total education expenses	**15.**	
16.	Enter the person's total medical and dental expenses not paid for or reimbursed by insurance	**16.**	
17.	Enter the person's total travel and recreation expenses	**17.**	
18.	Enter the total of the person's other expenses	**18.**	
19.	Add lines 13 through 18. This is the total cost of the person's support for the year	**19.**	

Did the Person Provide More Than Half of His or Her Own Support?

20.	Multiply line 19 by 50% (.50)	**20.**	
21.	Enter the amount from line 2, plus the amount from line 6b if the person you supported owned the home. This is the amount the person provided for his or her own support	**21.**	
22.	Is line 21 more than line 20?		

☐ **No.** You meet the support test for this person to be your qualifying child. If this person also meets the other tests to be a qualifying child, stop here; do not complete lines 23–26. Otherwise, go to line 23 and fill out the rest of the worksheet to determine if this person is your qualifying relative.

☐ **Yes.** You do not meet the support test for this person to be either your qualifying child or your qualifying relative. **Stop here.**

Did You Provide More Than Half?

23.	Enter the amount others provided for the person's support. Include amounts provided by state, local, and other welfare societies or agencies. Do not include any amounts included on line 1	**23.**	
24.	Add lines 21 and 23	**24.**	
25.	Subtract line 24 from line 19. This is the amount you provided for the person's support	**25.**	
26.	Is line 25 more than line 20?		

☐ **Yes.** You meet the support test for this person to be your qualifying relative.

☐ **No.** You do not meet the support test for this person to be your qualifying relative. You cannot claim an exemption for this person unless you can do so under a multiple support agreement, the support test for children of divorced or separated parents, or the special rule for kidnapped children. See *Multiple Support Agreement* or *Support Test for Children of Divorced or Separated Parents (or Parents Who Live Apart)*, or *Kidnapped child* under *Qualifying Relative*.

Example 1—child lived with parent and grandparent. You and your 3-year-old daughter Jane lived with your mother all year. You are 25 years old, unmarried, and your AGI is $9,000. Your mother's AGI is $15,000. Jane's father did not live with you or your daughter. You have not signed Form 8332 (or a similar statement) to release the child's exemption to the noncustodial parent.

Jane is a qualifying child of both you and your mother because she meets the relationship, age, residency, support, and joint return tests for both you and your mother. However, only one of you can claim her. Jane is not a qualifying child of anyone else, including her father. You agree to let your mother claim Jane. This means your mother can claim Jane as a qualifying child for all of the six tax benefits listed earlier, if she qualifies (and if you do not claim Jane as a qualifying child for any of those tax benefits).

Example 2—parent has higher AGI than grandparent. The facts are the same as in *Example 1* except your AGI is $18,000. Because your mother's AGI is not higher than yours, she cannot claim Jane. Only you can claim Jane.

Example 3—two persons claim same child. The facts are the same as in *Example 1* except that you and your mother both claim Jane as a qualifying child. In this case, you, as the child's parent, will be the only one allowed to claim Jane as a qualifying child. The IRS will disallow your mother's claim to the six tax benefits listed earlier unless she has another qualifying child.

Example 4—qualifying children split between two persons. The facts are the same as in *Example 1* except you also have two other young children who are qualifying children of both you and your mother. Only one of you can claim each child. However, if your mother's AGI is higher than yours, you can allow your mother to claim one or more of the children. For example, if you claim one child, your mother can claim the other two.

Example 5—taxpayer who is a qualifying child. The facts are the same as in *Example 1* except you are only 18 years old and did not provide more than half of your own support for the year. This means you are your mother's qualifying child. If she can claim you as a dependent, then you cannot claim your daughter as a dependent because of the *Dependent Taxpayer Test* explained earlier.

Example 6—child lived with both parents and grandparent. The facts are the same as in *Example 1* except you are married to your daughter's father. The two of you live together with your daughter and your mother, and have an AGI of $20,000 on a joint return. If you and your husband do not claim your daughter as a qualifying child, your mother can claim her instead. Even though the AGI on your joint return, $20,000, is more than your mother's AGI of $15,000, for this purpose each parent's AGI can be treated as $10,000, so your mother's $15,000 AGI is treated as higher than the highest AGI of any of the child's parents who can claim the child.

Example 7—separated parents. You, your husband, and your 10-year-old son lived together until August 1, 2012, when your husband moved out of the household. In August and September, your son lived with you. For the rest of the year, your son lived with your husband, the boy's father. Your son is a qualifying child of both you and your husband because your son lived with each of you for more than half the year and because he met the relationship, age, support, and joint return tests for both of you. At the end of the year, you and your husband still were not divorced, legally separated, or separated under a written separation agreement, so the rule for children of divorced or separated parents (or parents who live apart) does not apply.

You and your husband will file separate returns. Your husband agrees to let you treat your son as a qualifying child. This means, if your husband does not claim your son as a qualifying child, you can claim your son as a qualifying child for the dependency exemption, child tax credit, and exclusion for dependent care benefits (if you qualify for each of those tax benefits). However, you cannot claim head of household filing status because you and your husband did not live apart for the last 6 months of the year. As a result, your filing status is married filing separately, so you cannot claim the earned income credit or the credit for child and dependent care expenses.

Example 8—separated parents claim same child. The facts are the same as in *Example 7* except that you and your husband both claim your son as a qualifying child. In this case, only your husband will be allowed to treat your son as a qualifying child. This is because, during 2012, the boy lived with him longer than with you. If you claimed an exemption or the child tax credit for your son, or if you claimed the exclusion for dependent care benefits, the IRS will disallow your claim to all these tax benefits, unless you have another qualifying child. In addition, because you and your husband did not live apart for the last 6 months of the year, your husband cannot claim head of household filing status. As a result, his filing status is married filing separately, so he cannot claim the earned income credit or the credit for child and dependent care expenses.

Example 9—unmarried parents. You, your 5-year-old son, and your son's father lived together all year. You and your son's father are not married. Your son is a qualifying child of both you and his father because he meets the relationship, age, residency, support, and joint return tests for both you and his father. Your AGI is $12,000 and your son's father's AGI is $14,000. Your son's father agrees to let you claim the child as a qualifying child. This means you can claim him as a qualifying child for the dependency exemption, child tax credit, head of household filing status, credit for child and dependent care expenses, exclusion for dependent care benefits, and the earned income credit, if you qualify for each of those tax benefits (and if your son's father does not, in fact, claim your son as a qualifying child for any of those tax benefits).

Example 10—unmarried parents claim same child. The facts are the same as in *Example 9* except that you and your son's father both claim your son as a qualifying child. In this case, only your son's father will be allowed to treat your son as a qualifying child. This is because his AGI, $14,000, is more than your AGI, $12,000. If you claimed an exemption, the child tax credit, head of household filing status, credit for child and dependent care expenses, exclusion for dependent care benefits, or the earned income credit for your son, the IRS will disallow your claim to all these tax benefits, unless you have another qualifying child.

Example 11—child did not live with a parent. You and your 7-year-old niece, your sister's child, lived with your mother all year. You are 25 years old, and your AGI is $9,300. Your mother's AGI is $15,000. Your niece's parents file jointly, have an AGI of less than $9,000, and do not live with you or their child. Your niece is a qualifying child of both you and your mother because she meets the relationship, age, residency, support, and joint return tests for both you and your mother. However, only your mother can treat her as a qualifying child. This is because your mother's AGI, $15,000, is more than your AGI, $9,300.

Applying this special rule to divorced or separated parents (or parents who live apart). If a child is treated as the qualifying child of the noncustodial parent under the rules described earlier for children of divorced or separated parents (or parents who live apart), only the noncustodial parent can claim an exemption and the child tax credit for the child. However, the custodial parent, if eligible, or other eligible person can claim the child as a qualifying child for head of household filing status, the credit for child and dependent care expenses, the exclusion for dependent care benefits, and the earned income credit. If the child is the qualifying child of more than one person for these benefits, then the tiebreaker rules just explained determine which person can treat the child as a qualifying child.

Example 1. You and your 5-year-old son lived all year with your mother, who paid the entire cost of keeping up the home. Your AGI is $10,000. Your mother's AGI is $25,000. Your son's father did not live with you or your son.

Under the rules explained earlier for children of divorced or separated parents (or parents who live apart), your son is treated as the qualifying child of his father, who can claim an exemption and the child tax credit for him. Because of this, you cannot claim an exemption or the child tax credit for your son. However, your son's father cannot claim your son as a qualifying child for head of household filing status, the credit for child and dependent care expenses, the exclusion for dependent care benefits, or the earned income credit.

You and your mother did not have any child care expenses or dependent care benefits, but the boy is a qualifying child of both you and your mother for head of household filing status and the earned income credit because he meets the relationship, age, residency, support, and joint return tests for both you and your mother. (Note: The support test does not apply for the earned income credit.) However, you agree to let your mother claim your son. This means she can claim him for head of household filing status and the earned income credit if she qualifies for each and if you do not claim him as a qualifying child for the earned income credit. (You cannot claim head of household filing status because your mother paid the entire cost of keeping up the home.)

Example 2. The facts are the same as in *Example 1* except your AGI is $25,000 and your mother's AGI is $21,000. Your mother cannot claim your son as a qualifying child for any purpose because her AGI is not higher than yours.

Example 3. The facts are the same as in *Example 1* except you and your mother both claim your son as a qualifying child for the earned income credit. Your mother also claims him as a qualifying child for head of household filing status. You, as the child's parent, will be the only one allowed to claim your son as a qualifying child for the earned income credit. The IRS will disallow your mother's claim to the earned income credit and head of household filing status unless she has another qualifying child.

Qualifying Relative

Four tests must be met for a person to be your qualifying relative. The four tests are:

1. Not a qualifying child test,
2. Member of household or relationship test,
3. Gross income test, and
4. Support test.

Age. Unlike a qualifying child, a qualifying relative can be any age. There is no age test for a qualifying relative.

Kidnapped child. You may be able to treat a child as your qualifying relative even if the child has been kidnapped. See Publication 501 for details.

Not a Qualifying Child Test

A child is not your qualifying relative if the child is your qualifying child or the qualifying child of any other taxpayer.

Example 1. Your 22-year-old daughter, who is a student, lives with you and meets all the tests to be your qualifying child. She is not your qualifying relative.

Example 2. Your 2-year-old son lives with your parents and meets all the tests to be their qualifying child. He is not your qualifying relative.

Example 3. Your son lives with you but is not your qualifying child because he is 30 years old and does not meet the age test. He may be your qualifying relative if the gross income test and the support test are met.

Example 4. Your 13-year-old grandson lived with his mother for 3 months, with his uncle for 4 months, and with you for 5 months during the year. He is not your qualifying child because he does not meet the residency test. He may be your qualifying relative if the gross income test and the support test are met.

Child of person not required to file a return. A child is not the qualifying child of any other taxpayer and so may qualify as your qualifying relative if the child's parent (or other person for whom the child is defined as a qualifying child) is not required to file an income tax return and either:

- Does not file an income tax return, or
- Files a return only to get a refund of income tax withheld or estimated tax paid.

Example 1—return not required. You support an unrelated friend and her 3-year-old child, who lived with you all year in your home. Your friend has no gross income, is not required to file a 2012 tax return, and does not file a 2012 tax return. Both your friend and her child are your qualifying relatives if the member of household or relationship test, gross income test, and support test are met.

Example 2—return filed to claim refund. The facts are the same as in *Example 1* except your friend had wages of $1,500 during the year and had income tax withheld from her wages. She files a return only to get a refund of the income tax withheld and does not claim the earned income credit or any other tax credits or deductions. Both your friend and her child are your qualifying relatives if the member of household or relationship test, gross income test, and support test are met.

Example 3—earned income credit claimed. The facts are the same as in *Example 2* except your friend had wages of $8,000 during the year and claimed the earned income credit on her return. Your friend's child is the qualifying child of another taxpayer (your friend), so you cannot claim your friend's child as your qualifying relative.

Child in Canada or Mexico. A child who lives in Canada or Mexico may be your qualifying relative, and you may be able to claim the child as a dependent. If the child does not live with you, the child does not meet the residency test to be your qualifying child. If the persons the child does live with are not U.S. citizens and have no U.S. gross income, those persons are not “taxpayers,” so the child is not the qualifying child of any other taxpayer. If the child is not your qualifying child or the qualifying child of any other taxpayer, the child is your qualifying relative if the gross income test and the support test are met.

You cannot claim as a dependent a child who lives in a foreign country other than Canada or Mexico, unless the child is a U.S. citizen, U.S. resident alien, or U.S. national. There is an exception for certain adopted children who lived with you all year. See *Citizen or Resident Test*, earlier.

Example. You provide all the support of your children, ages 6, 8, and 12, who live in Mexico with your mother and have no income. You are single and live in the United States. Your mother is not a U.S. citizen and has no U.S. income, so she is not a “taxpayer.” Your children are not your qualifying children because they do not meet the residency test. Also, they are not the qualifying children of any other taxpayer, so they are your qualifying relatives and you can claim them as dependents if all the tests are met. You may also be able to claim your mother as a dependent if all the tests are met, including the gross income test and the support test.

Member of Household or Relationship Test

To meet this test, a person must either:

1. Live with you all year as a member of your household, or
2. Be related to you in one of the ways listed under *Relatives who do not have to live with you*.

If at any time during the year the person was your spouse, that person cannot be your qualifying relative. However, see *Personal Exemptions*, earlier.

Relatives who do not have to live with you. A person related to you in any of the following ways does not have to live with you all year as a member of your household to meet this test.

- Your child, stepchild, foster child, or a descendant of any of them (for example, your grandchild). (A legally adopted child is considered your child.)
- Your brother, sister, half brother, half sister, stepbrother, or stepsister.
- Your father, mother, grandparent, or other direct ancestor, but not foster parent.
- Your stepfather or stepmother.
- A son or daughter of your brother or sister.
- A son or daughter of your half brother or half sister.
- A brother or sister of your father or mother.
- Your son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law.

Any of these relationships that were established by marriage are not ended by death or divorce.

Example. You and your wife began supporting your wife's father, a widower, in 2006. Your wife died in 2011. Despite your wife's death, your father-in-law continues to meet this test, even if he does not live with you. You can claim him as a dependent if all other tests are met, including the gross income test and support test.

Foster child. A foster child is an individual who is placed with you by an authorized placement agency or by judgment, decree, or other order of any court of competent jurisdiction.

Joint return. If you file a joint return, the person can be related to either you or your spouse. Also, the person does not need to be related to the spouse who provides support.

For example, your spouse's uncle who receives more than half of his support from you may be your qualifying relative, even though he does not live with you. However, if you and your spouse file separate returns, your spouse's uncle can be your qualifying relative only if he lives with you all year as a member of your household.

Temporary absences. A person is considered to live with you as a member of your household during periods of time when one of you, or both, are temporarily absent due to special circumstances such as:

- Illness,
- Education,
- Business,
- Vacation, or
- Military service.

If the person is placed in a nursing home for an indefinite period of time to receive constant medical care, the absence may be considered temporary.

Death or birth. A person who died during the year, but lived with you as a member of your household until death, will meet this test. The same is true for a child who was born during the year and lived with you as a member of your household for the rest of the year. The test is also met if a child lived with you as a member of your household except for any required hospital stay following birth.

If your dependent died during the year and you otherwise qualify to claim an exemption for the dependent, you can still claim the exemption.

Example. Your dependent mother died on January 15. She met the tests to be your qualifying relative. The other tests to claim an exemption for a dependent were also met. You can claim an exemption for her on your return.

Local law violated. A person does not meet this test if at any time during the year the relationship between you and that person violates local law.

Example. Your girlfriend lived with you as a member of your household all year. However, your relationship with her violated the laws of the state where you live, because she was married to someone else. Therefore, she does not meet this test and you cannot claim her as a dependent.

Adopted child. An adopted child is always treated as your own child. The term “adopted child” includes a child who was lawfully placed with you for legal adoption.

Cousin. Your cousin meets this test only if he or she lives with you all year as a member of your household. A cousin is a descendant of a brother or sister of your father or mother.

Gross Income Test

To meet this test, a person's gross income for the year must be less than $3,800.

Gross income defined. Gross income is all income in the form of money, property, and services that is not exempt from tax.

In a manufacturing, merchandising, or mining business, gross income is the total net sales minus the cost of goods sold, plus any miscellaneous income from the business.

Gross receipts from rental property are gross income. Do not deduct taxes, repairs, etc., to determine the gross income from rental property.

Gross income includes a partner's share of the gross (not a share of the net) partnership income.

Gross income also includes all taxable unemployment compensation and certain scholarship and fellowship grants. Scholarships received by degree candidates and used for tuition, fees, supplies, books, and equipment required for particular courses generally are not included in gross income. For more information about scholarships, see chapter 12.

Tax-exempt income, such as certain social security benefits, is not included in gross income.

Disabled dependent working at sheltered workshop. For purposes of this test (the gross income test), the gross income of an individual who is permanently and totally disabled at any time during the year does not include income for services the individual performs at a sheltered workshop. The availability of medical care at the workshop must be the main reason for the individual's presence there. Also, the income must come solely from activities at the workshop that are incident to this medical care.

A “sheltered workshop” is a school that:

- Provides special instruction or training designed to alleviate the disability of the individual, and
- Is operated by certain tax-exempt organizations, or by a state, a U.S. possession, a political subdivision of a state or possession, the United States, or the District of Columbia.

“Permanently and totally disabled” has the same meaning here as under *Qualifying Child*, earlier.

Support Test (To Be a Qualifying Relative)

To meet this test, you generally must provide more than half of a person's total support during the calendar year.

However, if two or more persons provide support, but no one person provides more than half of a person's total support, see *Multiple Support Agreement*, later.

How to determine if support test is met. You figure whether you have provided more than half of a person's total support by comparing the amount you contributed to that person's support with the entire amount of support that person received from all sources. This includes support the person provided from his or her own funds.

You may find Worksheet 3-1 helpful in figuring whether you provided more than half of a person's support.

Person's own funds not used for support. A person's own funds are not support unless they are actually spent for support.

Example. Your mother received $2,400 in social security benefits and $300 in interest. She paid $2,000 for lodging and $400 for recreation. She put $300 in a savings account.

Even though your mother received a total of $2,700 ($2,400 + $300), she spent only $2,400 ($2,000 + $400) for her own support. If you spent more than $2,400 for her support and no other support was received, you have provided more than half of her support.

Child's wages used for own support. You cannot include in your contribution to your child's support any support paid for by the child with the child's own wages, even if you paid the wages.

Year support is provided. The year you provide the support is the year you pay for it, even if you do so with borrowed money that you repay in a later year.

If you use a fiscal year to report your income, you must provide more than half of the dependent's support for the calendar year in which your fiscal year begins.

Armed Forces dependency allotments. The part of the allotment contributed by the government and the part taken out of your military pay are both considered provided by you in figuring whether you provide more than half of the support. If your allotment is used to support persons other than those you name, you can take the exemptions for them if they otherwise qualify.

Example. You are in the Armed Forces. You authorize an allotment for your widowed mother that she uses to support herself and her sister. If the allotment provides more than half of each person's support, you can take an exemption for each of them, if they otherwise qualify, even though you authorize the allotment only for your mother.

Tax-exempt military quarters allowances. These allowances are treated the same way as dependency allotments in figuring support. The allotment of pay and the tax-exempt basic allowance for quarters are both considered as provided by you for support.

Tax-exempt income. In figuring a person's total support, include tax-exempt income, savings, and borrowed amounts used to support that person. Tax-exempt income includes certain social security benefits, welfare benefits, nontaxable life insurance proceeds, Armed Forces family allotments, nontaxable pensions, and tax-exempt interest.

Example 1. You provide $4,000 toward your mother's support during the year. She has earned income of $600, nontaxable social security benefits of $4,800, and tax-exempt interest of $200. She uses all these for her support. You cannot claim an exemption for your mother because the $4,000 you provide is not more than half of her total support of $9,600 ($4,000 + $600 + $4,800 + $200).

Example 2. Your niece takes out a student loan of $2,500 and uses it to pay her college tuition. She is personally responsible for the loan. You provide $2,000 toward her total support. You cannot claim an exemption for her because you provide less than half of her support.

Social security benefits. If a husband and wife each receive benefits that are paid by one check made out to both of them, half of the total paid is considered to be for the support of each spouse, unless they can show otherwise.

If a child receives social security benefits and uses them toward his or her own support, the benefits are considered as provided by the child.

Support provided by the state (welfare, food stamps, housing, etc.). Benefits provided by the state to a needy person generally are considered support provided by the state. However, payments based on the needs of the recipient will not be considered as used entirely for that person's support if it is shown that part of the payments were not used for that purpose.

Foster care. Payments you receive for the support of a foster child from a child placement agency are considered support provided by the agency. See *Foster care payments and expenses*, earlier.

Home for the aged. If you make a lump-sum advance payment to a home for the aged to take care of your relative for life and the payment is based on that person's life expectancy, the amount of support you provide each year is the lump-sum payment divided by the relative's life expectancy. The amount of support you provide also includes any other amounts you provided during the year.

Total Support

To figure if you provided more than half of a person's support, you must first determine the total support provided for that person. Total support includes amounts spent to provide food, lodging, clothing, education, medical and dental care, recreation, transportation, and similar necessities.

Generally, the amount of an item of support is the amount of the expense incurred in providing that item. For lodging, the amount of support is the fair rental value of the lodging.

Expenses not directly related to any one member of a household, such as the cost of food for the household, must be divided among the members of the household.

Example 1. Grace Brown, mother of Mary Miller, lives with Frank and Mary Miller and their two children. Grace gets social security benefits of $2,400, which she spends for clothing, transportation, and recreation. Grace has no other income. Frank and Mary's total food expense for the household is $5,200. They pay Grace's medical and drug expenses of $1,200. The fair rental value of the lodging provided for Grace is $1,800 a year, based on the cost of similar rooming facilities. Figure Grace's total support as follows:

Fair rental value of lodging	$ 1,800
Clothing, transportation, and recreation	2,400
Medical expenses	1,200
Share of food (1/5 of $5,200)	1,040
Total support	$6,440

The support Frank and Mary provide, $4,040 ($1,800 lodging + $1,200 medical expenses + $1,040 food), is more than half of Grace's $6,440 total support.

Example 2. Your parents live with you, your spouse, and your two children in a house you own. The fair rental value of your parents' share of the lodging is $2,000 a year ($1,000 each), which includes furnishings and utilities. Your father receives a nontaxable pension of $4,200, which he spends equally between your mother and himself for items of support such as clothing, transportation, and recreation. Your total food expense for the household is $6,000. Your heat and utility bills amount to $1,200. Your mother has hospital and medical expenses of $600, which you pay during the year. Figure your parents' total support as follows:

Support provided	Father	Mother
Fair rental value of lodging	$1,000	$1,000
Pension spent for their support	2,100	2,100
Share of food (1/6 of $6,000)	1,000	1,000
Medical expenses for mother		600
Parents' total support	$4,100	$4,700

You must apply the support test separately to each parent. You provide $2,000 ($1,000 lodging + $1,000 food) of your father's total support of $4,100 – less than half. You provide $2,600 to your mother ($1,000 lodging + $1,000 food + $600 medical) – more than half of her total support of $4,700. You meet the support test for your mother, but not your father. Heat and utility costs are included in the fair rental value of the lodging, so these are not considered separately.

Lodging. If you provide a person with lodging, you are considered to provide support equal to the fair rental value of the room, apartment, house, or other shelter in which the person lives. Fair rental value includes a reasonable allowance for the use of furniture and appliances, and for heat and other utilities that are provided.

Fair rental value defined. Fair rental value is the amount you could reasonably expect to receive from a stranger for the same kind of lodging. It is used instead of actual expenses such as taxes, interest, depreciation, paint, insurance, utilities, cost of furniture and appliances, etc. In some cases, fair rental value may be equal to the rent paid.

If you provide the total lodging, the amount of support you provide is the fair rental value of the room the person uses, or a share of the fair rental value of the entire dwelling if the person has use of your entire home. If you do not provide the total lodging, the total fair rental value must be divided depending on how much of the total lodging you provide. If you provide only a part and the person supplies the rest, the fair rental value must be divided between both of you according to the amount each provides.

Example. Your parents live rent free in a house you own. It has a fair rental value of $5,400 a year furnished, which includes a fair rental value of $3,600 for the house and $1,800 for the furniture. This does not include heat and utilities. The house is completely furnished with furniture belonging to your parents. You pay $600 for their utility bills. Utilities are not usually included in rent for houses in the area where your parents live. Therefore, you consider the total fair rental value of the lodging to be $6,000 ($3,600 fair rental value of the unfurnished house + $1,800 allowance for the furnishings provided by your parents + $600 cost of utilities) of which you are considered to provide $4,200 ($3,600 + $600).

Person living in his or her own home. The total fair rental value of a person's home that he or she owns is considered support contributed by that person.

Living with someone rent free. If you live with a person rent free in his or her home, you must reduce the amount you provide for support of that person by the fair rental value of lodging he or she provides you.

Property. Property provided as support is measured by its fair market value. Fair market value is the price that property would sell for on the open market. It is the price that would be agreed upon between a willing buyer and a willing seller, with neither being required to act, and both having reasonable knowledge of the relevant facts.

Capital expenses. Capital items, such as furniture, appliances, and cars, bought for a person during the year can be included in total support under certain circumstances.

The following examples show when a capital item is or is not support.

Example 1. You buy a $200 power lawn mower for your 13-year-old child. The child is given the duty of keeping the lawn trimmed. Because the lawn mower benefits all members of the household, do not include the cost of the lawn mower in the support of your child.

Example 2. You buy a $150 television set as a birthday present for your 12-year-old child. The television set is placed in your child's bedroom. You can include the cost of the television set in the support of your child.

Example 3. You pay $5,000 for a car and register it in your name. You and your 17-year-old daughter use the car equally. Because you own the car and do not give it to your daughter but merely let her use it, do not include the cost of the car in your daughter's total support. However, you can include in your daughter's support your out-of-pocket expenses of operating the car for her benefit.

Example 4. Your 17-year-old son, using personal funds, buys a car for $4,500. You provide the rest of your son's support – $4,000. Because the car is bought and owned by your son, the car's fair market value ($4,500) must be included in his support. Your son has provided more than half of his own total support of $8,500 ($4,500 + $4,000), so he is not your qualifying child. You did not provide more than half of his total support, so he is not your qualifying relative. You cannot claim an exemption for your son.

Medical insurance premiums. Medical insurance premiums you pay, including premiums for supplementary Medicare coverage, are included in the support you provide.

Medical insurance benefits. Medical insurance benefits, including basic and supplementary Medicare benefits, are not part of support.

Tuition payments and allowances under the GI Bill. Amounts veterans receive under the GI Bill for tuition payments and allowances while they attend school are included in total support.

Example. During the year, your son receives $2,200 from the government under the GI Bill. He uses this amount for his education. You provide the rest of his support – $2,000. Because GI benefits are included in total support, your son's total support is $4,200 ($2,200 + $2,000). You have not provided more than half of his support.

Child care expenses. If you pay someone to provide child or dependent care, you can include these payments in the amount you provided for the support of your child or disabled dependent, even if you claim a credit for the payments. For information on the credit, see chapter 31.

Other support items. Other items may be considered as support depending on the facts in each case.

Do Not Include in Total Support

The following items are not included in total support.

1. Federal, state, and local income taxes paid by persons from their own income.
2. Social security and Medicare taxes paid by persons from their own income.
3. Life insurance premiums.
4. Funeral expenses.
5. Scholarships received by your child if your child is a student.
6. Survivors' and Dependents' Educational Assistance payments used for the support of the child who receives them.

Multiple Support Agreement

Sometimes no one provides more than half of the support of a person. Instead, two or more persons, each of whom would be able to take the exemption but for the support test, together provide more than half of the person's support.

When this happens, you can agree that any one of you who individually provides more than 10% of the person's support, but only one, can claim an exemption for that person as a qualifying relative. Each of the others must sign a statement agreeing not to claim the exemption for that year. The person who claims the exemption must keep these signed statements for his or her records. A multiple support declaration identifying each of the others who agreed not to claim the exemption must be attached to the return of the person claiming the exemption. Form 2120, Multiple Support Declaration, can be used for this purpose.

You can claim an exemption under a multiple support agreement for someone related to you or for someone who lived with you all year as a member of your household.

Example 1. You, your sister, and your two brothers provide the entire support of your mother for the year. You provide 45%, your sister 35%, and your two brothers each provide 10%. Either you or your sister can claim an exemption for your mother. The other must sign a statement agreeing not to take an exemption for your mother. The one who claims the exemption must attach Form 2120, or a similar declaration, to his or her return and must keep the statement signed by the other for his or her records. Because neither brother provides more than 10% of the support, neither can take the exemption and neither has to sign a statement.

Example 2. You and your brother each provide 20% of your mother's support for the year. The remaining 60% of her support is provided equally by two persons who are not related to her. She does not live with them. Because more than half of her support is provided by persons who cannot claim an exemption for her, no one can take the exemption.

Example 3. Your father lives with you and receives 25% of his support from social security, 40% from you, 24% from his brother (your uncle), and 11% from a friend. Either you or your uncle can take the exemption for your father if the other signs a statement agreeing not to. The one who takes the exemption must attach Form 2120, or a similar declaration, to his return and must keep for his records the signed statement from the one agreeing not to take the exemption.

Support Test for Children of Divorced or Separated Parents (or Parents Who Live Apart)

In most cases, a child of divorced or separated parents (or parents who live apart) will be a qualifying child of one of the parents. See *Children of divorced or separated parents (or parents who live apart)* under *Qualifying Child*, earlier. However, if the child does not meet the requirements to be a qualifying child of either parent, the child may be a qualifying relative of one of the parents. In that case, the following rules must be used in applying the support test.

A child will be treated as being the qualifying relative of his or her noncustodial parent if all four of the following statements are true.

1. The parents:
   a. Are divorced or legally separated under a decree of divorce or separate maintenance,
   b. Are separated under a written separation agreement, or
   c. Lived apart at all times during the last 6 months of the year, whether or not they are or were married.
2. The child received over half of his or her support for the year from the parents (and the rules on multiple support agreements, explained earlier, do not apply).
3. The child is in the custody of one or both parents for more than half of the year.
4. Either of the following statements is true.
   a. The custodial parent signs a written declaration, discussed later, that he or she will not claim the child as a dependent for the year, and the noncustodial parent attaches this written declaration to his or her return. (If the decree or agreement went into effect after 1984 and before 2009, see *Post-1984 and pre-2009 divorce decree or separation agreement*, later. If the decree or agreement went into effect after 2008, see *Post-2008 divorce decree or separation agreement*, later.)
   b. A pre-1985 decree of divorce or separate maintenance or written separation agreement that applies to 2012 states that the noncustodial parent can claim the child as a dependent, the decree or agreement was not changed after 1984 to say the noncustodial parent cannot claim the child as a dependent, and the noncustodial parent provides at least $600 for the child's support during the year.

Custodial parent and noncustodial parent. The custodial parent is the parent with whom the child lived for the greater number of nights during the year. The other parent is the noncustodial parent.

If the parents divorced or separated during the year and the child lived with both parents before the separation, the custodial parent is the one with whom the child lived for the greater number of nights during the rest of the year.

A child is treated as living with a parent for a night if the child sleeps:

- At that parent's home, whether or not the parent is present, or
- In the company of the parent, when the child does not sleep at a parent's home (for example, the parent and child are on vacation together).

Equal number of nights. If the child lived with each parent for an equal number of nights during the year, the custodial parent is the parent with the higher adjusted gross income.

December 31. The night of December 31 is treated as part of the year in which it begins. For example, December 31, 2012, is treated as part of 2012.

Emancipated child. If a child is emancipated under state law, the child is treated as not living with either parent.

Absences. If a child was not with either parent on a particular night (because, for example, the child was staying at a friend's house), the child is treated as living with the parent with whom the child normally would have lived for that night. But if it cannot be determined with which parent the child normally would have lived or if the child would not have lived with either parent that night, the child is treated as not living with either parent that night.

Parent works at night. If, due to a parent's nighttime work schedule, a child lives for a greater number of days, but not nights, with the parent who works at night, that parent is treated as the custodial parent. On a school day, the child is treated as living at the primary residence registered with the school.

Written declaration. The custodial parent may use either Form 8332 or a similar statement (containing the same information required by the form) to make the written declaration to release the exemption to the noncustodial parent. The noncustodial parent must attach a copy of the form or statement to his or her tax return.

The exemption can be released for 1 year, for a number of specified years (for example, alternate years), or for all future years, as specified in the declaration.

Post-1984 and pre-2009 divorce decree or separation agreement. If the divorce decree or separation agreement went into effect after 1984 and before 2009, the noncustodial parent may be able to attach certain pages from the decree or agreement instead of Form 8332. The decree or agreement must state all three of the following.

1. The noncustodial parent can claim the child as a dependent without regard to any condition, such as payment of support.
2. The custodial parent will not claim the child as a dependent for the year.
3. The years for which the noncustodial parent, rather than the custodial parent, can claim the child as a dependent.

The noncustodial parent must attach all of the following pages of the decree or agreement to his or her tax return.

- The cover page (write the other parent's social security number on this page).
- The pages that include all of the information identified in items (1) through (3) above.
- The signature page with the other parent's signature and the date of the agreement.

Post-2008 divorce decree or separation agreement. The noncustodial parent cannot attach pages from the decree or agreement instead of Form 8332 if the decree or agreement went into effect after 2008. The custodial parent must sign either Form 8332 or a similar statement whose only purpose is to release the custodial parent's claim to an exemption for a child, and the noncustodial parent must attach a copy to his or her return. The form or statement must release the custodial parent's claim to the child without any conditions. For example, the release must not depend on the noncustodial parent paying support.

CAUTION *The noncustodial parent must attach the required information even if it was filed with a return in an earlier year.*

Revocation of release of claim to an exemption. The custodial parent can revoke a release of claim to an exemption that he or she previously released to the noncustodial parent on Form 8332 or a similar statement. For the revocation to be effective for 2012, the custodial parent must have given (or made reasonable efforts to give) written notice of the revocation to the noncustodial parent in 2011 or earlier. The custodial parent can use Part III of Form 8332 for this purpose and must attach a copy of the revocation to his or her return for each tax year he or she claims the child as a dependent as a result of the revocation.

Remarried parent. If you remarry, the support provided by your new spouse is treated as provided by you.

Child support under pre-1985 agreement. All child support payments actually received from the noncustodial parent under a pre-1985 agreement are considered used for the support of the child.

Example. Under a pre-1985 agreement, the noncustodial parent provides $1,200 for the child's support. This amount is considered support provided by the noncustodial parent even if the $1,200 was actually spent on things other than support.

Alimony. Payments to a spouse that are includible in the spouse's gross income as either alimony, separate maintenance payments, or similar payments from an estate or trust, are not treated as a payment for the support of a dependent.

Parents who never married. This special rule for divorced or separated parents also applies to parents who never married and lived apart at all times during the last 6 months of the year.

Multiple support agreement. If the support of the child is determined under a multiple support agreement, this special support test for divorced or separated parents (or parents who live apart) does not apply.

Social Security Numbers for Dependents

You must show the social security number (SSN) of any dependent for whom you claim an exemption in column (2) of line 6c of your Form 1040 or Form 1040A.

CAUTION *If you do not show the dependent's SSN when required or if you show an incorrect SSN, the exemption may be disallowed.*

No SSN. If a person for whom you expect to claim an exemption on your return does not have an SSN, either you or that person should apply for an SSN as soon as possible by filing Form SS-5, Application for a Social Security Card, with the Social Security Administration (SSA). You can get Form SS-5 online at www.socialsecurity.gov or at your local SSA office.

It usually takes about 2 weeks to get an SSN once the SSA has all the information it needs. If you do not have a required SSN by the filing due date, you can file Form 4868 for an extension of time to file.

Born and died in 2012. If your child was born and died in 2012, and you do not have an SSN for the child, you may attach a copy of the child's birth certificate, death certificate, or hospital records instead. The document must show the child was born alive. If you do this, enter "DIED" in column (2) of line 6c of your Form 1040 or Form 1040A.

Alien or adoptee with no SSN. If your dependent does not have and cannot get an SSN, you must list the individual taxpayer identification number (ITIN) or adoption taxpayer identification number (ATIN) instead of an SSN.

Taxpayer identification numbers for aliens. If your dependent is a resident or nonresident alien who does not have and is not eligible to get an SSN, your dependent must apply for an individual taxpayer identification number (ITIN). For details on how to apply, see Form W-7, Application for IRS Individual Taxpayer Identification Number.

Taxpayer identification numbers for adoptees. If you have a child who was placed with you by an authorized placement agency, you may be able to claim an exemption for the child. However, if you cannot get an SSN or an ITIN for the child, you must get an adoption taxpayer identification number (ATIN) for the child from the IRS. See Form W-7A, Application for Taxpayer Identification Number for Pending U.S. Adoptions, for details.

4.

Tax Withholding and Estimated Tax

What's New for 2013

Tax law changes for 2013. When you figure how much income tax you want withheld from your pay and when you figure your estimated tax, consider tax law changes effective in 2013. For more information, see Publication 505.

Reminders

Estimated tax safe harbor for higher income taxpayers. If your 2012 adjusted gross income was more than $150,000 ($75,000 if you are married filing a separate return), you must pay the smaller of 90% of your expected tax for 2013 or 110% of the tax shown on your 2012 return to avoid an estimated tax penalty.

Introduction

This chapter discusses how to pay your tax as you earn or receive income during the year. In general, the federal income tax is a pay-as-you-go tax. There are two ways to pay as you go.

- ***Withholding.*** If you are an employee, your employer probably withholds income tax from your pay. Tax also may be withheld from certain other income, such as pensions, bonuses, commissions, and gambling winnings. The amount withheld is paid to the IRS in your name.
- ***Estimated tax.*** If you do not pay your tax through withholding, or do not pay enough tax that way, you may have to pay estimated tax. People who are in business for themselves generally will have to pay their tax this way. Also, you may have to pay estimated tax if you receive income such as dividends, interest, capital gains, rent, and royalties. Estimated tax is used to pay not only income tax, but self-employment tax and alternative minimum tax as well.

This chapter explains these methods. In addition, it also explains the following.

- ***Credit for withholding and estimated tax.*** When you file your 2012 income tax return, take credit for all the income tax withheld from your salary, wages, pensions, etc., and for the estimated tax you paid for 2012. Also take credit for any excess social security or railroad retirement tax withheld (discussed in chapter 36).
- ***Underpayment penalty.*** If you did not pay enough tax during the year, either through withholding or by making estimated tax payments, you may have to pay a penalty. In most cases, the IRS can figure this penalty for you. See Underpayment Penalty for 2012 at the end of this chapter.

Useful Items

You may want to see:

Publication

- ❑ **505** Tax Withholding and Estimated Tax

Form (and Instructions)

- ❑ **W-4** Employee's Withholding Allowance Certificate
- ❑ **W-4P** Withholding Certificate for Pension or Annuity Payments
- ❑ **W-4S** Request for Federal Income Tax Withholding From Sick Pay
- ❑ **W-4V** Voluntary Withholding Request
- ❑ **1040-ES** Estimated Tax for Individuals
- ❑ **2210** Underpayment of Estimated Tax by Individuals, Estates, and Trusts
- ❑ **2210-F** Underpayment of Estimated Tax by Farmers and Fishermen

Tax Withholding for 2013

This section discusses income tax withholding on:

- Salaries and wages,
- Tips,
- Taxable fringe benefits,
- Sick pay,
- Pensions and annuities,
- Gambling winnings,
- Unemployment compensation, and
- Certain federal payments.

This section explains the rules for withholding tax from each of these types of income.

This section also covers backup withholding on interest, dividends, and other payments.

Salaries and Wages

Income tax is withheld from the pay of most employees. Your pay includes your regular pay, bonuses, commissions, and vacation allowances. It also includes reimbursements and other expense allowances paid under a nonaccountable plan. See Supplemental Wages, later, for more information about reimbursements and allowances paid under a nonaccountable plan.

If your income is low enough that you will not have to pay income tax for the year, you may be exempt from withholding. This is explained under Exemption From Withholding, later.

You can ask your employer to withhold income tax from noncash wages and other wages not subject to withholding. If your employer does not agree to withhold tax, or if not enough is withheld, you may have to pay estimated tax, as discussed later under Estimated Tax for 2013.

Military retirees. Military retirement pay is treated in the same manner as regular pay for income tax withholding purposes, even though it is treated as a pension or annuity for other tax purposes.

Household workers. If you are a household worker, you can ask your employer to withhold income tax from your pay. A household worker is an employee who performs household work in a private home, local college club, or local fraternity or sorority chapter.

Tax is withheld only if you want it withheld and your employer agrees to withhold it. If you do not have enough income tax withheld, you may have to pay estimated tax, as discussed later under Estimated Tax for 2013.

Farmworkers. Generally, income tax is withheld from your cash wages for work on a farm unless your employer does both of these:

- Pays you cash wages of less than $150 during the year, and
- Has expenditures for agricultural labor totaling less than $2,500 during the year.

Differential wage payments. When employees are on leave from employment for military duty, some employers make up the difference between the military pay and civilian pay. Payments to an employee who is on active duty for a period of more than 30 days will be subject to income tax withholding, but not subject to social security or Medicare taxes. The wages and withholding will be reported on Form W-2, Wage and Tax Statement.

Determining Amount of Tax Withheld Using Form W-4

The amount of income tax your employer withholds from your regular pay depends on two things.

- The amount you earn in each payroll period.
- The information you give your employer on Form W-4.

Form W-4 includes four types of information that your employer will use to figure your withholding.

- Whether to withhold at the single rate or at the lower married rate.
- How many withholding allowances you claim (each allowance reduces the amount withheld).
- Whether you want an additional amount withheld.
- Whether you are claiming an exemption from withholding in 2013. See Exemption From Withholding, later.

Note. You must specify a filing status and a number of withholding allowances on Form W-4. You cannot specify only a dollar amount of withholding.

New Job

When you start a new job, you must fill out Form W-4 and give it to your employer. Your employer should have copies of the form. If you need to change the information later, you must fill out a new form.

If you work only part of the year (for example, you start working after the beginning of the year), too much tax may be withheld. You may be able to avoid overwithholding if your employer agrees to use the part-year method. See *Part-Year Method* in chapter 1 of Publication 505 for more information.

Employee also receiving pension income. If you receive pension or annuity income and begin a new job, you will need to file Form W-4 with your new employer. However, you can choose to split your withholding allowances between your pension and job in any manner.

Changing Your Withholding

During the year changes may occur to your marital status, exemptions, adjustments, deductions, or credits you expect to claim on your tax return. When this happens, you may need to give your employer a new Form W-4 to change your withholding status or your number of allowances.

If the changes reduce the number of allowances you are claiming or changes your marital status from married to single, you must give your employer a new Form W-4 within 10 days.

Generally, you can submit a new Form W-4 whenever you wish to change the number of your withholding allowances for any other reason.

Changing your withholding for 2014. If events in 2013 will decrease the number of your withholding allowances for 2014, you must give your employer a new Form W-4 by December 1, 2013. If the event occurs in December 2013, submit a new Form W-4 within 10 days.

Checking Your Withholding

After you have given your employer a Form W-4, you can check to see whether the amount of tax withheld from your pay is too little or too much. If too much or too little tax is being withheld, you should give your employer a new Form W-4 to change your withholding. You should try to have your withholding match your actual tax liability. If not enough tax is withheld, you will owe tax at the end of the year and may have to pay interest and a penalty. If too much tax is withheld, you will lose the use of that money until you get your refund. Always check your withholding if there are personal or financial changes in your life or changes in the law that might change your tax liability.

Note. You cannot give your employer a payment to cover withholding on salaries and wages for past pay periods or a payment for estimated tax.

Completing Form W-4 and Worksheets

Form W-4 has worksheets to help you figure how many withholding allowances you can claim. The worksheets are for your own records. Do not give them to your employer.

Multiple jobs. If you have income from more than one job at the same time, complete only one set of Form W-4 worksheets. Then split your allowances between the Forms W-4 for each job. You cannot claim the same allowances with more than one employer at the same time. You can claim all your allowances with one employer and none with the other(s), or divide them any other way.

Married individuals. If both you and your spouse are employed and expect to file a joint return, figure your withholding allowances using your combined income, adjustments, deductions, exemptions, and credits. Use only one set of worksheets. You can divide your total allowances any way, but you cannot claim an allowance that your spouse also claims.

If you and your spouse expect to file separate returns, figure your allowances using separate worksheets based on your own individual income, adjustments, deductions, exemptions, and credits.

Alternative method of figuring withholding allowances. You do not have to use the Form W-4 worksheets if you use a more accurate method of figuring the number of withholding allowances. For more information, see *Alternative method of figuring withholding allowances* under *Completing Form W-4 and Worksheets* in Publication 505, chapter 1.

Personal Allowances Worksheet. Use the Personal Allowances Worksheet on page 1 of Form W-4 to figure your withholding allowances based on exemptions and any special allowances that apply.

Deductions and Adjustments Worksheet. Use the Deduction and Adjustments Worksheet on page 2 of Form W-4 if you plan to itemize your deductions, claim certain credits, or claim adjustments to the income on your 2013 tax return and you want to reduce your withholding. Also, complete this worksheet when you have changes to these items to see if you need to change your withholding.

The Deductions and Adjustments Worksheet is on page 2 of Form W-4. Chapter 1 of Publication 505 explains this worksheet.

Two-Earners/Multiple Jobs Worksheet. You may need to complete the Two-Earners/Multiple Jobs Worksheet on page 2 of Form W-4 if you have more than one job, a working spouse, or are also receiving a pension. Also, on line 8 of this worksheet you can add any additional withholding necessary to cover any amount you expect to owe other than income tax, such as self-employment tax.

Getting the Right Amount of Tax Withheld

In most situations, the tax withheld from your pay will be close to the tax you figure on your return if you follow these two rules.

- You accurately complete all the Form W-4 worksheets that apply to you.
- You give your employer a new Form W-4 when changes occur.

But because the worksheets and withholding methods do not account for all possible situations, you may not be getting the right amount withheld. This is most likely to happen in the following situations.

- You are married and both you and your spouse work.
- You have more than one job at a time.
- You have nonwage income, such as interest, dividends, alimony, unemployment compensation, or self-employment income.
- You will owe additional amounts with your return, such as self-employment tax.
- Your withholding is based on obsolete Form W-4 information for a substantial part of the year.
- Your earnings are more than the amount shown under *Check your withholding* in the instructions at the top of page 1 of Form W-4.
- You work only part of the year.
- You change the number of your withholding allowances during the year.

Cumulative wage method. If you change the number of your withholding allowances during the year, too much or too little tax may have been withheld for the period before you made the change. You may be able to compensate for this if your employer agrees to use the cumulative wage withholding method for the rest of the year. You must ask your employer in writing to use this method.

To be eligible, you must have been paid for the same kind of payroll period (weekly, biweekly, etc.) since the beginning of the year.

Publication 505

To make sure you are getting the right amount of tax withheld, get Publication 505. It will help you compare the total tax to be withheld during the year with the tax you can expect to figure on your return. It also will help you determine how much, if any, additional withholding is needed each payday to avoid owing tax when you file your return. If you do not have enough tax withheld, you may have to pay estimated tax, as explained under Estimated Tax for 2013, later.

TIP *You can use the IRS Withholding Calculator at www.irs.gov/Individuals, instead of Publication 505 or the worksheets included with Form W-4, to determine whether you need to have your withholding increased or decreased.*

Rules Your Employer Must Follow

It may be helpful for you to know some of the withholding rules your employer must follow. These rules can affect how to fill out your Form W-4 and how to handle problems that may arise.

New Form W-4. When you start a new job, your employer should give you a Form W-4 to fill out. Beginning with your first payday, your employer will use the information you give on the form to figure your withholding.

If you later fill out a new Form W-4, your employer can put it into effect as soon as possible. The deadline for putting it into effect is the start of the first payroll period ending 30 or more days after you turn it in.

No Form W-4. If you do not give your employer a completed Form W-4, your employer must withhold at the highest rate, as if you were single and claimed no withholding allowances.

Repaying withheld tax. If you find you are having too much tax withheld because you did not claim all the withholding allowances you are entitled to, you should give your employer a new Form W-4. Your employer cannot repay any of the tax previously withheld. Instead, claim the full amount withheld when you file your tax return.

However, if your employer has withheld more than the correct amount of tax for the Form W-4 you have in effect, you do not have to fill out a new Form W-4 to have your withholding lowered to the correct amount. Your employer can repay the amount that was withheld incorrectly. If you are not repaid, your Form W-2 will reflect the full amount actually withheld, which you would claim when you file your tax return.

Exemption From Withholding

If you claim exemption from withholding, your employer will not withhold federal income tax from your wages. The exemption applies only to income tax, not to social security or Medicare tax.

You can claim exemption from withholding for 2013 only if both of the following situations apply.

- For 2012 you had a right to a refund of all federal income tax withheld because you had no tax liability.
- For 2013 you expect a refund of all federal income tax withheld because you expect to have no tax liability.

Students. If you are a student, you are not automatically exempt. See chapter 1 to find out if you must file a return. If you work only part time or only during the summer, you may qualify for exemption from withholding.

Age 65 or older or blind. If you are 65 or older or blind, use Worksheet 1-1 or 1-2 in chapter 1 of Publication 505, to help you decide if you qualify for exemption from withholding. Do not use either worksheet if you will itemize deductions, claim exemptions for dependents, or claim tax credits on your 2013 return. Instead, see *Itemizing deductions or claiming exemptions or credits* in chapter 1 of Publication 505.

Claiming exemption from withholding. To claim exemption, you must give your employer a Form W-4. Do not complete lines 5 and 6. Enter "Exempt" on line 7.

If you claim exemption, but later your situation changes so that you will have to pay income tax after all, you must file a new Form W-4 within 10 days after the change. If you claim exemption in 2013, but you expect to owe income tax for 2014, you must file a new Form W-4 by December 1, 2013.

Your claim of exempt status may be reviewed by the IRS.

An exemption is good for only 1 year. You must give your employer a new Form W-4 by February 15 each year to continue your exemption.

Supplemental Wages

Supplemental wages include bonuses, commissions, overtime pay, vacation allowances, certain sick pay, and expense allowances under certain plans. The payer can figure withholding on supplemental wages using the same method used for your regular wages. However, if these payments are identified separately from your regular wages, your employer or other payer of supplemental wages can withhold income tax from these wages at a flat rate.

Expense allowances. Reimbursements or other expense allowances paid by your employer under a nonaccountable plan are treated as supplemental wages.

Reimbursements or other expense allowances paid under an accountable plan that are more than your proven expenses are treated as paid under a nonaccountable plan if you do not return the excess payments within a reasonable period of time.

For more information about accountable and nonaccountable expense allowance plans, see *Reimbursements* in chapter 26.

Penalties

You may have to pay a penalty of $500 if both of the following apply.

- You make statements or claim withholding allowances on your Form W-4 that reduce the amount of tax withheld.
- You have no reasonable basis for those statements or allowances at the time you prepare your Form W-4.

There is also a criminal penalty for willfully supplying false or fraudulent information on your Form W-4 or for willfully failing to supply information that would increase the amount withheld. The penalty upon conviction can be either a fine of up to $1,000 or imprisonment for up to 1 year, or both.

These penalties will apply if you deliberately and knowingly falsify your Form W-4 in an attempt to reduce or eliminate the proper withholding of taxes. A simple error or an honest mistake will not result in one of these penalties. For example, a person who has tried to figure the number of withholding allowances correctly, but claims seven when the proper number is six, will not be charged a W-4 penalty.

Tips

The tips you receive while working on your job are considered part of your pay. You must include your tips on your tax return on the same line as your regular pay. However, tax is not withheld directly from tip income, as it is from your regular pay. Nevertheless, your employer will take into account the tips you report when figuring how much to withhold from your regular pay.

See chapter 6 for information on reporting your tips to your employer. For more information on the withholding rules for tip income, see Publication 531, Reporting Tip Income.

How employer figures amount to withhold. The tips you report to your employer are counted as part of your income for the month you report them. Your employer can figure your withholding in either of two ways.

- By withholding at the regular rate on the sum of your pay plus your reported tips.
- By withholding at the regular rate on your pay plus a percentage of your reported tips.

Not enough pay to cover taxes. If your regular pay is not enough for your employer to withhold all the tax (including income tax and social security and Medicare taxes (or the equivalent railroad retirement tax)) due on your pay plus your tips, you can give your employer money to cover the shortage. See *Giving your employer money for taxes* in chapter 6.

Allocated tips. Your employer should not withhold income tax, Medicare tax, social security tax, or railroad retirement tax on any allocated tips. Withholding is based only on your pay plus your reported tips. Your employer should refund to you any incorrectly withheld tax. See *Allocated Tips* in chapter 6 for more information.

Taxable Fringe Benefits

The value of certain noncash fringe benefits you receive from your employer is considered part of your pay. Your employer generally must withhold income tax on these benefits from your regular pay.

For information on fringe benefits, see *Fringe Benefits* under *Employee Compensation* in chapter 5.

Although the value of your personal use of an employer-provided car, truck, or other highway motor vehicle is taxable, your employer can choose not to withhold income tax on that amount. Your employer must notify you if this choice is made.

For more information on withholding on taxable fringe benefits, see chapter 1 of Publication 505.

Sick Pay

Sick pay is a payment to you to replace your regular wages while you are temporarily absent from work due to sickness or personal injury. To qualify as sick pay, it must be paid under a plan to which your employer is a party.

If you receive sick pay from your employer or an agent of your employer, income tax must be withheld. An agent who does not pay regular wages to you may choose to withhold income tax at a flat rate.

However, if you receive sick pay from a third party who is not acting as an agent of your employer, income tax will be withheld only if you choose to have it withheld. See *Form W-4S*, below.

If you receive payments under a plan in which your employer does not participate (such as an accident or health plan where you paid all the premiums), the payments are not sick pay and usually are not taxable.

Union agreements. If you receive sick pay under a collective bargaining agreement between your union and your employer, the agreement may determine the amount of income tax withholding. See your union representative or your employer for more information.

Form W-4S. If you choose to have income tax withheld from sick pay paid by a third party, such as an insurance company, you must fill out Form W-4S. Its instructions contain a worksheet you can use to figure the amount you want withheld. They also explain restrictions that may apply.

Give the completed form to the payer of your sick pay. The payer must withhold according to your directions on the form.

Estimated tax. If you do not request withholding on Form W-4S, or if you do not have enough tax withheld, you may have to make estimated tax payments. If you do not pay enough tax, either through estimated tax or withholding, or a combination of both, you may have to pay a penalty. See *Underpayment Penalty for 2012* at the end of this chapter.

Pensions and Annuities

Income tax usually will be withheld from your pension or annuity distributions unless you choose not to have it withheld. This rule applies to distributions from:

- A traditional individual retirement arrangement (IRA);
- A life insurance company under an endowment, annuity, or life insurance contract;
- A pension, annuity, or profit-sharing plan;
- A stock bonus plan; and
- Any other plan that defers the time you receive compensation.

The amount withheld depends on whether you receive payments spread out over more than 1 year (periodic payments), within 1 year (nonperiodic payments), or as an eligible rollover distribution (ERD). Income tax withholding from an ERD is mandatory.

More information. For more information on taxation of annuities and distributions (including ERDs) from qualified retirement plans, see chapter 10. For information on IRAs, see chapter 17. For more information on withholding on pensions and annuities, including a discussion of Form W-4P, see *Pensions and Annuities* in chapter 1 of Publication 505.

Gambling Winnings

Income tax is withheld at a flat 25% rate from certain kinds of gambling winnings.

Gambling winnings of more than $5,000 from the following sources are subject to income tax withholding.

- Any sweepstakes; wagering pool, including payments made to winners of poker tournaments; or lottery.
- Any other wager, if the proceeds are at least 300 times the amount of the bet.

It does not matter whether your winnings are paid in cash, in property, or as an annuity. Winnings not paid in cash are taken into account at their fair market value.

Exception. Gambling winnings from bingo, keno, and slot machines generally are not subject to income tax withholding. However, you may need to provide the payer with a social security number to avoid withholding. See *Backup withholding on gambling winnings* in chapter 1 of Publication 505. If you receive gambling winnings not subject to withholding, you may need to pay estimated tax. See Estimated Tax for 2013, later.

If you do not pay enough tax, either through withholding or estimated tax, or a combination of both, you may have to pay a penalty. See Underpayment Penalty for 2012 at the end of this chapter.

Form W-2G. If a payer withholds income tax from your gambling winnings, you should receive a Form W-2G, Certain Gambling Winnings, showing the amount you won and the amount withheld. Report the tax withheld on line 62 of Form 1040.

Unemployment Compensation

You can choose to have income tax withheld from unemployment compensation. To make this choice, fill out Form W-4V (or a similar form provided by the payer) and give it to the payer.

All unemployment compensation is taxable. So, if you do not have income tax withheld, you may have to pay estimated tax. See Estimated Tax for 2013, later.

If you do not pay enough tax, either through withholding or estimated tax, or a combination of both, you may have to pay a penalty. For information, see Underpayment Penalty for 2012 at the end of this chapter.

Federal Payments

You can choose to have income tax withheld from certain federal payments you receive. These payments are:

1. Social security benefits,
2. Tier 1 railroad retirement benefits,
3. Commodity credit corporation loans you choose to include in your gross income, and
4. Payments under the Agricultural Act of 1949 (7 U.S.C. 1421 et. seq.), as amended, or title II of the Disaster Assistance Act of 1988, that are treated as insurance proceeds and that you receive because:
   a. Your crops were destroyed or damaged by drought, flood, or any other natural disaster, or
   b. You were unable to plant crops because of a natural disaster described in (a), and
5. Any other payment under Federal law as determined by the Secretary.

To make this choice, fill out Form W-4V (or a similar form provided by the payer) and give it to the payer.

If you do not choose to have income tax withheld, you may have to pay estimated tax. See Estimated Tax for 2013, later.

If you do not pay enough tax, either through withholding or estimated tax, or a combination of both, you may have to pay a penalty. For information, see Underpayment Penalty for 2012 at the end of this chapter.

More information. For more information about the tax treatment of social security and railroad retirement benefits, see chapter 11. Get Publication 225, Farmer's Tax Guide, for information about the tax treatment of commodity credit corporation loans or crop disaster payments.

Backup Withholding

Banks or other businesses that pay you certain kinds of income must file an information return (Form 1099) with the IRS. The information return shows how much you were paid during the year. It also includes your name and taxpayer identification number (TIN). TINs are explained in chapter 1 under Social Security Number (SSN).

These payments generally are not subject to withholding. However, "backup" withholding is required in certain situations. Backup withholding can apply to most kinds of payments that are reported on Form 1099.

The payer must withhold at a flat 28% rate in the following situations.

- You do not give the payer your TIN in the required manner.
- The IRS notifies the payer that the TIN you gave is incorrect.
- You are required, but fail, to certify that you are not subject to backup withholding.
- The IRS notifies the payer to start withholding on interest or dividends because you have underreported interest or dividends on your income tax return. The IRS will do this only after it has mailed you four notices over at least a 210-day period.

See *Backup Withholding* in chapter 1 of Publication 505 for more information.

Penalties. There are civil and criminal penalties for giving false information to avoid backup withholding. The civil penalty is $500. The criminal penalty, upon conviction, is a fine of up to $1,000 or imprisonment of up to 1 year, or both.

Estimated Tax for 2013

Estimated tax is the method used to pay tax on income that is not subject to withholding. This includes income from self-employment, interest, dividends, alimony, rent, gains from the sale of assets, prizes, and awards. You also may have to pay estimated tax if the amount of income tax being withheld from your salary, pension, or other income is not enough.

Estimated tax is used to pay both income tax and self-employment tax, as well as other taxes and amounts reported on your tax return. If you do not pay enough tax, either through withholding or estimated tax, or a combination of both, you may have to pay a penalty. If you do not pay enough by the due date of each payment period (see When To Pay Estimated Tax, later), you may be charged a penalty even if you are due a refund when you file your tax return. For information on when the penalty applies, see Underpayment Penalty for 2012 at the end of this chapter.

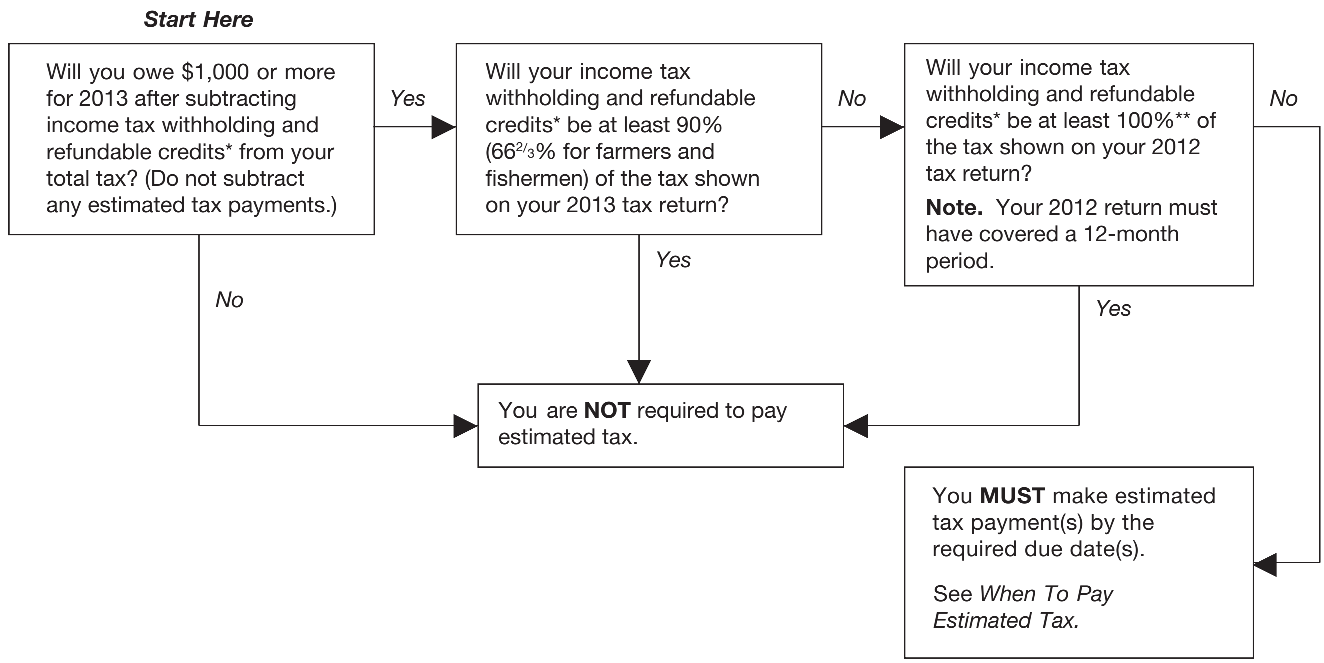
Who Does Not Have To Pay Estimated Tax

If you receive salaries or wages, you can avoid having to pay estimated tax by asking your employer to take more tax out of your earnings. To do this, give a new Form W-4 to your employer. See chapter 1 of Publication 505.

Estimated tax not required. You do not have to pay estimated tax for 2013 if you meet all three of the following conditions.

- You had no tax liability for 2012.
- You were a U.S. citizen or resident alien for the whole year.
- Your 2012 tax year covered a 12-month period.

Figure 4-A. Do You Have To Pay Estimated Tax?



*Use the refundable credits shown on the 2013 Estimated Tax Worksheet.
**110% if less than two-thirds of your gross income for 2012 and 2013 is from farming or fishing and your 2012 adjusted gross income was more than $150,000 ($75,000 if your filing status for 2013 is married filing a separate return).

You had no tax liability for 2012 if your total tax was zero or you did not have to file an income tax return. For the definition of "total tax" for 2012, see Publication 505, chapter 2.

Who Must Pay Estimated Tax

If you owe additional tax for 2012, you may have to pay estimated tax for 2013.

You can use the following general rule as a guide during the year to see if you will have enough withholding, or if you should increase your withholding or make estimated tax payments.

General rule. In most cases, you must pay estimated tax for 2013 if both of the following apply.

1. You expect to owe at least $1,000 in tax for 2013, after subtracting your withholding and refundable credits.
2. You expect your withholding plus your refundable credits to be less than the smaller of:
   a. 90% of the tax to be shown on your 2013 tax return, or
   b. 100% of the tax shown on your 2012 tax return (but see *Special rules for farmers, fishermen, and higher income taxpayers,* below). Your 2012 tax return must cover all 12 months.

CAUTION *If the result from using the general rule above suggests that you will not have enough withholding, complete the 2013 Estimated Tax Worksheet in Publication 505 for a more accurate calculation.*

Special rules for farmers, fishermen, and higher income taxpayers. If at least two-thirds of your gross income for tax year 2012 or 2013 is from farming or fishing, substitute 66⅔% for 90% in (2a) under the General rule, earlier. If your AGI for 2012 was more than $150,000 ($75,000 if your filing status for 2013 is married filing a separate return), substitute 110% for 100% in (2b) under General rule, earlier. See Figure 4-A and Publication 505, chapter 2 for more information.

Aliens. Resident and nonresident aliens also may have to pay estimated tax. Resident aliens should follow the rules in this chapter unless noted otherwise. Nonresident aliens should get Form 1040-ES (NR), U.S. Estimated Tax for Nonresident Alien Individuals.

You are an alien if you are not a citizen or national of the United States. You are a resident alien if you either have a green card or meet the substantial presence test. For more information about the substantial presence test, see Publication 519, U.S. Tax Guide for Aliens.

Married taxpayers. If you qualify to make joint estimated tax payments, apply the rules discussed here to your joint estimated income.

You and your spouse can make joint estimated tax payments even if you are not living together.

However, you and your spouse cannot make joint estimated tax payments if:

- You are legally separated under a decree of divorce or separate maintenance,
- You and your spouse have different tax years, or
- Either spouse is a nonresident alien (unless that spouse elected to be treated as a resident alien for tax purposes (see chapter 1 of Publication 519)).

If you do not qualify to make joint estimated tax payments, apply these rules to your separate estimated income. Making joint or separate estimated tax payments will not affect your choice of filing a joint tax return or separate returns for 2013.

2012 separate returns and 2013 joint return. If you plan to file a joint return with your spouse for 2013, but you filed separate returns for 2012, your 2012 tax is the total of the tax shown on your separate returns. You filed a separate return if you filed as single, head of household, or married filing separately.

2012 joint return and 2013 separate returns. If you plan to file a separate return for 2013 but you filed a joint return for 2012, your 2012 tax is your share of the tax on the joint return. You file a separate return if you file as single, head of household, or married filing separately.

To figure your share of the tax on the joint return, first figure the tax both you and your spouse would have paid had you filed separate returns for 2012 using the same filing status as for 2013. Then multiply the tax on the joint return by the following fraction.

$$\frac{\text{The tax you would have paid had you filed a separate return}}{\text{The total tax you and your spouse would have paid had you filed separate returns}}$$

Example. Joe and Heather filed a joint return for 2012 showing taxable income of

$48,500 and a tax of $6,409. Of the $48,500 taxable income, $40,100 was Joe's and the rest was Heather's. For 2013, they plan to file married filing separately. Joe figures his share of the tax on the 2012 joint return as follows.

Tax on $40,100 based on a separate return	$6,061
Tax on $8,400 based on a separate return	843
Total	$ 6,904
Joe's percentage of total ($6,061 ÷ $6,904)	87.79%
Joe's share of tax on joint return ($6,409 × 87.79%)	$ 5,626

How To Figure Estimated Tax

To figure your estimated tax, you must figure your expected adjusted gross income (AGI), taxable income, taxes, deductions, and credits for the year.

When figuring your 2013 estimated tax, it may be helpful to use your income, deductions, and credits for 2012 as a starting point. Use your 2012 federal tax return as a guide. You can use Form 1040-ES and Publication 505 to figure your estimated tax. Nonresident aliens use Form 1040-ES (NR) and Publication 505 to figure estimated tax (see chapter 8 of Publication 519 for more information).

You must make adjustments both for changes in your own situation and for recent changes in the tax law. For 2013, there are several changes in the law. For a discussion of these changes, visit IRS.gov.

For more complete information on how to figure your estimated tax for 2013, see chapter 2 of Publication 505.

When To Pay Estimated Tax

For estimated tax purposes, the tax year is divided into four payment periods. Each period has a specific payment due date. If you do not pay enough tax by the due date of each payment period, you may be charged a penalty even if you are due a refund when you file your income tax return. The payment periods and due dates for estimated tax payments are shown next.

For the period:	Due date:*
Jan. 1 – March 31	April 15
April 1 – May 31	June 17
June 1 – August 31	Sept. 16
Sept. 1– Dec. 31	Jan. 15, next year

*See Saturday, Sunday, holiday rule and January payment.

Saturday, Sunday, holiday rule. If the due date for an estimated tax payment falls on a Saturday, Sunday, or legal holiday, the payment will be on time if you make it on the next day that is not a Saturday, Sunday, or legal holiday.

January payment. If you file your 2013 Form 1040 or Form 1040A by January 31, 2014, and pay the rest of the tax you owe, you do not need to make the payment due on January 15, 2014.

Fiscal year taxpayers. If your tax year does not start on January 1, see the Form 1040-ES instructions for your payment due dates.

When To Start

You do not have to make estimated tax payments until you have income on which you will owe income tax. If you have income subject to estimated tax during the first payment period, you must make your first payment by the due date for the first payment period. You can pay all your estimated tax at that time, or you can pay it in installments. If you choose to pay in installments, make your first payment by the due date for the first payment period. Make your remaining installment payments by the due dates for the later periods.

No income subject to estimated tax during first period. If you do not have income subject to estimated tax until a later payment period, you must make your first payment by the due date for that period. You can pay your entire estimated tax by the due date for that period or you can pay it in installments by the due date for that period and the due dates for the remaining periods. The following chart shows when to make installment payments.

If you first have income on which you must pay estimated tax:	Make a payment by:*	Make later installments by:*
Before April 1	April 15	June 17 Sept. 16 Jan. 15 next year
April 1–May 31	June 17	Sept. 16 Jan. 15 next year
June 1–Aug. 31	Sept. 16	Jan. 15 next year
After Aug. 31	Jan. 15 next year	(None)

*See Saturday, Sunday, holiday rule and January payment.

How much to pay to avoid a penalty. To determine how much you should pay by each payment due date, see *How To Figure Each Payment*, next.

How To Figure Each Payment

You should pay enough estimated tax by the due date of each payment period to avoid a penalty for that period. You can figure your required payment for each period by using either the regular installment method or the annualized income installment method. These methods are described in chapter 2 of Publication 505. If you do not pay enough during each payment period, you may be charged a penalty even if you are due a refund when you file your tax return.

If the earlier discussion of No income subject to estimated tax during first period or the later discussion of Change in estimated tax applies to you, you may benefit from reading *Annualized Income Installment Method* in chapter 2 of Publication 505 for information on how to avoid a penalty.

Underpayment penalty. Under the regular installment method, if your estimated tax payment for any period is less than one-fourth of your estimated tax, you may be charged a penalty for underpayment of estimated tax for that period when you file your tax return. Under the annualized income installment method, your estimated tax payments vary with your income, but the amount required must be paid each period. See chapter 4 of Publication 505 for more information.

Change in estimated tax. After you make an estimated tax payment, changes in your income, adjustments, deductions, credits, or exemptions may make it necessary for you to refigure your estimated tax. Pay the unpaid balance of your amended estimated tax by the next payment due date after the change or in installments by that date and the due dates for the remaining payment periods.

Estimated Tax Payments Not Required

You do not have to pay estimated tax if your withholding in each payment period is at least as much as:

- One-fourth of your required annual payment, or
- Your required annualized income installment for that period.

You also do not have to pay estimated tax if you will pay enough through withholding to keep the amount you owe with your return under $1,000.

How To Pay Estimated Tax

There are several ways to pay estimated tax.

- Credit an overpayment on your 2012 return to your 2013 estimated tax.
- Pay by direct transfer from your bank account, or pay by credit or debit card using a pay-by-phone system or the Internet.
- Send in your payment (check or money order) with a payment voucher from Form 1040-ES.

Credit an Overpayment

If you show an overpayment of tax after completing your Form 1040 or Form 1040A for 2012, you can apply part or all of it to your estimated tax for 2013. On line 75 of Form 1040, or line 44 of Form 1040A, enter the amount you want credited to your estimated tax rather than refunded. Take the amount you have credited into account when figuring your estimated tax payments.

You cannot have any of the amount you credited to your estimated tax refunded to you until you file your tax return for the following year. You also cannot use that overpayment in any other way.

Pay Online

Paying online is convenient and secure and helps make sure we get your payments on time. You can pay using either of the following electronic payment methods.

- Direct transfer from your bank account.
- Credit or debit card.

To pay your taxes online or for more information, go to www.irs.gov/e-pay.

Pay by Phone

Paying by phone is another safe and secure method of paying electronically. Use one of the following methods.

- Direct transfer from your bank account.
- Credit or debit card.

To pay by direct transfer from your bank account, call 1-800-555-4477 (English), 1-800-244-4829 (Espanol). People who are deaf, hard of hearing, or have a speech disability and who have access to TTY/TDD can call 1-800-733-4829.

To pay using a credit or debit card, you can call one of the following service providers. There is a convenience fee charged by these providers that varies by provider, card type, and payment amount.

Official Payments Corporation
1-888-UPAY-TAX™ (1-888-872-9829)
www.officialpayments.com

Link2Gov Corporation
1-888-PAY-1040™ (1-888-729-1040)
www.PAY1040.com

WorldPay
1-888-9-PAY-TAX™(1-888-972-9829)
www.payUSAtax.com

For the latest details on how to pay by phone, go to www.irs.gov/e-pay.

Pay by Check or Money Order Using the Estimated Tax Payment Voucher

Each payment of estimated tax by check or money order must be accompanied by a payment voucher from Form 1040-ES. If you made estimated tax payments last year and did not use a paid preparer to file your return, you should receive a copy of the 2013 Form 1040-ES in the mail. It will contain payment vouchers preprinted with your name, address, and social security number. Using the preprinted vouchers will speed processing, reduce the chance of error, and help save processing costs.

Use the window envelopes that came with your Form 1040-ES package. If you use your own envelopes, make sure you mail your payment vouchers to the address shown in the Form 1040-ES instructions for the place where you live.

CAUTION *Do not use the address shown in the Form 1040 or Form 1040A instructions for your estimated tax payments.*

If you did not pay estimated tax last year, you can order Form 1040-ES from the IRS (see inside back cover of this publication) or download it from IRS.gov. Follow the instructions to make sure you use the vouchers correctly.

Joint estimated tax payments. If you file a joint return and are making joint estimated tax payments, enter the names and social security numbers on the payment voucher in the same order as they will appear on the joint return.

Change of address. You must notify the IRS if you are making estimated tax payments and you changed your address during the year. Send a clear and concise written statement to the Internal Revenue Service Center where you filed your last return and provide all of the following.

- Your full name (and spouse's full name).
- Your signature (and spouse's signature).
- Your old address (and spouse's old address if different).
- Your new address.
- Your social security number (and spouse's social security number).

You can use Form 8822, Change of Address, for this purpose.

Credit for Withholding and Estimated Tax for 2012

When you file your 2012 income tax return, take credit for all the income tax and excess social security or railroad retirement tax withheld from your salary, wages, pensions, etc. Also take credit for the estimated tax you paid for 2012. These credits are subtracted from your total tax. Because these credits are refundable, you should file a return and claim these credits, even if you do not owe tax.

Two or more employers. If you had two or more employers in 2012 and were paid wages of more than $110,100, too much social security or tier 1 railroad retirement tax may have been withheld from your pay. You may be able to claim the excess as a credit against your income tax when you file your return. See Credit for Excess Social Security Tax or Railroad Retirement Tax Withheld in chapter 36.

Withholding

If you had income tax withheld during 2012, you should be sent a statement by January 31, 2013, showing your income and the tax withheld. Depending on the source of your income, you should receive:

- Form W-2, Wage and Tax Statement,
- Form W-2G, Certain Gambling Winnings, or
- A form in the 1099 series.

Forms W-2 and W-2G. If you file a paper return, always file Form W-2 with your income tax return. File Form W-2G with your return only if it shows any federal income tax withheld from your winnings.

You should get at least two copies of each form you receive. If you file a paper return, attach one copy to the front of your federal income tax return. Keep one copy for your records. You also should receive copies to file with your state and local returns.

Form W-2

Your employer is required to provide or send Form W-2 to you no later than January 31, 2013. You should receive a separate Form W-2 from each employer you worked for.

If you stopped working before the end of 2012, your employer could have given you your Form W-2 at any time after you stopped working. However, your employer must provide or send it to you by January 31, 2013.

If you ask for the form, your employer must send it to you within 30 days after receiving your written request or within 30 days after your final wage payment, whichever is later.

If you have not received your Form W-2 by January 31, you should ask your employer for it. If you do not receive it by February 15, call the IRS.

Form W-2 shows your total pay and other compensation and the income tax, social security tax, and Medicare tax that was withheld during the year. Include the federal income tax withheld (as shown in box 2 of Form W-2) on:

- Line 62 if you file Form 1040,
- Line 36 if you file Form 1040A, or
- Line 7 if you file Form 1040EZ.

In addition, Form W-2 is used to report any taxable sick pay you received and any income tax withheld from your sick pay.

Form W-2G

If you had gambling winnings in 2012, the payer may have withheld income tax. If tax was withheld, the payer will give you a Form W-2G showing the amount you won and the amount of tax withheld.

Report the amounts you won on line 21 of Form 1040. Take credit for the tax withheld on line 62 of Form 1040. If you had gambling winnings, you must use Form 1040; you cannot use Form 1040A or Form 1040EZ.

The 1099 Series

Most forms in the 1099 series are not filed with your return. These forms should be furnished to you by January 31, 2013 (or, for Forms 1099-B, 1099-S, and certain Forms 1099-MISC, by February 15, 2013). Unless instructed to file any of these forms with your return, keep them for your records. There are several different forms in this series, including:

- Form 1099-B, Proceeds From Broker and Barter Exchange Transactions;
- Form 1099-DIV, Dividends and Distributions;
- Form 1099-G, Certain Government Payments;
- Form 1099-INT, Interest Income;
- Form 1099-K, Payment Card and Third Party Network Transactions;
- Form 1099-MISC, Miscellaneous Income;
- Form 1099-OID, Original Issue Discount;
- Form 1099-PATR, Taxable Distributions Received from Cooperatives;
- Form 1099-Q, Payments From Qualified Education Programs;
- Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.;
- Form 1099-S, Proceeds From Real Estate Transactions;
- Form RRB-1099, Payments by the Railroad Retirement Board.

If you received the types of income reported on some forms in the 1099 series, you may not be able to use Form 1040A or Form 1040EZ. See the instructions to these forms for details.

Form 1099-R. Attach Form 1099-R to your return if box 4 shows federal income tax withheld. Include the amount withheld in the total on line 62 of Form 1040 or line 36 of Form 1040A. You cannot use Form 1040EZ if you received payments reported on Form 1099-R.

Backup withholding. If you were subject to backup withholding on income you received during 2012, include the amount withheld, as shown on your Form 1099, in the total on line 62 of Form 1040, line 36 of Form 1040A, or line 7 of Form 1040EZ.

Form Not Correct

If you receive a form with incorrect information on it, you should ask the payer for a corrected form. Call the telephone number or write to the address given for the payer on the form. The corrected Form W-2G or Form 1099 you receive will have an "X" in the "CORRECTED" box at the top of the form. A special form, Form W-2c, Corrected Wage and Tax Statement, is used to correct a Form W-2.

In certain situations, you will receive two forms in place of the original incorrect form. This will happen when your taxpayer identification number is wrong or missing, your name and address are wrong, or you received the wrong type of form (for example, a Form 1099-DIV instead of a Form 1099-INT). One new form you receive will be the same incorrect form or have the same incorrect information, but all money amounts will be zero. This form will have an "X" in the "CORRECTED" box at the top of the form. The second new form should have all the correct information, prepared as though it is the original (the "CORRECTED" box will not be checked).

Form Received After Filing

If you file your return and you later receive a form for income that you did not include on your return, you should report the income and take credit for any income tax withheld by filing Form 1040X, Amended U.S. Individual Income Tax Return.

Separate Returns

If you are married but file a separate return, you can take credit only for the tax withheld from your own income. Do not include any amount withheld from your spouse's income. However, different rules may apply if you live in a community property state.

Community property states are listed in chapter 2. For more information on these rules, and some exceptions, see Publication 555, Community Property.

Fiscal Years

If you file your tax return on the basis of a fiscal year (a 12-month period ending on the last day of any month except December), you must follow special rules to determine your credit for federal income tax withholding. For a discussion of how to take credit for withholding on a fiscal year return, see *Fiscal Years (FY)* in chapter 3 of Publication 505.

Estimated Tax

Take credit for all your estimated tax payments for 2012 on line 63 of Form 1040 or line 37 of Form 1040A. Include any overpayment from 2011 that you had credited to your 2012 estimated tax. You must use Form 1040 or Form 1040A if you paid estimated tax. You cannot use Form 1040EZ.

Name changed. If you changed your name, and you made estimated tax payments using your old name, attach a brief statement to the front of your tax return indicating:

- When you made the payments,
- The amount of each payment,
- Your name when you made the payments, and
- Your social security number.

The statement should cover payments you made jointly with your spouse as well as any you made separately.

Be sure to report the change to the Social Security Administration. This prevents delays in processing your return and issuing the refunds.

Separate Returns

If you and your spouse made separate estimated tax payments for 2012 and you file separate returns, you can take credit only for your own payments.

If you made joint estimated tax payments, you must decide how to divide the payments between your returns. One of you can claim all of the estimated tax paid and the other none, or you can divide it in any other way you agree on. If you cannot agree, you must divide the payments in proportion to each spouse's individual tax as shown on your separate returns for 2012.

Divorced Taxpayers

If you made joint estimated tax payments for 2012, and you were divorced during the year, either you or your former spouse can claim all of the joint payments, or you each can claim part of them. If you cannot agree on how to divide the payments, you must divide them in proportion to each spouse's individual tax as shown on your separate returns for 2012.

If you claim any of the joint payments on your tax return, enter your former spouse's social security number (SSN) in the space provided on the front of Form 1040 or Form 1040A. If you divorced and remarried in 2012, enter your present spouse's SSN in that space and write your former spouse's SSN, followed by "DIV," to the left of Form 1040, line 63, or Form 1040A, line 37.

Underpayment Penalty for 2012

If you did not pay enough tax, either through withholding or by making timely estimated tax payments, you will have an underpayment of estimated tax and you may have to pay a penalty.

Generally, you will not have to pay a penalty for 2012 if any of the following apply.

- The total of your withholding and estimated tax payments was at least as much as your 2011 tax (or 110% of your 2011 tax if your AGI was more than $150,000, $75,000 if your 2012 filing status is married filing separately) and you paid all required estimated tax payments on time.
- The tax balance due on your 2012 return is no more than 10% of your total 2012 tax, and you paid all required estimated tax payments on time.
- Your total 2012 tax minus your withholding and refundable credits is less than $1,000.
- You did not have a tax liability for 2011 and your 2011 tax year was 12 months.
- You did not have any withholding taxes and your current year tax less any household employment taxes is less than $1,000.

See Publication 505, chapter 4, for a definition of "total tax" for 2011 and 2012.

Farmers and fishermen. Special rules apply if you are a farmer or fisherman. See *Farmers and Fishermen* in chapter 4 of Publication 505 for more information.

IRS can figure the penalty for you. If you think you owe the penalty but you do not want to figure it yourself when you file your tax return, you may not have to. Generally, the IRS will figure the penalty for you and send you a bill. However, if you think you are able to lower or eliminate your penalty, you must complete Form 2210 or Form 2210-F and attach it to your paper return. See chapter 4 of Publication 505.

Part Two.

Income

The eight chapters in this part discuss many kinds of income. They explain which income is and is not taxed. See Part Three for information on gains and losses you report on Form 8949 and Schedule D (Form 1040) and for information on selling your home.

5. Wages, Salaries, and Other Earnings

Reminder

Foreign income. If you are a U.S. citizen or resident alien, you must report income from sources outside the United States (foreign income) on your tax return unless it is exempt by U.S. law. This is true whether you reside inside or outside the United States and whether or not you receive a Form W-2, Wage and Tax Statement, or Form 1099 from the foreign payer. This applies to earned income (such as wages and tips) as well as unearned income (such as interest, dividends, capital gains, pensions, rents, and royalties).

If you reside outside the United States, you may be able to exclude part or all of your foreign source earned income. For details, see Publication 54, Tax Guide for U.S. Citizens and Resident Aliens Abroad.

Introduction

This chapter discusses compensation received for services as an employee, such as wages, salaries, and fringe benefits. The following topics are included.

- Bonuses and awards.
- Special rules for certain employees.
- Sickness and injury benefits.

The chapter explains what income is included in the employee's gross income and what is not included.

Useful Items

You may want to see:

Publication

- ❑ **463** Travel, Entertainment, Gift, and Car Expenses
- ❑ **525** Taxable and Nontaxable Income

Employee Compensation

This section discusses various types of employee compensation including fringe benefits, retirement plan contributions, stock options, and restricted property.

Form W-2. If you are an employee, you should receive Form W-2 from your employer showing the pay you received for your services. Include your pay on line 7 of Form 1040 or Form 1040A, or on line 1 of Form 1040EZ, even if you do not receive a Form W-2.

If you performed services, other than as an independent contractor, and your employer did not withhold social security and Medicare taxes from your pay, you must file Form 8919, Uncollected Social Security and Medicare Tax on Wages, with your Form 1040. These wages must be included on line 7 of Form 1040. See Form 8919 for more information.

Childcare providers. If you provide childcare, either in the child's home or in your home or other place of business, the pay you receive must be included in your income. If you are not an employee, you are probably self-employed and must include payments for your services on Schedule C (Form 1040), Profit or Loss From Business, or Schedule C-EZ (Form 1040), Net Profit From Business. You generally are not an employee unless you are subject to the will and control of the person who employs you as to what you are to do and how you are to do it.

Babysitting. If you babysit for relatives or neighborhood children, whether on a regular basis or only periodically, the rules for childcare providers apply to you.

Miscellaneous Compensation

This section discusses different types of employee compensation.

Advance commissions and other earnings. If you receive advance commissions or other amounts for services to be performed in the future and you are a cash-method taxpayer, you must include these amounts in your income in the year you receive them.

If you repay unearned commissions or other amounts in the same year you receive them, reduce the amount included in your income by the repayment. If you repay them in a later tax year, you can deduct the repayment as an itemized deduction on your Schedule A (Form 1040), or you may be able to take a credit for that year. See Repayments in chapter 12.

Allowances and reimbursements. If you receive travel, transportation, or other business expense allowances or reimbursements from your employer, see Publication 463. If you are reimbursed for moving expenses, see Publication 521, Moving Expenses.

Back pay awards. Include in income amounts you are awarded in a settlement or judgment for back pay. These include payments made to you for damages, unpaid life insurance premiums, and unpaid health insurance premiums. They should be reported to you by your employer on Form W-2.

Bonuses and awards. Bonuses or awards you receive for outstanding work are included in your income and should be shown on your Form W-2. These include prizes such as vacation trips for meeting sales goals. If the prize or award you receive is goods or services, you must include the fair market value of the goods or services in your income. However, if your employer merely promises to pay you a bonus or award at some future time, it is not taxable until you receive it or it is made available to you.

Employee achievement award. If you receive tangible personal property (other than cash, a gift certificate, or an equivalent item) as an award for length of service or safety achievement, you generally can exclude its value from your income. However, the amount you can exclude is limited to your employer's cost and cannot be more than $1,600 ($400 for awards that are not qualified plan awards) for all such awards you receive during the year. Your employer can tell you whether your award is a qualified plan award. Your employer must make the award as part of a meaningful presentation, under conditions and circumstances that do not create a significant likelihood of it being disguised pay.

However, the exclusion does not apply to the following awards.

- A length-of-service award if you received it for less than 5 years of service or if you received another length-of-service award during the year or the previous 4 years.
- A safety achievement award if you are a manager, administrator, clerical employee, or other professional employee or if more than 10% of eligible employees previously received safety achievement awards during the year.

Example. Ben Green received three employee achievement awards during the year: a nonqualified plan award of a watch valued at $250, and two qualified plan awards of a stereo valued at $1,000 and a set of golf clubs valued at $500. Assuming that the requirements for qualified plan awards are otherwise satisfied, each award by itself would be excluded from income. However, because the $1,750 total value of the awards is more than $1,600, Ben must include $150 ($1,750 – $1,600) in his income.

Differential wage payments. This is any payment made to you by an employer for any period during which you are, for a period of more than 30 days, an active duty member of the uniformed services and represents all or a portion of the wages you would have received from the employer during that period. These payments are treated as wages and are subject to income tax withholding, but not FICA or FUTA taxes. The payments are reported as wages on Form W-2.

Government cost-of-living allowances. Cost-of-living allowances generally are included in your income if you were a federal civilian employee or a federal court employee.

Allowances and differentials that increase your basic pay as an incentive for taking a less desirable post of duty are part of your compensation and must be included in income. For example, your compensation includes Foreign Post, Foreign Service, and Overseas Tropical differentials. For more information on taxable and tax-free payments, see Publication 516, U.S. Government Civilian Employees Stationed Abroad.

Nonqualified deferred compensation plans. Your employer will report to you the total amount of deferrals for the year under a nonqualified deferred compensation plan. This amount is shown on Form W-2, box 12, using code Y. This amount is not included in your income.

However, if at any time during the tax year, the plan fails to meet certain requirements, or is not operated under those requirements, all amounts deferred under the plan for the tax year and all preceding tax years are included in your income for the current year. This amount is included in your wages shown on Form W-2, box 1. It is also shown on Form W-2, box 12, using code Z.

Note received for services. If your employer gives you a secured note as payment for your services, you must include the fair market value (usually the discount value) of the note in your income for the year you receive it. When you later receive payments on the note, a proportionate part of each payment is the recovery of the fair market value that you previously included in your income. Do not include that part again in your income. Include the rest of the payment in your income in the year of payment.

If your employer gives you a nonnegotiable unsecured note as payment for your services, payments on the note that are credited toward the principal amount of the note are compensation income when you receive them.

Severance pay. You must include in income amounts you receive as severance pay and any payment for the cancellation of your employment contract.

Accrued leave payment. If you are a federal employee and receive a lump-sum payment for accrued annual leave when you retire or resign, this amount will be included as wages on your Form W-2.

If you resign from one agency and are reemployed by another agency, you may have to repay part of your lump-sum annual leave payment to the second agency. You can reduce gross wages by the amount you repaid in the same tax year in which you received it. Attach to your tax return a copy of the receipt or statement given to you by the agency you repaid to explain the difference between the wages on the return and the wages on your Forms W-2.

Outplacement services. If you choose to accept a reduced amount of severance pay so that you can receive outplacement services (such as training in résumé writing and interview techniques), you must include the unreduced amount of the severance pay in income.

However, you can deduct the value of these outplacement services (up to the difference between the severance pay included in income and the amount actually received) as a miscellaneous deduction (subject to the 2%-of-adjusted-gross-income (AGI) limit) on Schedule A (Form 1040).

Sick pay. Pay you receive from your employer while you are sick or injured is part of your salary or wages. In addition, you must include in your income sick pay benefits received from any of the following payers.

- A welfare fund.
- A state sickness or disability fund.
- An association of employers or employees.
- An insurance company, if your employer paid for the plan.

However, if you paid the premiums on an accident or health insurance policy, the benefits you receive under the policy are not taxable. For more information, see Publication 525.

Social security and Medicare taxes paid by employer. If you and your employer have an agreement that your employer pays your social security and Medicare taxes without deducting them from your gross wages, you must report the amount of tax paid for you as taxable wages on your tax return. The payment also is treated as wages for figuring your social security and Medicare taxes and your social security and Medicare benefits. However, these payments are not treated as social security and Medicare wages if you are a household worker or a farm worker.

Stock appreciation rights. Do not include a stock appreciation right granted by your employer in income until you exercise (use) the right. When you use the right, you are entitled to a cash payment equal to the fair market value of the corporation's stock on the date of use minus the fair market value on the date the right was granted. You include the cash payment in your income in the year you use the right.

Fringe Benefits

Fringe benefits received in connection with the performance of your services are included in your income as compensation unless you pay fair market value for them or they are specifically excluded by law. Abstaining from the performance of services (for example, under a covenant not to compete) is treated as the performance of services for purposes of these rules.

Accounting period. You must use the same accounting period your employer uses to report your taxable noncash fringe benefits. Your employer has the option to report taxable noncash fringe benefits by using either of the following rules.

- The general rule: benefits are reported for a full calendar year (January 1–December 31).
- The special accounting period rule: benefits provided during the last 2 months of the calendar year (or any shorter period) are treated as paid during the following calendar year. For example, each year your employer reports the value of benefits provided during the last 2 months of the prior year and the first 10 months of the current year.

Your employer does not have to use the same accounting period for each fringe benefit, but must use the same period for all employees who receive a particular benefit.

You must use the same accounting period that you use to report the benefit to claim an employee business deduction (for use of a car, for example).

Form W-2. Your employer reports your taxable fringe benefits in box 1 (Wages, tips, other compensation) of Form W-2. The total value of your fringe benefits also may be noted in box 14. The value of your fringe benefits may be added to your other compensation on one Form W-2, or you may receive a separate Form W-2 showing just the value of your fringe benefits in box 1 with a notation in box 14.

Accident or Health Plan

In most cases, the value of accident or health plan coverage provided to you by your employer is not included in your income. Benefits you receive from the plan may be taxable, as explained later under *Sickness and Injury Benefits*.

For information on the items covered in this section, other than *Long-term care coverage,* see Publication 969, Health Savings Accounts and Other Tax-Favored Health Plans.

Long-term care coverage. Contributions by your employer to provide coverage for long-term care services generally are not included in your income. However, contributions made through a flexible spending or similar arrangement (such as a cafeteria plan) must be included in your income. This amount will be reported as wages in box 1 of your Form W-2.

Contributions you make to the plan are discussed in Publication 502, Medical and Dental Expenses.

Archer MSA contributions. Contributions by your employer to your Archer MSA generally are not included in your income. Their total will be reported in box 12 of Form W-2 with code R. You must report this amount on Form 8853, Archer MSAs and Long-Term Care Insurance Contracts. File the form with your return.

Health flexible spending arrangement (health FSA). If your employer provides a health FSA that qualifies as an accident or health plan, the amount of your salary reduction, and reimbursements of your medical care expenses, in most cases, are not included in your income.

Health reimbursement arrangement (HRA). If your employer provides an HRA that qualifies as an accident or health plan, coverage and reimbursements of your medical care expenses generally are not included in your income.

Health savings accounts (HSA). If you are an eligible individual, you and any other person, including your employer or a family member, can make contributions to your HSA. Contributions, other than employer contributions, are deductible on your return whether or not you itemize deductions. Contributions made by your employer are not included in your income. Distributions from your HSA that are used to pay qualified medical expenses are not included in your income. Distributions not used for qualified medical expenses are included in your income. See Publication 969 for the requirements of an HSA.

Contributions by a partnership to a *bona fide* partner's HSA are not contributions by an employer. The contributions are treated as a distribution of money and are not included in the partner's gross income. Contributions by a partnership to a partner's HSA for services rendered are treated as guaranteed payments that are includible in the partner's gross income. In both situations, the partner can deduct the contribution made to the partner's HSA.

Contributions by an S corporation to a 2% shareholder-employee's HSA for services rendered are treated as guaranteed payments and are includible in the shareholder-employee's gross income. The shareholder-employee can deduct the contribution made to the shareholder-employee's HSA.

Qualified HSA funding distribution. You can make a one-time distribution from your individual retirement account (IRA) to an HSA and you generally will not include any of the distribution in your income. See Publication 590 for the requirements for these qualified HSA funding distributions.

Failure to maintain eligibility. If your HSA received qualified HSA distributions from a health FSA or HRA (discussed earlier) or a qualified HSA funding distribution, you must be an eligible individual for HSA purposes for the period beginning with the month in which the qualified distribution was made and ending on the last day of the 12th month following that month. If you fail to be an eligible individual during this period, other than because of death or disability, you must include the distribution in your income for the tax year in which you become ineligible. This income is also subject to an additional 10% tax.

Adoption Assistance

You may be able to exclude from your income amounts paid or expenses incurred by your employer for qualified adoption expenses in connection with your adoption of an eligible child. See the Instructions for Form 8839 for more information.

Adoption benefits are reported by your employer in box 12 of Form W-2 with code T. They also are included as social security and Medicare wages in boxes 3 and 5. However, they are not included as wages in box 1. To determine the taxable and nontaxable amounts, you must complete Part III of Form 8839, Qualified Adoption Expenses. File the form with your return.

De Minimis (Minimal) Benefits

If your employer provides you with a product or service and the cost of it is so small that it would be unreasonable for the employer to account for it, the value is not included in your income. In most cases, the value of benefits such as discounts at company cafeterias, cab fares home when working overtime, and company picnics are not included in your income.

Holiday gifts. If your employer gives you a turkey, ham, or other item of nominal value at Christmas or other holidays, do not include the value of the gift in your income. However, if your employer gives you cash, a gift certificate, or a similar item that you can easily exchange for cash, you include the value of that gift as extra salary or wages regardless of the amount involved.

Educational Assistance

You can exclude from your income up to $5,250 of qualified employer-provided educational assistance. For more information, see Publication 970, Tax Benefits for Education.

Group-Term Life Insurance

In most cases, the cost of up to $50,000 of group-term life insurance coverage provided to you by your employer (or former employer) is not included in your income. However, you must include in income the cost of employer-provided insurance that is more than the cost of $50,000 of coverage reduced by any amount you pay toward the purchase of the insurance.

For exceptions, see Entire cost excluded, and Entire cost taxed, later.

If your employer provided more than $50,000 of coverage, the amount included in your income is reported as part of your wages in box 1 of your Form W-2. Also, it is shown separately in box 12 with code C.

Group-term life insurance. This insurance is term life insurance protection (insurance for a fixed period of time) that:

- Provides a general death benefit,
- Is provided to a group of employees,
- Is provided under a policy carried by the employer, and
- Provides an amount of insurance to each employee based on a formula that prevents individual selection.

Permanent benefits. If your group-term life insurance policy includes permanent benefits, such as a paid-up or cash surrender value, you must include in your income, as wages, the cost of the permanent benefits minus the amount you pay for them. Your employer should be able to tell you the amount to include in your income.

Accidental death benefits. Insurance that provides accidental or other death benefits but does not provide general death benefits (travel insurance, for example) is not group-term life insurance.

Former employer. If your former employer provided more than $50,000 of group-term life insurance coverage during the year, the amount included in your income is reported as wages in box 1 of Form W-2. Also, it is shown separately in box 12 with code C. Box 12 also will show the amount of uncollected social security and Medicare taxes on the excess coverage, with codes M and N. You must pay these taxes with your income tax return. Include them on line 60, Form 1040, and enter "UT" and the amount of the taxes on the dotted line next to line 60. For more information, see the Instructions for Form 1040.

Two or more employers. Your exclusion for employer-provided group-term life insurance coverage cannot exceed the cost of $50,000 of coverage, whether the insurance is provided by a single employer or multiple employers. If two or more employers provide insurance coverage that totals more than $50,000, the amounts reported as wages on your Forms W-2 will not be correct. You must figure how much to include in your income. Reduce the amount you figure by any amount reported with code C in box 12 of your Forms W-2, add the result to the wages reported in box 1, and report the total on your return.

Figuring the taxable cost. Use the following worksheet to figure the amount to include in your income.

Worksheet 5-1. **Figuring the Cost of Group-Term Life Insurance To Include in Income**
Keep for Your Records

1. Enter the total amount of your insurance coverage from your employer(s)	**1.**	
2. Limit on exclusion for employer-provided group-term life insurance coverage	**2.**	50,000
3. Subtract line 2 from line 1	**3.**	
4. Divide line 3 by $1,000. Figure to the nearest tenth	**4.**	
5. Go to Table 5-1. Using your age on the last day of the tax year, find your age group in the left column, and enter the cost from the column on the right for your age group	**5.**	
6. Multiply line 4 by line 5	**6.**	
7. Enter the number of full months of coverage at this cost.	**7.**	
8. Multiply line 6 by line 7	**8.**	
9. Enter the premiums you paid per month	**9.**	
10. Enter the number of months you paid the premiums	**10.**	
11. Multiply line 9 by line 10.	**11.**	
12. Subtract line 11 from line 8. **Include this amount in your income as wages**	**12.**	

Table 5-1. **Cost of $1,000 of Group-Term Life Insurance for One Month**

Age	Cost
Under 25	$ .05
25 through 29	.06
30 through 34	.08
35 through 39	.09
40 through 44	.10
45 through 49	.15
50 through 54	.23
55 through 59	.43
60 through 64	.66
65 through 69	1.27
70 and older	2.06

Example. You are 51 years old and work for employers A and B. Both employers provide group-term life insurance coverage for you for the entire year. Your coverage is $35,000 with employer A and $45,000 with employer B. You pay premiums of $4.15 a month under the employer B group plan. You figure the amount to include in your income as shown in Worksheet 5-1. Figuring the Cost of Group-Term Life Insurance to Include in Income—Illustrated, later.

Worksheet 5-1. **Figuring the Cost of Group-Term Life Insurance to Include in Income—Illustrated**
Keep for Your Records

1. Enter the total amount of your insurance coverage from your employer(s)	**1.**	80,000
2. Limit on exclusion for employer-provided group-term life insurance coverage	**2.**	50,000
3. Subtract line 2 from line 1	**3.**	30,000
4. Divide line 3 by $1,000. Figure to the nearest tenth	**4.**	30.0
5. Go to Table 5-1. Using your age on the last day of the tax year, find your age group in the left column, and enter the cost from the column on the right for your age group	**5.**	.23
6. Multiply line 4 by line 5	**6.**	6.90
7. Enter the number of full months of coverage at this cost.	**7.**	12
8. Multiply line 6 by line 7	**8.**	82.80
9. Enter the premiums you paid per month	**9.**	4.15
10. Enter the number of months you paid the premiums	**10.**	12
11. Multiply line 9 by line 10.	**11.**	49.80
12. Subtract line 11 from line 8. **Include this amount in your income as wages**	**12.**	33.00

Entire cost excluded. You are not taxed on the cost of group-term life insurance if any of the following circumstances apply.

1. You are permanently and totally disabled and have ended your employment.
2. Your employer is the beneficiary of the policy for the entire period the insurance is in force during the tax year.
3. A charitable organization (defined in chapter 24) to which contributions are deductible is the only beneficiary of the policy for the entire period the insurance is in force during the tax year. (You are not entitled to a deduction for a charitable contribution for naming a charitable organization as the beneficiary of your policy.)
4. The plan existed on January 1, 1984, and
   a. You retired before January 2, 1984, and were covered by the plan when you retired, or
   b. You reached age 55 before January 2, 1984, and were employed by the employer or its predecessor in 1983.

Entire cost taxed. You are taxed on the entire cost of group-term life insurance if either of the following circumstances apply.

- The insurance is provided by your employer through a qualified employees' trust, such as a pension trust or a qualified annuity plan.
- You are a key employee and your employer's plan discriminates in favor of key employees.

Retirement Planning Services

If your employer has a qualified retirement plan, qualified retirement planning services provided to you (and your spouse) by your employer are not included in your income. Qualified services include retirement planning advice, information about your employer's retirement plan, and information about how the plan may fit into your overall individual retirement income plan. You cannot exclude the value of any tax preparation, accounting, legal, or brokerage services provided by your employer.

Transportation

If your employer provides you with a qualified transportation fringe benefit, it can be excluded from your income, up to certain limits. A qualified transportation fringe benefit is:

- Transportation in a commuter highway vehicle (such as a van) between your home and work place,
- A transit pass,
- Qualified parking, or
- Qualified bicycle commuting reimbursement.

Cash reimbursement by your employer for these expenses under a *bona fide* reimbursement arrangement also is excludable. However, cash reimbursement for a transit pass is excludable only if a voucher or similar item that can be exchanged only for a transit pass is not readily available for direct distribution to you.

Exclusion limit. The exclusion for commuter vehicle transportation and transit pass fringe benefits cannot be more than $125 a month.

The exclusion for the qualified parking fringe benefit cannot be more than $240 a month.

The exclusion for qualified bicycle commuting in a calendar year is $20 multiplied by the number of qualified bicycle commuting months that year.

If the benefits have a value that is more than these limits, the excess must be included in your income. You are not entitled to these exclusions if the reimbursements are made under a compensation reduction agreement.

Commuter highway vehicle. This is a highway vehicle that seats at least six adults (not including the driver). At least 80% of the vehicle's mileage must reasonably be expected to be:

- For transporting employees between their homes and work place, and
- On trips during which employees occupy at least half of the vehicle's adult seating capacity (not including the driver).

Transit pass. This is any pass, token, farecard, voucher, or similar item entitling a person to ride mass transit (whether public or private) free or at a reduced rate or to ride in a commuter highway vehicle operated by a person in the business of transporting persons for compensation.

Qualified parking. This is parking provided to an employee at or near the employer's place of business. It also includes parking provided on or near a location from which the employee commutes to work by mass transit, in a commuter highway vehicle, or by carpool. It does not include parking at or near the employee's home.

Qualified bicycle commuting. This is reimbursement based on the number of qualified bicycle commuting months for the year. A qualified bicycle commuting month is any month you use the bicycle regularly for a substantial portion of the travel between your home and place of employment and you do not receive any of the other qualified transportation fringe benefits. The reimbursement can be for expenses you incurred during the year for the purchase of a bicycle and bicycle improvements, repair, and storage.

Retirement Plan Contributions

Your employer's contributions to a qualified retirement plan for you are not included in income at the time contributed. (Your employer can tell you whether your retirement plan is qualified.) However, the cost of life insurance coverage included in the plan may have to be included. See *Group-Term Life Insurance*, earlier, under *Fringe Benefits*.

If your employer pays into a nonqualified plan for you, you generally must include the contributions in your income as wages for the tax year in which the contributions are made. However, if your interest in the plan is not transferable or is subject to a substantial risk of forfeiture (you have a good chance of losing it) at the time of the contribution, you do not have to include the value of your interest in your income until it is transferable or is no longer subject to a substantial risk of forfeiture.

TIP *For information on distributions from retirement plans, see Publication 575, Pension and Annuity Income (or Publication 721, Tax Guide to U.S. Civil Service Retirement Benefits, if you are a federal employee or retiree).*

Elective deferrals. If you are covered by certain kinds of retirement plans, you can choose to have part of your compensation contributed by your employer to a retirement fund, rather than have it paid to you. The amount you set aside (called an elective deferral) is treated as an employer contribution to a qualified plan. An elective deferral, other than a designated Roth contribution (discussed later), is not included in wages subject to income tax at the time contributed. However, it is included in wages subject to social security and Medicare taxes.

Elective deferrals include elective contributions to the following retirement plans.

1. Cash or deferred arrangements (section 401(k) plans).
2. The Thrift Savings Plan for federal employees.
3. Salary reduction simplified employee pension plans (SARSEP).
4. Savings incentive match plans for employees (SIMPLE plans).
5. Tax-sheltered annuity plans (403(b) plans).
6. Section 501(c)(18)(D) plans.
7. Section 457 plans.

Qualified automatic contribution arrangements. Under a qualified automatic contribution arrangement, your employer can treat you as having elected to have a part of your compensation contributed to a section 401(k) plan. You are to receive written notice of your rights and obligations under the qualified automatic contribution arrangement. The notice must explain:

- Your rights to elect not to have elective contributions made, or to have contributions made at a different percentage, and
- How contributions made will be invested in the absence of any investment decision by you.

You must be given a reasonable period of time after receipt of the notice and before the first elective contribution is made to make an election with respect to the contributions.

Overall limit on deferrals. For 2012, in most cases, you should not have deferred more than a total of $17,000 of contributions to the plans listed in (1) through (3) and (5) above. The limit for SIMPLE plans is $11,500. The limit for section 501(c)(18)(D) plans is the lesser of $7,000 or 25% of your compensation. The limit for section 457 plans is the lesser of your includible compensation or $17,000. Amounts deferred under specific plan limits are part of the overall limit on deferrals.

Designated Roth contributions. Employers with section 401(k) and section 403(b) plans can create qualified Roth contribution programs so that you may elect to have part or all of your elective deferrals to the plan designated as after-tax Roth contributions. Designated Roth contributions are treated as elective deferrals, except that they are included in income.

Excess deferrals. Your employer or plan administrator should apply the proper annual limit when figuring your plan contributions. However, you are responsible for monitoring the total you defer to ensure that the deferrals are not more than the overall limit.

If you set aside more than the limit, the excess generally must be included in your income for that year, unless you have an excess deferral of a designated Roth contribution. See Publication 525 for a discussion of the tax treatment of excess deferrals.

Catch-up contributions. You may be allowed catch-up contributions (additional elective deferral) if you are age 50 or older by the end of your tax year.

Stock Options

If you receive a nonstatutory option to buy or sell stock or other property as payment for your services, you usually will have income when you receive the option, when you exercise the option (use it to buy or sell the stock or other property), or when you sell or otherwise dispose of the option. However, if your option is a statutory stock option, you will not have any income until you sell or exchange your stock. Your employer can tell you which kind of option you hold. For more information, see Publication 525.

Restricted Property

In most cases, if you receive property for your services, you must include its fair market value in your income in the year you receive the property. However, if you receive stock or other property that has certain restrictions that affect its value, you do not include the value of the property in your income until it has substantially vested. (You can choose to include the value of the property in your income in the year it is transferred to you.) For more information, see *Restricted Property* in Publication 525.

Dividends received on restricted stock. Dividends you receive on restricted stock are treated as compensation and not as dividend income. Your employer should include these payments on your Form W-2.

Stock you chose to include in income. Dividends you receive on restricted stock you chose to include in your income in the year transferred are treated the same as any other dividends. Report them on your return as dividends. For a discussion of dividends, see chapter 8.

For information on how to treat dividends reported on both your Form W-2 and Form 1099-DIV, see *Dividends received on restricted stock* in Publication 525.

Special Rules for Certain Employees

This section deals with special rules for people in certain types of employment: members of the clergy, members of religious orders, people working for foreign employers, military personnel, and volunteers.

Clergy

If you are a member of the clergy, you must include in your income offerings and fees you receive for marriages, baptisms, funerals, masses, etc., in addition to your salary. If the offering is made to the religious institution, it is not taxable to you.

If you are a member of a religious organization and you give your outside earnings to the religious organization, you still must include the earnings in your income. However, you may be entitled to a charitable contribution deduction for the amount paid to the organization. See chapter 24.

Pension. A pension or retirement pay for a member of the clergy usually is treated as any other pension or annuity. It must be reported on lines 16a and 16b of Form 1040 or on lines 12a and 12b of Form 1040A.

Housing. Special rules for housing apply to members of the clergy. Under these rules, you do not include in your income the rental value of a home (including utilities) or a designated housing allowance provided to you as part of your pay. However, the exclusion cannot be more than the reasonable pay for your service. If you pay for the utilities, you can exclude any allowance designated for utility cost, up to your actual cost. The home or allowance must be provided as compensation for your services as an ordained, licensed, or commissioned minister. However, you must include the rental value of the home or the housing allowance as earnings from self-employment on Schedule SE (Form 1040) if you are subject to the self-employment tax. For more information, see Publication 517, Social Security and Other Information for Members of the Clergy and Religious Workers.

Members of Religious Orders

If you are a member of a religious order who has taken a vow of poverty, how you treat earnings that you renounce and turn over to the order depends on whether your services are performed for the order.

Services performed for the order. If you are performing the services as an agent of the order in the exercise of duties required by the order, do not include in your income the amounts turned over to the order.

If your order directs you to perform services for another agency of the supervising church or an associated institution, you are considered to be performing the services as an agent of the order. Any wages you earn as an agent of an order that you turn over to the order are not included in your income.

Example. You are a member of a church order and have taken a vow of poverty. You renounce any claims to your earnings and turn over to the order any salaries or wages you earn. You are a registered nurse, so your order assigns you to work in a hospital that is an associated institution of the church. However, you remain under the general direction and control of the order. You are considered to be an agent of the order and any wages you earn at the hospital that you turn over to your order are not included in your income.

Services performed outside the order. If you are directed to work outside the order, your services are not an exercise of duties required by the order unless they meet both of the following requirements.

- They are the kind of services that are ordinarily the duties of members of the order.
- They are part of the duties that you must exercise for, or on behalf of, the religious order as its agent.

If you are an employee of a third party, the services you perform for the third party will not be considered directed or required of you by the order. Amounts you receive for these services are included in your income, even if you have taken a vow of poverty.

Example. Mark Brown is a member of a religious order and has taken a vow of poverty. He renounces all claims to his earnings and turns over his earnings to the order.

Mark is a schoolteacher. He was instructed by the superiors of the order to get a job with a private tax-exempt school. Mark became an employee of the school, and, at his request, the school made the salary payments directly to the order.

Because Mark is an employee of the school, he is performing services for the school rather than as an agent of the order. The wages Mark earns working for the school are included in his income.

Foreign Employer

Special rules apply if you work for a foreign employer.

U.S. citizen. If you are a U.S. citizen who works in the United States for a foreign government, an international organization, a foreign embassy, or any foreign employer, you must include your salary in your income.

Social security and Medicare taxes. You are exempt from social security and Medicare employee taxes if you are employed in the United States by an international organization or a foreign government. However, you must pay self-employment tax on your earnings from services performed in the United States, even though you are not self-employed. This rule also applies if you are an employee of a qualifying wholly owned instrumentality of a foreign government.

Employees of international organizations or foreign governments. Your compensation for official services to an international organization is exempt from federal income tax if you are not a citizen of the United States or you are a citizen of the Philippines (whether or not you are a citizen of the United States).

Your compensation for official services to a foreign government is exempt from federal income tax if all of the following are true.

- You are not a citizen of the United States or you are a citizen of the Philippines (whether or not you are a citizen of the United States).
- Your work is like the work done by employees of the United States in foreign countries.
- The foreign government gives an equal exemption to employees of the United States in its country.

Waiver of alien status. If you are an alien who works for a foreign government or international organization and you file a waiver under section 247(b) of the Immigration and Nationality Act to keep your immigrant status, different rules may apply. See *Foreign Employer* in Publication 525.

Employment abroad. For information on the tax treatment of income earned abroad, see Publication 54.

Military

Payments you receive as a member of a military service generally are taxed as wages except for retirement pay, which is taxed as a pension. Allowances generally are not taxed. For more information on the tax treatment of military allowances and benefits, see Publication 3, Armed Forces' Tax Guide.

Differential wage payments. Any payments made to you by an employer during the time you are performing service in the uniformed services are treated as compensation. These wages are subject to income tax withholding and are reported on a Form W-2. See the discussion under *Miscellaneous Compensation*, earlier.

Military retirement pay. If your retirement pay is based on age or length of service, it is taxable and must be included in your income as a pension on lines 16a and 16b of Form 1040 or on lines 12a and 12b of Form 1040A. Do not include in your income the amount of any reduction in retirement or retainer pay to provide a survivor annuity for your spouse or children under the Retired Serviceman's Family Protection Plan or the Survivor Benefit Plan.

For more detailed discussion of survivor annuities, see chapter 10.

Disability. If you are retired on disability, see *Military and Government Disability Pensions* under *Sickness and Injury Benefits*, later.

Veterans' benefits. Do not include in your income any veterans' benefits paid under any law, regulation, or administrative practice administered by the Department of Veterans Affairs (VA). The following amounts paid to veterans or their families are not taxable.

- Education, training, and subsistence allowances.
- Disability compensation and pension payments for disabilities paid either to veterans or their families.
- Grants for homes designed for wheelchair living.
- Grants for motor vehicles for veterans who lost their sight or the use of their limbs.
- Veterans' insurance proceeds and dividends paid either to veterans or their beneficiaries, including the proceeds of a veteran's endowment policy paid before death.
- Interest on insurance dividends you leave on deposit with the VA.
- Benefits under a dependent-care assistance program.
- The death gratuity paid to a survivor of a member of the Armed Forces who died after September 10, 2001.
- Payments made under the compensated work therapy program.
- Any bonus payment by a state or political subdivision because of service in a combat zone.

Volunteers

The tax treatment of amounts you receive as a volunteer worker for the Peace Corps or similar agency is covered in the following discussions.

Peace Corps. Living allowances you receive as a Peace Corps volunteer or volunteer leader for housing, utilities, household supplies, food, and clothing are exempt from tax.

Taxable allowances. The following allowances must be included in your income and reported as wages.

- Allowances paid to your spouse and minor children while you are a volunteer leader training in the United States.
- Living allowances designated by the Director of the Peace Corps as basic compensation. These are allowances for personal items such as domestic help, laundry and clothing maintenance, entertainment and recreation, transportation, and other miscellaneous expenses.
- Leave allowances.
- Readjustment allowances or termination payments. These are considered received by you when credited to your account.

Example. Gary Carpenter, a Peace Corps volunteer, gets $175 a month as a readjustment allowance during his period of service, to be paid to him in a lump sum at the end of his tour of duty. Although the allowance is not available to him until the end of his service, Gary must include it in his income on a monthly basis as it is credited to his account.

Volunteers in Service to America (VISTA). If you are a VISTA volunteer, you must include meal and lodging allowances paid to you in your income as wages.

National Senior Services Corps programs. Do not include in your income amounts you receive for supportive services or reimbursements for out-of-pocket expenses from the following programs.

- Retired Senior Volunteer Program (RSVP).
- Foster Grandparent Program.
- Senior Companion Program.

Service Corps of Retired Executives (SCORE). If you receive amounts for supportive services or reimbursements for out-of-pocket expenses from SCORE, do not include these amounts in income.

Volunteer tax counseling. Do not include in your income any reimbursements you receive for transportation, meals, and other expenses you have in training for, or actually providing, volunteer federal income tax counseling for the elderly (TCE).

You can deduct as a charitable contribution your unreimbursed out-of-pocket expenses in taking part in the volunteer income tax assistance (VITA) program. See chapter 24.

Sickness and Injury Benefits

This section discusses sickness and injury benefits including disability pensions, long-term care insurance contracts, workers' compensation, and other benefits.

In most cases, you must report as income any amount you receive for personal injury or sickness through an accident or health plan that is paid for by your employer. If both you and your employer pay for the plan, only the amount you receive that is due to your employer's payments is reported as income. However, certain payments may not be taxable to you. Your employer should be able to give you specific details about your pension plan and tell you the amount you paid for your disability pension. In addition to disability pensions and annuities, you may be receiving other payments for sickness and injury.

TIP *Do not report as income any amounts paid to reimburse you for medical expenses you incurred after the plan was established.*

Cost paid by you. If you pay the entire cost of a health or accident insurance plan, do not include any amounts you receive from the plan for personal injury or sickness as income on your tax return. If your plan reimbursed you for medical expenses you deducted in an earlier year, you may have to include some, or all, of the reimbursement in your income. See *Reimbursement in a later year* in chapter 21.

Cafeteria plans. In most cases, if you are covered by an accident or health insurance plan through a cafeteria plan, and the amount of the insurance premiums was not included in your income, you are not considered to have paid the premiums and you must include any benefits you receive in your income. If the amount of the premiums was included in your income, you are considered to have paid the premiums, and any benefits you receive are not taxable.

Disability Pensions

If you retired on disability, you must include in income any disability pension you receive under a plan that is paid for by your employer. You must report your taxable disability payments as wages on line 7 of Form 1040 or Form 1040A, until you reach minimum retirement age. Minimum retirement age generally is the age at which you can first receive a pension or annuity if you are not disabled.

TIP *You may be entitled to a tax credit if you were permanently and totally disabled when you retired. For information on this credit and the definition of permanent and total disability, see* *chapter 32*.

Beginning on the day after you reach minimum retirement age, payments you receive are taxable as a pension or annuity. Report the payments on lines 16a and 16b of Form 1040 or on lines 12a and 12b of Form 1040A. The rules for reporting pensions are explained in *How To Report* in chapter 10.

For information on disability payments from a governmental program provided as a substitute for unemployment compensation, see chapter 12.

Retirement and profit-sharing plans. If you receive payments from a retirement or profit-sharing plan that does not provide for disability retirement, do not treat the payments as a disability pension. The payments must be reported as a pension or annuity. For more information on pensions, see chapter 10.

Accrued leave payment. If you retire on disability, any lump-sum payment you receive for accrued annual leave is a salary payment. The payment is not a disability payment. Include it in your income in the tax year you receive it.

Military and Government Disability Pensions

Certain military and government disability pensions are not taxable.

Service-connected disability. You may be able to exclude from income amounts you receive as a pension, annuity, or similar allowance for personal injury or sickness resulting from active service in one of the following government services.

- The armed forces of any country.
- The National Oceanic and Atmospheric Administration.
- The Public Health Service.
- The Foreign Service.

Conditions for exclusion. Do not include the disability payments in your income if any of the following conditions apply.

1. You were entitled to receive a disability payment before September 25, 1975.
2. You were a member of a listed government service or its reserve component, or were under a binding written commitment to become a member, on September 24, 1975.
3. You receive the disability payments for a combat-related injury. This is a personal injury or sickness that
   a. Results directly from armed conflict,
   b. Takes place while you are engaged in extra-hazardous service,
   c. Takes place under conditions simulating war, including training exercises such as maneuvers, or
   d. Is caused by an instrumentality of war.
4. You would be entitled to receive disability compensation from the Department of Veterans Affairs (VA) if you filed an application for it. Your exclusion under this condition is equal to the amount you would be entitled to receive from the VA.

Pension based on years of service. If you receive a disability pension based on years of service, in most cases you must include it in your income. However, if the pension qualifies for the exclusion for a service-connected disability (discussed earlier), do not include in income the part of your pension that you would have received if the pension had been based on a percentage of disability. You must include the rest of your pension in your income.

Retroactive VA determination. If you retire from the armed services based on years of service and are later given a retroactive service-connected disability rating by the VA, your retirement pay for the retroactive period is excluded from income up to the amount of VA disability benefits you would have been entitled to receive. You can claim a refund of any tax paid on the excludable amount (subject to the statute of limitations) by filing an amended return on Form 1040X for each previous year during the retroactive period. You must include with each Form 1040X a copy of the official VA Determination letter granting the retroactive benefit. The letter must show the amount withheld and the effective date of the benefit.

If you receive a lump-sum disability severance payment and are later awarded VA disability benefits, exclude 100% of the severance benefit from your income. However, you must include in your income any lump-sum readjustment or other nondisability severance payment you received on release from active duty, even if you are later given a retroactive disability rating by the VA.

Special statute of limitations. In most cases, under the statute of limitations a claim for credit or refund must be filed within 3 years from the time a return was filed. However, if you receive a retroactive service-connected disability rating determination, the statute of limitations is extended by a 1-year period beginning on the date of the determination. This 1-year extended period applies to claims for credit or refund filed after June 17, 2008, and does not apply to any tax year that began more than 5 years before the date of the determination.

Example. You retired in 2006 and receive a pension based on your years of service. On August 1, 2012, you receive a determination of service-connected disability retroactive to 2006. Generally, you could claim a refund for the taxes paid on your pension for 2009, 2010, and 2011. However, under the special limitation period, you can also file a claim for 2008 as long as you file the claim by August 1, 2013. You cannot file a claim for 2006 and 2007 because those tax years began more than 5 years before the determination.

Terrorist attack or military action. Do not include in your income disability payments you receive for injuries resulting directly from a terrorist or military action.

Long-Term Care Insurance Contracts

Long-term care insurance contracts in most cases are treated as accident and health insurance contracts. Amounts you receive from them (other than policyholder dividends or premium refunds) in most cases are excludable from income as amounts received for personal injury or sickness. To claim an exclusion for payments made on a *per diem* or other periodic basis under a long-term care insurance contract, you must file Form 8853 with your return.

A long-term care insurance contract is an insurance contract that only provides coverage for qualified long-term care services. The contract must:

- Be guaranteed renewable,
- Not provide for a cash surrender value or other money that can be paid, assigned, pledged, or borrowed,
- Provide that refunds, other than refunds on the death of the insured or complete surrender or cancellation of the contract, and dividends under the contract may be used only to reduce future premiums or increase future benefits, and
- In most cases, not pay or reimburse expenses incurred for services or items that would be reimbursed under Medicare, except where Medicare is a secondary payer or the contract makes *per diem* or other periodic payments without regard to expenses.

Qualified long-term care services. Qualified long-term care services are:

- Necessary diagnostic, preventive, therapeutic, curing, treating, mitigating, and rehabilitative services, and maintenance and personal care services, and
- Required by a chronically ill individual and provided pursuant to a plan of care as prescribed by a licensed health care practitioner.

Chronically ill individual. A chronically ill individual is one who has been certified by a licensed health care practitioner within the previous 12 months as one of the following.

- An individual who, for at least 90 days, is unable to perform at least two activities of daily living without substantial assistance due to loss of functional capacity. Activities of daily living are eating, toileting, transferring, bathing, dressing, and continence.
- An individual who requires substantial supervision to be protected from threats to health and safety due to severe cognitive impairment.

Limit on exclusion. You generally can exclude from gross income up to $310 a day for 2012. See *Limit on exclusion,* under *Long-Term Care Insurance Contracts,* under *Sickness and Injury Benefits* in Publication 525 for more information.

Workers' Compensation

Amounts you receive as workers' compensation for an occupational sickness or injury are fully exempt from tax if they are paid under a workers' compensation act or a statute in the nature of a workers' compensation act. The exemption also applies to your survivors. The exemption, however, does not apply to retirement plan benefits you receive based on your age, length of service, or prior contributions to the plan, even if you retired because of an occupational sickness or injury.

If part of your workers' compensation reduces your social security or equivalent railroad retirement benefits received, that part is considered social security (or equivalent railroad retirement) benefits and may be taxable. For more information, see Publication 915, Social Security and Equivalent Railroad Retirement Benefits.

Return to work. If you return to work after qualifying for workers' compensation, salary payments you receive for performing light duties are taxable as wages.

Other Sickness and Injury Benefits

In addition to disability pensions and annuities, you may receive other payments for sickness or injury.

Railroad sick pay. Payments you receive as sick pay under the Railroad Unemployment Insurance Act are taxable and you must include them in your income. However, do not include them in your income if they are for an on-the-job injury.

If you received income because of a disability, see [Disability Pensions](#), earlier.

Federal Employees' Compensation Act (FECA). Payments received under this Act for personal injury or sickness, including payments to beneficiaries in case of death, are not taxable. However, you are taxed on amounts you receive under this Act as continuation of pay for up to 45 days while a claim is being decided. Report this income on line 7 of Form 1040 or Form 1040A or on line 1 of Form 1040-EZ. Also, pay for sick leave while a claim is being processed is taxable and must be included in your income as wages.

If part of the payments you receive under FECA reduces your social security or equivalent railroad retirement benefits received, that part is considered social security (or equivalent railroad retirement) benefits and may be taxable. For a discussion of the taxability of these benefits, see Social security and equivalent railroad retirement benefits *under* Other Income, *in Publication 525.*

You can deduct the amount you spend to buy back sick leave for an earlier year to be eligible for nontaxable FECA benefits for that period. It is a miscellaneous deduction subject to the 2%-of-AGI limit on Schedule A (Form 1040). If you buy back sick leave in the same year you used it, the amount reduces your taxable sick leave pay. Do not deduct it separately.

Other compensation. Many other amounts you receive as compensation for sickness or injury are not taxable. These include the following amounts.

- Compensatory damages you receive for physical injury or physical sickness, whether paid in a lump sum or in periodic payments.

- Benefits you receive under an accident or health insurance policy on which either you paid the premiums or your employer paid the premiums but you had to include them in your income.
- Disability benefits you receive for loss of income or earning capacity as a result of injuries under a no-fault car insurance policy.
- Compensation you receive for permanent loss or loss of use of a part or function of your body, or for your permanent disfigurement. This compensation must be based only on the injury and not on the period of your absence from work. These benefits are not taxable even if your employer pays for the accident and health plan that provides these benefits.

Reimbursement for medical care. A reimbursement for medical care is generally not taxable. However, it may reduce your medical expense deduction. For more information, see chapter 21.

6.

Tip Income

Introduction

This chapter is for employees who receive tips.

All tips you receive are income and are subject to federal income tax. You must include in gross income all tips you receive directly, charged tips paid to you by your employer, and your share of any tips you receive 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 your tip income correctly is not difficult. You must do three things.

1. Keep a daily tip record.
2. Report tips to your employer.
3. Report all your tips on your income tax return.

This chapter will explain these three things and show you what to do on your tax return if you have not done the first two. This chapter will also show you how to treat allocated tips.

For information on special tip programs and agreements, see Publication 531.

Useful Items

You may want to see:

Publication

- ❑ **531** Reporting Tip Income
- ❑ **1244** Employee's Daily Record of Tips and Report to Employer

Form (and Instructions)

- ❑ **4137** Social Security and Medicare Tax on Unreported Tip Income
- ❑ **4070** Employee's Report of Tips to Employer

Keeping a Daily Tip Record

Why keep a daily tip record. You must keep a daily tip record so you can:

- Report your tips accurately to your employer,
- Report your tips accurately on your tax return, and
- Prove your tip income if your return is ever questioned.

How to keep a daily tip record. There are two ways to keep a daily tip record. You can either:

- Write information about your tips in a tip diary, or
- Keep copies of documents that show your tips, such as restaurant bills and credit or debit card charge slips.

You should keep your daily tip record with your tax or other personal records. You must keep your records for as long as they are important for administration of the federal tax law. For information on how long to keep records, see *How long to keep records* in chapter 1.

If you keep a tip diary, you can use Form 4070A, Employee's Daily Record of Tips. To get Form 4070A, ask the Internal Revenue Service (IRS) or your employer for Publication 1244. Also, Publication 1244 is available online at *www.irs.gov/pub/irs-pdf/p1244.pdf*. Publication 1244 includes a 1-year supply of Form 4070A. Each day, write in the information asked for on the form.

In addition to the information asked for on Form 4070A, you also need to keep a record of the date and value of any noncash tips you get, such as tickets, passes, or other items of value. Although you do not report these tips to your employer, you must report them on your tax return.

If you do not use Form 4070A, start your records by writing your name, your employer's name, and the name of the business (if it is different from your employer's name). Then, each workday, write the date and the following information.

- Cash tips you get directly from customers or from other employees.
- Tips from credit and debit card charge customers that your employer pays you.
- The value of any noncash tips you get, such as tickets, passes, or other items of value.
- The amount of tips you paid out to other employees through tip pools or tip splitting, or other arrangements, and the names of the employees to whom you paid the tips.

Electronic tip record. You can use an electronic system provided by your employer to record your daily tips. If you do, you must receive and keep a paper copy of this record.

Service charges. Do not write in your tip diary the amount of any service charge that your employer adds to a customer's bill and then pays to you and treats as wages. This is part of your wages, not a tip. See examples below.

Example 1. 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 did not have an unrestricted right to determine the amount on the "tip line," the 18% charge is considered a service charge. Do not include the 18% charge in your tip diary. Service charges that are paid to you are considered wages, not tips.

Example 2. Good Food Restaurant also includes sample calculations of tip amounts at the bottom of its bills for food and beverages provided to customers. David's bill includes a blank "tip line," with sample tip calculations of 15%, 18%, and 20% of his charges for food and beverages at the bottom of the bill beneath the signature line. Because David is free to enter any amount on the "tip line" or leave it blank, any amount he includes is considered a tip. Be sure to include this amount in your tip diary.

Reporting Tips to Your Employer

Why report tips to your employer. You must report tips to your employer so that:

- Your employer can withhold federal income tax and social security and Medicare taxes or railroad retirement tax,
- Your employer can report the correct amount of your earnings to the Social Security Administration or Railroad Retirement Board (which affects your benefits when you retire or if you become disabled, or your family's benefits if you die), and
- You can avoid the penalty for not reporting tips to your employer (explained later).

What tips to report. Report to your employer only cash, check, and debit and credit card tips you receive.

If your total tips for any 1 month from any one job are less than $20, do not report the tips for that month to that employer.

If you participate in a tip-splitting or tip-pooling arrangement, report only the tips you receive and retain. Do not report to your employer any portion of the tips you receive that you pass on to other employees. However, you must report tips you receive from other employees.

Do not report the value of any noncash tips, such as tickets or passes, to your employer. You do not pay social security and Medicare taxes or railroad retirement tax on these tips.

How to report. If your employer does not give you any other way to report tips, you can use Form 4070. Fill in the information asked for on the form, sign and date the form, and give it to your employer. To get a 1-year supply of the form, ask the IRS or your employer for Publication 1244.

If you do not use Form 4070, give your employer a statement with the following information.

- Your name, address, and social security number.
- Your employer's name, address, and business name (if it is different from your employer's name).
- The month (or the dates of any shorter period) in which you received tips.
- The total tips required to be reported for that period.

You must sign and date the statement. Be sure to keep a copy with your tax or other personal records.

Your employer may require you to report your tips more than once a month. However, the statement cannot cover a period of more than 1 calendar month.

Electronic tip statement. Your employer can have you furnish your tip statements electronically.

When to report. Give your report for each month to your employer by the 10th of the next month. If the 10th falls on a Saturday, Sunday, or legal holiday, give your employer the report by the next day that is not a Saturday, Sunday, or legal holiday.

Example 1. You must report your tips received in October 2013 by November 12, 2013. November 10 is a Sunday. November 11 is a legal holiday (Veterans' Day). November 12 is the next day that is not a Saturday, Sunday, or legal holiday.

Example 2. You must report your tips received in September 2013 by October 10, 2013.

Final report. If your employment ends during the month, you can report your tips when your employment ends.

Penalty for not reporting tips. If you do not report tips to your employer as required, you may be subject to a penalty equal to 50% of the social security and Medicare taxes or railroad retirement tax you owe on the unreported tips. (For information about these taxes, see *Reporting social security and Medicare taxes on tips not reported to your employer* under *Reporting Tips on Your Tax Return*, later.) The penalty amount is in addition to the taxes you owe.

You can avoid this penalty if you can show reasonable cause for not reporting the tips to your employer. To do so, attach a statement to your return explaining why you did not report them.

Giving your employer money for taxes. Your regular pay may not be enough for your employer to withhold all the taxes you owe on your regular pay plus your reported tips. If this happens, you can give your employer money until the close of the calendar year to pay the rest of the taxes.

If you do not give your employer enough money, your employer will apply your regular pay and any money you give in the following order.

1. All taxes on your regular pay.
2. Social security and Medicare taxes or railroad retirement tax on your reported tips.
3. Federal, state, and local income taxes on your reported tips.

Any taxes that remain unpaid can be collected by your employer from your next paycheck. If withholding taxes remain uncollected at the end of the year, you may be subject to a penalty for underpayment of estimated taxes. See Publication 505, Tax Withholding and Estimated Tax, for more information.

CAUTION

Uncollected taxes. *You must report on your tax return any social security and Medicare taxes or railroad retirement tax that remained uncollected at the end of 2012. These uncollected taxes will be shown on your 2012 Form W-2. See Reporting uncollected social security and Medicare taxes on tips reported to your employer under* Reporting Tips on Your Tax Return*, later.*

Reporting Tips on Your Tax Return

How to report tips. Report your tips with your wages on Form 1040, line 7; Form 1040A, line 7; or Form 1040EZ, line 1.

What tips to report. You must report all tips you received in 2012 on your tax return, including both cash tips and noncash tips. Any tips you reported to your employer for 2012 are included in the wages shown in box 1 of your Form W-2. Add to the amount in box 1 only the tips you did not report to your employer.

CAUTION

If you received $20 or more in cash and charge tips in a month and did not report all of those tips to your employer, see Reporting social security and Medicare taxes on tips not reported to your employer, later.

CAUTION

If you did not keep a daily tip record as required and an amount is shown in box 8 of your Form W-2, see Allocated Tips, later.

If you kept a daily tip record and reported tips to your employer as required under the rules explained earlier, add the following tips to the amount in box 1 of your Form W-2.

- Cash and charge tips you received that totaled less than $20 for any month.
- The value of noncash tips, such as tickets, passes, or other items of value.

Example. Ben Smith began working at the Blue Ocean Restaurant (his only employer in 2012) on June 30 and received $10,000 in wages during the year. Ben kept a daily tip record showing that his tips for June were $18 and his tips for the rest of the year totaled $7,000. He was not required to report his June tips to his employer, but he reported all of the rest of his tips to his employer as required.

Ben's Form W-2 from Blue Ocean Restaurant shows $17,000 ($10,000 wages plus $7,000 reported tips) in box 1. He adds the $18 unreported tips to that amount and reports $17,018 as wages on his tax return.

Reporting social security and Medicare taxes on tips not reported to your employer. If you received $20 or more in cash and charge tips in a month from any one job and did not report all of those tips to your employer, you must report the social security and Medicare taxes on the unreported tips as additional tax on your return. To report these taxes, you must file a return even if you would not otherwise have to file. You must use Form 1040. (You cannot file Form 1040EZ or Form 1040A.)

Use Form 4137 to figure these taxes. Enter the tax on your return as instructed, and attach the completed Form 4137 to your return.

CAUTION

If you are subject to the Railroad Retirement Tax Act, you cannot use Form 4137 to pay railroad retirement tax on unreported tips. To get railroad retirement credit, you must report tips to your employer.

Reporting uncollected social security and Medicare taxes on tips reported to your employer. You may have uncollected taxes if your regular pay was not enough for your employer to withhold all the taxes you owe and you did not give your employer enough money to pay the rest of the taxes. For more information, see *Giving your employer money for taxes*, under *Reporting Tips to Your Employer*, earlier.

If your employer could not collect all the social security and Medicare taxes or railroad retirement tax you owe on tips reported for 2012, the uncollected taxes will be shown in box 12 of your Form W-2 (codes A and B). You must report these amounts as additional tax on your return.

To report these uncollected taxes, you must file a return even if you would not otherwise have to file. Include the taxes in your total tax amount on Form 1040, line 60, and write “UT” and the total of the uncollected taxes in the space next to line 60. (You cannot file Form 1040EZ or Form 1040A.)

Allocated Tips

If your employer allocated tips to you, they are shown separately in box 8 of your Form W-2. They are not included in box 1 with your wages and reported tips. If box 8 is blank, this discussion does not apply to you.

What are allocated tips. These are tips that your employer assigned to you in addition to the tips you reported to your employer for the year. Your employer will have done this only if:

- You worked in an establishment (restaurant, cocktail lounge, or similar business) that must allocate tips to employees, and
- The tips you reported to your employer were less than your share of 8% of food and drink sales.

No income, social security, or Medicare taxes are withheld on allocated tips.

How were your allocated tips figured. The tips allocated to you are your share of an amount figured by subtracting the reported tips of all employees from 8% (or an approved lower rate) of food and drink sales (other than carry-out sales and sales with a service charge of 10% or more). Your share of that amount was figured using either a method provided by an employer-employee agreement or a method provided by IRS regulations based on employees' sales or hours worked. For information about the exact allocation method used, ask your employer.

Must you report your allocated tips on your tax return. You must report all tips you received in 2012 on your tax return, including both cash tips and noncash tips. Any tips you reported to your employer for 2012 are included in the wages shown in box 1 of your Form W-2. Add to the amount in box 1 only the tips you did not report to your employer. This should include any allocated tips shown in box 8 on your Form(s) W-2, unless you have adequate records to show that you received less tips in the year than the allocated figures.

See *What tips to report* under *Reporting Tips on Your Tax Return*, and *Keeping a Daily Tip Record*, earlier.

How to report allocated tips. Report the amount in box 1 and the allocated tips in box 8 of your Form(s) W-2 as wages on Form 1040, line 7; Form 1040NR, line 8; or Form 1040NR-EZ, line 3. (You cannot file Form 1040A or Form 1040EZ when you have allocated tips.)

Because social security and Medicare taxes were not withheld from the allocated tips, you must report those taxes as additional tax on your return. Complete Form 4137, and include the allocated tips on line 1 of the form. See *Reporting social security and Medicare taxes on tips not reported to your employer* under *Reporting Tips on Your Tax Return*, earlier.

7.

Interest Income

Reminder

Foreign-source income. If you are a U.S. citizen with interest income from sources outside the United States (foreign income), you must report that income on your tax return unless it is exempt by U.S. law. This is true whether you reside inside or outside the United States and whether or not you receive a Form 1099 from the foreign payer.

Introduction

This chapter discusses the following topics.

- Different types of interest income.
- What interest is taxable and what interest is nontaxable.
- When to report interest income.
- How to report interest income on your tax return.

In general, any interest you receive or that is credited to your account and can be withdrawn is taxable income. Exceptions to this rule are discussed later in this chapter.

You may be able to deduct expenses you have in earning this income on Schedule A (Form 1040) if you itemize your deductions. See *Money borrowed to invest in certificate of deposit*, later, and chapter 28.

Useful Items

You may want to see:

Publication

- ❑ **537** Installment Sales
- ❑ **550** Investment Income and Expenses
- ❑ **1212** Guide to Original Issue Discount (OID) Instruments

Form (and Instructions)

- ❑ **Schedule B (Form 1040A or 1040)** Interest and Ordinary Dividends
- ❑ **8815** Exclusion of Interest From Series EE and I U.S. Savings Bonds Issued After 1989
- ❑ **8818** Optional Form To Record Redemption of Series EE and I U.S. Savings Bonds Issued After 1989

General Information

A few items of general interest are covered here.

Recordkeeping. You should keep a list showing sources and interest amounts received during the year. Also, keep the forms you receive showing your interest income (Forms 1099-INT, for example) as an important part of your records.

Tax on investment income of certain children. Part of a child's 2012 investment income may be taxed at the parent's tax rate. If so, Form 8615, Tax for Certain Children Who Have Investment Income of More Than $1,900, must be completed and attached to the child's tax return. If not, Form 8615 is not required and the child's income is taxed at his or her own tax rate.

Some parents can choose to include the child's interest and dividends on the parent's return. If you can, use Form 8814, Parents' Election To Report Child's Interest and Dividends, for this purpose.

For more information about the tax on investment income of children and the parents' election, see chapter 30.

Beneficiary of an estate or trust. Interest you receive as a beneficiary of an estate or trust is generally taxable income. You should receive a Schedule K-1 (Form 1041), Beneficiary's Share of Income, Deductions, Credits, etc., from the fiduciary. Your copy of Schedule K-1 (Form 1041) and its instructions will tell you where to report the income on your Form 1040.

Social security number (SSN). You must give your name and SSN to any person required by federal tax law to make a return, statement, or other document that relates to you. This includes payers of interest.

SSN for joint account. If the funds in a joint account belong to one person, list that person's name first on the account and give that person's SSN to the payer. (For information on who owns the funds in a joint account, see *Joint accounts*, later.) If the joint account contains combined funds, give the SSN of the person whose name is listed first on the account. This is because only one name and SSN can be shown on Form 1099.

These rules apply both to joint ownership by a married couple and to joint ownership by other individuals. For example, if you open a joint savings account with your child using funds belonging to the child, list the child's name first on the account and give the child's SSN.

Custodian account for your child. If your child is the actual owner of an account that is recorded in your name as custodian for the child, give the child's SSN to the payer. For example, you must give your child's SSN to the payer of interest on an account owned by your child, even though the interest is paid to you as custodian.

Penalty for failure to supply SSN. If you do not give your SSN to the payer of interest, you may have to pay a penalty. See *Failure to supply SSN* under *Penalties* in chapter 1. Backup withholding also may apply.

Backup withholding. Your interest income is generally not subject to regular withholding. However, it may be subject to backup withholding to ensure that income tax is collected on the income. Under backup withholding, the payer of interest must withhold, as income tax, on the amount you are paid, applying the appropriate withholding rate.

Backup withholding may also be required if the IRS has determined that you underreported your interest or dividend income. For more information, see *Backup Withholding* in chapter 4.

Reporting backup withholding. If backup withholding is deducted from your interest income, the payer must give you a Form 1099-INT for the year indicating the amount withheld. The Form 1099-INT will show any backup withholding as "Federal income tax withheld."

Joint accounts. If two or more persons hold property (such as a savings account or bond) as joint tenants, tenants by the entirety, or tenants in common, each person's share of any interest from the property is determined by local law.

Income from property given to a child. Property you give as a parent to your child under the Model Gifts of Securities to Minors Act, the Uniform Gifts to Minors Act, or any similar law becomes the child's property.

Income from the property is taxable to the child, except that any part used to satisfy a legal obligation to support the child is taxable to the parent or guardian having that legal obligation.

Savings account with parent as trustee. Interest income from a savings account opened for a minor child, but placed in the name and subject to the order of the parents as trustees, is taxable to the child if, under the law of the state in which the child resides, both of the following are true.

- The savings account legally belongs to the child.
- The parents are not legally permitted to use any of the funds to support the child.

Form 1099-INT. Interest income is generally reported to you on Form 1099-INT, or a similar statement, by banks, savings and loans, and other payers of interest. This form shows you the interest you received during the year. Keep this form for your records. You do not have to attach it to your tax return.

Report on your tax return the total interest income you receive for the tax year.

Interest not reported on Form 1099-INT. Even if you do not receive Form 1099-INT, you must still report all of your taxable interest income. For example, you may receive distributive shares of interest from partnerships or S corporations. This interest is reported to you on Schedule K-1 (Form 1065), Partner's Share of Income, Deduction, Credits, etc., or Schedule K-1 (Form 1120S), Shareholder's Share of Income, Deductions, Credits, etc.

Nominees. Generally, if someone receives interest as a nominee for you, that person will give you a Form 1099-INT showing the interest received on your behalf.

If you receive a Form 1099-INT that includes amounts belonging to another person, see the discussion on nominee distributions under *How To Report Interest Income* in chapter 1 of Publication 550, or Schedule B (Form 1040A or 1040) instructions.

Incorrect amount. If you receive a Form 1099-INT that shows an incorrect amount (or other incorrect information), you should ask the issuer for a corrected form. The new Form 1099-INT you receive will be marked "Corrected."

Form 1099-OID. Reportable interest income also may be shown on Form 1099-OID, Original Issue Discount. For more information about amounts shown on this form, see *Original Issue Discount (OID)*, later in this chapter.

Exempt-interest dividends. Exempt-interest dividends you receive from a mutual fund or other regulated investment company, including those received from a qualified fund of funds in any tax year beginning after December 22, 2010, are not included in your taxable income. (However, see *Information reporting requirement*, next.) Exempt-interest dividends should be shown in box 10 of Form 1099-DIV. You do not reduce your basis for distributions that are exempt-interest dividends.

Information reporting requirement. Although exempt-interest dividends are not taxable, you must show them on your tax return if you have to file. This is an information reporting requirement and does not change the exempt-interest dividends into taxable income.

Note. Exempt-interest dividends paid from specified private activity bonds may be subject to the alternative minimum tax. See *Alternative Minimum Tax (AMT)* in chapter 29 for more information. Chapter 1 of Publication 550 contains a discussion on private activity bonds under *State or Local Government Obligations*.

Interest on VA dividends. Interest on insurance dividends left on deposit with the Department of Veterans Affairs (VA) is not taxable. This includes interest paid on dividends on converted United States Government Life Insurance and on National Service Life Insurance policies.

Individual retirement arrangements (IRAs). Interest on a Roth IRA generally is not taxable. Interest on a traditional IRA is tax deferred. You generally do not include it in your income until you make withdrawals from the IRA. See chapter 17.

Taxable Interest

Taxable interest includes interest you receive from bank accounts, loans you make to others, and other sources. The following are some sources of taxable interest.

Dividends that are actually interest. Certain distributions commonly called dividends are actually interest. You must report as interest so-called "dividends" on deposits or on share accounts in:

- Cooperative banks,
- Credit unions,
- Domestic building and loan associations,
- Domestic savings and loan associations,
- Federal savings and loan associations, and
- Mutual savings banks.

The "dividends" will be shown as interest income on Form 1099-INT.

Money market funds. Money market funds pay dividends and are offered by nonbank financial institutions, such as mutual funds and stock brokerage houses. Generally, amounts you receive from money market funds should be reported as dividends, not as interest.

Certificates of deposit and other deferred interest accounts. If you open any of these accounts, interest may be paid at fixed intervals of 1 year or less during the term of the account. You generally must include this interest in your income when you actually receive it or are entitled to receive it without paying a substantial penalty. The same is true for accounts that mature in 1 year or less and pay interest in a single payment at maturity. If interest is deferred for more than 1 year, see *Original Issue Discount (OID)*, later.

Interest subject to penalty for early withdrawal. If you withdraw funds from a deferred interest account before maturity, you may have to pay a penalty. You must report the total amount of interest paid or credited to your account during the year, without subtracting the penalty. See *Penalty on early withdrawal of savings* in chapter 1 of Publication 550 for more information on how to report the interest and deduct the penalty.

Money borrowed to invest in certificate of deposit. The interest you pay on money borrowed from a bank or savings institution to meet the minimum deposit required for a certificate of deposit from the institution and the interest you earn on the certificate are two separate items. You must report the total interest you earn on the certificate in your income. If you itemize deductions, you can deduct the interest you pay as investment interest, up to the amount of your net investment income. See *Interest Expenses* in chapter 3 of Publication 550.

Example. You deposited $5,000 with a bank and borrowed $5,000 from the bank to make up the $10,000 minimum deposit required to buy a 6-month certificate of deposit. The certificate earned $575 at maturity in 2012, but you received only $265, which represented the $575 you earned minus $310 interest charged on your $5,000 loan. The bank gives you a Form 1099-INT for 2012 showing the $575 interest you earned. The bank also gives you a statement showing that you paid $310 interest for 2012. You must include the $575 in your income. If you itemize your deductions on Schedule A (Form 1040), you can deduct $310, subject to the net investment income limit.

Gift for opening account. If you receive noncash gifts or services for making deposits or for opening an account in a savings institution, you may have to report the value as interest.

For deposits of less than $5,000, gifts or services valued at more than $10 must be reported as interest. For deposits of $5,000 or more, gifts or services valued at more than $20 must be reported as interest. The value is determined by the cost to the financial institution.

Example. You open a savings account at your local bank and deposit $800. The account earns $20 interest. You also receive a $15 calculator. If no other interest is credited to your account during the year, the Form 1099-INT you receive will show $35 interest for the year. You must report $35 interest income on your tax return.

Interest on insurance dividends. Interest on insurance dividends left on deposit with an insurance company that can be withdrawn annually is taxable to you in the year it is credited to your account. However, if you can withdraw it only on the anniversary date of the policy (or other specified date), the interest is taxable in the year that date occurs.

Prepaid insurance premiums. Any increase in the value of prepaid insurance premiums, advance premiums, or premium deposit funds is interest if it is applied to the payment of premiums due on insurance policies or made available for you to withdraw.

U.S. obligations. Interest on U.S. obligations, such as U.S. Treasury bills, notes, and bonds, issued by any agency or instrumentality of the United States is taxable for federal income tax purposes.

Interest on tax refunds. Interest you receive on tax refunds is taxable income.

Interest on condemnation award. If the condemning authority pays you interest to compensate you for a delay in payment of an award, the interest is taxable.

Installment sale payments. If a contract for the sale or exchange of property provides for deferred payments, it also usually provides for interest payable with the deferred payments. That interest is taxable when you receive it. If little or no interest is provided for in a deferred payment contract, part of each payment may be treated as interest. See *Unstated Interest and Original Issue Discount* in Publication 537, Installment Sales.

Interest on annuity contract. Accumulated interest on an annuity contract you sell before its maturity date is taxable.

Usurious interest. Usurious interest is interest charged at an illegal rate. This is taxable as interest unless state law automatically changes it to a payment on the principal.

Interest income on frozen deposits. Exclude from your gross income interest on frozen deposits. A deposit is frozen if, at the end of the year, you cannot withdraw any part of the deposit because:

- The financial institution is bankrupt or insolvent, or
- The state where the institution is located has placed limits on withdrawals because other financial institutions in the state are bankrupt or insolvent.

The amount of interest you must exclude is the interest that was credited on the frozen deposits minus the sum of:

- The net amount you withdrew from these deposits during the year, and
- The amount you could have withdrawn as of the end of the year (not reduced by any penalty for premature withdrawals of a time deposit).

If you receive a Form 1099-INT for interest income on deposits that were frozen at the end of 2012, see *Frozen deposits* under *How To Report Interest Income* in chapter 1 of Publication 550, for information about reporting this interest income exclusion on your tax return.

The interest you exclude is treated as credited to your account in the following year. You must include it in income in the year you can withdraw it.

Example. $100 of interest was credited on your frozen deposit during the year. You withdrew $80 but could not withdraw any more as of the end of the year. You must include $80 in your income and exclude $20 from your income for the year. You must include the $20 in your income for the year you can withdraw it.

Bonds traded flat. If you buy a bond at a discount when interest has been defaulted or when the interest has accrued but has not been paid, the transaction is described as trading a bond flat. The defaulted or unpaid interest is not income and is not taxable as interest if paid later. When you receive a payment of that interest, it is a return of capital that reduces the remaining cost basis of your bond. Interest that accrues after the date of purchase, however, is taxable interest income for the year it is received or accrued. See *Bonds Sold Between Interest Dates*, later, for more information.

Below-market loans. In general, a below-market loan is a loan on which no interest is charged or on which interest is charged at a rate below the applicable federal rate. See *Below-Market Loans* in chapter 1 of Publication 550 for more information.

U.S. Savings Bonds

This section provides tax information on U.S. savings bonds. It explains how to report the interest income on these bonds and how to treat transfers of these bonds.

For other information on U.S. savings bonds, write to:

For series EE and I paper savings bonds:
Bureau of the Public Debt
Division of Customer Assistance
P.O. Box 7012
Parkersburg, WV 26106-7012

For series EE and I electronic bonds:
Bureau of the Public Debt
Division of Customer Assistance
P.O. Box 7015
Parkersburg, WV 26106–7015

For series HH/H:
Bureau of the Public Debt
Division of Customer Assistance
P.O. Box 2186
Parkersburg, WV 26106-2186

Or, on the Internet, visit: *www.treasurydirect.gov/indiv/indiv.htm*.

Accrual method taxpayers. If you use an accrual method of accounting, you must report interest on U.S. savings bonds each year as it accrues. You cannot postpone reporting interest until you receive it or until the bonds mature. Accrual methods of accounting are explained in chapter 1 under *Accounting Methods*.

Cash method taxpayers. If you use the cash method of accounting, as most individual taxpayers do, you generally report the interest on U.S. savings bonds when you receive it. The cash method of accounting is explained in chapter 1 under *Accounting Methods*. But see *Reporting options for cash method taxpayers*, later.

Series HH bonds. These bonds were issued at face value. Interest is paid twice a year by direct deposit to your bank account. If you are a cash method taxpayer, you must report interest on these bonds as income in the year you receive it.

Series HH bonds were first offered in 1980 and last offered in August 2004. Before 1980, series H bonds were issued. Series H bonds are treated the same as series HH bonds. If you are a cash method taxpayer, you must report the interest when you receive it.

Series H bonds have a maturity period of 30 years. Series HH bonds mature in 20 years. The last series H bonds matured in 2009.

Series EE and series I bonds. Interest on these bonds is payable when you redeem the bonds. The difference between the purchase price and the redemption value is taxable interest.

Series EE bonds. Series EE bonds were first offered in January 1980 and have a maturity period of 30 years.

Before July 1980, series E bonds were issued. The original 10-year maturity period of series E bonds has been extended to 40 years for bonds issued before December 1965 and 30 years for bonds issued after November 1965. Paper series EE and series E bonds are issued at a discount. The face value is payable to you at maturity. Electronic series EE bonds are issued at their face value. The face value plus accrued interest is payable to you at maturity. As of January 1, 2012, paper savings bonds will no longer be sold at financial institutions.

Owners of paper series EE bonds can convert them to electronic bonds. These converted bonds do not retain the denomination listed on the paper certificate but are posted at their purchase price (with accrued interest).

Series I bonds. Series I bonds were first offered in 1998. These are inflation-indexed bonds issued at their face amount with a maturity period of 30 years. The face value plus all accrued interest is payable to you at maturity.

Reporting options for cash method taxpayers. If you use the cash method of reporting income, you can report the interest on series EE, series E, and series I bonds in either of the following ways.

1. ***Method 1.*** Postpone reporting the interest until the earlier of the year you cash or dispose of the bonds or the year they mature. (However, see *Savings bonds traded*, later.)
   Note. Series EE bonds issued in 1982 matured in 2012. If you have used method 1, you generally must report the interest on these bonds on your 2012 return. The last series E bonds were issued in 1980 and matured in 2010. If you used method 1, you generally should have reported the interest on these bonds on your 2010 return.
2. ***Method 2.*** Choose to report the increase in redemption value as interest each year.

Table 7-1. **Who Pays the Tax on U.S. Savings Bond Interest**

IF ...	THEN the interest must be reported by ...
you buy a bond in your name and the name of another person as co-owners, using only your own funds	you.
you buy a bond in the name of another person, who is the sole owner of the bond	the person for whom you bought the bond.
you and another person buy a bond as co-owners, each contributing part of the purchase price	both you and the other co-owner, in proportion to the amount each paid for the bond.
you and your spouse, who live in a community property state, buy a bond that is community property	you and your spouse. If you file separate returns, both you and your spouse generally report one-half of the interest.

You must use the same method for all series EE, series E, and series I bonds you own. If you do not choose method 2 by reporting the increase in redemption value as interest each year, you must use method 1.

If you plan to cash your bonds in the same year you will pay for higher education expenses, you may want to use method 1 because you may be able to exclude the interest from your income. To learn how, see Education Savings Bond Program*, later.*

Change from method 1. If you want to change your method of reporting the interest from method 1 to method 2, you can do so without permission from the IRS. In the year of change you must report all interest accrued to date and not previously reported for all your bonds.

Once you choose to report the interest each year, you must continue to do so for all series EE, series E, and series I bonds you own and for any you get later, unless you request permission to change, as explained next.

Change from method 2. To change from method 2 to method 1, you must request permission from the IRS. Permission for the change is automatically granted if you send the IRS a statement that meets all the following requirements.

1. You have typed or printed the following number at the top: "131."
2. It includes your name and social security number under "131."
3. It includes the year of change (both the beginning and ending dates).
4. It identifies the savings bonds for which you are requesting this change.
5. It includes your agreement to:
    a. Report all interest on any bonds acquired during or after the year of change when the interest is realized upon disposition, redemption, or final maturity, whichever is earliest, and
    b. Report all interest on the bonds acquired before the year of change when the interest is realized upon disposition, redemption, or final maturity, whichever is earliest, with the exception of the interest reported in prior tax years.

You must attach this statement to your tax return for the year of change, which you must file by the due date (including extensions).

You can have an automatic extension of 6 months from the due date of your return for the year of change (excluding extensions) to file the statement with an amended return. On the statement, type or print "Filed pursuant to section 301.9100-2." To get this extension, you must have filed your original return for the year of the change by the due date (including extensions).

By the date you file the original statement with your return, you must also send a signed copy to the address below.

Internal Revenue Service
Attention: CC:IT&A (Automatic Rulings Branch)
P.O. Box 7604
Benjamin Franklin Station
Washington, DC 20044

If you use a private delivery service, send the signed copy to the address below.

Internal Revenue Service
Attention: CC:IT&A (Automatic Rulings Branch)
Room 5336
1111 Constitution Avenue, NW
Washington, DC 20224

Instead of filing this statement, you can request permission to change from method 2 to method 1 by filing Form 3115, Application for Change in Accounting Method. In that case, follow the form instructions for an automatic change. No user fee is required.

Co-owners. If a U.S. savings bond is issued in the names of co-owners, such as you and your child or you and your spouse, interest on the bond is generally taxable to the co-owner who bought the bond.

One co-owner's funds used. If you used your funds to buy the bond, you must pay the tax on the interest. This is true even if you let the other co-owner redeem the bond and keep all the proceeds. Under these circumstances, the co-owner who redeemed the bond will receive a Form 1099-INT at the time of redemption and must provide you with another Form 1099-INT showing the amount of interest from the bond taxable to you. The co-owner who redeemed the bond is a "nominee." See *Nominee distributions* under *How To Report Interest Income* in chapter 1 of Publication 550 for more information about how a person who is a nominee reports interest income belonging to another person.

Both co-owners' funds used. If you and the other co-owner each contribute part of the bond's purchase price, the interest is generally taxable to each of you, in proportion to the amount each of you paid.

Community property. If you and your spouse live in a community property state and hold bonds as community property, one-half of the interest is considered received by each of you. If you file separate returns, each of you generally must report one-half of the bond interest. For more information about community property, see Publication 555.

Table 7-1. These rules are also shown in Table 7-1.

Ownership transferred. If you bought series E, series EE, or series I bonds entirely with your own funds and had them reissued in your co-owner's name or beneficiary's name alone, you must include in your gross income for the year of reissue all interest that you earned on these bonds and have not previously reported. But, if the bonds were reissued in your name alone, you do not have to report the interest accrued at that time.

This same rule applies when bonds (other than bonds held as community property) are transferred between spouses or incident to divorce.

Purchased jointly. If you and a co-owner each contributed funds to buy series E, series EE, or series I bonds jointly and later have the bonds reissued in the co-owner's name alone, you must include in your gross income for the year of reissue your share of all the interest earned on the bonds that you have not previously reported. The former co-owner does not have to include in gross income at the time of reissue his or her share of the interest earned that was not reported before the transfer. This interest, however, as well as all interest earned after the reissue, is income to the former co-owner.

This income-reporting rule also applies when the bonds are reissued in the name of your former co-owner and a new co-owner. But the new co-owner will report only his or her share of the interest earned after the transfer.

If bonds that you and a co-owner bought jointly are reissued to each of you separately in the same proportion as your contribution to the purchase price, neither you nor your co-owner has to report at that time the interest earned before the bonds were reissued.

Example 1. You and your spouse each spent an equal amount to buy a $1,000 series EE savings bond. The bond was issued to you and your spouse as co-owners. You both postpone reporting interest on the bond. You later have the bond reissued as two $500 bonds, one in your name and one in your spouse's name. At that time neither you nor your spouse has to report the interest earned to the date of reissue.

Example 2. You bought a $1,000 series EE savings bond entirely with your own funds. The bond was issued to you and your spouse as co-owners. You both postpone reporting interest on the bond. You later have the bond reissued as two $500 bonds, one in your name and one in your spouse's name. You must report half the interest earned to the date of reissue.

Transfer to a trust. If you own series E, series EE, or series I bonds and transfer them to a trust, giving up all rights of ownership, you must include in your income for that year the interest earned to the date of transfer if you have not already reported it. However, if you are considered the owner of the trust and if the increase in value both before and after the transfer continues to be taxable to you, you can continue to defer reporting the interest earned each year. You must include the total interest in your income in the year you cash or dispose of the bonds or the year the bonds finally mature, whichever is earlier.

The same rules apply to previously unreported interest on series EE or series E bonds if the transfer to a trust consisted of series HH or series H bonds you acquired in a trade for the series EE or series E bonds. See *Savings bonds traded*, later.

Decedents. The manner of reporting interest income on series E, series EE, or series I bonds, after the death of the owner, depends on the accounting and income-reporting methods previously used by the decedent. This is explained in chapter 1 of Publication 550.

Savings bonds traded. If you postponed reporting the interest on your series EE or series E bonds, you did not recognize taxable income when you traded the bonds for series HH or series H bonds, unless you received cash in the trade. (You cannot trade series I bonds for series HH bonds. After August 31, 2004, you cannot trade any other series of bonds for series HH bonds.) Any cash you received is income up to the amount of the interest earned on the bonds traded. When your series HH or series H bonds mature, or if you dispose of them before maturity, you report as interest the difference between their redemption value and your cost. Your cost is the sum of the amount you paid for the traded series EE or series E bonds plus any amount you had to pay at the time of the trade.

Example. You traded series EE bonds (on which you postponed reporting the interest) for $2,500 in series HH bonds and $223 in cash. You reported the $223 as taxable income on your tax return. At the time of the trade, the series EE bonds had accrued interest of $523 and a redemption value of $2,723. You hold the series HH bonds until maturity, when you receive $2,500. You must report $300 as interest income in the year of maturity. This is the difference between their redemption value, $2,500, and your cost, $2,200 (the amount you paid for the series EE bonds). (It is also the difference between the accrued interest of $523 on the series EE bonds and the $223 cash received on the trade.)

Choice to report interest in year of trade. You could have chosen to treat all of the previously unreported accrued interest on the series EE or series E bonds traded for series HH bonds as income in the year of the trade. If you made this choice, it is treated as a change from method 1. See *Change from method 1* under *Series EE and series I bonds*, earlier.

Form 1099-INT for U.S. savings bonds interest. When you cash a bond, the bank or other payer that redeems it must give you a Form 1099-INT if the interest part of the payment you receive is $10 or more. Box 3 of your Form 1099-INT should show the interest as the difference between the amount you received and the amount paid for the bond. However, your Form 1099-INT may show more interest than you have to include on your income tax return. For example, this may happen if any of the following are true.

- You chose to report the increase in the redemption value of the bond each year. The interest shown on your Form 1099-INT will not be reduced by amounts previously included in income.
- You received the bond from a decedent. The interest shown on your Form 1099-INT will not be reduced by any interest reported by the decedent before death, or on the decedent's final return, or by the estate on the estate's income tax return.
- Ownership of the bond was transferred. The interest shown on your Form 1099-INT will not be reduced by interest that accrued before the transfer.
- You were named as a co-owner, and the other co-owner contributed funds to buy the bond. The interest shown on your Form 1099-INT will not be reduced by the amount you received as nominee for the other co-owner. (See *Co-owners*, earlier in this chapter, for more information about the reporting requirements.)
- You received the bond in a taxable distribution from a retirement or profit-sharing plan. The interest shown on your Form 1099-INT will not be reduced by the interest portion of the amount taxable as a distribution from the plan and not taxable as interest. (This amount is generally shown on Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc., for the year of distribution.)

For more information on including the correct amount of interest on your return, see *How To Report Interest Income*, later. Publication 550 includes examples showing how to report these amounts.

TIP *Interest on U.S. savings bonds is exempt from state and local taxes. The Form 1099-INT you receive will indicate the amount that is for U.S. savings bond interest in box 3.*

Education Savings Bond Program

You may be able to exclude from income all or part of the interest you receive on the redemption of qualified U.S. savings bonds during the year if you pay qualified higher educational expenses during the same year. This exclusion is known as the Education Savings Bond Program.

You do not qualify for this exclusion if your filing status is married filing separately.

Form 8815. Use Form 8815 to figure your exclusion. Attach the form to your Form 1040 or Form 1040A.

Qualified U.S. savings bonds. A qualified U.S. savings bond is a series EE bond issued after 1989 or a series I bond. The bond must be issued either in your name (sole owner) or in your and your spouse's names (co-owners). You must be at least 24 years old before the bond's issue date. For example, a bond bought by a parent and issued in the name of his or her child under age 24 does not qualify for the exclusion by the parent or child.

CAUTION *The issue date of a bond may be earlier than the date the bond is purchased because the issue date assigned to a bond is the first day of the month in which it is purchased.*

Beneficiary. You can designate any individual (including a child) as a beneficiary of the bond.

Verification by IRS. If you claim the exclusion, the IRS will check it by using bond redemption information from the Department of the Treasury.

Qualified expenses. Qualified higher educational expenses are tuition and fees required for you, your spouse, or your dependent (for whom you claim an exemption) to attend an eligible educational institution.

Qualified expenses include any contribution you make to a qualified tuition program or to a Coverdell education savings account.

Qualified expenses do not include expenses for room and board or for courses involving sports, games, or hobbies that are not part of a degree or certificate granting program.

Eligible educational institutions. These institutions include most public, private, and nonprofit universities, colleges, and vocational schools that are accredited and eligible to participate in student aid programs run by the U.S. Department of Education.

Reduction for certain benefits. You must reduce your qualified higher educational expenses by all of the following tax-free benefits.

1. Tax-free part of scholarships and fellowships (see *Scholarships and fellowships* in chapter 12).
2. Expenses used to figure the tax-free portion of distributions from a Coverdell ESA.
3. Expenses used to figure the tax-free portion of distributions from a qualified tuition program.
4. Any tax-free payments (other than gifts or inheritances) received for educational expenses, such as
    a. Veterans' educational assistance benefits,
    b. Qualified tuition reductions, or
    c. Employer-provided educational assistance.
5. Any expense used in figuring the American Opportunity and lifetime learning credits.

Amount excludable. If the total proceeds (interest and principal) from the qualified U.S. savings bonds you redeem during the year are not more than your adjusted qualified higher educational expenses for the year, you may be able to exclude all of the interest. If the proceeds are more than the expenses, you may be able to exclude only part of the interest.

To determine the excludable amount, multiply the interest part of the proceeds by a fraction. The numerator of the fraction is the qualified higher educational expenses you paid during the year. The denominator of the fraction is the total proceeds you received during the year.

Example. In February 2012, Mark and Joan, a married couple, cashed a qualified series EE U.S. savings bond they bought in April 1996. They received proceeds of $8,636 representing principal of $5,000 and interest of $3,636. In 2012, they paid $4,000 of their daughter's college tuition. They are not claiming an education credit for that amount, and their daughter does not have any tax-free educational assistance. They can exclude $1,684 ($3,636 × ($4,000 ÷ $8,636)) of interest in 2012. They must pay tax on the remaining $1,952 ($3,636 – $1,684) interest.

Modified adjusted gross income limit. The interest exclusion is limited if your modified adjusted gross income (modified AGI) is:

- $72,850 to $87,850 for taxpayers filing single or head of household, and
- $109,250 to $139,250 for married taxpayers filing jointly or for a qualifying widow(er) with dependent child.

You do not qualify for the interest exclusion if your modified AGI is equal to or more than the upper limit for your filing status.

Modified AGI, for purposes of this exclusion, is adjusted gross income (Form 1040, line 37, or Form 1040A, line 21) figured before the interest exclusion, and modified by adding back any:

1. Foreign earned income exclusion,
2. Foreign housing exclusion and deduction,
3. Exclusion of income for *bona fide* residents of American Samoa,
4. Exclusion for income from Puerto Rico,
5. Exclusion for adoption benefits received under an employer's adoption assistance program,
6. Deduction for tuition and fees,
7. Deduction for student loan interest, and
8. Deduction for domestic production activities.

Use the Line 9 Worksheet in the Form 8815 instructions to figure your modified AGI. If you claim any of the exclusion or deduction items listed above (except items 6, 7, and 8), add the amount of the exclusion or deduction (except items 6, 7, and 8) to the amount on line 5 of the worksheet, and enter the total on Form 8815, line 9, as your modified AGI.

If you have investment interest expense incurred to earn royalties and other investment income, see *Education Savings Bond Program* in chapter 1 of Publication 550.

RECORDS

Recordkeeping. If you claim the interest exclusion, you must keep a written record of the qualified U.S. savings bonds you redeem. Your record must include the serial number, issue date, face value, and total redemption proceeds (principal and interest) of each bond. You can use Form 8818 to record this information. You should also keep bills, receipts, canceled checks, or other documentation that shows you paid qualified higher educational expenses during the year.

U.S. Treasury Bills, Notes, and Bonds

Treasury bills, notes, and bonds are direct debts (obligations) of the U.S. Government.

Taxation of interest. Interest income from Treasury bills, notes, and bonds is subject to federal income tax but is exempt from all state and local income taxes. You should receive Form 1099-INT showing the interest (in box 3) paid to you for the year.

Payments of principal and interest generally will be credited to your designated checking or savings account by direct deposit through the TreasuryDirect® system.

Treasury bills. These bills generally have a 4-week, 13-week, 26-week, or 52-week maturity period. They are issued at a discount in the amount of $100 and multiples of $100. The difference between the discounted price you pay for the bills and the face value you receive at maturity is interest income. Generally, you report this interest income when the bill is paid at maturity.

Treasury notes and bonds. Treasury notes have maturity periods of more than 1 year, ranging up to 10 years. Maturity periods for Treasury bonds are longer than 10 years. Both generally are issued in denominations of $100 to $1 million and generally pay interest every 6 months. Generally, you report this interest for the year paid. For more information, see *U.S. Treasury Bills, Notes, and Bonds* in chapter 1 of Publication 550.

For other information on Treasury notes or bonds, write to:

Bureau of The Public Debt
P.O. Box 7015
Parkersburg, WV 26106-7015

Or, on the Internet, visit: *www.treasurydirect.gov/indiv/indiv.htm*.

For information on series EE, series I, and series HH savings bonds, see *U.S. Savings Bonds*, earlier.

Treasury inflation-protected securities (TIPS). These securities pay interest twice a year at a fixed rate, based on a principal amount adjusted to take into account inflation and deflation. For the tax treatment of these securities, see *Inflation-Indexed Debt Instruments* under *Original Issue Discount (OID)*, in Publication 550.

Bonds Sold Between Interest Dates

If you sell a bond between interest payment dates, part of the sales price represents interest accrued to the date of sale. You must report that part of the sales price as interest income for the year of sale.

If you buy a bond between interest payment dates, part of the purchase price represents interest accrued before the date of purchase. When that interest is paid to you, treat it as a return of your capital investment, rather than interest income, by reducing your basis in the bond. See *Accrued interest on bonds* under *How To Report Interest Income* in chapter 1 of Publication 550 for information on reporting the payment.

Insurance

Life insurance proceeds paid to you as beneficiary of the insured person are usually not taxable. But if you receive the proceeds in installments, you must usually report a part of each installment payment as interest income.

For more information about insurance proceeds received in installments, see Publication 525, Taxable and Nontaxable Income.

Annuity. If you buy an annuity with life insurance proceeds, the annuity payments you receive are taxed as pension and annuity income from a nonqualified plan, not as interest income. See chapter 10 for information on pension and annuity income from nonqualified plans.

State or Local Government Obligations

Interest on a bond used to finance government operations generally is not taxable if the bond is issued by a state, the District of Columbia, a possession of the United States, or any of their political subdivisions.

Bonds issued after 1982 (including tribal economic development bonds issued after February 17, 2009) by an Indian tribal government are treated as issued by a state. Interest on these bonds is generally tax exempt if the bonds are part of an issue of which substantially all proceeds are to be used in the exercise of any essential government function.

For information on federally guaranteed bonds, mortgage revenue bonds, arbitrage bonds, private activity bonds, qualified tax credit bonds, and Build America bonds, see *State or Local Government Obligations* in chapter 1 of Publication 550.

Information reporting requirement. If you must file a tax return, you are required to show any tax-exempt interest you received on your return. This is an information reporting requirement only. It does not change tax-exempt interest to taxable interest.

Original Issue Discount (OID)

Original issue discount (OID) is a form of interest. You generally include OID in your income as it accrues over the term of the debt instrument, whether or not you receive any payments from the issuer.

A debt instrument generally has OID when the instrument is issued for a price that is less than its stated redemption price at maturity. OID is the difference between the stated redemption price at maturity and the issue price.

All debt instruments that pay no interest before maturity are presumed to be issued at a discount. Zero coupon bonds are one example of these instruments.

The OID accrual rules generally do not apply to short-term obligations (those with a fixed maturity date of 1 year or less from date of issue). See *Discount on Short-Term Obligations* in chapter 1 of Publication 550.

***De minimis* OID.** You can treat the discount as zero 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. This small discount is known as *"de minimis"* OID.

Example 1. You bought a 10-year bond with a stated redemption price at maturity of $1,000, issued at $980 with OID of $20. One-fourth of 1% of $1,000 (stated redemption price) times 10 (the number of full years from the date of original issue to maturity) equals $25. Because the $20 discount is less than $25, the OID is treated as zero. (If you hold the bond at maturity, you will recognize $20 ($1,000 − $980) of capital gain.)

Example 2. The facts are the same as in *Example 1*, except that the bond was issued at $950. The OID is $50. Because the $50 discount is more than the $25 figured in *Example 1*, you must include the OID in income as it accrues over the term of the bond.

Debt instrument bought after original issue. If you buy a debt instrument with *de minimis* OID at a premium, the discount is not includible in income. If you buy a debt instrument with *de minimis* OID at a discount, the discount is reported under the market discount rules. See *Market Discount Bonds* in chapter 1 of Publication 550.

Exceptions to reporting OID. The OID rules discussed in this chapter do not apply to the following debt instruments.

1. Tax-exempt obligations. (However, see *Stripped tax-exempt obligations* under *Stripped Bonds and Coupons* in chapter 1 of Publication 550).
2. U.S. savings bonds.
3. Short-term debt instruments (those with a fixed maturity date of not more than 1 year from the date of issue).
4. Obligations issued by an individual before March 2, 1984.
5. Loans between individuals if all the following are true.
   a. The lender is not in the business of lending money.
   b. The amount of the loan, plus the amount of any outstanding prior loans between the same individuals, is $10,000 or less.
   c. Avoiding any federal tax is not one of the principal purposes of the loan.

Form 1099-OID. The issuer of the debt instrument (or your broker if you held the instrument through a broker) should give you Form 1099-OID, or a similar statement, if the total OID for the calendar year is $10 or more. Form 1099-OID will show, in box 1, the amount of OID for the part of the year that you held the bond. It also will show, in box 2, the stated interest you must include in your income. A copy of Form 1099-OID will be sent to the IRS. Do not file your copy with your return. Keep it for your records.

In most cases, you must report the entire amount in boxes 1 and 2 of Form 1099-OID as interest income. But see *Refiguring OID shown on Form 1099-OID,* later in this discussion, for more information.

Form 1099-OID not received. If you had OID for the year but did not receive a Form 1099-OID, you can find tables on IRS.gov that list total OID on certain debt instruments and have information that will help you figure OID. The tables are available at *www.irs.gov/uac/Original-Issue-Discount-(OID)-Tables----13-JAN-2012*. If your debt instrument is not listed, consult the issuer for further information about the accrued OID for the year.

Nominee. If someone else is the holder of record (the registered owner) of an OID instrument belonging to you and receives a Form 1099-OID on your behalf, that person must give you a Form 1099-OID.

Refiguring OID shown on Form 1099-OID. You must refigure the OID shown in box 1 or box 6 of Form 1099-OID if either of the following apply.

- You bought the debt instrument after its original issue and paid a premium or an acquisition premium.
- The debt instrument is a stripped bond or a stripped coupon (including certain zero coupon instruments).

For information about figuring the correct amount of OID to include in your income, see *Figuring OID on Long-Term Debt Instruments* in Publication 1212.

Refiguring periodic interest shown on Form 1099-OID. If you disposed of a debt instrument or acquired it from another holder during the year, see *Bonds Sold Between Interest Dates*, earlier, for information about the treatment of periodic interest that may be shown in box 2 of Form 1099-OID for that instrument.

Certificates of deposit (CDs). If you buy a CD with a maturity of more than 1 year, you must include in income each year a part of the total interest due and report it in the same manner as other OID.

This also applies to similar deposit arrangements with banks, building and loan associations, etc., including:

- Time deposits,
- Bonus plans,
- Savings certificates,
- Deferred income certificates,
- Bonus savings certificates, and
- Growth savings certificates.

Bearer CDs. CDs issued after 1982 generally must be in registered form. Bearer CDs are CDs not in registered form. They are not issued in the depositor's name and are transferable from one individual to another.

Banks must provide the IRS and the person redeeming a bearer CD with a Form 1099-INT.

More information. See chapter 1 of Publication 550 for more information about OID and related topics, such as market discount bonds.

When To Report Interest Income

When to report your interest income depends on whether you use the cash method or an accrual method to report income.

Cash method. Most individual taxpayers use the cash method. If you use this method, you generally report your interest income in the year in which you actually or constructively receive it. However, there are special rules for reporting the discount on certain debt instruments. See *U.S. Savings Bonds* and *Original Issue Discount (OID)*, earlier.

Example. On September 1, 2010, you loaned another individual $2,000 at 12%, compounded annually. You are not in the business of lending money. The note stated that principal and interest would be due on August 31, 2012. In 2012, you received $2,508.80 ($2,000 principal and $508.80 interest). If you use the cash method, you must include in income on your 2012 return the $508.80 interest you received in that year.

Constructive receipt. You constructively receive income when it is credited to your account or made available to you. You do not need to have physical possession of it. For example, you are considered to receive interest, dividends, or other earnings on any deposit or account in a bank, savings and loan, or similar financial institution, or interest on life insurance policy dividends left to accumulate, when they are credited to your account and subject to your withdrawal. This is true even if they are not yet entered in your passbook.

You constructively receive income on the deposit or account even if you must:

- Make withdrawals in multiples of even amounts,
- Give a notice to withdraw before making the withdrawal,
- Withdraw all or part of the account to withdraw the earnings, or

- Pay a penalty on early withdrawals, unless the interest you are to receive on an early withdrawal or redemption is substantially less than the interest payable at maturity.

Accrual method. If you use an accrual method, you report your interest income when you earn it, whether or not you have received it. Interest is earned over the term of the debt instrument.

Example. If, in the previous example, you use an accrual method, you must include the interest in your income as you earn it. You would report the interest as follows: 2010, $80; 2011, $249.60; and 2012, $179.20.

Coupon bonds. Interest on coupon bonds is taxable in the year the coupon becomes due and payable. It does not matter when you mail the coupon for payment.

How To Report Interest Income

Generally, you report all your taxable interest income on Form 1040, line 8a; Form 1040A, line 8a; or Form 1040EZ, line 2.

You cannot use Form 1040EZ if your taxable interest income is more than $1,500. Instead, you must use Form 1040A or Form 1040.

Form 1040A. You must complete Schedule B (Form 1040A or 1040), Part I, if you file Form 1040A and any of the following are true.

1. Your taxable interest income is more than $1,500.
2. You are claiming the interest exclusion under the Education Savings Bond Program (discussed earlier).
3. You received interest from a seller-financed mortgage, and the buyer used the property as a home.
4. You received a Form 1099-INT for U.S. savings bond interest that includes amounts you reported before 2012.
5. You received, as a nominee, interest that actually belongs to someone else.
6. You received a Form 1099-INT for interest on frozen deposits.
7. You are reporting OID in an amount less than the amount shown on Form 1099-OID.
8. You received a Form 1099-INT for interest on a bond you bought between interest payment dates.
9. You acquired taxable bonds after 1987 and choose to reduce interest income from the bonds by any amortizable bond premium (see *Bond Premium Amortization* in chapter 3 of Publication 550).

List each payer's name and the amount of interest income received from each payer on line 1. If you received a Form 1099-INT or Form 1099-OID from a brokerage firm, list the brokerage firm as the payer.

You cannot use Form 1040A if you must use Form 1040, as described next.

Form 1040. You must use Form 1040 instead of Form 1040A or Form 1040EZ if:

1. You forfeited interest income because of the early withdrawal of a time deposit;
2. You acquired taxable bonds after 1987, you choose to reduce interest income from the bonds by any amortizable bond premium, and you are deducting the excess of bond premium amortization for the accrual period over the qualified stated interest for the period (see *Bond Premium Amortization* in chapter 3 of Publication 550); or
3. You received tax-exempt interest from private activity bonds issued after August 7, 1986.

Schedule B (Form 1040A or 1040). You must complete Schedule B (Form 1040A or 1040), Part I, if you file Form 1040 and any of the following apply.

1. Your taxable interest income is more than $1,500.
2. You are claiming the interest exclusion under the Education Savings Bond Program (discussed earlier).
3. You received interest from a seller-financed mortgage, and the buyer used the property as a home.
4. You received a Form 1099-INT for U.S. savings bond interest that includes amounts you reported before 2012.
5. You received, as a nominee, interest that actually belongs to someone else.
6. You received a Form 1099-INT for interest on frozen deposits.
7. You received a Form 1099-INT for interest on a bond you bought between interest payment dates.
8. You are reporting OID in an amount less than the amount shown on Form 1099-OID.
9. Statement (2) in the preceding list under Form 1040 is true.

In Part I, line 1, list each payer's name and the amount received from each. If you received a Form 1099-INT or Form 1099-OID from a brokerage firm, list the brokerage firm as the payer.

Reporting tax-exempt interest. Total your tax-exempt interest (such as interest or accrued OID on certain state and municipal bonds, including tax-exempt interest on zero coupon municipal bonds) and exempt-interest dividends from a mutual fund as shown in box 8 of Form 1099-INT. Add this amount to any other tax-exempt interest you received. Report the total on line 8b of Form 1040A or 1040. If you file Form 1040EZ, enter "TEI" and the amount in the space to the left of line 2. Do not add tax-exempt interest in the total on Form 1040EZ, line 2.

Form 1099-INT, box 9, and Form 1099-DIV, box 11, show the tax-exempt interest subject to the alternative minimum tax on Form 6251. These amounts are already included in the amounts on Form 1099-INT, box 8, and Form 1099-DIV, box 10. Do not add the amounts in Form 1099-INT, box 9 and Form 1099-DIV, box 11 to, or subtract them from, the amounts on Form 1099-INT, box 8, and Form 1099-DIV, box 10.

CAUTION *Do not report interest from an individual retirement account (IRA) as tax-exempt interest.*

Form 1099-INT. Your taxable interest income, except for interest from U.S. savings bonds and Treasury obligations, is shown in box 1 of Form 1099-INT. Add this amount to any other taxable interest income you received. You must report all of your taxable interest income even if you do not receive a Form 1099-INT. Contact your financial institution if you do not receive a Form 1099-INT by February 15. Your identifying number may be truncated on any paper Form 1099-INT you receive for 2012.

If you forfeited interest income because of the early withdrawal of a time deposit, the deductible amount will be shown on Form 1099-INT in box 2. See *Penalty on early withdrawal of savings* in chapter 1 of Publication 550.

Box 3 of Form 1099-INT shows the interest income you received from U.S. savings bonds, Treasury bills, Treasury notes, and Treasury bonds. Add the amount shown in box 3 to any other taxable interest income you received, unless part of the amount in box 3 was previously included in your interest income. If part of the amount shown in box 3 was previously included in your interest income, see *U.S. savings bond interest previously reported*, later.

Box 4 of Form 1099-INT will contain an amount if you were subject to backup withholding. Report the amount from box 4 on Form 1040EZ, line 7; on Form 1040A, line 36; or Form 1040, line 62 (federal income tax withheld).

Box 5 of Form 1099-INT shows investment expenses you may be able to deduct as an itemized deduction. See chapter 28 for more information about investment expenses.

If there are entries in boxes 6 and 7 of Form 1099-INT, you must file Form 1040. You may be able to take a credit for the amount shown in box 6 unless you deduct this amount on line 8 of Schedule A (Form 1040). To take the credit, you may have to file Form 1116, Foreign Tax Credit. For more information, see Publication 514, Foreign Tax Credit for Individuals.

U.S. savings bond interest previously reported. If you received a Form 1099-INT for U.S. savings bond interest, the form may show interest you do not have to report. See *Form 1099-INT for U.S. savings bonds interest*, earlier, under *U.S. Savings Bonds*.

On Schedule B (Form 1040A or 1040), Part I, line 1, report all the interest shown on your Form 1099-INT. Then follow these steps.

1. Several lines above line 2, enter a subtotal of all interest listed on line 1.
2. Below the subtotal enter "U.S. Savings Bond Interest Previously Reported" and enter amounts previously reported or interest accrued before you received the bond.
3. Subtract these amounts from the subtotal and enter the result on line 2.

More information. For more information about how to report interest income, see chapter 1 of Publication 550 or the instructions for the form you must file.

8. Dividends and Other Distributions

Reminder

Foreign-source income. If you are a U.S. citizen with dividend income from sources outside the United States (foreign-source income), you must report that income on your tax return unless it is exempt by U.S. law. This is true whether you reside inside or outside the United States and whether or not you receive a Form 1099 from the foreign payer.

Introduction

This chapter discusses the tax treatment of:

- Ordinary dividends,
- Capital gain distributions,
- Nondividend distributions, and
- Other distributions you may receive from a corporation or a mutual fund.

This chapter also explains how to report dividend income on your tax return.

Dividends are distributions of money, stock, or other property paid to you by a corporation or by a mutual fund. You also may receive dividends through a partnership, an estate, a trust, or an association that is taxed as a corporation. However, some amounts you receive that are called dividends are actually interest income. (See *Dividends that are actually interest* under *Taxable Interest* in chapter 7.)

Most distributions are paid in cash (or check). However, distributions can consist of more stock, stock rights, other property, or services.

Useful Items

You may want to see:

Publication

- ❑ **514** Foreign Tax Credit for Individuals
- ❑ **550** Investment Income and Expenses

Form (and Instructions)

- ❑ **Schedule B (Form 1040A or 1040)** Interest and Ordinary Dividends

General Information

This section discusses general rules for dividend income.

Tax on investment income of certain children. Part of a child's 2012 investment income may be taxed at the parent's tax rate. If it is, Form 8615, Tax for Certain Children Who Have Investment Income of More Than $1,900, must be completed and attached to the child's tax return. If not, Form 8615 is not required and the child's income is taxed at his or her own tax rate.

Some parents can choose to include the child's interest and dividends on the parent's return if certain requirements are met. Use Form 8814, Parents' Election To Report Child's Interest and Dividends, for this purpose.

For more information about the tax on investment income of children and the parents' election, see chapter 30.

Beneficiary of an estate or trust. Dividends and other distributions you receive as a beneficiary of an estate or trust are generally taxable income. You should receive a Schedule K-1 (Form 1041), Beneficiary's Share of Income, Deductions, Credits, etc., from the fiduciary. Your copy of Schedule K-1 (Form 1041) and its instructions will tell you where to report the income on your Form 1040.

Social security number (SSN). You must give your name and SSN (or individual taxpayer identification number (ITIN)) to any person required by federal tax law to make a return, statement, or other document that relates to you. This includes payers of dividends. If you do not give your SSN or ITIN to the payer of dividends, you may have to pay a penalty.

For more information on SSNs and ITINs, see *Social Security Number (SSN)* in chapter 1.

Backup withholding. Your dividend income is generally not subject to regular withholding. However, it may be subject to backup withholding to ensure that income tax is collected on the income. Under backup withholding, the payer of dividends must withhold, as income tax, on the amount you are paid, applying the appropriate withholding rate.

Backup withholding may also be required if the IRS has determined that you underreported your interest or dividend income. For more information, see *Backup Withholding* in chapter 4.

Stock certificate in two or more names. If two or more persons hold stock as joint tenants, tenants by the entirety, or tenants in common, each person's share of any dividends from the stock is determined by local law.

Form 1099-DIV. Most corporations and mutual funds use Form 1099-DIV, Dividends and Distributions, to show you the distributions you received from them during the year. Keep this form with your records. You do not have to attach it to your tax return.

Dividends not reported on Form 1099-DIV. Even if you do not receive Form 1099-DIV, you must still report all your taxable dividend income. For example, you may receive distributive shares of dividends from partnerships or S corporations. These dividends are reported to you on Schedule K-1 (Form 1065), Partner's Share of Income, Deductions, Credits, etc., and Schedule K-1 (Form 1120S), Shareholder's Share of Income, Deductions, Credits, etc.

Reporting tax withheld. If tax is withheld from your dividend income, the payer must give you a Form 1099-DIV that indicates the amount withheld.

Nominees. If someone receives distributions as a nominee for you, that person will give you a Form 1099-DIV, which will show distributions received on your behalf.

Form 1099-MISC. Certain substitute payments in lieu of dividends or tax-exempt interest received by a broker on your behalf must be reported to you on Form 1099-MISC, Miscellaneous Income, or a similar statement. See *Reporting Substitute Payments* under *Short Sales* in chapter 4 of Publication 550 for more information about reporting these payments.

Incorrect amount shown on a Form 1099. If you receive a Form 1099 that shows an incorrect amount (or other incorrect information), you should ask the issuer for a corrected form. The new Form 1099 you receive will be marked "Corrected."

Dividends on stock sold. If stock is sold, exchanged, or otherwise disposed of after a dividend is declared but before it is paid, the owner of record (usually the payee shown on the dividend check) must include the dividend in income.

Dividends received in January. If a mutual fund (or other regulated investment company) or real estate investment trust (REIT) declares a dividend (including any exempt-interest dividend or capital gain distribution) in October, November, or December, payable to shareholders of record on a date in one of those months but actually pays the dividend during January of the next calendar year, you are considered to have received the dividend on December 31. You report the dividend in the year it was declared.

Ordinary Dividends

Ordinary (taxable) dividends are the most common type of distribution from a corporation or a mutual fund. They are paid out of earnings and profits and are ordinary income to you. This means they are not capital gains. You can assume that any dividend you receive on common or preferred stock is an ordinary dividend unless the paying corporation or mutual fund tells you otherwise. Ordinary dividends will be shown in box 1a of the Form 1099-DIV you receive.

Qualified Dividends

Qualified dividends are the ordinary dividends subject to the same 0% or 15% maximum tax rate that applies to net capital gain. They should be shown in box 1b of the Form 1099-DIV you receive.

Qualified dividends are subject to the 15% rate if the regular tax rate that would apply is 25% or higher. If the regular tax rate that would apply is lower than 25%, qualified dividends are subject to the 0% rate.

To qualify for the 0% or 15% maximum rate, all of the following requirements must be met.

- The dividends must have been paid by a U.S. corporation or a qualified foreign corporation. (See *Qualified foreign corporation*, later.)
- The dividends are not of the type listed later under *Dividends that are not qualified dividends*.
- You meet the holding period (discussed next).

Holding period. 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. Instead, the seller will get the dividend.

When counting the number of days you held the stock, include the day you disposed of the stock, but not the day you acquired it. See the examples later.

Exception for preferred stock. In the case of 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.

Example 1. You bought 5,000 shares of XYZ Corp. common stock on July 10, 2012. XYZ Corp. paid a cash dividend of 10 cents per share. The ex-dividend date was July 17, 2012. Your Form 1099-DIV from XYZ Corp. shows $500 in box 1a (ordinary dividends) and in box 1b (qualified dividends). However, you sold the 5,000 shares on August 13, 2012. You held your shares of XYZ Corp. for only 34 days of the 121-day period (from July 11, 2012, through August 13, 2012). The 121-day period began on May 18, 2012 (60 days before the ex-dividend date), and ended on September 15, 2012. You have no qualified dividends from XYZ Corp. because you held the XYZ stock for less than 61 days.

Example 2. Assume the same facts as in Example 1 except that you bought the stock on July 16, 2012 (the day before the ex-dividend date), and you sold the stock on September 17, 2012. You held the stock for 63 days (from July 17, 2012, through September 17, 2012). The $500 of qualified dividends shown in box 1b of your Form 1099-DIV are all qualified dividends because you held the stock for 61 days of the 121-day period (from July 17, 2012, through September 15, 2012).

Example 3. You bought 10,000 shares of ABC Mutual Fund common stock on July 10, 2012. ABC Mutual Fund paid a cash dividend of 10 cents a share. The ex-dividend date was July 17, 2012. The ABC Mutual Fund advises you that the portion of the dividend eligible to be treated as qualified dividends equals 2 cents per share. Your Form 1099-DIV from ABC Mutual Fund shows total ordinary dividends of $1,000 and qualified dividends of $200. However, you sold the 10,000 shares on August 13, 2012. You have no qualified dividends from ABC Mutual Fund because you held the ABC Mutual Fund stock for less than 61 days.

Holding period reduced where risk of loss is diminished. When determining whether you met the minimum holding period discussed earlier, you cannot count any day during which you meet any of the following conditions.

1. You had an option to sell, were under a contractual obligation to sell, or had made (and not closed) a short sale of substantially identical stock or securities.
2. You were grantor (writer) of an option to buy substantially identical stock or securities.
3. Your risk of loss is diminished by holding one or more other positions in substantially similar or related property.

For information about how to apply condition (3), see Regulations section 1.246-5.

Qualified foreign corporation. A foreign corporation is a qualified foreign corporation if it meets any of the following conditions.

1. The corporation is incorporated in a U.S. possession.
2. The corporation is eligible for the benefits of a comprehensive income tax treaty with the United States that the Treasury Department determines is satisfactory for this purpose and that includes an exchange of information program. For a list of those treaties, see Table 8-1.
3. The corporation does not meet (1) or (2) above, but the stock for which the dividend is paid is readily tradable on an established securities market in the United States. See *Readily tradable stock*, later.

Exception. A corporation is not a qualified foreign corporation if it is a passive foreign investment company during its tax year in which the dividends are paid or during its previous tax year.

Readily tradable stock. Any stock (such as common, ordinary stock, or preferred stock) or an American depositary receipt in respect of that stock is considered to satisfy requirement (3), under *Qualified foreign corporation*, if it is listed on one of the following securities markets: the New York Stock Exchange, the NASDAQ Stock Market, the American Stock Exchange, the Boston Stock Exchange, the Cincinnati Stock Exchange, the Chicago Stock Exchange, the Philadelphia Stock Exchange, or the Pacific Exchange, Inc.

Dividends that are not qualified dividends. The following dividends are not qualified dividends. They are not qualified dividends even if they are shown in box 1b of Form 1099-DIV.

- Capital gain distributions.
- Dividends paid on deposits with mutual savings banks, cooperative banks, credit unions, U.S. building and loan associations, U.S. savings and loan associations, federal savings and loan associations, and similar financial institutions. (Report these amounts as interest income.)
- Dividends from a corporation that is a tax-exempt organization or farmer's cooperative during the corporation's tax year in which the dividends were paid or during the corporation's previous tax year.
- Dividends paid by a corporation on employer securities held on the date of record by an employee stock ownership plan (ESOP) maintained by that corporation.
- Dividends on any share of stock to the extent you are obligated (whether under a short sale or otherwise) to make related payments for positions in substantially similar or related property.
- Payments in lieu of dividends, but only if you know or have reason to know the payments are not qualified dividends.
- Payments shown in Form 1099-DIV, box 1b, from a foreign corporation to the extent you know or have reason to know the payments are not qualified dividends.

Table 8-1. **Income Tax Treaties**

Income tax treaties the United States has with the following countries satisfy requirement (2) under *Qualified foreign corporation.*

Australia	Indonesia	Romania
Austria	Ireland	Russian
Bangladesh	Israel	Federation
Barbados	Italy	Slovak
Belgium	Jamaica	Republic
Bulgaria	Japan	Slovenia
Canada	Kazakhstan	South Africa
China	Korea	Spain
Cyprus	Latvia	Sri Lanka
Czech	Lithuania	Sweden
Republic	Luxembourg	Switzerland
Denmark	Malta	Thailand
Egypt	Mexico	Trinidad and
Estonia	Morocco	Tobago
Finland	Netherlands	Tunisia
France	New Zealand	Turkey
Germany	Norway	Ukraine
Greece	Pakistan	United
Hungary	Philippines	Kingdom
Iceland	Poland	Venezuela
India	Portugal	

Dividends Used to Buy More Stock

The corporation in which you own stock may have a dividend reinvestment plan. This plan lets you choose to use your dividends to buy (through an agent) more shares of stock in the corporation instead of receiving the dividends in cash. Most mutual funds also permit shareholders to automatically reinvest distributions in more shares in the fund, instead of receiving cash. If you use your dividends to buy more stock at a price equal to its fair market value, you still must report the dividends as income.

If you are a member of a dividend reinvestment plan that lets you buy more stock at a price less than its fair market value, you must report as dividend income the fair market value of the additional stock on the dividend payment date.

You also must report as dividend income any service charge subtracted from your cash dividends before the dividends are used to buy the additional stock. But you may be able to deduct the service charge. See chapter 28 for more information about deducting expenses of producing income.

In some dividend reinvestment plans, you can invest more cash to buy shares of stock at a price less than fair market value. If you choose to do this, you must report as dividend income the difference between the cash you invest and the fair market value of the stock you buy. When figuring this amount, use the fair market value of the stock on the dividend payment date.

Money Market Funds

Report amounts you receive from money market funds as dividend income. Money market funds are a type of mutual fund and should not be confused with bank money market accounts that pay interest.

Capital Gain Distributions

Capital gain distributions (also called capital gain dividends) are paid to you or credited to your account by mutual funds (or other regulated investment companies) and real estate investment trusts (REITs). They will be shown in box 2a of the Form 1099-DIV you receive from the mutual fund or REIT.

Report capital gain distributions as long-term capital gains, regardless of how long you owned your shares in the mutual fund or REIT.

Undistributed capital gains of mutual funds and REITs. Some mutual funds and REITs keep their long-term capital gains and pay tax on them. You must treat your share of these gains as distributions, even though you did not actually receive them. However, they are not included on Form 1099-DIV. Instead, they are reported to you in box 1a of Form 2439.

Report undistributed capital gains (box 1a of Form 2439) as long-term capital gains on Schedule D (Form 1040), column (h), line 11.

The tax paid on these gains by the mutual fund or REIT is shown in box 2 of Form 2439. You take credit for this tax by including it on Form 1040, line 71, and checking box a on that line. Attach Copy B of Form 2439 to your return, and keep Copy C for your records.

Basis adjustment. Increase your basis in your mutual fund, or your interest in a REIT, by the difference between the gain you report and the credit you claim for the tax paid.

Additional information. For more information on the treatment of distributions from mutual funds, see Publication 550.

Nondividend Distributions

A nondividend distribution is a distribution that is not paid out of the earnings and profits of a corporation or a mutual fund. You should receive a Form 1099-DIV or other statement showing the nondividend distribution. On Form 1099-DIV, a nondividend distribution will be shown in box 3. If you do not receive such a statement, you report the distribution as an ordinary dividend.

Basis adjustment. A nondividend distribution reduces the basis of your stock. It is not taxed until your basis in the stock is fully recovered. This nontaxable portion is also called a return of capital; it is a return of your investment in the stock of the company. If you buy stock in a corporation in different lots at different times, and you cannot definitely identify the shares subject to the nondividend distribution, reduce the basis of your earliest purchases first.

When the basis of your stock has been reduced to zero, report any additional nondividend distribution you receive as a capital gain. Whether you report it as a long-term or short-term capital gain depends on how long you have held the stock. See *Holding Period* in chapter 14.

Example. You bought stock in 1999 for $100. In 2002, you received a nondividend distribution of $80. You did not include this amount in your income, but you reduced the basis of your stock to $20. You received a nondividend distribution of $30 in 2012. The first $20 of this amount reduced your basis to zero. You report the other $10 as a long-term capital gain for 2012. You must report as a long-term capital gain any nondividend distribution you receive on this stock in later years.

Liquidating Distributions

Liquidating distributions, sometimes called liquidating dividends, are distributions you receive during a partial or complete liquidation of a corporation. These distributions are, at least in part, one form of a return of capital. They may be paid in one or more installments. You will receive Form 1099-DIV from the corporation showing you the amount of the liquidating distribution in box 8 or 9.

For more information on liquidating distributions, see chapter 1 of Publication 550.

Distributions of Stock and Stock Rights

Distributions by a corporation of its own stock are commonly known as stock dividends. Stock rights (also known as "stock options") are distributions by a corporation of rights to acquire the corporation's stock. Generally, stock dividends and stock rights are not taxable to you, and you do not report them on your return.

Taxable stock dividends and stock rights. Distributions of stock dividends and stock rights are taxable to you if any of the following apply.

1. You or any other shareholder have the choice to receive cash or other property instead of stock or stock rights.
2. The distribution gives cash or other property to some shareholders and an increase in the percentage interest in the corporation's assets or earnings and profits to other shareholders.
3. The distribution is in convertible preferred stock and has the same result as in (2).
4. The distribution gives preferred stock to some common stock shareholders and common stock to other common stock shareholders.
5. The distribution is on preferred stock. (The distribution, however, is not taxable if it is an increase in the conversion ratio of convertible preferred stock made solely to take into account a stock dividend, stock split, or similar event that would otherwise result in reducing the conversion right.)

The term "stock" includes rights to acquire stock, and the term "shareholder" includes a holder of rights or of convertible securities.

If you receive taxable stock dividends or stock rights, include their fair market value at the time of distribution in your income.

Preferred stock redeemable at a premium. If you hold preferred stock having a redemption price higher than its issue price, the difference (the redemption premium) generally is taxable as a constructive distribution of additional stock on the preferred stock. For more information, see chapter 1 of Publication 550.

Basis. Your basis in stock or stock rights received in a taxable distribution is their fair market value when distributed. If you receive stock or stock rights that are not taxable to you, see *Stocks and Bonds* under *Basis of Investment Property* in chapter 4 of Publication 550 for information on how to figure their basis.

Fractional shares. You may not own enough stock in a corporation to receive a full share of stock if the corporation declares a stock dividend. However, with the approval of the shareholders, the corporation may set up a plan in which fractional shares are not issued but instead are sold, and the cash proceeds are given to the shareholders. Any cash you receive for fractional shares under such a plan is treated as an amount realized on the sale of the fractional shares. Report this transaction on Form 8949, Sales and Other Dispositions of Capital Assets. Enter your gain or loss, the difference between the cash you receive and the basis of the fractional shares sold, in column (h) of Schedule D (Form 1040) in Part I or Part II, whichever is appropriate.

CAUTION *Report these transactions on Form 8949 with the correct box checked.*

For more information on Form 8949 and Schedule D (Form 1040), see chapter 4 of Publication 550. Also see the Instructions for Form 8949 and the Instructions for Schedule D (Form 1040).

Example. You own one share of common stock that you bought on January 3, 2003, for $100. The corporation declared a common stock dividend of 5% on June 30, 2012. The fair market value of the stock at the time the stock dividend was declared was $200. You were paid $10 for the fractional-share stock dividend under a plan described in the discussion above. You figure your gain or loss as follows:

Fair market value of old stock	$200.00
Fair market value of stock dividend (cash received)	+10.00
Fair market value of old stock and stock dividend	$210.00
Basis (cost) of old stock after the stock dividend (($200 ÷ $210) × $100)	$95.24
Basis (cost) of stock dividend (($10 ÷ $210) × $100)	+ 4.76
Total	$100.00
Cash received	$10.00
Basis (cost) of stock dividend	− 4.76
Gain	$5.24

Because you had held the share of stock for more than 1 year at the time the stock dividend was declared, your gain on the stock dividend is a long-term capital gain.

Scrip dividends. A corporation that declares a stock dividend may issue you a scrip certificate that entitles you to a fractional share. The certificate is generally nontaxable when you receive it. If you choose to have the corporation sell the certificate for you and give you the proceeds, your gain or loss is the difference between the proceeds and the portion of your basis in the corporation's stock allocated to the certificate.

However, if you receive a scrip certificate that you can choose to redeem for cash instead of stock, the certificate is taxable when you receive it. You must include its fair market value in income on the date you receive it.

Other Distributions

You may receive any of the following distributions during the year.

Exempt-interest dividends. Exempt-interest dividends you receive from a mutual fund or other regulated investment company, including those received from a qualified fund of funds in any tax year beginning after December 22, 2010, are not included in your taxable income. Exempt-interest dividends should be shown in box 10 of Form 1099-DIV.

Information reporting requirement. Although exempt-interest dividends are not taxable, you must show them on your tax return if you have to file a return. This is an information reporting requirement and does not change the exempt-interest dividends to taxable income.

Alternative minimum tax treatment. Exempt-interest dividends paid from specified private activity bonds may be subject to the alternative minimum tax. See *Alternative Minimum Tax (AMT)* in chapter 29 for more information.

Dividends on insurance policies. Insurance policy dividends the insurer keeps and uses to pay your premiums are not taxable. However, you must report as taxable interest income the interest that is paid or credited on dividends left with the insurance company.

If dividends on an insurance contract (other than a modified endowment contract) are distributed to you, they are a partial return of the premiums you paid. Do not include them in your gross income until they are more than the total of all net premiums you paid for the contract. Report any taxable distributions on insurance policies on Form 1040, line 21.

Dividends on veterans' insurance. Dividends you receive on veterans' insurance policies are not taxable. In addition, interest on dividends left with the Department of Veterans Affairs is not taxable.

Patronage dividends. Generally, patronage dividends you receive in money from a cooperative organization are included in your income.

Do not include in your income patronage dividends you receive on:

- Property bought for your personal use, or
- Capital assets or depreciable property bought for use in your business. But you must reduce the basis (cost) of the items bought. If the dividend is more than the adjusted basis of the assets, you must report the excess as income.

These rules are the same whether the cooperative paying the dividend is a taxable or tax-exempt cooperative.

Alaska Permanent Fund dividends. Do not report these amounts as dividends. Instead, report these amounts on Form 1040, line 21; Form 1040A, line 13; or Form 1040EZ, line 3.

How To Report Dividend Income

Generally, you can use either Form 1040 or Form 1040A to report your dividend income. Report the total of your ordinary dividends on line 9a of Form 1040 or Form 1040A. Report qualified dividends on line 9b of Form 1040 or Form 1040A.

If you receive capital gain distributions, you may be able to use Form 1040A or you may have to use Form 1040. See *Exceptions to filing Form 8949 and Schedule D (Form 1040)* in chapter 16. If you receive nondividend distributions required to be reported as capital gains, you must use Form 1040. You cannot use Form 1040EZ if you receive any dividend income.

Form 1099-DIV. If you owned stock on which you received $10 or more in dividends and other distributions, you should receive a Form 1099-DIV. Even if you do not receive Form 1099-DIV, you must report all your taxable dividend income.

See Form 1099-DIV for more information on how to report dividend income.

Form 1040A or 1040. You must complete Schedule B (Form 1040A or 1040), Part II, and attach it to your Form 1040A or 1040, if:

- Your ordinary dividends (Form 1099-DIV, box 1a) are more than $1,500, or
- You received, as a nominee, dividends that actually belong to someone else.

If your ordinary dividends are more than $1,500, you must also complete Schedule B (Form 1040A or 1040), Part III.

List on Schedule B (Form 1040A or 1040), Part II, line 5, each payer's name and the ordinary dividends you received. If your securities are held by a brokerage firm (in “street name”), list the name of the brokerage firm shown on Form 1099-DIV as the payer. If your stock is held by a nominee who is the owner of record, and the nominee credited or paid you dividends on the stock, show the name of the nominee and the dividends you received or for which you were credited.

Enter on line 6 the total of the amounts listed on line 5. Also enter this total on line 9a of Form 1040A or 1040.

Qualified dividends. Report qualified dividends (Form 1099-DIV, box 1b) on line 9b of Form 1040 or Form 1040A. The amount in box 1b is already included in box 1a. Do not add the amount in box 1b to, or substract it from, the amount in box 1a.

Do not include any of the following on line 9b.

- Qualified dividends you received as a nominee. See *Nominees* under *How to Report Dividend Income* in chapter 1 of Publication 550.
- Dividends on stock for which you did not meet the holding period. See *Holding period*, earlier under *Qualified Dividends*.
- Dividends on any share of stock to the extent you are obligated (whether under a short sale or otherwise) to make related payments for positions in substantially similar or related property.
- Payments in lieu of dividends, but only if you know or have reason to know the payments are not qualified dividends.
- Payments shown in Form 1099-DIV, box 1b, from a foreign corporation to the extent you know or have reason to know the payments are not qualified dividends.

If you have qualified dividends, you must figure your tax by completing the Qualified Dividends and Capital Gain Tax Worksheet in the Form 1040 or 1040A instructions or the Schedule D Tax Worksheet in the Schedule D (Form 1040) instructions, whichever applies. Enter qualified dividends on line 2 of the worksheet.

Investment interest deducted. If you claim a deduction for investment interest, you may have to reduce the amount of your qualified dividends that are eligible for the 0% or 15% tax rate. Reduce it by the qualified dividends you choose to include in investment income when figuring the limit on your investment interest deduction. This is done on the Qualified Dividends and Capital Gain Tax Worksheet or the Schedule D Tax Worksheet. For more information about the limit on investment interest, see *Investment expenses* in chapter 23.

Expenses related to dividend income. You may be able to deduct expenses related to dividend income if you itemize your deductions on Schedule A (Form 1040). See chapter 28 for general information about deducting expenses of producing income.

More information. For more information about how to report dividend income, see chapter 1 of Publication 550 or the instructions for the form you must file.

9.

Rental Income and Expenses

Introduction

This chapter discusses rental income and expenses. It also covers the following topics.

- Personal use of dwelling unit (including vacation home).
- Depreciation.
- Limits on rental losses.
- How to report your rental income and expenses.

If you sell or otherwise dispose of your rental property, see Publication 544, Sales and Other Dispositions of Assets.

If you have a loss from damage to, or theft of, rental property, see Publication 547, Casualties, Disasters, and Thefts.

If you rent a condominium or a cooperative apartment, some special rules apply to you even though you receive the same tax treatment as other owners of rental property. See Publication 527, Residential Rental Property, for more information.

Useful Items

You may want to see:

Publication

- ❏ **527** Residential Rental Property
- ❏ **534** Depreciating Property Placed in Service Before 1987
- ❏ **535** Business Expenses
- ❏ **925** Passive Activity and At-Risk Rules
- ❏ **946** How To Depreciate Property

Form (and Instructions)

- ❏ **4562** Depreciation and Amortization
- ❏ **6251** Alternative Minimum Tax—Individuals
- ❏ **8582** Passive Activity Loss Limitations
- ❏ **Schedule E (Form 1040)** Supplemental Income and Loss

Rental Income

In most cases, you must include in your gross income all amounts you receive as rent. Rental income is any payment you receive for the use or occupation of property. In addition to amounts you receive as normal rent payments, there are other amounts that may be rental income.

When to report. If you are a cash-basis taxpayer, you report rental income on your return for the year you actually or constructively receive it. You are a cash-basis taxpayer if you report income in the year you receive it, regardless of when it was earned. You constructively receive income when it is made available to you, for example, by being credited to your bank account.

For more information about when you constructively receive income, see *Accounting Methods* in chapter 1.

Advance rent. Advance rent is any amount you receive before the period that it covers. Include advance rent in your rental income in the year you receive it regardless of the period covered or the method of accounting you use.

Example. You sign a 10-year lease to rent your property. In the first year, you receive $5,000 for the first year's rent and $5,000 as rent for the last year of the lease. You must include $10,000 in your income in the first year.

Canceling a lease. If your tenant pays you to cancel a lease, the amount you receive is rent. Include the payment in your income in the year you receive it regardless of your method of accounting.

Expenses paid by tenant. If your tenant pays any of your expenses, the payments are rental income. Because you must include this amount in income, you can deduct the expenses if they are deductible rental expenses. See *Rental Expenses*, later, for more information.

Property or services. If you receive property or services, instead of money, as rent, include the fair market value of the property or services in your rental income.

If the services are provided at an agreed upon or specified price, that price is the fair market value unless there is evidence to the contrary.

Security deposits. Do not include a security deposit in your income when you receive it if you plan to return it to your tenant at the end of the lease. But if you keep part or all of the security deposit during any year because your tenant does not live up to the terms of the lease, include the amount you keep in your income in that year.

If an amount called a security deposit is to be used as a final payment of rent, it is advance rent. Include it in your income when you receive it.

Part interest. If you own a part interest in rental property, you must report your part of the rental income from the property.

Rental of property also used as your home. If you rent property that you also use as your home and you rent it less than 15 days during the tax year, do not include the rent you receive in your income and do not deduct rental expenses. However, you can deduct on Schedule A (Form 1040) the interest, taxes, and casualty and theft losses that are allowed for nonrental property. See *Personal Use of Dwelling Unit (Including Vacation Home)*, later.

Rental Expenses

This part discusses expenses of renting property that you ordinarily can deduct from your rental income. It includes information on the expenses you can deduct if you rent part of your property, or if you change your property to rental use. *Depreciation*, which you can also deduct from your rental income, is discussed later.

Personal use of rental property. If you sometimes use your rental property for personal purposes, you must divide your expenses between rental and personal use. Also, your rental expense deductions may be limited. See *Personal Use of Dwelling Unit (Including Vacation Home)*, later.

Part interest. If you own a part interest in rental property, you can deduct expenses that you paid according to your percentage of ownership.

When to deduct. If you are a cash-basis taxpayer, you generally deduct your rental expenses in the year you pay them.

Depreciation. You can begin to depreciate rental property when it is ready and available for rent. See *Placed-in-Service* under *When Does Depreciation Begin and End* in chapter 2 of Publication 527.

Pre-rental expenses. You can deduct your ordinary and necessary expenses for managing, conserving, or maintaining rental property from the time you make it available for rent.

Uncollected rent. If you are a cash-basis taxpayer, do not deduct uncollected rent. Because you have not included it in your income, it is not deductible.

If you use an accrual method, you report income when you earn it. If you are unable to collect the rent, you may be able to deduct it as a business bad debt. See chapter 10 of Publication 535 for more information about business bad debts.

Vacant rental property. If you hold property for rental purposes, you may be able to deduct your ordinary and necessary expenses (including depreciation) for managing, conserving, or maintaining the property while the property is vacant. However, you cannot deduct any loss of rental income for the period the property is vacant.

Vacant while listed for sale. If you sell property you held for rental purposes, you can deduct the ordinary and necessary expenses for managing, conserving, or maintaining the property until it is sold. If the property is not held out and available for rent while listed for sale, the expenses are not deductible rental expenses.

Repairs and Improvements

Generally, an expense for repairing or maintaining your rental property may be deducted if you are not required to capitalize the expense.

Improvements. You must capitalize any expense you pay to improve your rental property. An expense is for an improvement if it results in a betterment to your property, restores your property, or adapts your property to a new or different use.

Betterments. Expenses that may result in a betterment to your property include expenses for fixing a pre-existing defect or condition, enlarging or expanding your property, or increasing the capacity, strength, or quality of your property.

Restoration. Expenses that may be for restoration include expenses for replacing a substantial structural part of your property, repairing damage to your property after you properly adjusted the basis of your property as a result of a casualty loss, or rebuilding your property to a like-new condition.

Adaptation. Expenses that may be for adaptation include expenses for altering your property to a use that is not consistent with the intended ordinary use of your property when you began renting the property.

RECORDS Separate the costs of repairs and improvements, and keep accurate records. You will need to know the cost of improvements when you sell or depreciate your property.

The expenses you capitalize for improving your property can generally be depreciated as if the improvement were separate property.

Other Expenses

Other expenses you can deduct from your rental income include advertising, cleaning and maintenance, utilities, fire and liability insurance, taxes, interest, commissions for the collection of rent, ordinary and necessary travel and transportation, and other expenses, discussed next.

Insurance premiums paid in advance. If you pay an insurance premium for more than one year in advance, for each year of coverage you can deduct the part of the premium payment that will apply to that year. You cannot deduct the total premium in the year you pay it.

Legal and other professional fees. You can deduct, as a rental expense, legal and other professional expenses, such as tax return preparation fees you paid to prepare Schedule E (Form 1040), Part I. For example, on your 2012 Schedule E, you can deduct fees paid in 2012 to prepare your 2011 Schedule E, Part I. You can also deduct, as a rental expense, any expense (other than federal taxes and penalties) you paid to resolve a tax underpayment related to your rental activities.

Local benefit taxes. In most cases, you cannot deduct charges for local benefits that increase the value of your property, such as charges for putting in streets, sidewalks, or water and sewer systems. These charges are nondepreciable capital expenditures, and must be added to the basis of your property. However, you can deduct local benefit taxes that are for maintaining, repairing, or paying interest charges for the benefits.

Local transportation expenses. You may be able to deduct your ordinary and necessary local transportation expenses if you incur them to collect rental income or to manage, conserve, or maintain your rental property. Transportation expenses incurred to travel between your home and a rental property generally constitute nondeductible commuting costs unless you use your home as your principal place of business. See Publication 587, Business Use of Your Home, for information on determining if your home office qualifies as a principal place of business.

Generally, if you use your personal car, pickup truck, or light van for rental activities, you can deduct the expenses using one of two methods: actual expenses or the standard mileage rate. For 2012, the standard mileage rate for business use is 55.5 cents per mile. For more information, see chapter 26.

RECORDS To deduct car expenses under either method, you must keep records that follow the rules in chapter 26. In addition, you must complete Form 4562, Part V, and attach it to your tax return.

Rental of equipment. You can deduct the rent you pay for equipment that you use for rental purposes. However, in some cases, lease contracts are actually purchase contracts. If so, you cannot deduct these payments. You can recover the cost of purchased equipment through depreciation.

Rental of property. You can deduct the rent you pay for property that you use for rental purposes. If you buy a leasehold for rental purposes, you can deduct an equal part of the cost each year over the term of the lease.

Travel expenses. You can deduct the ordinary and necessary expenses of traveling away from home if the primary purpose of the trip is to collect rental income or to manage, conserve, or maintain your rental property. You must properly allocate your expenses between rental and nonrental activities. You cannot deduct the cost of traveling away from home if the primary purpose of the trip was to improve your property. You recover the cost of improvements by taking depreciation. For information on travel expenses, see chapter 26.

RECORDS To deduct travel expenses, you must keep records that follow the rules in chapter 26.

See *Rental Expenses* in Publication 527 for more information.

Property Changed to Rental Use

If you change your home or other property (or a part of it) to rental use at any time other than the beginning of your tax year, you must divide yearly expenses, such as taxes and insurance, between rental use and personal use.

You can deduct as rental expenses only the part of the expense that is for the part of the year the property was used or held for rental purposes.

You cannot deduct depreciation or insurance for the part of the year the property was held for personal use. However, you can include the home mortgage interest, qualified mortgage insurance premiums, and real estate tax expenses for the part of the year the property was held for personal use as an itemized deduction on Schedule A (Form 1040).

Example. Your tax year is the calendar year. You moved from your home in May and started renting it out on June 1. You can deduct as rental expenses seven-twelfths of your yearly expenses, such as taxes and insurance.

Starting with June, you can deduct as rental expenses the amounts you pay for items generally billed monthly, such as utilities.

Renting Part of Property

If you rent part of your property, you must divide certain expenses between the part of the property used for rental purposes and the part of the property used for personal purposes, as though you actually had two separate pieces of property.

You can deduct the expenses related to the part of the property used for rental purposes, such as home mortgage interest, qualified mortgage insurance premiums, and real estate taxes, as rental expenses on Schedule E (Form 1040). You can also deduct as rental expenses a portion of other expenses that normally are nondeductible personal expenses, such as expenses for electricity or painting the outside of your house.

There is no change in the types of expenses deductible for the personal-use part of your property. Generally, these expenses may be deducted only if you itemize your deductions on Schedule A (Form 1040).

You cannot deduct any part of the cost of the first phone line even if your tenants have unlimited use of it.

You do not have to divide the expenses that belong only to the rental part of your property. For example, if you paint a room that you rent, or if you pay premiums for liability insurance in connection with renting a room in your home, your entire cost is a rental expense. If you install a second phone line strictly for your tenants' use, all of the cost of the second line is deductible as a rental expense. You can deduct depreciation, discussed later, on the part of the house used for rental purposes as well as on the furniture and equipment you use for rental purposes.

How to divide expenses. If an expense is for both rental use and personal use, such as mortgage interest or heat for the entire house, you must divide the expense between the rental use and the personal use. You can use any reasonable method for dividing the expense. It may be reasonable to divide the cost of some items (for example, water) based on the number of people using them. The two most common methods for dividing an expense are based on (1) the number of rooms in your home, and (2) the square footage of your home.

Not Rented for Profit

If you do not rent your property to make a profit, you can deduct your rental expenses only up to the amount of your rental income. You cannot deduct a loss or carry forward to the next year any rental expenses that are more than your rental income for the year. For more information about the rules for an activity not engaged in for profit, see *Not-for-Profit Activities* in chapter 1 of Publication 535.

Where to report. Report your not-for-profit rental income on Form 1040, line 21. For example, you can include your mortgage interest and any qualified mortgage insurance premiums (if you use the property as your main home or second home), real estate taxes, and casualty losses on the appropriate lines of Schedule A (Form 1040) if you itemize your deductions.

If you itemize your deductions, claim your other rental expenses, subject to the rules explained in chapter 1 of Publication 535, as miscellaneous itemized deductions on Form 1040, Schedule A, line 23. You can deduct these expenses only if they, together with certain other miscellaneous itemized deductions, total more than 2% of your adjusted gross income.

Personal Use of Dwelling Unit (Including Vacation Home)

If you have any personal use of a dwelling unit (including a vacation home) that you rent, you must divide your expenses between rental use and personal use. In general, your rental expenses will be no more than your total expenses multiplied by a fraction; the denominator of which is the total number of days the dwelling unit is used and the numerator of which is the total number days actually rented at a fair rental price. Only your rental expenses may be deducted on Schedule E (Form 1040). Some of your personal expenses may be deductible if you itemize your deductions on Schedule A (Form 1040).

You must also determine if the dwelling unit is considered a home. The amount of rental expenses that you can deduct may be limited if the dwelling unit is considered a home. Whether a dwelling unit is considered a home depends on how many days during the year are considered to be days of personal use. There is a special rule if you used the dwelling unit as a home and you rented it for less than 15 days during the year.

Dwelling unit. A dwelling unit includes a house, apartment, condominium, mobile home, boat, vacation home, or similar property. It also includes all structures or other property belonging to the dwelling unit. A dwelling unit has basic living accommodations, such as sleeping space, a toilet, and cooking facilities.

A dwelling unit does not include property used solely as a hotel, motel, inn, or similar establishment. Property is used solely as a hotel, motel, inn, or similar establishment if it is regularly available for occupancy by paying customers and is not used by an owner as a home during the year.

Example. You rent a room in your home that is always available for short-term occupancy by paying customers. You do not use the room yourself, and you allow only paying customers to use the room. The room is used solely as a hotel, motel, inn, or similar establishment and is not a dwelling unit.

Dividing Expenses

If you use a dwelling unit for both rental and personal purposes, divide your expenses between the rental use and the personal use based on the number of days used for each purpose.

When dividing your expenses, follow these rules.

- Any day that the unit is rented at a fair rental price is a day of rental use even if you used the unit for personal purposes that day. This rule does not apply when determining whether you used the unit as a home.
- Any day that the unit is available for rent but not actually rented is not a day of rental use.

Example. Your beach cottage was available for rent from June 1 through August 31 (92 days). During that time, except for the first week in August (7 days) when you were unable to find a renter, you rented the cottage at a fair rental price. The person who rented the cottage for July allowed you to use it over the weekend (2 days) without any reduction in or refund of rent. Your family also used the cottage during the last 2 weeks of May (14 days). The cottage was not used at all before May 17 or after August 31.

You figure the part of the cottage expenses to treat as rental expenses as follows.

- The cottage was used for rental a total of 85 days (92 – 7). The days it was available for rent but not rented (7 days) are not days of rental use. The July weekend (2 days) you used it is rental use because you received a fair rental price for the weekend.
- You used the cottage for personal purposes for 14 days (the last 2 weeks in May).
- The total use of the cottage was 99 days (14 days personal use + 85 days rental use).
- Your rental expenses are 85/99 (86%) of the cottage expenses.

Note. When determining whether you used the cottage as a home, the July weekend (2 days) you used it is considered personal use even though you received a fair rental price for the weekend. Therefore, you had 16 days of personal use and 83 days of rental use for this purpose. Because you used the cottage for personal purposes more than 14 days and more than 10% of the days of rental use (8 days), you used it as a home. If you have a net loss, you may not be able to deduct all of the rental expenses. See *Dwelling Unit Used as a Home*, next.

Dwelling Unit Used as a Home

If you use a dwelling unit for both rental and personal purposes, the tax treatment of the rental expenses you figured earlier under *Dividing Expenses* and rental income depends on whether you are considered to be using the dwelling unit as a home.

You use a dwelling unit as a home during the tax year if you use it for personal purposes more than the greater of:

1. 14 days, or
2. 10% of the total days it is rented to others at a fair rental price.

See *What is a day of personal use*, later.

Fair rental price. A fair rental price for your property generally is the amount of rent that a person who is not related to you would be willing to pay. The rent you charge is not a fair rental price if it is substantially less than the rents charged for other properties that are similar to your property in your area.

If a dwelling unit is used for personal purposes on a day it is rented at a fair rental price, do not count that day as a day of rental use in applying (2) above. Instead, count it as a day of personal use in applying both (1) and (2) above.

What is a day of personal use? A day of personal use of a dwelling unit is any day that the unit is used by any of the following persons.

1. You or any other person who has an interest in the unit, unless you rent it to another owner as his or her main home under a shared equity financing agreement (defined later). However, see *Days used as a main home before or after renting*, later.
2. A member of your family or a member of the family of any other person who owns an interest in the unit, unless the family member uses the dwelling unit as his or her main home and pays a fair rental price. Family includes only your spouse, brothers and sisters, half-brothers and half-sisters, ancestors (parents, grandparents, etc.), and lineal descendants (children, grandchildren, etc.).
3. Anyone under an arrangement that lets you use some other dwelling unit.
4. Anyone at less than a fair rental price.

Main home. If the other person or member of the family in (1) or (2) above has more than one home, his or her main home is ordinarily the one he or she lived in most of the time.

Shared equity financing agreement. This is an agreement under which two or more persons acquire undivided interests for more than 50 years in an entire dwelling unit, including the land, and one or more of the co-owners is entitled to occupy the unit as his or her main home upon payment of rent to the other co-owner or owners.

Donation of use of property. You use a dwelling unit for personal purposes if:

- You donate the use of the unit to a charitable organization,
- The organization sells the use of the unit at a fund-raising event, and
- The "purchaser" uses the unit.

Examples. The following examples show how to determine days of personal use.

Example 1. You and your neighbor are co-owners of a condominium at the beach. Last year, you rented the unit to vacationers whenever possible. The unit was not used as a main home by anyone. Your neighbor used the unit for 2 weeks last year; you did not use it at all.

Because your neighbor has an interest in the unit, both of you are considered to have used the unit for personal purposes during those 2 weeks.

Example 2. You and your neighbors are co-owners of a house under a shared equity financing agreement. Your neighbors live in the house and pay you a fair rental price.

Even though your neighbors have an interest in the house, the days your neighbors live there are not counted as days of personal use by you. This is because your neighbors rent the house as their main home under a shared equity financing agreement.

Example 3. You own a rental property that you rent to your son. Your son does not own any interest in this property. He uses it as his main home and pays you a fair rental price.

Your son's use of the property is not personal use by you because your son is using it as his main home, he owns no interest in the property, and he is paying you a fair rental price.

Example 4. You rent your beach house to Joshua. Joshua rents his cabin in the mountains to you. You each pay a fair rental price.

You are using your house for personal purposes on the days that Joshua uses it because your house is used by Joshua under an arrangement that allows you to use his house.

Days used for repairs and maintenance. Any day that you spend working substantially full time repairing and maintaining (not improving) your property is not counted as a day of personal use. Do not count such a day as a day of personal use even if family members use the property for recreational purposes on the same day.

Days used as a main home before or after renting. For purposes of determining whether a dwelling unit was used as a home, you may not have to count days you used the property as your main home before or after renting it or offering it for rent as days of personal use. Do not count them as days of personal use if:

- You rented or tried to rent the property for 12 or more consecutive months.
- You rented or tried to rent the property for a period of less than 12 consecutive months and the period ended because you sold or exchanged the property.

However, this special rule does not apply when dividing expenses between rental and personal use.

Examples. The following examples show how to determine whether you used your rental property as a home.

Example 1. You converted the basement of your home into an apartment with a bedroom, a bathroom, and a small kitchen. You rented the basement apartment at a fair rental price to college students during the regular school year. You rented to them on a 9-month lease (273 days). You figured 10% of the total days rented to others at a fair rental price is 27 days.

During June (30 days), your brothers stayed with you and lived in the basement apartment rent free.

Your basement apartment was used as a home because you used it for personal purposes for 30 days. Rent-free use by your brothers is considered personal use. Your personal use (30 days) is more than the greater of 14 days or 10% of the total days it was rented (27 days).

Example 2. You rented the guest bedroom in your home at a fair rental price during the local college's homecoming, commencement, and football weekends (a total of 27 days). Your sister-in-law stayed in the room, rent free, for the last 3 weeks (21 days) in July. You figured 10% of the total days rented to others at a fair rental price is 3 days.

The room was used as a home because you used it for personal purposes for 21 days. That is more than the greater of 14 days or 10% of the 27 days it was rented (3 days).

Example 3. You own a condominium apartment in a resort area. You rented it at a fair rental price for a total of 170 days during the year. For 12 of those days, the tenant was not able to use the apartment and allowed you to use it even though you did not refund any of the rent. Your family actually used the apartment for 10 of those days. Therefore, the apartment is treated as having been rented for 160 (170 − 10) days. You figured 10% of the total days rented to others at a fair rental price is 16 days. Your family also used the apartment for 7 other days during the year.

You used the apartment as a home because you used it for personal purposes for 17 days. That is more than the greater of 14 days or 10% of the 160 days it was rented (16 days).

Minimal rental use. If you use the dwelling unit as a home and you rent it less than 15 days during the year, that period is not treated as rental activity. See *Used as a home but rented less than 15 days*, later, for more information.

Limit on deductions. Renting a dwelling unit that is considered a home is not a passive activity. Instead, if your rental expenses are more than your rental income, some or all of the excess expenses cannot be used to offset income from other sources. The excess expenses that cannot be used to offset income from other sources are carried forward to the next year and treated as rental expenses for the same property. Any expenses carried forward to the next year will be subject to any limits that apply for that year. This limitation will apply to expenses carried forward to another year even if you do not use the property as your home for that subsequent year.

To figure your deductible rental expenses for this year and any carryover to next year, use Worksheet 9-1.

Reporting Income and Deductions

Property not used for personal purposes. If you do not use a dwelling unit for personal purposes, see *How To Report Rental Income and Expenses*, later, for how to report your rental income and expenses.

Property used for personal purposes. If you do use a dwelling unit for personal purposes, then how you report your rental income and expenses depends on whether you used the dwelling unit as a home.

Not used as a home. If you use a dwelling unit for personal purposes, but not as a home, report all the rental income in your income. Since you used the dwelling unit for personal purposes, you must divide your expenses between the rental use and the personal use as described earlier in *Dividing Expenses*. The expenses for personal use are not deductible as rental expenses.

Your deductible rental expenses can be more than your gross rental income; however, see *Limits on Rental Losses*, later.

Used as a home but rented less than 15 days. If you use a dwelling unit as a home and you rent it less than 15 days during the year, its primary function is not considered to be rental and it should not be reported on Schedule E (Form 1040). You are not required to report the rental income and rental expenses from this activity. The expenses, including qualified mortgage interest, property taxes, and any qualified casualty loss will be reported as normally allowed on Schedule A (Form 1040). See the Instructions for Schedule A (Form 1040) for more information on deducting these expenses.

Used as a home and rented 15 days or more. If you use a dwelling unit as a home and rent it 15 days or more during the year, include all your rental income in your income. Since you used the dwelling unit for personal purposes, you must divide your expenses between the rental use and the personal use as described earlier in *Dividing Expenses*. The expenses for personal use are not deductible as rental expenses.

If you had a net profit from renting the dwelling unit for the year (that is, if your rental income is more than the total of your rental expenses, including depreciation), deduct all of your rental expenses. You do not need to use Worksheet 9-1.

However, if you had a net loss from renting the dwelling unit for the year, your deduction for certain rental expenses is limited. To figure your deductible rental expenses and any carryover to next year, use Worksheet 9-1.

Depreciation

You recover the cost of income-producing property through yearly tax deductions. You do this by depreciating the property; that is, by deducting some of the cost each year on your tax return.

Three factors determine how much depreciation you can deduct each year: (1) your basis in the property, (2) the recovery period for the property, and (3) the depreciation method used. You cannot simply deduct your mortgage or principal payments, or the cost of furniture, fixtures, and equipment, as an expense.

You can deduct depreciation only on the part of your property used for rental purposes. Depreciation reduces your basis for figuring gain or loss on a later sale or exchange.

You may have to use Form 4562 to figure and report your depreciation. See *How To Report Rental Income and Expenses*, later.

Alternative minimum tax (AMT). If you use accelerated depreciation, you may be subject to the AMT. Accelerated depreciation allows you to deduct more depreciation earlier in the recovery period than you could deduct using a straight line method (same deduction each year).

Claiming the correct amount of depreciation. You should claim the correct amount of depreciation each tax year. If you did not claim all the depreciation you were entitled to deduct, you must still reduce your basis in the property by the full amount of depreciation that you could have deducted.

If you deducted an incorrect amount of depreciation for property in any year, you may be able to make a correction by filing Form 1040X, Amended U.S Individual Income Tax Return. If you are not allowed to make the correction on an amended return, you can change your accounting method to claim the correct amount of depreciation. See *Claiming the correct amount of depreciation* in chapter 2 of Publication 527 for more information.

Changing your accounting method to deduct unclaimed depreciation. To change your accounting method, you generally must file Form 3115, Application for Change in Accounting Method, to get the consent of the IRS. In some instances, that consent is automatic. For more information, see chapter 1 of Publication 946.

Land. You cannot depreciate the cost of land because land generally does not wear out, become obsolete, or get used up. The costs of clearing, grading, planting, and landscaping are usually all part of the cost of land and cannot be depreciated.

More information. See Publication 527 for more information about depreciating rental property and see Publication 946 for more information about depreciation.

Limits on Rental Losses

If you have a loss from your rental real estate activity, two sets of rules may limit the amount of loss you can deduct. You must consider these rules in the order shown below.

1. At-risk rules. These rules are applied first if there is investment in your rental real estate activity for which you are not at risk. This applies only if the real property was placed in service after 1986.
2. Passive activity limits. Generally, rental real estate activities are considered passive activities and losses are not deductible unless you have income from other passive activities to offset them. However, there are exceptions.

At-Risk Rules

You may be subject to the at-risk rules if you have:

- A loss from an activity carried on as a trade or business or for the production of income, and
- Amounts invested in the activity for which you are not fully at risk.

Losses from holding real property (other than mineral property) placed in service before 1987 are not subject to the at-risk rules.

In most cases, any loss from an activity subject to the at-risk rules is allowed only to the extent of the total amount you have at risk in the activity at the end of the tax year. You are considered at risk in an activity to the extent of cash and the adjusted basis of other property you contributed to the activity and certain amounts borrowed for use in the activity. See Publication 925 for more information.

Passive Activity Limits

In most cases, all rental real estate activities (except those of certain real estate professionals, discussed later) are passive activities. For this purpose, a rental activity is an activity from which you receive income mainly for the use of tangible property, rather than for services.

Limits on passive activity deductions and credits. Deductions or losses from passive activities are limited. You generally cannot offset income, other than passive income, with losses from passive activities. Nor can you offset taxes on income, other than passive income, with credits resulting from passive activities. Any excess loss or credit is carried forward to the next tax year.

For a detailed discussion of these rules, see Publication 925.

You may have to complete Form 8582 to figure the amount of any passive activity loss for the current tax year for all activities and the amount of the passive activity loss allowed on your tax return.

Real estate professionals. Rental activities in which you materially participated during the year are not passive activities if, for that year, you were a real estate professional. For a detailed discussion of the requirements, see Publication 527. For a detailed discussion of material participation, see Publication 925.

Losses From Rental Real Estate Activities With Active Participation

If you or your spouse actively participated in a passive rental real estate activity, you can deduct up to $25,000 of loss from the activity from your nonpassive income. This special allowance is an exception to the general rule disallowing losses in excess of income from passive activities. Similarly, you can offset credits from the activity against the tax on up to $25,000 of nonpassive income after taking into account any losses allowed under this exception.

Active participation. You actively participated in a rental real estate activity if you (and your spouse) owned at least 10% of the rental property and you made management decisions or arranged for others to provide services (such as repairs) in a significant and *bona fide* sense. Management decisions that may count as active participation include approving new tenants, deciding on rental terms, approving expenditures, and similar decisions.

Maximum special allowance. The maximum special allowance is:

- $25,000 for single individuals and married individuals filing a joint return for the tax year,
- $12,500 for married individuals who file separate returns for the tax year and lived apart from their spouses at all times during the tax year, and
- $25,000 for a qualifying estate reduced by the special allowance for which the surviving spouse qualified.

If your modified adjusted gross income (MAGI) is $100,000 or less ($50,000 or less if married filing separately), you can deduct your loss up to the amount specified above. If your MAGI is more than $100,000 (more than $50,000 if married filing separately), your special allowance is limited to 50% of the difference between $150,000 ($75,000 if married filing separately) and your MAGI.

Generally, if your MAGI is $150,000 or more ($75,000 or more if you are married filing separately), there is no special allowance.

More information. See Publication 925 for more information on the passive loss limits, including information on the treatment of unused disallowed passive losses and credits and the treatment of gains and losses realized on the disposition of a passive activity.

How To Report Rental Income and Expenses

The basic form for reporting residential rental income and expenses is Schedule E (Form 1040). However, do not use that schedule to report a not-for-profit activity. See *Not Rented for Profit,* earlier.

Providing substantial services. If you provide substantial services that are primarily for your tenant's convenience, such as regular cleaning, changing linen, or maid service, report your rental income and expenses on Schedule C (Form 1040), Profit or Loss From Business, or Schedule C-EZ (Form 1040), Net Profit From Business (Sole Proprietorship). Substantial services do not include the furnishing of heat and light, cleaning of public areas, trash collection, etc. For information, see Publication 334, Tax Guide for Small Business. You also may have to pay self-employment tax on your rental income using Schedule SE (Form 1040), Self-Employment Tax.

Use Form 1065, U.S. Return of Partnership Income, if your rental activity is a partnership (including a partnership with your spouse unless it is a qualified joint venture).

Qualified joint venture. If you and your spouse each materially participate as the only members of a jointly owned and operated real estate business, and you file a joint return for the tax year, you can make a joint election to be treated as a qualified joint venture instead of a partnership. This election, in most cases, will not increase the total tax owed on the joint return, but it does give each of you credit for social security earnings on which retirement benefits are based and for Medicare coverage if your rental income is subject to self-employment tax. For more information, see Publication 527.

Form 1098, Mortgage Interest Statement. If you paid $600 or more of mortgage interest on your rental property to any one person, you should receive a Form 1098, or similar statement showing the interest you paid for the year. If you and at least one other person (other than your spouse if you file a joint return) were liable for, and paid interest on the mortgage, and the other person received the Form 1098, report your share of the interest on Schedule E (Form 1040), line 13. Attach a statement to your return showing the name and address of the other person. In the left margin of Schedule E, next to line 13, enter "See attached."

Schedule E (Form 1040)

If you rent buildings, rooms, or apartments, and provide basic services such as heat and light, trash collection, etc., you normally report your rental income and expenses on Schedule E, Part I.

List your total income, expenses, and depreciation for each rental property. Be sure to enter the number of fair rental and personal use days on line 2.

If you have more than three rental or royalty properties, complete and attach as many Schedules E as are needed to list the properties. Complete lines 1 and 2 for each property. However, fill in lines 23a through 26 on only one Schedule E.

On Schedule E, page 1, line 18, enter the depreciation you are claiming for each property. To find out if you need to attach Form 4562, see *Form 4562*, in chapter 3 of Publication 527.

If you have a loss from your rental real estate activity, you also may need to complete one or both of the following forms.

- Form 6198, At-Risk Limitations. See *At-Risk Rules*, earlier. Also see Publication 925.
- Form 8582, Passive Activity Loss Limitations. See *Passive Activity Limits*, earlier.

Page 2 of Schedule E is used to report income or loss from partnerships, S corporations, estates, trusts, and real estate mortgage investment conduits. If you need to use page 2 of Schedule E, use page 2 of the same Schedule E you used to enter your rental activity on page 1. Also, include the amount from line 26 (Part I) in the "Total income or (loss)" on line 41 (Part V).

Worksheet 9-1. **Worksheet for Figuring Rental Deductions for a Dwelling Unit Used as a Home**

Keep for Your Records

Use this worksheet only if you answer "yes" to all of the following questions.

- Did you use the dwelling unit as a home this year? (See *Dwelling Unit Used as a Home*.)
- Did you rent the dwelling unit at a fair rental price 15 days or more this year?
- Is the total of your rental expenses and depreciation more than your rental income?

PART I. Rental Use Percentage

A.	Total days available for rent at fair rental price	**A.**	______
B.	Total days available for rent (line A) but not rented	**B.**	______
C.	**Total days of rental use.** Subtract line B from line A	**C.**	______
D.	**Total days of personal use** (including days rented at less than fair rental price)	**D.**	______
E.	**Total days of rental and personal use.** Add lines C and D	**E.**	______
F.	**Percentage of expenses allowed for rental.** Divide line C by line E	**F.**	______

PART II. Allowable Rental Expenses

1.	Enter rents received	**1.**	______
2a.	Enter the rental portion of deductible home mortgage interest and qualified mortgage insurance premiums (see instructions)	**2a.**	______
b.	Enter the rental portion of real estate taxes	**b.**	______
c.	Enter the rental portion of deductible casualty and theft losses (see instructions)	**c.**	______
d.	Enter direct rental expenses (see instructions)	**d.**	______
e.	**Fully deductible rental expenses.** Add lines 2a–2d. Enter here and on the appropriate lines on Schedule E (see instructions)	**2e.**	______
3.	Subtract line 2e from line 1. If zero or less, enter -0-	**3.**	______
4a.	Enter the rental portion of expenses directly related to operating or maintaining the dwelling unit (such as repairs, insurance, and utilities)	**4a.**	______
b.	Enter the rental portion of excess mortgage interest and qualified mortgage insurance premiums (see instructions)	**b.**	______
c.	Carryover of operating expenses from 2011 worksheet	**c.**	______
d.	Add lines 4a–4c	**d.**	______
e.	**Allowable expenses.** Enter the **smaller** of line 3 or line 4d (see instructions)	**4e.**	______
5.	Subtract line 4e from line 3. If zero or less, enter -0-	**5.**	______
6a.	Enter the rental portion of excess casualty and theft losses (see instructions)	**6a.**	______
b.	Enter the rental portion of depreciation of the dwelling unit	**b.**	______
c.	Carryover of excess casualty losses and depreciation from 2011 worksheet	**c.**	______
d.	Add lines 6a–6c	**d.**	______
e.	**Allowable excess casualty and theft losses and depreciation.** Enter the **smaller** of line 5 or line 6d (see instructions)	**6e.**	______

PART III. Carryover of Unallowed Expenses to Next Year

7a.	**Operating expenses to be carried over to next year.** Subtract line 4e from line 4d	**7a.**	______
b.	**Excess casualty and theft losses and depreciation to be carried over to next year.** Subtract line 6e from line 6d	**b.**	______

Worksheet 9-1 Instructions. **Worksheet for Figuring Rental Deductions for a Dwelling Unit Used as a Home**

Keep for Your Records

Caution. Use the percentage determined in Part I, line F, to figure the rental portions to enter on lines 2a–2c, 4a–4b, and 6a–6b of Part II.

Line 2a. Figure the mortgage interest on the dwelling unit that you could deduct on Schedule A (as if you were itemizing your deductions) if you had not rented the unit. Do not include interest on a loan that did not benefit the dwelling unit. For example, do not include interest on a home equity loan used to pay off credit cards or other personal loans, buy a car, or pay college tuition. Include interest on a loan used to buy, build, or improve the dwelling unit, or to refinance such a loan. Include the rental portion of this interest in the total you enter on line 2a of the worksheet.

Figure the qualified mortgage insurance premiums on the dwelling unit that you could deduct on line 13 of Schedule A, if you had not rented the unit. See the Schedule A instructions. However, figure your adjusted gross income (Form 1040, line 38) without your rental income and expenses from the dwelling unit. See *Line 4b* to deduct the part of the qualified mortgage insurance premiums not allowed because of the adjusted gross income limit. Include the rental portion of the amount from Schedule A, line 13, in the total you enter on line 2a of the worksheet.

Note. Do not file this Schedule A or use it to figure the amount to deduct on line 13 of that schedule. Instead, figure the personal portion on a separate Schedule A. If you have deducted mortgage interest or qualified mortgage insurance premiums on the dwelling unit on other forms, such as Schedule C or F, remember to reduce your Schedule A deduction by that amount.

Line 2c. Figure the casualty and theft losses related to the dwelling unit that you could deduct on Schedule A if you had not rented the dwelling unit. To do this, complete Section A of Form 4684, Casualties and Thefts, treating the losses as personal losses. If any of the loss is due to a federally declared disaster, see the Instructions for Form 4684. On Form 4684, line 17, enter 10% of your adjusted gross income figured without your rental income and expenses from the dwelling unit. Enter the rental portion of the result from Form 4684, line 18, on line 2c of this worksheet.

Note. Do not file this Form 4684 or use it to figure your personal losses on Schedule A. Instead, figure the personal portion on a separate Form 4684.

Line 2d. Enter the total of your rental expenses that are directly related only to the rental activity. These include interest on loans used for rental activities other than to buy, build, or improve the dwelling unit. Also include rental agency fees, advertising, office supplies, and depreciation on office equipment used in your rental activity.

Line 2e. You can deduct the amounts on lines 2a, 2b, 2c, and 2d as rental expenses on Schedule E even if your rental expenses are more than your rental income. Enter the amounts on lines 2a, 2b, 2c, and 2d on the appropriate lines of Schedule E.

Line 4b. On line 2a, you entered the rental portion of the mortgage interest and qualified mortgage insurance premiums you could deduct on Schedule A if you had not rented the dwelling unit. If you had additional mortgage interest and qualified mortgage insurance premiums that would not be deductible on Schedule A because of limits imposed on them, enter on line 4b of this worksheet the rental portion of those excess amounts. Do not include interest on a loan that did not benefit the dwelling unit (as explained in the line 2a instructions).

Line 4e. You can deduct the amounts on lines 4a, 4b, and 4c as rental expenses on Schedule E only to the extent they are not more than the amount on line 4e.*

Line 6a. To find the rental portion of excess casualty and theft losses, use the Form 4684 you prepared for line 2c of this worksheet.

A. Enter the amount from Form 4684, line 10 . . . . ________

B. Enter the rental portion of line A . . . . ________

C. Enter the amount from line 2c of this worksheet . . . . ________

D. Subtract line C from line B. Enter the result here and on line 6a of this worksheet . . . . . . ________

Line 6e. You can deduct the amounts on lines 6a, 6b, and 6c as rental expenses on Schedule E only to the extent they are not more than the amount on line 6e.*

***Allocating the limited deduction.** If you cannot deduct all of the amount on line 4d or 6d this year, you can allocate the allowable deduction in any way you wish among the expenses included on line 4d or 6d. Enter the amount you allocate to each expense on the appropriate line of Schedule E, Part I.

10.

Retirement Plans, Pensions, and Annuities

What's New

Starting in 2013, the American Taxpayer Relief Act of 2012 expanded the rules for in-plan Roth rollovers to include more taxpayers. At the time this publication went to print, guidance had not yet been issued. Once guidance is issued, we will post it on *www.irs.gov/pub575*.

Reminder

Disaster-related tax relief. Special rules apply to retirement funds received by qualified individuals who suffered an economic loss as a result of the severe storms in the Midwestern disaster areas in 2008. For more information on these special rules, see *Relief for Midwestern Disaster Areas* in Publication 575, Pension and Annuity Income.

2010 Roth IRA rollovers. If you rolled over an amount from a qualified retirement plan to your Roth IRA in 2010 that you are including in income in 2011 and 2012, see your tax return instructions and Publication 575 for details on how to report any taxable amount for 2012.

2010 in-plan Roth rollovers. If you rolled over an amount from your 401(k) or 403(b) plan in 2010 to a designated Roth account, within the same plan, that you are including in income in 2011 and 2012, see your tax return instructions and Publication 575 for details on how to report any taxable amount for 2012.

Introduction

This chapter discusses the tax treatment of distributions you receive from:

- An employee pension or annuity from a qualified plan,
- A disability retirement, and
- A purchased commercial annuity.

What is not covered in this chapter. The following topics are not discussed in this chapter.

The General Rule. This is the method generally used to determine the tax treatment of pension and annuity income from nonqualified plans (including commercial annuities). For a qualified plan, you generally cannot use the General Rule unless your annuity starting date is before November 19, 1996. For more information about the General Rule, see Publication 939, General Rule for Pensions and Annuities.

Individual retirement arrangements (IRAs). Information on the tax treatment of amounts you receive from an IRA is in chapter 17.

Civil service retirement benefits. If you are retired from the federal government (either regular or disability retirement), see Publication 721, Tax Guide to U.S. Civil Service Retirement Benefits. Publication 721 also covers the information that you need if you are the survivor or beneficiary of a federal employee or retiree who died.

Useful Items

You may want to see:

Publication

- ❏ **575** Pension and Annuity Income
- ❏ **721** Tax Guide to U.S. Civil Service Retirement Benefits
- ❏ **939** General Rule for Pensions and Annuities

Form (and Instructions)

- ❏ **W-4P** Withholding Certificate for Pension or Annuity Payments
- ❏ **1099-R** Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.
- ❏ **4972** Tax on Lump-Sum Distributions
- ❏ **5329** Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts

General Information

Designated Roth accounts. A designated Roth account is a separate account created under a qualified Roth contribution program to which participants may elect to have part or all of their elective deferrals to a 401(k), 403(b), or 457(b) plan designated as Roth contributions. Elective deferrals that are designated as Roth contributions are included in your income. However, qualified distributions are not included in your income. See Publication 575 for more information.

In-plan rollovers to designated Roth accounts. If you are a participant in a 401(k), 403(b), or 457(b) plan, your plan may permit you to roll over amounts in those plans to a designated Roth account within the same plan. The rollover of any untaxed amounts must be included in income. For 2010 in-plan Roth rollovers, the taxable amount is included in income in equal amounts in 2011 and 2012 unless you elected to include the entire amount in income in 2010. You may be required to include an amount other than half of a 2010 in-plan Roth rollover in income in 2012 if you also took a distribution from your designated Roth account in 2010 or 2011. See Publication 575 for more information.

More than one program. If you receive benefits from more than one program under a single trust or plan of your employer, such as a pension plan and a profit-sharing plan, you may have to figure the taxable part of each pension or annuity contract separately. Your former employer or the plan administrator should be able to tell you if you have more than one pension or annuity contract.

Section 457 deferred compensation plans. If you work for a state or local government or for a tax-exempt organization, you may be able to participate in a section 457 deferred compensation plan. If your plan is an eligible plan, you are not taxed currently on pay that is deferred under the plan or on any earnings from the plan's investment of the deferred pay. You are generally taxed on amounts deferred in an eligible state or local government plan only when they are distributed from the plan. You are taxed on amounts deferred in an eligible tax-exempt organization plan when they are distributed or otherwise made available to you.

Your 457(b) plan may have a designated Roth account option. If so, you may be able to roll over amounts to the designated Roth account or make contributions. Elective deferrals to a designated Roth account are included in your income. Qualified distributions from a designated Roth account are not subject to tax.

This chapter covers the tax treatment of benefits under eligible section 457 plans, but it does not cover the treatment of deferrals. For information on deferrals under section 457 plans, see *Retirement Plan Contributions* under *Employee Compensation* in Publication 525, Taxable and Nontaxable Income.

For general information on these deferred compensation plans, see *Section 457 Deferred Compensation Plans* in Publication 575.

Disability pensions. If you retired on disability, you generally must include in income any disability pension you receive under a plan that is paid for by your employer. You must report your taxable disability payments as wages on line 7 of Form 1040 or Form 1040A until you reach minimum retirement age. Minimum retirement age generally is the age at which you can first receive a pension or annuity if you are not disabled.

TIP *You may be entitled to a tax credit if you were permanently and totally disabled when you retired. For information on the credit for the elderly or the disabled, see chapter 32.*

Beginning on the day after you reach minimum retirement age, payments you receive are taxable as a pension or annuity. Report the payments on Form 1040, lines 16a and 16b, or on Form 1040A, lines 12a and 12b.

TIP *Disability payments for injuries incurred as a direct result of a terrorist attack directed against the United States (or its allies) are not included in income. For more information about payments to survivors of terrorist attacks, see Publication 3920, Tax Relief for Victims of Terrorist Attacks.*

For more information on how to report disability pensions, including military and certain government disability pensions, see chapter 5.

Retired public safety officers. An eligible retired public safety officer can elect to exclude from income distributions of up to $3,000 made directly from a government retirement plan to the provider of accident, health, or long-term disability insurance. See *Insurance Premiums for Retired Public Safety Officers* in Publication 575 for more information.

Railroad retirement benefits. Part of any railroad retirement benefits you receive is treated for tax purposes as social security benefits, and part is treated as an employee pension. For information about railroad retirement benefits treated as social security benefits, see Publication 915, Social Security and Equivalent Railroad Retirement Benefits. For information about railroad retirement benefits treated as an employee pension, see *Railroad Retirement Benefits* in Publication 575.

Withholding and estimated tax. The payer of your pension, profit-sharing, stock bonus, annuity, or deferred compensation plan will withhold income tax on the taxable parts of amounts paid to you. You can tell the payer how much to withhold, or not to withhold, by filing Form W-4P. If you choose not to have tax withheld, or you do not have enough tax withheld, you may have to pay estimated tax.

If you receive an eligible rollover distribution, you cannot choose not to have tax withheld. Generally, 20% will be withheld, but no tax will be withheld on a direct rollover of an eligible rollover distribution. See *Direct rollover option* under *Rollovers,* later.

For more information, see *Pensions and Annuities* under *Tax Withholding for 2013* in chapter 4.

Qualified plans for self-employed individuals. Qualified plans set up by self-employed individuals are sometimes called Keogh or H.R. 10 plans. Qualified plans can be set up by sole proprietors, partnerships (but not a partner), and corporations. They can cover self-employed persons, such as the sole proprietor or partners, as well as regular (common-law) employees.

Distributions from a qualified plan are usually fully taxable because most recipients have no cost basis. If you have an investment (cost) in the plan, however, your pension or annuity payments from a qualified plan are taxed under the Simplified Method. For more information about qualified plans, see Publication 560, Retirement Plans for Small Business.

Purchased annuities. If you receive pension or annuity payments from a privately purchased annuity contract from a commercial organization, such as an insurance company, you generally must use the General Rule to figure the tax-free part of each annuity payment. For more information about the General Rule, get Publication 939. Also, see *Variable Annuities* in Publication 575 for the special provisions that apply to these annuity contracts.

Loans. If you borrow money from your retirement plan, you must treat the loan as a nonperiodic distribution from the plan unless certain exceptions apply. This treatment also applies to any loan under a contract purchased under your retirement plan, and to the value of any part of your interest in the plan or contract that you pledge or assign. This means that you must include in income all or part of the amount borrowed. Even if you do not have to treat the loan as a nonperiodic distribution, you may not be able to deduct the interest on the loan in some situations. For details, see *Loans Treated as Distributions* in Publication 575. For information on the deductibility of interest, see chapter 23.

Tax-free exchange. No gain or loss is recognized on an exchange of an annuity contract for another annuity contract if the insured or annuitant remains the same. However, if an annuity contract is exchanged for a life insurance or endowment contract, any gain due to interest accumulated on the contract is ordinary income. See *Transfers of Annuity Contracts* in Publication 575 for more information about exchanges of annuity contracts.

How To Report

If you file Form 1040, report your total annuity on line 16a and the taxable part on line 16b. If your pension or annuity is fully taxable, enter it on line 16b; do not make an entry on line 16a.

If you file Form 1040A, report your total annuity on line 12a and the taxable part on line 12b. If your pension or annuity is fully taxable, enter it on line 12b; do not make an entry on line 12a.

More than one annuity. If you receive more than one annuity and at least one of them is not fully taxable, enter the total amount received from all annuities on Form 1040, line 16a, or Form 1040A, line 12a, and enter the taxable part on Form 1040, line 16b, or Form 1040A, line 12b. If all the annuities you receive are fully taxable, enter the total of all of them on Form 1040, line 16b, or Form 1040A, line 12b.

Joint return. If you file a joint return and you and your spouse each receive one or more pensions or annuities, report the total of the pensions and annuities on Form 1040, line 16a, or Form 1040A, line 12a, and report the taxable part on Form 1040, line 16b, or Form 1040A, line 12b.

Cost (Investment in the Contract)

Before you can figure how much, if any, of a distribution from your pension or annuity plan is taxable, you must determine your cost (your investment in the contract) in the pension or annuity. Your total cost in the plan includes the total premiums, contributions, or other amounts you paid. This includes the amounts your employer contributed that were taxable to you when paid. Cost does not include any amounts you deducted or were excluded from your income.

From this total cost, subtract any refunds of premiums, rebates, dividends, unrepaid loans that were not included in your income, or other tax-free amounts that you received by the later of the annuity starting date or the date on which you received your first payment.

Your annuity starting date is the later of the first day of the first period for which you received a payment or the date the plan's obligations became fixed.

Designated Roth accounts. Your cost in these accounts is your designated Roth contributions that were included in your income as wages subject to applicable withholding requirements. Your cost will also include any in-plan Roth rollovers you included in income.

Foreign employment contributions. If you worked in a foreign country and contributions were made to your retirement plan, special rules apply in determining your cost. See Publication 575.

Taxation of Periodic Payments

Fully taxable payments. Generally, if you did not pay any part of the cost of your employee pension or annuity and your employer did not withhold part of the cost from your pay while you worked, the amounts you receive each year are fully taxable. You must report them on your income tax return.

Partly taxable payments. If you paid part of the cost of your pension or annuity, you are not taxed on the part of the pension or annuity you receive that represents a return of your cost. The rest of the amount you receive is generally taxable. You figure the tax-free part of the payment using either the Simplified Method or the General Rule. Your annuity starting date and whether or not your plan is qualified determine which method you must or may use.

If your annuity starting date is after November 18, 1996, and your payments are from a qualified plan, you must use the Simplified Method. Generally, you must use the General Rule if your annuity is paid under a nonqualified plan, and you cannot use this method if your annuity is paid under a qualified plan.

If you had more than one partly taxable pension or annuity, figure the tax-free part and the taxable part of each separately.

If your annuity is paid under a qualified plan and your annuity starting date is after July 1, 1986, and before November 19, 1996, you could have chosen to use either the General Rule or the Simplified Method.

Exclusion limit. Your annuity starting date determines the total amount of annuity payments that you can exclude from your taxable income over the years. Once your annuity starting date is determined, it does not change. If you calculate the taxable portion of your annuity payments using the simplified method worksheet, the annuity starting date determines the recovery period for your cost. That recovery period begins on your annuity starting date and is not affected by the date you first complete the worksheet.

Exclusion limited to cost. If your annuity starting date is after 1986, the total amount of annuity income that you can exclude over the years as a recovery of the cost cannot exceed your total cost. Any unrecovered cost at your (or the last annuitant's) death is allowed as a miscellaneous itemized deduction on the final return of the decedent. This deduction is not subject to the 2%-of-adjusted-gross-income limit.

Exclusion not limited to cost. If your annuity starting date is before 1987, you can continue to take your monthly exclusion for as long as you receive your annuity. If you chose a joint and survivor annuity, your survivor can continue to take the survivor's exclusion figured as of the annuity starting date. The total exclusion may be more than your cost.

Simplified Method

Under the Simplified Method, you figure the tax-free part of each annuity payment by dividing your cost by the total number of anticipated monthly payments. For an annuity that is payable for the lives of the annuitants, this number is based on the annuitants' ages on the annuity starting date and is determined from a table. For any other annuity, this number is the number of monthly annuity payments under the contract.

Who must use the Simplified Method. You must use the Simplified Method if your annuity starting date is after November 18, 1996, and you both:

1. Receive pension or annuity payments from a qualified employee plan, qualified employee annuity, or a tax-sheltered annuity (403(b)) plan, and
2. On your annuity starting date, you were either under age 75, or entitled to less than 5 years of guaranteed payments.

Guaranteed payments. Your annuity contract provides guaranteed payments if a minimum number of payments or a minimum amount (for example, the amount of your investment) is payable even if you and any survivor annuitant do not live to receive the minimum. If the minimum amount is less than the total amount of the payments you are to receive, barring death, during the first 5 years after payments begin (figured by ignoring any payment increases), you are entitled to less than 5 years of guaranteed payments.

How to use the Simplified Method. Complete the Simplified Method Worksheet in Publication 575 to figure your taxable annuity for 2012.

Single-life annuity. If your annuity is payable for your life alone, use Table 1 at the bottom of the worksheet to determine the total number of expected monthly payments. Enter on line 3 the number shown for your age at the annuity starting date.

Multiple-lives annuity. If your annuity is payable for the lives of more than one annuitant, use Table 2 at the bottom of the worksheet to determine the total number of expected monthly payments. Enter on line 3 the number shown for the combined ages of you and the youngest survivor annuitant at the annuity starting date.

Worksheet 10-A. **Simplified Method Worksheet for Bill Smith**

Keep for Your Records

1. Enter the total pension or annuity payments received this year. Also, add this amount to the total for Form 1040, line 16a, or Form 1040A, line 12a		**1.** *14,400*
2. Enter your cost in the plan (contract) at the annuity starting date plus any death benefit exclusion*. See *Cost (Investment in the Contract)*, earlier	**2.** *31,000*	
Note: *If your annuity starting date was* ***before this year*** *and you completed this worksheet last year, skip line 3 and enter the amount from line 4 of last year's worksheet on line 4 below (even if the amount of your pension or annuity has changed). Otherwise, go to line 3.*		
3. Enter the appropriate number from Table 1 below. **But** if your annuity starting date was **after** 1997 **and** the payments are for your life and that of your beneficiary, enter the appropriate number from Table 2 below	**3.** *310*	
4. Divide line 2 by the number on line 3	**4.** *100*	
5. Multiply line 4 by the number of months for which this year's payments were made. If your annuity starting date was ***before*** 1987, enter this amount on line 8 below and skip lines 6, 7, 10, and 11. Otherwise, go to line 6	**5.** *1,200*	
6. Enter any amounts previously recovered tax free in years after 1986. This is the amount shown on line 10 of your worksheet for last year	**6.** *-0-*	
7. Subtract line 6 from line 2	**7.** *31,000*	
8. Enter the ***smaller*** of line 5 or line 7		**8.** *1,200*
9. Taxable amount for year. Subtract line 8 from line 1. Enter the result, but not less than zero. Also, add this amount to the total for Form 1040, line 16b, or Form 1040A, line 12b		**9.** *13,200*
Note: *If your Form 1099-R shows a larger taxable amount, use the amount figured on this line instead. If you are a retired public safety officer, see* Insurance Premiums for Retired Public Safety Officers *in Publication 575 before entering an amount on your tax return.*		
10. Was your annuity starting date before 1987? ☐ Yes. **STOP.** Do not complete the rest of this worksheet. ☑ No. Add lines 6 and 8. This is the amount you have recovered tax free through 2012. You will need this number if you need to fill out this worksheet next year		**10.** *1,200*
11. Balance of cost to be recovered. Subtract line 10 from line 2. If zero, you will not have to complete this worksheet next year. The payments you receive next year will generally be fully taxable		**11.** *29,800*

TABLE 1 FOR LINE 3 ABOVE

IF the age at annuity starting date was...	AND your annuity starting date was— **before** November 19, 1996, enter on line 3...	**after** November 18, 1996, enter on line 3...
55 or under	300	360
56–60	260	310
61–65	240	260
66–70	170	210
71 or older	120	160

TABLE 2 FOR LINE 3 ABOVE

IF the combined ages at annuity starting date were...	**THEN** enter on line 3...
110 or under	410
111–120	360
121–130	310
131–140	260
141 or older	210

* A death benefit exclusion (up to $5,000) applied to certain benefits received by employees who died before August 21, 1996.

However, if your annuity starting date is before 1998, do not use Table 2 and do not combine the annuitants' ages. Instead you must use Table 1 and enter on line 3 the number shown for the primary annuitant's age on the annuity starting date.

Be sure to keep a copy of the completed worksheet; it will help you figure your taxable annuity next year.

Example. Bill Smith, age 65, began receiving retirement benefits in 2012, under a joint and survivor annuity. Bill's annuity starting date is January 1, 2012. The benefits are to be paid for the joint lives of Bill and his wife Kathy, age 65. Bill had contributed $31,000 to a qualified plan and had received no distributions before the annuity starting date. Bill is to receive a retirement benefit of $1,200 a month, and Kathy is to receive a monthly survivor benefit of $600 upon Bill's death.

Bill must use the Simplified Method to figure his taxable annuity because his payments are from a qualified plan and he is under age 75. Because his annuity is payable over the lives of more than one annuitant, he uses his and Kathy's combined ages and Table 2 at the bottom of the worksheet in completing line 3 of the worksheet. His completed worksheet is shown in Worksheet 10-A.

Bill's tax-free monthly amount is $100 ($31,000 ÷ 310) as shown on line 4 of the worksheet. Upon Bill's death, if Bill has not recovered the full $31,000 investment, Kathy will also exclude $100 from her $600 monthly payment. The full amount of any annuity payments received after 310 payments are paid must be included in gross income.

If Bill and Kathy die before 310 payments are made, a miscellaneous itemized deduction will be allowed for the unrecovered cost on the final income tax return of the last to die. This deduction is not subject to the 2%-of-adjusted-gross-income limit.

Who must use the General Rule. You must use the General Rule if you receive pension or annuity payments from:

- A nonqualified plan (such as a private annuity, a purchased commercial annuity, or a nonqualified employee plan), or
- A qualified plan if you are age 75 or older on your annuity starting date and your annuity payments are guaranteed for at least 5 years.

Annuity starting before November 19, 1996. If your annuity starting date is after July 1, 1986, and before November 19, 1996, you had to use the General Rule for either circumstance just described. You also had to use it for any fixed-period annuity. If you did not have to use the General Rule, you could have chosen to use it. If your annuity starting date is before July 2, 1986, you had to use the General Rule unless you could use the Three-Year Rule.

If you had to use the General Rule (or chose to use it), you must continue to use it each year that you recover your cost.

Who cannot use the General Rule. You cannot use the General Rule if you receive your pension or annuity from a qualified plan and none of the circumstances described in the preceding discussions apply to you. See *Who must use the Simplified Method*, earlier.

More information. For complete information on using the General Rule, including the actuarial tables you need, see Publication 939.

Taxation of Nonperiodic Payments

Nonperiodic distributions are also known as amounts not received as an annuity. They include all payments other than periodic payments and corrective distributions. Examples of nonperiodic payments are cash withdrawals, distributions of current earnings, certain loans, and the value of annuity contracts transferred without full and adequate consideration.

Corrective distributions of excess plan contributions. Generally, if the contributions made for you during the year to certain retirement plans exceed certain limits, the excess is taxable to you. To correct an excess, your plan may distribute it to you (along with any income earned on the excess). For information on plan contribution limits and how to report corrective distributions of excess contributions, see *Retirement Plan Contributions* under *Employee Compensation* in Publication 525.

Figuring the taxable amount of nonperiodic payments. How you figure the taxable amount of a nonperiodic distribution depends on whether it is made before the annuity starting date or on or after the annuity starting date. If it is made before the annuity starting date, its tax treatment also depends on whether it is made under a qualified or nonqualified plan and, if it is made under a nonqualified plan, whether it fully discharges the contract, is received under certain life insurance or endowment contracts, or is allocable to an investment you made before August 14, 1982.

Annuity starting date. The annuity starting date is either the first day of the first period for which you receive an annuity payment under the contract or the date on which the obligation under the contract becomes fixed, whichever is later.

Distribution on or after annuity starting date. If you receive a nonperiodic payment from your annuity contract on or after the annuity starting date, you generally must include all of the payment in gross income.

Distribution before annuity starting date. If you receive a nonperiodic distribution before the annuity starting date from a qualified retirement plan, you generally can allocate only part of it to the cost of the contract. You exclude from your gross income the part that you allocate to the cost. You include the remainder in your gross income.

If you receive a nonperiodic distribution before the annuity starting date from a plan other than a qualified retirement plan, it is allocated first to earnings (the taxable part) and then to the cost of the contract (the tax-free part). This allocation rule applies, for example, to a commercial annuity contract you bought directly from the issuer.

For more information, see *Figuring the Taxable Amount* under *Taxation of Nonperiodic Payments* in Publication 575.

Lump-Sum Distributions

TIP *This section on lump-sum distributions only applies if the plan participant was born before January 2, 1936. If the plan participant was born after January 1, 1936, the taxable amount of this nonperiodic payment is reported as discussed earlier.*

A lump-sum distribution is the distribution or payment in one tax year of a plan participant's entire balance from all of the employer's qualified plans of one kind (for example, pension, profit-sharing, or stock bonus plans). A distribution from a nonqualified plan (such as a privately purchased commercial annuity or a section 457 deferred compensation plan of a state or local government or tax-exempt organization) cannot qualify as a lump-sum distribution.

The participant's entire balance from a plan does not include certain forfeited amounts. It also does not include any deductible voluntary employee contributions allowed by the plan after 1981 and before 1987. For more information about distributions that do not qualify as lump-sum distributions, see *Distributions that do not qualify* under *Lump-Sum Distributions* in Publication 575.

If you receive a lump-sum distribution from a qualified employee plan or qualified employee annuity and the plan participant was born before January 2, 1936, you may be able to elect optional methods of figuring the tax on the distribution. The part from active participation in the plan before 1974 may qualify as capital gain subject to a 20% tax rate. The part from participation after 1973 (and any part from participation before 1974 that you do not report as capital gain) is ordinary income. You may be able to use the 10-year tax option, discussed later, to figure tax on the ordinary income part.

Use Form 4972 to figure the separate tax on a lump-sum distribution using the optional methods. The tax figured on Form 4972 is added to the regular tax figured on your other income. This may result in a smaller tax than you would pay by including the taxable amount of the distribution as ordinary income in figuring your regular tax.

How to treat the distribution. If you receive a lump-sum distribution, you may have the following options for how you treat the taxable part.

- Report the part of the distribution from participation before 1974 as a capital gain (if you qualify) and the part from participation after 1973 as ordinary income.
- Report the part of the distribution from participation before 1974 as a capital gain (if you qualify) and use the 10-year tax option to figure the tax on the part from participation after 1973 (if you qualify).
- Use the 10-year tax option to figure the tax on the total taxable amount (if you qualify).
- Roll over all or part of the distribution. See *Rollovers*, later. No tax is currently due on the part rolled over. Report any part not rolled over as ordinary income.
- Report the entire taxable part of the distribution as ordinary income on your tax return.

The first three options are explained in the following discussions.

Electing optional lump-sum treatment. You can choose to use the 10-year tax option or capital gain treatment only once after 1986 for any plan participant. If you make this choice, you cannot use either of these optional treatments for any future distributions for the participant.

Taxable and tax-free parts of the distribution. The taxable part of a lump-sum distribution is the employer's contributions and income earned on your account. You may recover your cost in the lump sum and any net unrealized appreciation (NUA) in employer securities tax free.

Cost. In general, your cost is the total of:

- The plan participant's nondeductible contributions to the plan,
- The plan participant's taxable costs of any life insurance contract distributed,
- Any employer contributions that were taxable to the plan participant, and
- Repayments of any loans that were taxable to the plan participant.

You must reduce this cost by amounts previously distributed tax free.

Net unrealized appreciation (NUA). The NUA in employer securities (box 6 of Form 1099-R) received as part of a lump-sum distribution is generally tax free until you sell or exchange the securities. (For more information, see *Distributions of employer securities* under *Taxation of Nonperiodic Payments* in Publication 575.)

Capital Gain Treatment

Capital gain treatment applies only to the taxable part of a lump-sum distribution resulting from participation in the plan before 1974. The amount treated as capital gain is taxed at a 20% rate. You can elect this treatment only once for any plan participant, and only if the plan participant was born before January 2, 1936.

Complete Part II of Form 4972 to choose the 20% capital gain election. For more information, see *Capital Gain Treatment* under *Lump-Sum Distributions* in Publication 575.

10-Year Tax Option

The 10-year tax option is a special formula used to figure a separate tax on the ordinary income part of a lump-sum distribution. You pay the tax only once, for the year in which you receive the distribution, not over the next 10 years. You can elect this treatment only once for any plan participant, and only if the plan participant was born before January 2, 1936.

The ordinary income part of the distribution is the amount shown in box 2a of the Form 1099-R given to you by the payer, minus the amount, if any, shown in box 3. You also can treat the capital gain part of the distribution (box 3 of Form 1099-R) as ordinary income for the 10-year tax option if you do not choose capital gain treatment for that part.

Complete Part III of Form 4972 to choose the 10-year tax option. You must use the special Tax Rate Schedule shown in the instructions for Part III to figure the tax. Publication 575 illustrates how to complete Form 4972 to figure the separate tax.

Rollovers

If you withdraw cash or other assets from a qualified retirement plan in an eligible rollover distribution, you can defer tax on the distribution by rolling it over to another qualified retirement plan or a traditional IRA.

For this purpose, the following plans are qualified retirement plans.

- A qualified employee plan.
- A qualified employee annuity.
- A tax-sheltered annuity plan (403(b) plan).
- An eligible state or local government section 457 deferred compensation plan.

Eligible rollover distributions. Generally, an eligible rollover distribution is any distribution of all or any part of the balance to your credit in a qualified retirement plan. For information about exceptions to eligible rollover distributions, see Publication 575.

Rollover of nontaxable amounts. You may be able to roll over the nontaxable part of a distribution (such as your after-tax contributions) made to another qualified retirement plan that is a qualified employee plan or a 403(b) plan, or to a traditional or Roth IRA. The transfer must be made either through a direct rollover to a qualified plan or 403(b) plan that separately accounts for the taxable and nontaxable parts of the rollover or through a rollover to a traditional or Roth IRA.

If you roll over only part of a distribution that includes both taxable and nontaxable amounts, the amount you roll over is treated as coming first from the taxable part of the distribution.

Any after-tax contributions that you roll over into your traditional IRA become part of your basis (cost) in your IRAs. To recover your basis when you take distributions from your IRA, you must complete Form 8606 for the year of the distribution. For more information, see the Form 8606 instructions.

Direct rollover option. You can choose to have any part or all of an eligible rollover distribution paid directly to another qualified retirement plan that accepts rollover distributions or to a traditional or Roth IRA. If you choose the direct rollover option, or have an automatic rollover, no tax will be withheld from any part of the distribution that is directly paid to the trustee of the other plan.

Payment to you option. If an eligible rollover distribution is paid to you, 20% generally will be withheld for income tax. However, the full amount is treated as distributed to you even though you actually receive only 80%. You generally must include in income any part (including the part withheld) that you do not roll over within 60 days to another qualified retirement plan or to a traditional or Roth IRA. (See *Pensions and Annuities* under *Tax Withholding for 2013* in chapter 4.)

CAUTION *If you decide to roll over an amount equal to the distribution before withholding, your contribution to the new plan or IRA must include other money (for example, from savings or amounts borrowed) to replace the amount withheld.*

Time for making rollover. You generally must complete the rollover of an eligible rollover distribution paid to you by the 60th day following the day on which you receive the distribution from your employer's plan. (If an amount distributed to you becomes a frozen deposit in a financial institution during the 60-day period after you receive it, the rollover period is extended for the period during which the distribution is in a frozen deposit in a financial institution.)

The IRS may waive the 60-day requirement where the failure to do so would be against equity or good conscience, such as in the event of a casualty, disaster, or other event beyond your reasonable control.

The administrator of a qualified plan must give you a written explanation of your distribution options within a reasonable period of time before making an eligible rollover distribution.

Qualified domestic relations order (QDRO). You may be able to roll over tax free all or part of a distribution from a qualified retirement plan that you receive under a QDRO. If you receive the distribution as an employee's spouse or former spouse (not as a nonspousal beneficiary), the rollover rules apply to you as if you were the employee. You can roll over the distribution from the plan into a traditional IRA or to another eligible retirement plan. See Publication 575 for more information on benefits received under a QDRO.

Rollover by surviving spouse. You may be able to roll over tax free all or part of a distribution from a qualified retirement plan you receive as the surviving spouse of a deceased employee. The rollover rules apply to you as if you were the employee. You can roll over a distribution into a qualified retirement plan or a traditional or Roth IRA. For a rollover to a Roth IRA, see *Rollovers to Roth IRAs*, later.

A distribution paid to a beneficiary other than the employee's surviving spouse is generally not an eligible rollover distribution. However, see *Rollovers by nonspouse beneficiary* next.

Rollovers by nonspouse beneficiary. If you are a designated beneficiary (other than a surviving spouse) of a deceased employee, you may be able to roll over tax free all or a portion of a distribution you receive from an eligible retirement plan of the employee. The distribution must be a direct trustee-to-trustee transfer to your traditional or Roth IRA that was set up to receive the distribution. The transfer will be treated as an eligible rollover distribution and the receiving plan will be treated as an inherited IRA. For information on inherited IRAs, see Publication 590, Individual Retirement Arrangements (IRAs).

Retirement bonds. If you redeem retirement bonds purchased under a qualified bond purchase plan, you can roll over the proceeds that exceed your basis tax free into an IRA (as discussed in Publication 590) or a qualified employer plan.

Designated Roth accounts. You can roll over an eligible rollover distribution from a designated Roth account into another designated Roth account or a Roth IRA. If you want to roll over the part of the distribution that is not included in income, you must make a direct rollover of the entire distribution or you can roll over the entire amount (or any portion) to a Roth IRA. For more information on rollovers from designated Roth accounts, see Publication 575.

In-plan rollovers to designated Roth accounts. If you are a plan participant in a 401(k), 403(b), or 457(b) plan, your plan may permit you to roll over amounts in those plans to a designated Roth account within the same plan. The rollover of any untaxed amounts must be included income. For 2010 in-plan Roth rollovers, the taxable amount is included in income in equal amounts in 2011 and 2012 unless you elected to include the entire amount in income in 2010. You may be required to include an amount other than half of a 2010 in-plan Roth rollover in income in 2012 if you also took a distribution from your designated Roth account in 2010 or 2011. See Publication 575 for more information.

Rollovers to Roth IRAs. You can roll over distributions directly from a qualified retirement plan (other than a designated Roth account) to a Roth IRA.

You must include in your gross income distributions from a qualified retirement plan (other than a designated Roth account) that you would have had to include in income if you had not rolled them over into a Roth IRA. You do not include in gross income any part of a distribution from a qualified retirement plan that is a return of contributions to the plan that were taxable to you when paid. In addition, the 10% tax on early distributions does not apply.

Special rules for 2010 rollovers to Roth IRAs. If you made a rollover to a Roth IRA in 2010 and did not elect to include the taxable amount in income for 2010, you must include the taxable amount in income for 2011 and 2012.

You may be required to include an amount other than half of the 2010 rollover from a qualified employer plan to a Roth IRA in income for 2012 if you took a Roth IRA distribution in 2010 or 2011. See Publication 575 for more information.

More information. For more information on the rules for rolling over distributions, see Publication 575.

Special Additional Taxes

To discourage the use of pension funds for purposes other than normal retirement, the law imposes additional taxes on early distributions of those funds and on failures to withdraw the funds timely. Ordinarily, you will not be subject to these taxes if you roll over all early distributions you receive, as explained earlier, and begin drawing out the funds at a normal retirement age, in reasonable amounts over your life expectancy. These special additional taxes are the taxes on:

- Early distributions, and
- Excess accumulation (not receiving minimum distributions).

These taxes are discussed in the following sections.

If you must pay either of these taxes, report them on Form 5329. However, you do not have to file Form 5329 if you owe only the tax on early distributions and your Form 1099-R correctly shows a "1" in box 7. Instead, enter 10% of the taxable part of the distribution on Form 1040, line 58 and write "No" under the heading "Other Taxes" to the left of line 58.

Even if you do not owe any of these taxes, you may have to complete Form 5329 and attach it to your Form 1040. This applies if you meet an exception to the tax on early distributions but box 7 of your Form 1099-R does not indicate an exception.

Tax on Early Distributions

Most distributions (both periodic and nonperiodic) from qualified retirement plans and nonqualified annuity contracts made to you before you reach age $59^1/_2$ are subject to an additional tax of 10%. This tax applies to the part of the distribution that you must include in gross income.

For this purpose, a qualified retirement plan is:

- A qualified employee plan,
- A qualified employee annuity plan,
- A tax-sheltered annuity plan, or
- An eligible state or local government section 457 deferred compensation plan (to the extent that any distribution is attributable to amounts the plan received in a direct transfer or rollover from one of the other plans listed here or an IRA).

5% rate on certain early distributions from deferred annuity contracts. If an early withdrawal from a deferred annuity is otherwise subject to the 10% additional tax, a 5% rate may apply instead. A 5% rate applies to distributions under a written election providing a specific schedule for the distribution of your interest in the contract if, as of March 1, 1986, you had begun receiving payments under the election. On line 4 of Form 5329, multiply the line 3 amount by 5% instead of 10%. Attach an explanation to your return.

Distributions from Roth IRAs allocable to a rollover from an eligible retirement plan within the 5-year period. If, within the 5-year period starting with the first day of your tax year in which you rolled over an amount from an eligible retirement plan to a Roth IRA, you take a distribution from the Roth IRA, you may have to pay the additional 10% tax on early distributions. You generally must pay the 10% additional tax on any amount attributable to the part of the rollover that you had to include in income. The additional tax is figured on Form 5329. For more information, see Form 5329 and its instructions. For information on qualified distributions from Roth IRAs, see *Additional Tax on Early Distributions* in chapter 2 of Publication 590.

Distributions from designated Roth accounts allocable to in-plan Roth rollovers within the 5-year period. If, within the 5-year period starting with the first day of your tax year in which you rolled over an amount from a 401(k), 403(b), or 457(b) plan to a designated Roth account, you take a distribution from the designated Roth account, you may have to pay the additional 10% tax on early distributions. You generally must pay the 10% additional tax on any amount attributable to the part of the in-plan rollover that you had to include in income. The additional tax is figured on Form 5329. For more information, see Form 5329 and its instructions. For information on qualified distributions from designated Roth accounts, see *Designated Roth accounts* under *Taxation of Periodic Payments* in Publication 575.

Exceptions to tax. Certain early distributions are excepted from the early distribution tax. If the payer knows that an exception applies to your early distribution, distribution code "2,""3," or "4" should be shown in box 7 of your Form 1099-R and you do not have to report the distribution on Form 5329. If an exception applies but distribution code "1" (early distribution, no known exception) is shown in box 7, you must file Form 5329. Enter the taxable amount of the distribution shown in box 2a of your Form 1099-R on line 1 of Form 5329. On line 2, enter the amount that can be excluded and the exception number shown in the Form 5329 instructions.

TIP *If distribution code "1" is incorrectly shown on your Form 1099-R for a distribution received when you were age $59^1/_2$ or older, include that distribution on Form 5329. Enter exception number "12" on line 2.*

General exceptions. The tax does not apply to distributions that are:

- Made as part of a series of substantially equal periodic payments (made at least annually) for your life (or life expectancy) or the joint lives (or joint life expectancies) of you and your designated beneficiary (if from a qualified retirement plan, the payments must begin after your separation from service),
- Made because you are totally and permanently disabled, or
- Made on or after the death of the plan participant or contract holder.

Additional exceptions for qualified retirement plans. The tax does not apply to distributions that are:

- From a qualified retirement plan (other than an IRA) after your separation from service in or after the year you reached age 55 (age 50 for qualified public safety employees),
- From a qualified retirement plan (other than an IRA) to an alternate payee under a qualified domestic relations order,
- From a qualified retirement plan to the extent you have deductible medical expenses (medical expenses that exceed 7.5% of your adjusted gross income), whether or not you itemize your deductions for the year,
- From an employer plan under a written election that provides a specific schedule for distribution of your entire interest if, as of March 1, 1986, you had separated from service and had begun receiving payments under the election,
- From an employee stock ownership plan for dividends on employer securities held by the plan,
- From a qualified retirement plan due to an IRS levy of the plan, or
- From elective deferral accounts under 401(k) or 403(b) plans or similar arrangements that are qualified reservist distributions.

Qualified public safety employees. If you are a qualified public safety employee, distributions made from a governmental defined benefit pension plan are not subject to the additional tax on early distributions. You are a qualified public safety employee if you provide police protection, firefighting services, or emergency medical services for a state or municipality, and you separated from service in or after the year you attained age 50.

Qualified reservist distributions. A qualified reservist distribution is not subject to the additional tax on early distributions. A qualified reservist distribution is a distribution (a) from elective deferrals under a section 401(k) or 403(b) plan, or a similar arrangement, (b) to an individual ordered or called to active duty (because he or she is a member of a reserve component) for a period of more than 179 days or for an indefinite period, and (c) made during the period beginning on the date of the order or call and ending at the close of the active duty period. You must have been ordered or called to active duty after September 11, 2001. For more information, see Publication 575.

Additional exceptions for nonqualified annuity contracts. The tax does not apply to distributions from:

- A deferred annuity contract to the extent allocable to investment in the contract before August 14, 1982,
- A deferred annuity contract under a qualified personal injury settlement,
- A deferred annuity contract purchased by your employer upon termination of a qualified employee plan or qualified employee annuity plan and held by your employer until your separation from service, or
- An immediate annuity contract (a single premium contract providing substantially equal annuity payments that start within 1 year from the date of purchase and are paid at least annually).

Tax on Excess Accumulation

To make sure that most of your retirement benefits are paid to you during your lifetime, rather than to your beneficiaries after your death, the payments that you receive from qualified retirement plans must begin no later than your required beginning date (defined later). The payments each year cannot be less than the required minimum distribution.

Required distributions not made. If the actual distributions to you in any year are less than the minimum required distribution for that year, you are subject to an additional tax. The tax equals 50% of the part of the required minimum distribution that was not distributed.

For this purpose, a qualified retirement plan includes:

- A qualified employee plan,
- A qualified employee annuity plan,
- An eligible section 457 deferred compensation plan, or
- A tax-sheltered annuity plan (403(b) plan) (for benefits accruing after 1986).

Waiver. The tax may be waived if you establish that the shortfall in distributions was due to reasonable error and that reasonable steps are being taken to remedy the shortfall. See the Instructions for Form 5329 for the procedure to follow if you believe you qualify for a waiver of this tax.

State insurer delinquency proceedings. You might not receive the minimum distribution because assets are invested in a contract issued by an insurance company in state insurer delinquency proceedings. If your payments are reduced below the minimum due to these proceedings, you should contact your plan administrator. Under certain conditions, you will not have to pay the 50% excise tax.

Required beginning date. Unless the rule for 5% owners applies, you generally must begin to receive distributions from your qualified retirement plan by April 1 of the year that follows the later of:

- The calendar year in which you reach age 70½, or
- The calendar year in which you retire from employment with the employer maintaining the plan.

However, your plan may require you to begin to receive distributions by April 1 of the year that follows the year in which you reach age 70½, even if you have not retired.

If you reached age 70½ in 2012, you may be required to receive your first distribution by April 1, 2013. Your required distribution then must be made for 2013 by December 31, 2013.

5% owners. If you are a 5% owner, you must begin to receive distributions by April 1 of the year that follows the calendar year in which you reach age 70½.

You are a 5% owner if, for the plan year ending in the calendar year in which you reach age 70½, you own (or are considered to own under section 318 of the Internal Revenue Code) more than 5% of the outstanding stock (or more than 5% of the total voting power of all stock) of the employer, or more than 5% of the capital or profits interest in the employer.

Age 70½. You reach age 70½ on the date that is 6 calendar months after the date of your 70th birthday.

For example, if you are retired and your 70th birthday was on June 30, 2012, you were age 70½ on December 30, 2012. If your 70th birthday was on July 1, 2012, you reached age 70½ on January 1, 2013.

Required distributions. By the required beginning date, as explained earlier, you must either:

- Receive your entire interest in the plan (for a tax-sheltered annuity, your entire benefit accruing after 1986), or
- Begin receiving periodic distributions in annual amounts calculated to distribute your entire interest (for a tax-sheltered annuity, your entire benefit accruing after 1986) over your life or life expectancy or over the joint lives or joint life expectancies of you and a designated beneficiary (or over a shorter period).

Additional information. For more information on this rule, see *Tax on Excess Accumulation* in Publication 575.

Form 5329. You must file Form 5329 if you owe tax because you did not receive a minimum required distribution from your qualified retirement plan.

Survivors and Beneficiaries

Generally, a survivor or beneficiary reports pension or annuity income in the same way the plan participant would have. However, some special rules apply. See Publication 575 for more information.

Survivors of employees. If you are entitled to receive a survivor annuity on the death of an employee who died before becoming entitled to any annuity payments, you can exclude part of each annuity payment as a tax-free recovery of the employee's investment in the contract. You must figure the taxable and tax-free parts of your annuity payments using the method that applies as if you were the employee.

Survivors of retirees. If you receive benefits as a survivor under a joint and survivor annuity, include those benefits in income in the same way the retiree would have included them in income. If you receive a survivor annuity because of the death of a retiree who had reported the annuity under the Three-Year Rule and recovered all of the cost tax free, your survivor payments are fully taxable.

If the retiree was reporting the annuity payments under the General Rule, you must apply the same exclusion percentage to your initial survivor annuity payment called for in the contract. The resulting tax-free amount will then remain fixed. Any increases in the survivor annuity are fully taxable.

If the retiree was reporting the annuity payments under the Simplified Method, the part of each payment that is tax free is the same as the tax-free amount figured by the retiree at the annuity starting date. This amount remains fixed even if the annuity payments are increased or decreased. See *Simplified Method*, earlier.

In any case, if the annuity starting date is after 1986, the total exclusion over the years cannot be more than the cost.

Estate tax deduction. If your annuity was a joint and survivor annuity that was included in the decedent's estate, an estate tax may have been paid on it. You can deduct the part of the total estate tax that was based on the annuity. The deceased annuitant must have died after the annuity starting date. (For details, see section 1.691(d)-1 of the regulations.) Deduct it in equal amounts over your remaining life expectancy.

If the decedent died before the annuity starting date of a deferred annuity contract and you receive a death benefit under that contract, the amount you receive (either in a lump sum or as periodic payments) in excess of the decedent's cost is included in your gross income as income in respect of a decedent for which you may be able to claim an estate tax deduction.

You can take the estate tax deduction as an itemized deduction on Schedule A, Form 1040. This deduction is not subject to the 2%-of-adjusted-gross-income limit on miscellaneous deductions. See Publication 559, Survivors, Executors, and Administrators, for more information on the estate tax deduction.

11.

Social Security and Equivalent Railroad Retirement Benefits

Introduction

This chapter explains the federal income tax rules for social security benefits and equivalent tier 1 railroad retirement benefits. It explains the following topics.

- How to figure whether your benefits are taxable.
- How to use the social security benefits worksheet (with examples).
- How to report your taxable benefits.
- How to treat repayments that are more than the benefits you received during the year.

Social security benefits include monthly retirement, survivor, and disability benefits. They do not include supplemental security income (SSI) payments, which are not taxable.

Equivalent tier 1 railroad retirement benefits are the part of tier 1 benefits that a railroad employee or beneficiary would have been entitled to receive under the social security system. They are commonly called the social security equivalent benefit (SSEB) portion of tier 1 benefits.

If you received these benefits during 2012, you should have received a Form SSA-1099, Social Security Benefit Statement, or Form RRB-1099, Payments by the Railroad Retirement Board. These forms show the amounts received and repaid, and taxes withheld for the year. You may receive more than one of these forms for the same year. You should add the amounts shown on all the Forms SSA-1099 and Forms RRB-1099 you receive for the year to determine the total amounts received and repaid, and taxes withheld for that year. See the *Appendix* at the end of Publication 915 for more information.

Note. When the term "benefits" is used in this chapter, it applies to both social security benefits and the SSEB portion of tier 1 railroad retirement benefits.

What is not covered in this chapter. This chapter does not cover the tax rules for the following railroad retirement benefits.

- Non-social security equivalent benefit (NSSEB) portion of tier 1 benefits.
- Tier 2 benefits.
- Vested dual benefits.
- Supplemental annuity benefits.

For information on these benefits, see Publication 575, Pension and Annuity Income.

This chapter does not cover the tax rules for social security benefits reported on Form SSA-1042S, Social Security Benefit Statement, or Form RRB-1042S, Statement for Nonresident Alien Recipients of: Payments by the Railroad Retirement Board. For information about these benefits, see Publication 519, U.S. Tax Guide for Aliens, and Publication 915, Social Security and Equivalent Railroad Retirement Benefits.

This chapter also does not cover the tax rules for foreign social security benefits. These benefits are taxable as annuities, unless they are exempt from U.S. tax or treated as a U.S. social security benefit under a tax treaty.

Useful Items

You may want to see:

Publication

- ❑ **505** Tax Withholding and Estimated Tax
- ❑ **575** Pension and Annuity Income
- ❑ **590** Individual Retirement Arrangements (IRAs)
- ❑ **915** Social Security and Equivalent Railroad Retirement Benefits

Forms (and Instructions)

- ❑ **1040-ES** Estimated Tax for Individuals
- ❑ **SSA-1099** Social Security Benefit Statement
- ❑ **RRB-1099** Payments by the Railroad Retirement Board
- ❑ **W-4V** Voluntary Withholding Request

Are Any of Your Benefits Taxable?

To find out whether any of your benefits may be taxable, compare the base amount for your filing status with the total of:

1. One-half of your benefits, plus
2. All your other income, including tax-exempt interest.

When making this comparison, do not reduce your other income by any exclusions for:

- Interest from qualified U.S. savings bonds,
- Employer-provided adoption benefits,
- Foreign earned income or foreign housing, or
- Income earned by bona fide residents of American Samoa or Puerto Rico.

Children's benefits. The rules in this chapter apply to benefits received by children. See *Who is taxed*, later.

Figuring total income. To figure the total of one-half of your benefits plus your other income, use Worksheet 11-1 later in this discussion. If the total is more than your base amount, part of your benefits may be taxable.

If you are married and file a joint return for 2012, you and your spouse must combine your incomes and your benefits to figure whether any of your combined benefits are taxable. Even if your spouse did not receive any benefits, you must add your spouse's income to yours to figure whether any of your benefits are taxable.

TIP *If the only income you received during 2012 was your social security or the SSEB portion of tier 1 railroad retirement benefits, your benefits generally are not taxable and you probably do not have to file a return. If you have income in addition to your benefits, you may have to file a return even if none of your benefits are taxable.*

Base amount. Your base amount is:

- $25,000 if you are single, head of household, or qualifying widow(er),
- $25,000 if you are married filing separately and lived apart from your spouse for all of 2012,
- $32,000 if you are married filing jointly, or
- $-0- if you are married filing separately and lived with your spouse at any time during 2012.

Worksheet 11-1. You can use Worksheet 11-1 to figure the amount of income to compare with your base amount. This is a quick way to check whether some of your benefits may be taxable.

Worksheet 11-1. **A Quick Way To Check if Your Benefits May Be Taxable**

A. Enter the amount from ***box 5*** of all your Forms SSA-1099 and RRB-1099. Include the full amount of any lump-sum benefit payments received in 2012, for 2012 and earlier years. (If you received more than one form, combine the amounts from box 5 and enter the total.)	A.	

Note. If the amount on line A is zero or less, stop here; none of your benefits are taxable this year.

B. Enter one-half of the amount on line A	B.	
C. Enter your taxable pensions, wages, interest, dividends, and other taxable income	C.	
D. Enter any tax-exempt interest income (such as interest on municipal bonds) plus any exclusions from income (listed earlier)	D.	
E. Add lines B, C, and D	E.	

Note. Compare the amount on line E to your **base amount** for your filing status. If the amount on line E equals or is less than the **base amount** for your filing status, none of your benefits are taxable this year. If the amount on line E is more than your **base amount,** some of your benefits may be taxable. You need to complete Worksheet 1 in Publication 915 (or the Social Security Benefits Worksheet in your tax form instructions). If none of your benefits are taxable, but you otherwise must file a tax return, see *Benefits not taxable*, later, under *How To Report Your Benefits*.

Example. You and your spouse (both over 65) are filing a joint return for 2012 and you both received social security benefits during the year. In January 2013, you received a Form SSA-1099 showing net benefits of $7,500 in box 5. Your spouse received a Form SSA-1099 showing net benefits of $3,500 in box 5. You also received a taxable pension of $22,000 and interest income of $500. You did not have any tax-exempt interest income. Your benefits are not taxable for 2012 because your income, as figured in Worksheet 11-1, is not more than your base amount ($32,000) for married filing jointly.

Even though none of your benefits are taxable, you must file a return for 2012 because your taxable gross income ($22,500) exceeds the minimum filing requirement amount for your filing status.

Filled-in Worksheet 11-1. **A Quick Way To Check if Your Benefits May Be Taxable**

A. Enter the amount from ***box 5*** of all your Forms SSA-1099 and RRB-1099. Include the full amount of any lump-sum benefit payments received in 2012, for 2012 and earlier years. (If you received more than one form, combine the amounts from box 5 and enter the total.)	A.	$ 11,000

Note. If the amount on line A is zero or less, stop here; none of your benefits are taxable this year.

B. Enter one-half of the amount on line A	B.	5,500
C. Enter your taxable pensions, wages, interest, dividends, and other taxable income	C.	22,500
D. Enter any tax-exempt interest income (such as interest on municipal bonds) plus any exclusions from income (listed earlier)	D.	-0-
E. Add lines B, C, and D	E.	$28,000

Note. Compare the amount on line E to your **base amount** for your filing status. If the amount on line E equals or is less than the **base amount** for your filing status, none of your benefits are taxable this year. If the amount on line E is more than your **base amount,** some of your benefits may be taxable. You then need to complete Worksheet 1 in Publication 915 (or the Social Security Benefits Worksheet in your tax form instructions). If none of your benefits are taxable, but you otherwise must file a tax return, see *Benefits not taxable*, later, under *How To Report Your Benefits*.

Who is taxed. Benefits are included in the taxable income (to the extent they are taxable) of the person who has the legal right to receive the benefits. For example, if you and your child receive benefits, but the check for your child is made out in your name, you must use only your part of the benefits to see whether any benefits are taxable to you. One-half of the part that belongs to your child must be added to your child's other income to see whether any of those benefits are taxable to your child.

Repayment of benefits. Any repayment of benefits you made during 2012 must be subtracted from the gross benefits you received in 2012. It does not matter whether the repayment was for a benefit you received in 2012 or in an earlier year. If you repaid more than the gross benefits you received in 2012, see *Repayments More Than Gross Benefits*, later.

Your gross benefits are shown in box 3 of Form SSA-1099 or RRB-1099. Your repayments are shown in box 4. The amount in box 5 shows your net benefits for 2012 (box 3 minus box 4). Use the amount in box 5 to figure whether any of your benefits are taxable.

Tax withholding and estimated tax. You can choose to have federal income tax withheld from your social security benefits and/or the SSEB portion of your tier 1 railroad retirement benefits. If you choose to do this, you must complete a Form W-4V.

If you do not choose to have income tax withheld, you may have to request additional withholding from other income or pay estimated tax during the year. For details, see Publication 505 or the instructions for Form 1040-ES.

How To Report Your Benefits

If part of your benefits are taxable, you must use Form 1040 or Form 1040A. You cannot use Form 1040EZ.

Reporting on Form 1040. Report your net benefits (the total amount from box 5 of all your Forms SSA-1099 and Forms RRB-1099) on line 20a and the taxable part on line 20b. If you are married filing separately and you lived apart from your spouse for all of 2012, also enter "D" to the right of the word "benefits" on line 20a.

Reporting on Form 1040A. Report your net benefits (the total amount from box 5 of all your Forms SSA-1099 and Forms RRB-1099) on line 14a and the taxable part on line 14b. If you are married filing separately and you lived apart from your spouse for all of 2012, also enter "D" to the right of the word "benefits" on line 14a.

Benefits not taxable. If you are filing Form 1040EZ, do not report any benefits on your tax return. If you are filing Form 1040 or Form 1040A, report your net benefits (the total amount from box 5 of all your Forms SSA-1099 and Forms RRB-1099) on Form 1040, line 20a, or Form 1040A, line 14a. Enter -0- on Form 1040, line 20b, or Form 1040A, line 14b. If you are married filing separately and you lived apart from your spouse for all of 2012, also enter "D" to the right of the word "benefits" on Form 1040, line 20a, or Form 1040A, line 14a.

How Much Is Taxable?

If part of your benefits are taxable, how much is taxable depends on the total amount of your benefits and other income. Generally, the higher that total amount, the greater the taxable part of your benefits.

Maximum taxable part. Generally, up to 50% of your benefits will be taxable. However, up to 85% of your benefits can be taxable if either of the following situations applies to you.

- The total of one-half of your benefits and all your other income is more than $34,000 ($44,000 if you are married filing jointly).
- You are married filing separately and lived with your spouse at any time during 2012.

Which worksheet to use. A worksheet you can use to figure your taxable benefits is in the instructions for your Form 1040 or Form 1040A. You can use either that worksheet or Worksheet 1 in Publication 915, unless any of the following situations applies to you.

1. You contributed to a traditional individual retirement arrangement (IRA) and you or your spouse is covered by a retirement plan at work. In this situation, you must

use the special worksheets in *Appendix B* of Publication 590 to figure both your IRA deduction and your taxable benefits.

2. Situation (1) does not apply and you take an exclusion for interest from qualified U.S. savings bonds (Form 8815), for adoption benefits (Form 8839), for foreign earned income or housing (Form 2555 or Form 2555-EZ), or for income earned in American Samoa (Form 4563) or Puerto Rico by bona fide residents. In this situation, you must use Worksheet 1 in Publication 915 to figure your taxable benefits.
3. You received a lump-sum payment for an earlier year. In this situation, also complete Worksheet 2 or 3 and Worksheet 4 in Publication 915. See *Lump-sum election* next.

Lump-sum election. You must include the taxable part of a lump-sum (retroactive) payment of benefits received in 2012 in your 2012 income, even if the payment includes benefits for an earlier year.

TIP *This type of lump-sum benefit payment should not be confused with the lump-sum death benefit that both the SSA and RRB pay to many of their beneficiaries. No part of the lump-sum death benefit is subject to tax.*

Generally, you use your 2012 income to figure the taxable part of the total benefits received in 2012. However, you may be able to figure the taxable part of a lump-sum payment for an earlier year separately, using your income for the earlier year. You can elect this method if it lowers your taxable benefits.

Making the election. If you received a lump-sum benefit payment in 2012 that includes benefits for one or more earlier years, follow the instructions in Publication 915 under *Lump-Sum Election* to see whether making the election will lower your taxable benefits. That discussion also explains how to make the election.

CAUTION *Because the earlier year's taxable benefits are included in your 2012 income, no adjustment is made to the earlier year's return. Do not file an amended return for the earlier year.*

Examples

The following are a few examples you can use as a guide to figure the taxable part of your benefits.

Example 1. George White is single and files Form 1040 for 2012. He received the following income in 2012:

Fully taxable pension	$18,600
Wages from part-time job	9,400
Taxable interest income	990
Total	$28,990

George also received social security benefits during 2012. The Form SSA-1099 he received in January 2013 shows $5,980 in box 5. To figure his taxable benefits, George completes the worksheet shown here.

Filled-in Worksheet 1.
Figuring Your Taxable Benefits

1. Enter the total amount from box 5 of ALL your Forms SSA-1099 and RRB-1099. Also enter this amount on Form 1040, line 20a, or Form 1040A, line 14a	$5,980
2. Enter one-half of line 1	2,990
3. Combine the amounts from: ***Form 1040:*** Lines 7, 8a, 9a, 10 through 14, 15b, 16b, 17 through 19, and 21. ***Form 1040A:*** Lines 7, 8a, 9a, 10, 11b, 12b, and 13	28,990
4. Enter the amount, if any, from Form 1040 or 1040A, line 8b	-0-
5. Enter the total of any exclusions/adjustments for: • Adoption benefits (Form 8839, line 24), • Foreign earned income or housing (Form 2555, lines 45 and 50, or Form 2555-EZ, line 18), and • Certain income of bona fide residents of American Samoa (Form 4563, line 15) or Puerto Rico	-0-
6. Combine lines 2, 3, 4, and 5	31,980
7. ***Form 1040 filers:*** Enter the amount from Form 1040, lines 23 through 32, and any write-in adjustments you entered on the dotted line next to line 36. ***Form 1040A filers:*** Enter the amount from Form 1040A, lines 16 and 17	-0-
8. Is the amount on line 7 less than the amount on line 6? **No.** STOP None of your social security benefits are taxable. Enter -0- on Form 1040, line 20b, or Form 1040A, line 14b. **Yes.** Subtract line 7 from line 6	31,980
9. If you are: • Married filing jointly, enter $32,000 • Single, head of household, qualifying widow(er), or married filing separately and you **lived apart** from your spouse for all of 2012, enter $25,000	25,000
Note. If you are married filing separately and you lived with your spouse at any time in 2012, skip lines 9 through 16; multiply line 8 by 85% (.85) and enter the result on line 17. Then go to line 18.	
10. Is the amount on line 9 less than the amount on line 8? **No.** STOP None of your benefits are taxable. Enter -0- on Form 1040, line 20b, or on Form 1040A, line 14b. If you are married filing separately and you **lived apart** from your spouse for all of 2012, be sure you entered "D" to the right of the word "benefits" on Form 1040, line 20a, or on Form 1040A, line 14a. **Yes.** Subtract line 9 from line 8	6,980
11. Enter $12,000 if married filing jointly; $9,000 if single, head of household, qualifying widow(er), or married filing separately and you **lived apart** from your spouse for all of 2012	9,000
12. Subtract line 11 from line 10. If zero or less, enter -0-	-0-
13. Enter the **smaller** of line 10 or line 11	6,980
14. Enter one-half of line 13	3,490
15. Enter the **smaller** of line 2 or line 14	2,990
16. Multiply line 12 by 85% (.85). If line 12 is zero, enter -0-	-0-
17. Add lines 15 and 16	2,990
18. Multiply line 1 by 85% (.85)	5,083
19. Taxable benefits. Enter the **smaller** of line 17 or line 18. Also enter this amount on Form 1040, line 20b, or Form 1040A, line 14b	$2,990

The amount on line 19 of George's worksheet shows that $2,990 of his social security benefits is taxable. On line 20a of his Form 1040, George enters his net benefits of $5,980. On line 20b, he enters his taxable benefits of $2,990.

Example 2. Ray and Alice Hopkins file a joint return on Form 1040A for 2012. Ray is retired and received a fully taxable pension of $15,500. He also received social security benefits, and his Form SSA-1099 for 2012 shows net benefits of $5,600 in box 5. Alice worked during the year and had wages of $14,000. She made a deductible payment to her IRA account of $1,000. Ray and Alice have two savings accounts with a total of $250 in taxable interest income. They complete Worksheet 1, entering $29,750 ($15,500 + $14,000 + $250) on line 3. They find none of Ray's social security benefits are taxable. On Form 1040A, they enter $5,600 on line 14a and -0- on line 14b.

Filled-in Worksheet 1.
Figuring Your Taxable Benefits

1. Enter the total amount from box 5 of ALL your Forms SSA-1099 and RRB-1099. Also enter this amount on Form 1040, line 20a, or Form 1040A, line 14a $5,600
2. Enter one-half of line 1 2,800
3. Combine the amounts from:
   Form 1040: Lines 7, 8a, 9a, 10 through 14, 15b, 16b, 17 through 19, and 21.
   Form 1040A: Lines 7, 8a, 9a, 10, 11b, 12b, and 13 29,750
4. Enter the amount, if any, from Form 1040 or 1040A, line 8b . . . . -0-
5. Enter the total of any exclusions/ adjustments for:
   - Adoption benefits (Form 8839, line 24),
   - Foreign earned income or housing (Form 2555, lines 45 and 50, or Form 2555-EZ, line 18), and
   - Certain income of bona fide residents of American Samoa (Form 4563, line 15) or Puerto Rico . . . . -0-
6. Combine lines 2, 3, 4, and 5 32,550
7. ***Form 1040 filers:*** Enter the amount from Form 1040, lines 23 through 32, and any write-in adjustments you entered on the dotted line next to line 36.
   Form 1040A filers: Enter the amount from Form 1040A, lines 16 and 17 . . 1,000
8. Is the amount on line 7 less than the amount on line 6?
   No. STOP None of your benefits are taxable. Enter -0- on Form 1040, line 20b, or Form 1040A, line 14b.
   Yes. Subtract line 7 from line 6 . . . 31,550
9. If you are:
   - Married filing jointly, enter $32,000
   - Single, head of household, qualifying widow(er), or married filing separately and you **lived apart** from your spouse for all of 2012, enter $25,000 32,000

   Note. If you are married filing separately and you lived with your spouse at any time in 2012, skip lines 9 through 16; multiply line 8 by 85% (.85) and enter the result on line 17. Then go to line 18.
10. Is the amount on line 9 less than the amount on line 8?
    No. STOP None of your benefits are taxable. Enter -0- on Form 1040, line 20b, or on Form 1040A, line 14b. If you are married filing separately and you **lived apart** from your spouse for all of 2012, be sure you entered “D” to the right of the word “benefits” on Form 1040, line 20a, or on Form 1040A, line 14a.
    Yes. Subtract line 9 from line 8 . . . ______
11. Enter $12,000 if married filing jointly; $9,000 if single, head of household, qualifying widow(er), or married filing separately and you **lived apart** from your spouse for all of 2012 . . . . . . ______
12. Subtract line 11 from line 10. If zero or less, enter -0- . . . . ______
13. Enter the **smaller** of line 10 or line 11 . . . . ______
14. Enter one-half of line 13 . . . . ______
15. Enter the **smaller** of line 2 or line 14 . . . . ______
16. Multiply line 12 by 85% (.85). If line 12 is zero, enter -0- . . . . ______
17. Add lines 15 and 16 . . . . ______
18. Multiply line 1 by 85% (.85) . . . . . . ______
19. **Taxable benefits.** Enter the **smaller** of line 17 or line 18. Also enter this amount on Form 1040, line 20b, or Form 1040A, line 14b . . . . ______

Example 3. Joe and Betty Johnson file a joint return on Form 1040 for 2012. Joe is a retired railroad worker and in 2012 received the social security equivalent benefit (SSEB) portion of tier 1 railroad retirement benefits. Joe's Form RRB-1099 shows $10,000 in box 5. Betty is a retired government worker and receives a fully taxable pension of $38,000. They had $2,300 in taxable interest income plus interest of $200 on a qualified U.S. savings bond. The savings bond interest qualified for the exclusion. They figure their taxable benefits by completing Worksheet 1. Because they have qualified U.S. savings bond interest, they follow the note at the beginning of the worksheet and use the amount from line 2 of their Schedule B (Form 1040A or 1040) on line 3 of the worksheet instead of the amount from line 8a of their Form 1040. On line 3 of the worksheet, they enter $40,500 ($38,000 + $2,500).

Filled-in Worksheet 1.
Figuring Your Taxable Benefits

Before you begin:
- If you are married filing separately and you lived apart from your spouse for all of 2012, enter “D” to the right of the word “benefits” on Form 1040, line 20a, or Form 1040A, line 14a.
- Do not use this worksheet if you repaid benefits in 2012 and your total repayments (box 4 of Forms SSA-1099 and RRB-1099) were more than your gross benefits for 2012 (box 3 of Forms SSA-1099 and RRB-1099). None of your benefits are taxable for 2012. For more information, see *Repayments More Than Gross Benefits*.
- If you are filing Form 8815, Exclusion of Interest From Series EE and I U.S. Savings Bonds Issued After 1989, do not include the amount from line 8a of Form 1040 or Form 1040A on line 3 of this worksheet. Instead, include the amount from Schedule B (Form 1040A or 1040), line 2.

1. Enter the total amount from box 5 of ALL your Forms SSA-1099 and RRB-1099. Also enter this amount on Form 1040, line 20a, or Form 1040A, line 14a $10,000
2. Enter one-half of line 1 5,000
3. Combine the amounts from:
   Form 1040: Lines 7, 8a, 9a, 10 through 14, 15b, 16b, 17 through 19, and 21.
   Form 1040A: Lines 7, 8a, 9a, 10, 11b, 12b, and 13 40,500
4. Enter the amount, if any, from Form 1040 or 1040A, line 8b . . . . -0-
5. Enter the total of any exclusions/ adjustments for:
   - Adoption benefits (Form 8839, line 24),
   - Foreign earned income or housing (Form 2555, lines 45 and 50, or Form 2555-EZ, line 18), and
   - Certain income of bona fide residents of American Samoa (Form 4563, line 15) or Puerto Rico . . . . -0-
6. Combine lines 2, 3, 4, and 5 45,500
7. ***Form 1040 filers:*** Enter the amount from Form 1040, lines 23 through 32, and any write-in adjustments you entered on the dotted line next to line 36.
   Form 1040A filers: Enter the amount from Form 1040A, lines 16 and 17 . . -0-
8. Is the amount on line 7 less than the amount on line 6?
   No. STOP None of your benefits are taxable. Enter -0- on Form 1040, line 20b, or Form 1040A, line 14b.
   Yes. Subtract line 7 from line 6 . . . 45,500
9. If you are:
   - Married filing jointly, enter $32,000
   - Single, head of household, qualifying widow(er), or married filing separately and you **lived apart** from your spouse for all of 2012, enter $25,000 32,000

Note. If you are married filing separately and you lived with your spouse at any time in 2012, skip lines 9 through 16; multiply line 8 by 85% (.85) and enter the result on line 17. Then go to line 18.

10. Is the amount on line 9 less than the amount on line 8?

No. STOP None of your benefits are taxable. Enter -0- on Form 1040, line 20b, or on Form 1040A, line 14b. If you are married filing separately and you **lived apart** from your spouse for all of 2012, be sure you entered "D" to the right of the word "benefits" on Form 1040, line 20a, or on Form 1040A, line 14a.

Yes. Subtract line 9 from line 8 . . . 13,500

11. Enter $12,000 if married filing jointly; $9,000 if single, head of household, qualifying widow(er), or married filing separately and you **lived apart** from your spouse for all of 2012 12,000

12. Subtract line 11 from line 10. If zero or less, enter -0- 1,500

13. Enter the **smaller** of line 10 or line 11 12,000

14. Enter one-half of line 13 6,000

15. Enter the **smaller** of line 2 or line 14 5,000

16. Multiply line 12 by 85% (.85). If line 12 is zero, enter -0- 1,275

17. Add lines 15 and 16 6,275

18. Multiply line 1 by 85% (.85) 8,500

19. **Taxable benefits.** Enter the **smaller** of line 17 or line 18. Also enter this amount on Form 1040, line 20b, or Form 1040A, line 14b $6,275

More than 50% of Joe's net benefits are taxable because the income on line 8 of the worksheet ($45,500) is more than $44,000. Joe and Betty enter $10,000 on Form 1040, line 20a, and $6,275 on Form 1040, line 20b.

Deductions Related to Your Benefits

You may be entitled to deduct certain amounts related to the benefits you receive.

Disability payments. You may have received disability payments from your employer or an insurance company that you included as income on your tax return in an earlier year. If you received a lump-sum payment from SSA or RRB, and you had to repay the employer or insurance company for the disability payments, you can take an itemized deduction for the part of the payments you included in gross income in the earlier year. If the amount you repay is more than $3,000, you may be able to claim a tax credit instead. Claim the deduction or credit in the same way explained under *Repayments More Than Gross Benefits*, later.

Legal expenses. You can usually deduct legal expenses that you pay or incur to produce or collect taxable income or in connection with the determination, collection, or refund of any tax.

Legal expenses for collecting the taxable part of your benefits are deductible as a miscellaneous itemized deduction on Schedule A (Form 1040), line 23.

Repayments More Than Gross Benefits

In some situations, your Form SSA-1099 or Form RRB-1099 will show that the total benefits you repaid (box 4) are more than the gross benefits (box 3) you received. If this occurred, your net benefits in box 5 will be a negative figure (a figure in parentheses) and none of your benefits will be taxable. Do not use a worksheet in this case. If you receive more than one form, a negative figure in box 5 of one form is used to offset a positive figure in box 5 of another form for that same year.

If you have any questions about this negative figure, contact your local SSA office or your local RRB field office.

Joint return. If you and your spouse file a joint return, and your Form SSA-1099 or RRB-1099 has a negative figure in box 5, but your spouse's does not, subtract the amount in box 5 of your form from the amount in box 5 of your spouse's form. You do this to get your net benefits when figuring if your combined benefits are taxable.

Example. John and Mary file a joint return for 2012. John received Form SSA-1099 showing $3,000 in box 5. Mary also received Form SSA-1099 and the amount in box 5 was ($500). John and Mary will use $2,500 ($3,000 minus $500) as the amount of their net benefits when figuring if any of their combined benefits are taxable.

Repayment of benefits received in an earlier year. If the total amount shown in box 5 of all of your Forms SSA-1099 and RRB-1099 is a negative figure, you can take an itemized deduction for the part of this negative figure that represents benefits you included in gross income in an earlier year.

Deduction $3,000 or less. If this deduction is $3,000 or less, it is subject to the 2%-of-adjusted-gross-income limit that applies to certain miscellaneous itemized deductions. Claim it on Schedule A (Form 1040), line 23.

Deduction more than $3,000. If this deduction is more than $3,000, you should figure your tax two ways:

1. Figure your tax for 2012 with the itemized deduction included on Schedule A, line 28.
2. Figure your tax for 2012 in the following steps.
   a. Figure the tax without the itemized deduction included on Schedule A, line 28.
   b. For each year after 1983 for which part of the negative figure represents a repayment of benefits, refigure your taxable benefits as if your total benefits for the year were reduced by that part of the negative figure. Then refigure the tax for that year.
   c. Subtract the total of the refigured tax amounts in (b) from the total of your actual tax amounts.
   d. Subtract the result in (c) from the result in (a).

Compare the tax figured in methods (1) and (2). Your tax for 2012 is the smaller of the two amounts. If method (1) results in less tax, take the itemized deduction on Schedule A (Form 1040), line 28. If method (2) results in less tax, claim a credit for the amount from step 2(c) above on Form 1040, line 71, and enter "I.R.C. 1341" in the column to the right of line 71. If both methods produce the same tax, deduct the repayment on Schedule A (Form 1040), line 28.

12.

Other Income

Introduction

You must include on your return all items of income you receive in the form of money, property, and services unless the tax law states that you do not include them. Some items, however, are only partly excluded from income. This chapter discusses many kinds of income and explains whether they are taxable or nontaxable.

- Income that is taxable must be reported on your tax return and is subject to tax.
- Income that is nontaxable may have to be shown on your tax return but is not taxable.

This chapter begins with discussions of the following income items.

- Bartering.
- Canceled debts.
- Sales parties at which you are the host or hostess.
- Life insurance proceeds.
- Partnership income.
- S Corporation income.
- Recoveries (including state income tax refunds).
- Rents from personal property.
- Repayments.
- Royalties.
- Unemployment benefits.
- Welfare and other public assistance benefits.

These discussions are followed by brief discussions of other income items.

Useful Items

You may want to see:

Publication

- ❑ **525** Taxable and Nontaxable Income
- ❑ **544** Sales and Other Dispositions of Assets
- ❑ **4681** Canceled Debts, Foreclosures, Repossessions, and Abandonments

Bartering

Bartering is an exchange of property or services. You must include in your income, at the time received, the fair market value of property or services you receive in bartering. If you exchange services with another person and you both have agreed ahead of time on the value of the services, that value will be accepted as fair market value unless the value can be shown to be otherwise.

Generally, you report this income on Schedule C (Form 1040), Profit or Loss From Business, or Schedule C-EZ (Form 1040), Net Profit From Business. However, if the barter involves an exchange of something other than services, such as in *Example 3* below, you may have to use another form or schedule instead.

Example 1. You are 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) or Schedule C-EZ (Form 1040) in the year you receive them.

Example 2. You are 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.

Example 3. 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), Supplemental Income and Loss, the fair market value of the artwork, and the artist must report as income on Schedule C (Form 1040) or Schedule C-EZ (Form 1040) the fair rental value of the apartment.

Form 1099-B from barter exchange. If you exchanged property or services through a barter exchange, Form 1099-B, Proceeds From Broker and Barter Exchange Transactions, or a similar statement from the barter exchange should be sent to you by February 15, 2013. It should show the value of cash, property, services, credits, or scrip you received from exchanges during 2012. The IRS also will receive a copy of Form 1099-B.

Canceled Debts

In most cases, if a debt you owe is canceled or forgiven, other than as a gift or bequest, you must include the canceled amount in your income. You have no income from the canceled debt if it is intended as a gift to you. A debt includes any indebtedness for which you are liable or which attaches to property you hold.

If the debt is a nonbusiness debt, report the canceled amount on Form 1040, line 21. If it is a business debt, report the amount on Schedule C (Form 1040) or Schedule C-EZ (Form 1040) (or on Schedule F (Form 1040), Profit or Loss From Farming, if the debt is farm debt and you are a farmer).

Form 1099-C. If a Federal Government agency, financial institution, or credit union cancels or forgives a debt you owe of $600 or more, you will receive a Form 1099-C, Cancellation of Debt. The amount of the canceled debt is shown in box 2.

Interest included in canceled debt. If any interest is forgiven and included in the amount of canceled debt in box 2, the amount of interest also will be shown in box 3. Whether or not you must include the interest portion of the canceled debt in your income depends on whether the interest would be deductible if you paid it. See *Deductible debt* under *Exceptions*, later.

If the interest would not be deductible (such as interest on a personal loan), include in your income the amount from Form 1099-C, box 2. If the interest would be deductible (such as on a business loan), include in your income the net amount of the canceled debt (the amount shown in box 2 less the interest amount shown in box 3).

Discounted mortgage loan. If your financial institution offers a discount for the early payment of your mortgage loan, the amount of the discount is canceled debt. You must include the canceled amount in your income.

Mortgage relief upon sale or other disposition. If you are personally liable for a mortgage (recourse debt), and you are relieved of the mortgage when you dispose of the property, you may realize gain or loss up to the fair market value of the property. To the extent the mortgage discharge exceeds the fair market value of the property, it is income from discharge of indebtedness unless it qualifies for exclusion under *Excluded debt*, later. Report any income from discharge of indebtedness on nonbusiness debt that does not qualify for exclusion as other income on Form 1040, line 21.

> **TIP** *You may be able to exclude part of the mortgage relief on your principal residence. See Excluded debt, later.*

If you are not personally liable for a mortgage (nonrecourse debt), and you are relieved of the mortgage when you dispose of the property (such as through foreclosure), that relief is included in the amount you realize. You may have a taxable gain if the amount you realize exceeds your adjusted basis in the property. Report any gain on nonbusiness property as a capital gain.

See Publication 4681 for more information.

Stockholder debt. If you are a stockholder in a corporation and the corporation cancels or forgives your debt to it, the canceled debt is a constructive distribution that is generally dividend income to you. For more information, see Publication 542, Corporations.

If you are a stockholder in a corporation and you cancel a debt owed to you by the corporation, you generally do not realize income. This is because the canceled debt is considered as a contribution to the capital of the corporation equal to the amount of debt principal that you canceled.

Repayment of canceled debt. If you included a canceled amount in your income and later pay the debt, you may be able to file a claim for refund for the year the amount was included in income. You can file a claim on Form 1040X if the statute of limitations for filing a claim is still open. The statute of limitations generally does not end until 3 years after the due date of your original return.

Exceptions

There are several exceptions to the inclusion of canceled debt in income. These are explained next.

Student loans. Certain student loans contain a provision that all or part of the debt incurred to attend the qualified educational institution will be canceled if you work for a certain period of time in certain professions for any of a broad class of employers.

You do not have income if your student loan is canceled after you agreed to this provision and then performed the services required. To qualify, the loan must have been made by:

1. The Federal Government, a state or local government, or an instrumentality, agency, or subdivision thereof,
2. A tax-exempt public benefit corporation that has assumed control of a state, county, or municipal hospital, and whose employees are considered public employees under state law, or
3. An educational institution:
   a. Under an agreement with an entity described in (1) or (2) that provided the funds to the institution to make the loan, or
   b. As part of a program of the institution designed to encourage students to serve in occupations or areas with unmet needs and under which the services provided are for or under the direction of a governmental unit or a tax-exempt section 501(c)(3) organization. Section 501(c)(3) organizations are defined in chapter 24.

A loan to refinance a qualified student loan also will qualify if it was made by an educational institution or a tax-exempt 501(a) organization under its program designed as described in (3)(b) above.

Education loan repayment assistance. Education loan repayments made to you by the National Health Service Corps Loan Repayment Program (NHSC Loan Repayment Program), a state education loan repayment program eligible for funds under the Public Health Service Act, or any other state loan repayment or loan forgiveness program that is intended to provide for the increased availability of health services in underserved or health professional shortage areas are not taxable.

TIP *The provision relating to the "other state loan repayment or loan forgiveness program" was added to this exclusion for amounts received in tax years beginning after December 31, 2008. If you included these amounts in income in 2009, 2010, or 2011, you should file an amended tax return to exclude this income. See Form 1040X and its instructions for details on filing.*

Deductible debt. You do not have income from the cancellation of a debt if your payment of the debt would be deductible. This exception applies only if you use the cash method of accounting. For more information, see chapter 5 of Publication 334, Tax Guide for Small Business.

Price reduced after purchase. In most cases, if the seller reduces the amount of debt you owe for property you purchased, you do not have income from the reduction. The reduction of the debt is treated as a purchase price adjustment and reduces your basis in the property.

Excluded debt. Do not include a canceled debt in your gross income in the following situations.

- The debt is canceled in a bankruptcy case under title 11 of the U.S. Code. See Publication 908, Bankruptcy Tax Guide.
- The debt is canceled when you are insolvent. However, you cannot exclude any amount of canceled debt that is more than the amount by which you are insolvent. See Publication 908.
- The debt is qualified farm debt and is canceled by a qualified person. See chapter 3 of Publication 225, Farmer's Tax Guide.
- The debt is qualified real property business debt. See chapter 5 of Publication 334.
- The cancellation is intended as a gift.
- The debt is qualified principal residence indebtedness. See Publication 525 for additional information.

Host or Hostess

If you host a party or event at which sales are made, any gift or gratuity you receive for giving the event is a payment for helping a direct seller make sales. You must report this item as income at its fair market value.

Your out-of-pocket party expenses are subject to the 50% limit for meal and entertainment expenses. These expenses are deductible as miscellaneous itemized deductions subject to the 2%-of-AGI limit on Schedule A (Form 1040), but only up to the amount of income you receive for giving the party.

For more information about the 50% limit for meal and entertainment expenses, see chapter 26.

Life Insurance Proceeds

Life insurance proceeds paid to you because of the death of the insured person are not taxable unless the policy was turned over to you for a price. This is true even if the proceeds were paid under an accident or health insurance policy or an endowment contract. However, interest income received as a result of life insurance proceeds may be taxable.

Proceeds not received in installments. If death benefits are paid to you in a lump sum or other than at regular intervals, include in your income only the benefits that are more than the amount payable to you at the time of the insured person's death. If the benefit payable at death is not specified, you include in your income the benefit payments that are more than the present value of the payments at the time of death.

Proceeds received in installments. If you receive life insurance proceeds in installments, you can exclude part of each installment from your income.

To determine the excluded part, divide the amount held by the insurance company (generally the total lump sum payable at the death of the insured person) by the number of installments to be paid. Include anything over this excluded part in your income as interest.

Surviving spouse. If your spouse died before October 23, 1986, and insurance proceeds paid to you because of the death of your spouse are received in installments, you can exclude up to $1,000 a year of the interest included in the installments. If you remarry, you can continue to take the exclusion.

Surrender of policy for cash. If you surrender a life insurance policy for cash, you must include in income any proceeds that are more than the cost of the life insurance policy. In most cases, your cost (or investment in the contract) is the total of premiums that you paid for the life insurance policy, less any refunded premiums, rebates, dividends, or unrepaid loans that were not included in your income.

You should receive a Form 1099-R showing the total proceeds and the taxable part. Report these amounts on lines 16a and 16b of Form 1040 or lines 12a and 12b of Form 1040A.

More information. For more information, see *Life Insurance Proceeds* in Publication 525.

Endowment Contract Proceeds

An endowment contract is a policy under which you are paid a specified amount of money on a certain date unless you die before that date, in which case, the money is paid to your designated beneficiary. Endowment proceeds paid in a lump sum to you at maturity are taxable only if the proceeds are more than the cost of the policy. To determine your cost, subtract any amount that you previously received under the contract and excluded from your income from the total premiums (or other consideration) paid for the contract. Include the part of the lump sum payment that is more than your cost in your income.

Accelerated Death Benefits

Certain amounts paid as accelerated death benefits under a life insurance contract or viatical settlement before the insured's death are excluded from income if the insured is terminally or chronically ill.

Viatical settlement. This is the sale or assignment of any part of the death benefit under a life insurance contract to a viatical settlement provider. A viatical settlement provider is a person who regularly engages in the business of buying or taking assignment of life insurance contracts on the lives of insured individuals who are terminally or chronically ill and who meets the requirements of section 101(g)(2)(B) of the Internal Revenue Code.

Exclusion for terminal illness. Accelerated death benefits are fully excludable if the insured is a terminally ill individual. This is a person who has been certified by a physician as having an illness or physical condition that can reasonably be expected to result in death within 24 months from the date of the certification.

Exclusion for chronic illness. If the insured is a chronically ill individual who is not terminally ill, accelerated death benefits paid on the basis of costs incurred for qualified long-term care services are fully excludable. Accelerated death benefits paid on a *per diem* or other periodic basis are excludable up to a limit. This limit applies to the total of the accelerated death benefits and any periodic payments received from long-term care insurance contracts. For information on the limit and the definitions of chronically ill individual, qualified long-term care services, and long-term care insurance contracts, see *Long-Term Care Insurance Contracts* under *Sickness and Injury Benefits* in Publication 525.

Exception. The exclusion does not apply to any amount paid to a person (other than the insured) who has an insurable interest in the life of the insured because the insured:

- Is a director, officer, or employee of the person, or
- Has a financial interest in the person's business.

Form 8853. To claim an exclusion for accelerated death benefits made on a *per diem* or other periodic basis, you must file Form 8853, Archer MSAs and Long-term Care Insurance Contracts, with your return. You do not have to file Form 8853 to exclude accelerated death benefits paid on the basis of actual expenses incurred.

Public Safety Officer Killed in the Line of Duty

If you are a survivor of a public safety officer who was killed in the line of duty, you may be able to exclude from income certain amounts you receive.

For this purpose, the term public safety officer includes law enforcement officers, firefighters, chaplains, and rescue squad and ambulance crew members. For more information, see Publication 559, Survivors, Executors, and Administrators.

Partnership Income

A partnership generally is not a taxable entity. The income, gains, losses, deductions, and credits of a partnership are passed through to the partners based on each partner's distributive share of these items.

Schedule K-1 (Form 1065). Although a partnership generally pays no tax, it must file an information return on Form 1065, U.S. Return of Partnership Income, and send Schedule K-1 (Form 1065) to each partner. In addition, the partnership will send each partner a copy of the Partner's Instructions for Schedule K-1 (Form 1065) to help each partner report his or her share of the partnership's income, deductions, credits, and tax preference items.

RECORDS Keep Schedule K-1 (Form 1065) for your records. Do not attach it to your Form 1040.

For more information on partnerships, see Publication 541, Partnerships.

Qualified joint venture. If you and your spouse each materially participate as the only members of a jointly owned and operated business, and you file a joint return for the tax year, you can make a joint election to be treated as a qualified joint venture instead of a partnership. To make this election, you must divide all items of income, gain, loss, deduction, and credit attributable to the business between you and your spouse in accordance with your respective interests in the venture. Each of you must file a separate Schedule C or Schedule C-EZ (Form 1040).

S Corporation Income

In most cases, an S corporation does not pay tax on its income. Instead, the income, losses, deductions, and credits of the corporation are passed through to the shareholders based on each shareholder's *pro rata* share.

Schedule K-1 (Form 1120S). An S corporation must file a return on Form 1120S, U.S. Income Tax Return for an S Corporation, and send Schedule K-1 (Form 1120S) to each shareholder. In addition, the S corporation will send each shareholder a copy of the Shareholder's Instructions for Schedule K-1 (Form 1120S) to help each shareholder report his or her share of the S corporation's income, losses, credits, and deductions.

RECORDS Keep Schedule K-1 (Form 1120S) for your records. Do not attach it to your Form 1040.

For more information on S corporations and their shareholders, see the Instructions for Form 1120S.

Recoveries

A recovery is a return of an amount you 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). You also may have recoveries of non-itemized deductions (such as payments on previously deducted bad debts) and recoveries of items for which you previously claimed a tax credit.

Tax benefit rule. You must include a recovery in your income in the year you receive it up to the amount by which the deduction or credit you took for the recovered amount reduced your 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 your tax in the earlier year. For more information, see Publication 525.

Federal income tax refund. Refunds of federal income taxes are not included in your income because they are never allowed as a deduction from income.

State tax refund. If you received a state or local income tax refund (or credit or offset) in 2012, you generally must include it in income if you deducted the tax in an earlier year. The payer should send Form 1099-G, Certain Government Payments, to you by January 31, 2013. The IRS also will receive a copy of the Form 1099-G. If you file Form 1040, use the State and Local Income Tax Refund Worksheet in the 2012 Form 1040 instructions for line 10 to figure the amount (if any) to include in your income. See Publication 525 for when you must use another worksheet.

If you could 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 you may have to include in income is limited to the excess of the tax you chose to deduct for that year over the tax you did not choose to deduct for that year. For examples, see Publication 525.

Mortgage interest refund. If you received a refund or credit in 2012 of mortgage interest paid in an earlier year, the amount should be shown in box 3 of your Form 1098, Mortgage Interest Statement. Do not subtract the refund amount from the interest you paid in 2012. You may have to include it in your income under the rules explained in the following discussions.

Interest on recovery. Interest on any of the amounts you recover must be reported as interest income in the year received. For example, report any interest you received on state or local income tax refunds on Form 1040, line 8a.

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 you receive a refund or other recovery that is for amounts you paid in 2 or more separate years, you must allocate, on a *pro rata* basis, the recovered amount between the years in which you paid it. This allocation is necessary to determine the amount of recovery from any earlier years and to determine the amount, if any, of your allowable deduction for this item for the current year. For information on how to compute the allocation, see *Recoveries* in Publication 525.

Itemized Deduction Recoveries

If you recover any amount that you deducted in an earlier year on Schedule A (Form 1040), you generally must include the full amount of the recovery in your income in the year you receive it.

Where to report. Enter your 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. You cannot use Form 1040A or Form 1040EZ.

Standard deduction limit. You generally are allowed to claim the standard deduction if you do not itemize your deductions. Only your itemized deductions that are more than your standard deduction are subject to the recovery rule (unless you are required to itemize your deductions). If your total deductions on the earlier year return were not more than your income for that year, include in your income this year the lesser of:

- Your recoveries, or
- The amount by which your itemized deductions exceeded the standard deduction.

Example. For 2011, you filed a joint return. Your taxable income was $60,000 and you were not entitled to any tax credits. Your standard deduction was $11,600, and you had itemized deductions of $13,000. In 2012, you received the following recoveries for amounts deducted on your 2011 return:

Medical expenses	$200
State and local income tax refund	400
Refund of mortgage interest	325
Total recoveries	$925

None of the recoveries were more than the deductions taken for 2011. The difference between the state and local income tax you deducted and your local general sales tax was more than $400.

Your total recoveries are less than the amount by which your itemized deductions exceeded the standard deduction ($13,000 − 11,600 = $1,400), so you must include your total recoveries in your income for 2012. Report the state and local income tax refund of $400 on Form 1040, line 10, and the balance of your recoveries, $525, on Form 1040, line 21.

Standard deduction for earlier years. To determine if amounts recovered in 2012 must be included in your income, you must know the standard deduction for your filing status for the year the deduction was claimed. Look in the instructions for your tax return from prior years to locate the standard deduction for the filing status for that prior year.

Example. You filed a joint return on Form 1040 for 2011 with taxable income of $45,000. Your itemized deductions were $12,050. The standard deduction that you could have claimed was $11,600. In 2012, you recovered $2,100 of your 2011 itemized deductions. None of the recoveries were more than the actual deductions for 2011. Include $450 of the recoveries in your 2012 income. This is the smaller of your recoveries ($2,100) or the amount by which your itemized deductions were more than the standard deduction ($12,050 – $11,600 = $450).

Recovery limited to deduction. You do not include in your income any amount of your recovery that is more than the amount you deducted in the earlier year. The amount you include in your income is limited to the smaller of:

- The amount deducted on Schedule A (Form 1040), or
- The amount recovered.

Example. During 2011 you paid $1,700 for medical expenses. From this amount you subtracted $1,500, which was 7.5% of your adjusted gross income. Your actual medical expense deduction was $200. In 2012, you received a $500 reimbursement from your medical insurance for your 2011 expenses. The only amount of the $500 reimbursement that must be included in your income for 2012 is $200—the amount actually deducted.

Other recoveries. See *Recoveries* in Publication 525 if:

- You have recoveries of items other than itemized deductions, or
- You received a recovery for an item for which you claimed a tax credit (other than investment credit or foreign tax credit) in a prior year.

Rents from Personal Property

If you rent out personal property, such as equipment or vehicles, how you report your income and expenses is in most cases determined by:

- Whether or not the rental activity is a business, and
- Whether or not the rental activity is conducted for profit.

In most cases, if your primary purpose is income or profit and you are involved in the rental activity with continuity and regularity, your rental activity is a business. See Publication 535, Business Expenses, for details on deducting expenses for both business and not-for-profit activities.

Reporting business income and expenses. If you are in the business of renting personal property, report your income and expenses on Schedule C or Schedule C-EZ (Form 1040). The form instructions have information on how to complete them.

Reporting nonbusiness income. If you are not in the business of renting personal property, report your rental income on Form 1040, line 21. List the type and amount of the income on the dotted line next to line 21.

Reporting nonbusiness expenses. If you rent personal property for profit, include your rental expenses in the total amount you enter on Form 1040, line 36. Also enter the amount and "PPR" on the dotted line next to line 36.

If you do not rent personal property for profit, your deductions are limited and you cannot report a loss to offset other income. See Activity not for profit, under *Other Income*, later.

Repayments

If you had to repay an amount that you included in your income in an earlier year, you may be able to deduct the amount repaid from your income for the year in which you repaid it. Or, if the amount you repaid is more than $3,000, you may be able to take a credit against your tax for the year in which you repaid it. Generally, you can claim a deduction or credit only if the repayment qualifies as an expense or loss incurred in your trade or business or in a for-profit transaction.

Type of deduction. The type of deduction you are allowed in the year of repayment depends on the type of income you included in the earlier year. You generally deduct the repayment on the same form or schedule on which you previously reported it as income. For example, if you reported it as self-employment income, deduct it as a business expense on Schedule C or Schedule C-EZ (Form 1040) or Schedule F (Form 1040). If you reported it as a capital gain, deduct it as a capital loss as explained in the Instructions for Schedule D (Form 1040). If you reported it as wages, unemployment compensation, or other nonbusiness income, deduct it as a miscellaneous itemized deduction on Schedule A (Form 1040).

Repaid social security benefits. If you repaid social security benefits or equivalent railroad retirement benefits, see Repayment of benefits in chapter 11.

Repayment of $3,000 or less. If the amount you repaid was $3,000 or less, deduct it from your income in the year you repaid it. If you must deduct it as a miscellaneous itemized deduction, enter it on Schedule A (Form 1040), line 23.

Repayment over $3,000. If the amount you repaid was more than $3,000, you can deduct the repayment (as explained under Type of deduction, earlier). However, you can choose instead to take a tax credit for the year of repayment if you included the income under a claim of right. This means that at the time you included the income, it appeared that you had an unrestricted right to it. If you qualify for this choice, figure your tax under both methods and compare the results. Use the method (deduction or credit) that results in less tax.

CAUTION

When determining whether the amount you repaid was more or less than $3,000, consider the total amount being repaid on the return. Each instance of repayment is not considered separately.

Method 1. Figure your tax for 2012 claiming a deduction for the repaid amount. If you must deduct it as a miscellaneous itemized deduction, enter it on Schedule A (Form 1040), line 28.

Method 2. Figure your tax for 2012 claiming a credit for the repaid amount. Follow these steps.

1. Figure your tax for 2012 without deducting the repaid amount.
2. Refigure your tax from the earlier year without including in income the amount you repaid in 2012.
3. Subtract the tax in (2) from the tax shown on your return for the earlier year. This is the credit.
4. Subtract the answer in (3) from the tax for 2012 figured without the deduction (Step 1).

If method 1 results in less tax, deduct the amount repaid. If method 2 results in less tax, claim the credit figured in (3) above on Form 1040, line 71, by adding the amount of the credit to any other credits on this line, and entering "I.R.C. 1341" in the column to the right of line 71.

An example of this computation can be found in Publication 525.

Royalties

Royalties from copyrights, patents, and oil, gas, and mineral properties are taxable as ordinary income.

In most cases you report royalties in Part I of Schedule E (Form 1040). However, if you hold an operating oil, gas, or mineral interest or are in business as a self-employed writer, inventor, artist, etc., report your income and expenses on Schedule C or Schedule C-EZ (Form 1040).

Copyrights and patents. Royalties from copyrights on literary, musical, or artistic works, and similar property, or from patents on inventions, are amounts paid to you for the right to use your work over a specified period of time. Royalties generally are based on the number of units sold, such as the number of books, tickets to a performance, or machines sold.

Oil, gas, and minerals. Royalty income from oil, gas, and mineral properties is the amount you receive when natural resources are extracted from your property. The royalties are based on units, such as barrels, tons, etc., and are paid to you by a person or company who leases the property from you.

Depletion. If you are the owner of an economic interest in mineral deposits or oil and gas wells, you can recover your investment through the depletion allowance. For information on this subject, see chapter 9 of Publication 535.

Coal and iron ore. Under certain circumstances, you can treat amounts you receive from the disposal of coal and iron ore as payments from the sale of a capital asset, rather than as royalty income. For information about gain or loss from the sale of coal and iron ore, see Publication 544.

Sale of property interest. If you sell your complete interest in oil, gas, or mineral rights, the amount you receive is considered payment for the sale of property used in a trade or business under section 1231, not royalty income. Under certain circumstances, the sale is subject to capital gain or loss treatment as explained in the Instructions for Schedule D (Form 1040). For more information on selling section 1231 property, see chapter 3 of Publication 544.

If you retain a royalty, an overriding royalty, or a net profit interest in a mineral property for the life of the property, you have made a lease or a sublease, and any cash you receive for the assignment of other interests in the property is ordinary income subject to a depletion allowance.

Part of future production sold. If you own mineral property but sell part of the future production, in most cases you treat the money you receive from the buyer at the time of the sale as a loan from the buyer. Do not include it in your income or take depletion based on it.

When production begins, you include all the proceeds in your income, deduct all the production expenses, and deduct depletion from that amount to arrive at your taxable income from the property.

Unemployment Benefits

The tax treatment of unemployment benefits you receive depends on the type of program paying the benefits.

Unemployment compensation. You must include in income all unemployment compensation you receive. You should receive a Form 1099-G showing in box 1 the total unemployment compensation paid to you. In most cases, you enter unemployment compensation on line 19 of Form 1040, line 13 of Form 1040A, or line 3 of Form 1040EZ.

Types of unemployment compensation. Unemployment compensation generally includes any amount received under an unemployment compensation law of the United States or of a state. It includes the following benefits.

- Benefits paid by a state or the District of Columbia from the Federal Unemployment Trust Fund.
- State unemployment insurance benefits.
- Railroad unemployment compensation benefits.
- Disability payments from a government program paid as a substitute for unemployment compensation. (Amounts received as workers' compensation for injuries or illness are not unemployment compensation. See chapter 5 for more information.)
- Trade readjustment allowances under the Trade Act of 1974.
- Unemployment assistance under the Disaster Relief and Emergency Assistance Act.
- Unemployment assistance under the Airline Deregulation Act of 1974 Program.

Governmental program. If you contribute to a governmental unemployment compensation program and your contributions are not deductible, amounts you receive under the program are not included as unemployment compensation until you recover your contributions. If you deducted all of your contributions to the program, the entire amount you receive under the program is included in your income.

Repayment of unemployment compensation. If you repaid in 2012 unemployment compensation you received in 2012, subtract the amount you repaid from the total amount you received and enter the difference on line 19 of Form 1040, line 13 of Form 1040A, or line 3 of Form 1040EZ. On the dotted line next to your entry enter "Repaid" and the amount you repaid. If you repaid unemployment compensation in 2012 that you included in income in an earlier year, you can deduct the amount repaid on Schedule A (Form 1040), line 23, if you itemize deductions. If the amount is more than $3,000, see *Repayments*, earlier.

Tax withholding. You can choose to have federal income tax withheld from your unemployment compensation. To make this choice, complete Form W-4V, Voluntary Withholding Request, and give it to the paying office. Tax will be withheld at 10% of your payment.

CAUTION *If you do not choose to have tax withheld from your unemployment compensation, you may be liable for estimated tax. If you do not pay enough tax, either through withholding or estimated tax, or a combination of both, you may have to pay a penalty. For more information on estimated tax, see chapter 4.*

Supplemental unemployment benefits. Benefits received from an employer-financed fund (to which the employees did not contribute) are not unemployment compensation. They are taxable as wages and are subject to withholding for income tax. They may be subject to social security and Medicare taxes. For more information, see *Supplemental Unemployment Benefits* in section 5 of Publication 15-A, Employer's Supplemental Tax Guide. Report these payments on line 7 of Form 1040 or Form 1040A or on line 1 of Form 1040EZ.

Repayment of benefits. You may have to repay some of your supplemental unemployment benefits to qualify for trade readjustment allowances under the Trade Act of 1974. If you repay supplemental unemployment benefits in the same year you receive them, reduce the total benefits by the amount you repay. If you repay the benefits in a later year, you must include the full amount of the benefits received in your income for the year you received them.

Deduct the repayment in the later year as an adjustment to gross income on Form 1040. (You cannot use Form 1040A or Form 1040EZ.) Include the repayment on Form 1040, line 36, and enter "Sub-Pay TRA" and the amount on the dotted line next to line 36. If the amount you repay in a later year is more than $3,000, you may be able to take a credit against your tax for the later year instead of deducting the amount repaid. For more information on this, see *Repayments*, earlier.

Private unemployment fund. Unemployment benefit payments from a private (nonunion) fund to which you voluntarily contribute are taxable only if the amounts you receive are more than your total payments into the fund. Report the taxable amount on Form 1040, line 21.

Payments by a union. Benefits paid to you as an unemployed member of a union from regular union dues are included in your income on Form 1040, line 21. However, if you contribute to a special union fund and your payments to the fund are not deductible, the unemployment benefits you receive from the fund are includible in your income only to the extent they are more than your contributions.

Guaranteed annual wage. Payments you receive from your employer during periods of unemployment, under a union agreement that guarantees you full pay during the year, are taxable as wages. Include them on line 7 of Form 1040 or Form 1040A or on line 1 of Form 1040EZ.

State employees. Payments similar to a state's unemployment compensation may be made by the state to its employees who are not covered by the state's unemployment compensation law. Although the payments are fully taxable, do not report them as unemployment compensation. Report these payments on Form 1040, line 21.

Welfare and Other Public Assistance Benefits

Do not include in your income governmental benefit payments from a public welfare fund based upon need, such as payments due to blindness. Payments from a state fund for the victims of crime should not be included in the victims' incomes if they are in the nature of welfare payments. Do not deduct medical expenses that are reimbursed by such a fund. You must include in your income any welfare payments that are compensation for services or that are obtained fraudulently.

Alternative trade adjustment assistance (ATAA) payments. Payments you receive from a state agency under the Demonstration Project for Alternative Trade Adjustment Assistance for Older Workers (ATAA) must be included in your income. The state must send you Form 1099-G to advise you of the amount you should include in income. The amount should be reported on Form 1040, line 21.

Persons with disabilities. If you have a disability, you must include in income compensation you receive for services you perform unless the compensation is otherwise excluded. However, you do not include in income the value of goods, services, and cash that you receive, not in return for your services, but for your training and rehabilitation because you have a disability. Excludable amounts include payments for transportation and attendant care, such as interpreter services for the deaf, reader services for the blind, and services to help individuals with an intellectual disability do their work.

Disaster relief grants. Do not include post-disaster grants received under the Disaster Relief and Emergency Assistance Act in your income if the grant payments are made to help you meet necessary expenses or serious needs for medical, dental, housing, personal property, transportation, or funeral expenses. Do not deduct casualty losses or medical expenses that are specifically reimbursed by these disaster relief grants. If you have deducted a casualty loss for the loss of your personal residence and you later receive a disaster relief grant for the loss of the same residence, you may have to include part or all of the grant in your taxable income. See *Recoveries*, earlier. Unemployment assistance payments under the Act are taxable unemployment compensation. See *Unemployment compensation* under *Unemployment Benefits*, earlier.

Disaster relief payments. You can exclude from income any amount you receive that is a qualified disaster relief payment. A qualified disaster relief payment is an amount paid to you:

1. To reimburse or pay reasonable and necessary personal, family, living, or funeral expenses that result from a qualified disaster;
2. To reimburse or pay reasonable and necessary expenses incurred for the repair or rehabilitation of your home or repair or replacement of its contents to the extent it is due to a qualified disaster;
3. By a person engaged in the furnishing or sale of transportation as a common carrier because of the death or personal physical injuries incurred as a result of a qualified disaster; or
4. By a federal, state, or local government, or agency, or instrumentality in connection with a qualified disaster in order to promote the general welfare.

You can exclude this amount only to the extent any expense it pays for is not paid for by insurance or otherwise. The exclusion does not apply if you were a participant or conspirator in a terrorist action or a representative of one.

A qualified disaster is:

- A disaster which results from a terrorist or military action;
- A federally declared disaster; or
- A disaster which results from an accident involving a common carrier, or from any other event, which is determined to be catastrophic by the Secretary of the Treasury or his or her delegate.

For amounts paid under item (4), a disaster is qualified if it is determined by an applicable federal, state, or local authority to warrant assistance from the federal, state, or local government, agency, or instrumentality.

Disaster mitigation payments. You also can exclude from income any amount you receive that is a qualified disaster mitigation payment. Qualified disaster mitigation payments are also most commonly paid to you in the period immediately following damage to property as a result of a natural disaster. However, disaster mitigation payments are used to mitigate (reduce the severity of) potential damage from future natural disasters. They are paid to you through state and local governments based on the provisions of the Robert T. Stafford Disaster Relief and Emergency Assistance Act or the National Flood Insurance Act.

You cannot increase the basis or adjusted basis of your property for improvements made with nontaxable disaster mitigation payments.

Home Affordable Modification Program (HAMP). If you benefit from Pay-for-Performance Success Payments under HAMP, the payments are not taxable.

Mortgage assistance payments under section 235 of the National Housing Act. Payments made under section 235 of the National Housing Act for mortgage assistance are not included in the homeowner's income. Interest paid for the homeowner under the mortgage assistance program cannot be deducted.

Medicare. Medicare benefits received under title XVIII of the Social Security Act are not includible in the gross income of the individuals for whom they are paid. This includes basic (part A (Hospital Insurance Benefits for the Aged)) and supplementary (part B (Supplementary Medical Insurance Benefits for the Aged)).

Old-age, survivors, and disability insurance benefits (OASDI). OASDI payments under section 202 of title II of the Social Security Act are not includible in the gross income of the individuals to whom they are paid. This applies to old-age insurance benefits, and insurance benefits for wives, husbands, children, widows, widowers, mothers and fathers, and parents, as well as the lump-sum death payment.

Nutrition Program for the Elderly. Food benefits you receive under the Nutrition Program for the Elderly are not taxable. If you prepare and serve free meals for the program, include in your income as wages the cash pay you receive, even if you are also eligible for food benefits.

Payments to reduce cost of winter energy. Payments made by a state to qualified people to reduce their cost of winter energy use are not taxable.

Other Income

The following brief discussions are arranged in alphabetical order. Other income items briefly discussed below are referenced to publications which provide more topical information.

Activity not for profit. You must include on your return income from an activity from which you do not expect to make a profit. An example of this type of activity is a hobby or a farm you 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 you report and can be taken only if you itemize deductions on Schedule A (Form 1040). See *Not-for-Profit Activities* in chapter 1 of Publication 535 for information on whether an activity is considered carried on for a profit.

Alaska Permanent Fund dividend. If you received a payment from Alaska's mineral income fund (Alaska Permanent Fund dividend), report it as income on line 21 of Form 1040, line 13 of Form 1040A, or line 3 of Form 1040EZ. The state of Alaska sends each recipient a document that shows the amount of the payment with the check. The amount also is reported to IRS.

Alimony. Include in your income on Form 1040, line 11, any alimony payments you receive. Amounts you receive for child support are not income to you. Alimony and child support payments are discussed in chapter 18.

Bribes. If you receive a bribe, include it in your income.

Campaign contributions. These contributions are not income to a candidate unless they are diverted to his or her personal use. To be exempt from tax, the contributions must be spent for campaign purposes or kept in a fund for use in future campaigns. However, interest earned on bank deposits, dividends received on contributed securities, and net gains realized on sales of contributed securities are taxable and must be reported on Form 1120-POL, U.S. Income Tax Return for Certain Political Organizations. Excess campaign funds transferred to an office account must be included in the officeholder's income on Form 1040, line 21, in the year transferred.

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

Cash rebates. A cash rebate you receive from a dealer or manufacturer of an item you buy is not income, but you must reduce your basis by the amount of the rebate.

Example. You buy a new car for $24,000 cash and receive a $2,000 rebate check from the manufacturer. The $2,000 is not income to you. Your basis in the car is $22,000. This is the basis on which you figure gain or loss if you sell the car and depreciation if you use it for business.

Casualty insurance and other reimbursements. You generally should not report these reimbursements on your return unless you are figuring gain or loss from the casualty or theft. See chapter 25 for more information.

Child support payments. You should not report these payments on your return. See chapter 18 for more information.

Court awards and damages. To determine if settlement amounts you receive by compromise or judgment must be included in your income, you 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 you did not contribute to the plan).
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.

Do not include in your 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 you receive 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 your 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), you must include the damages in your income, except for any damages you receive 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.

Deduction for costs involved in unlawful discrimination suits. You may be able to deduct attorney fees and court costs paid to recover a judgment or settlement for a claim of unlawful discrimination under various provisions of federal, state, and local law listed in Internal Revenue Code section 62(e), a claim against the United States government, or a claim under section 1862(b)(3)(A) of the Social Security Act. For more information, see Publication 525.

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

Down payment assistance. If you purchase a home and receive assistance from a nonprofit corporation to make the down payment, that assistance is not included in your income. If the corporation qualifies as a tax-exempt charitable organization, the assistance is treated as a gift and is included in your 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 your basis.

Employment agency fees. If you get a job through an employment agency, and the fee is paid by your employer, the fee is not includible in your income if you are not liable for it. However, if you pay it and your employer reimburses you for it, it is includible in your income.

Energy conservation subsidies. You can exclude from gross income any subsidy provided, either directly or indirectly, by public utilities for the purchase or installation of an energy conservation measure for a dwelling unit.

Energy conservation measure. This includes installations or modifications that are primarily designed to reduce consumption of electricity or natural gas, or improve the management of energy demand.

Dwelling unit. This includes a house, apartment, condominium, mobile home, boat, or similar property. If a building or structure contains both dwelling and other units, any subsidy must be properly allocated.

Estate and trust income. An estate or trust, unlike a partnership, may have to pay federal income tax. If you are a beneficiary of an estate or trust, you may be taxed on your share of its income distributed or required to be distributed to you. However, there is never a double tax. Estates and trusts file their returns on Form 1041, U.S. Income Tax Return for Estates and Trusts, and your share of the income is reported to you on Schedule K-1 (Form 1041).

Current income required to be distributed. If you are the beneficiary of an estate or trust that must distribute all of its current income, you must report your share of the distributable net income, whether or not you actually received it.

Current income not required to be distributed. If you are the beneficiary of an estate or trust and the fiduciary has the choice of whether to distribute all or part of the current income, you must report:

- All income that is required to be distributed to you, whether or not it is actually distributed, plus
- All other amounts actually paid or credited to you,

up to the amount of your share of distributable net income.

How to report. Treat each item of income the same way that the estate or trust would treat it. For example, if a trust's dividend income is distributed to you, you report the distribution as dividend income on your return. The same rule applies to distributions of tax-exempt interest and capital gains.

The fiduciary of the estate or trust must tell you the type of items making up your share of the estate or trust income and any credits you are allowed on your individual income tax return.

Losses. Losses of estates and trusts generally are not deductible by the beneficiaries.

Grantor trust. Income earned by a grantor trust is taxable to the grantor, not the beneficiary, if the grantor keeps certain control over the trust. (The grantor is the one who transferred property to the trust.) This rule applies if the property (or income from the property) put into the trust will or may revert (be returned) to the grantor or the grantor's spouse.

Generally, a trust is a grantor trust if the grantor has a reversionary interest valued (at the date of transfer) at more than 5% of the value of the transferred property.

Expenses paid by another. If your personal expenses are paid for by another person, such as a corporation, the payment may be taxable to you depending upon your relationship with that person and the nature of the payment. But if the payment makes up for a loss caused by that person, and only restores you to the position you were in before the loss, the payment is not includible in your income.

Fees for services. Include all fees for your services in your income. Examples of these fees are amounts you receive for services you perform as:

- A corporate director,
- An executor, administrator, or personal representative of an estate,
- A manager of a trade or business you operated before declaring Chapter 11 bankruptcy,
- A notary public, or
- An election precinct official.

Nonemployee compensation. If you are not an employee and the fees for your services from the same payer total $600 or more for the year, you may receive a Form 1099-MISC. You may need to report your fees as self-employment income. See Self-Employed Persons, in chapter 1, for a discussion of when you are considered self-employed.

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 you are not in the trade or business of being an executor (for instance, you are the executor of a friend's or relative's estate), report these fees on Form 1040, line 21. If you 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 your income all payments received from your bankruptcy estate for managing or operating a trade or business that you operated before you 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. See the separate instructions for Schedule SE (Form 1040) for details.

Election precinct official. You 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. Payments you receive from a state, political subdivision, or a qualified foster care placement agency for providing care to qualified foster individuals in your home generally are not included in your income. However, you must include in your income payments received for the care of more than 5 individuals age 19 or older and certain difficulty-of-care payments.

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.

Difficulty-of-care payments. These are additional payments that are designated by the payer as compensation for providing the additional care that is required for physically, mentally, or emotionally handicapped qualified foster individuals. A state must determine that the additional compensation is needed, and the care for which the payments are made must be provided in your home.

You must include in your income difficulty-of-care payments received for more than:

- 10 qualified foster individuals under age 19, or
- 5 qualified foster individuals age 19 or older.

Maintaining space in home. If you are paid to maintain space in your home for emergency foster care, you must include the payment in your income.

Reporting taxable payments. If you receive payments that you must include in your income, you are in business as a foster care provider and you are self-employed. Report the payments on Schedule C or Schedule C-EZ (Form 1040). See Publication 587, Business Use of Your Home, to help you determine the amount you can deduct for the use of your home.

Found property. If you find and keep property that does not belong to you that has been lost or abandoned (treasure-trove), it is taxable to you at its fair market value in the first year it is your undisputed possession.

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

Gambling winnings. You must include your gambling winnings in income on Form 1040, line 21. If you itemize your deductions on Schedule A (Form 1040), you can deduct gambling losses you had during the year, but only up to the amount of your winnings.

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

TIP *If you win a state lottery prize payable in installments, see Publication 525 for more information.*

Form W-2G. You may have received a Form W-2G, Certain Gambling Winnings, showing the amount of your gambling winnings and any tax taken out of them. Include the amount from box 1 on Form 1040, line 21. Include the amount shown in box 2 on Form 1040, line 62, as federal income tax withheld.

Reporting winnings and recordkeeping. For more information on reporting gambling winnings and recordkeeping, see *Gambling Losses Up to the Amount of Gambling Winnings* in chapter 28.

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

Inherited pension or IRA. If you inherited a pension or an individual retirement arrangement (IRA), you may have to include part of the inherited amount in your income. See chapter 10 if you inherited a pension. See chapter 17 if you inherited an IRA.

Hobby losses. Losses from a hobby are not deductible from other income. A hobby is an activity from which you do not expect to make a profit. See *Activity not for profit*, earlier.

CAUTION *If you collect stamps, coins, or other items as a hobby for recreation and pleasure, and you sell any of the items, your gain is taxable as a capital gain. (See chapter 16.) However, if you sell items from your collection at a loss, you cannot deduct the loss.*

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

Indian fishing rights. If you are a member of a qualified Indian tribe that has fishing rights secured by treaty, executive order, or an Act of Congress as of March 17, 1988, do not include in your income amounts you receive from activities related to those fishing rights. The income is not subject to income tax, self-employment tax, or employment taxes.

Interest on frozen deposits. In general, you exclude from your income the amount of interest earned on a frozen deposit. See *Interest income on frozen deposits* in chapter 7.

Interest on qualified savings bonds. You may be able to exclude from income the interest from qualified U.S. savings bonds you redeem if you pay qualified higher educational expenses in the same year. For more information on this exclusion, see *Education Savings Bond Program* under *U.S. Savings Bonds* in chapter 7.

Job interview expenses. If a prospective employer asks you to appear for an interview and either pays you an allowance or reimburses you for your transportation and other travel expenses, the amount you receive is generally not taxable. You include in income only the amount you receive that is more than your actual expenses.

Jury duty. Jury duty pay you receive must be included in your income on Form 1040, line 21. If you must give the pay to your employer because your employer continues to pay your salary while you serve on the jury, you can deduct the amount turned over to your employer as an adjustment to your income. Enter the amount you repay your employer on Form 1040, line 36. Enter "Jury Pay" and the amount on the dotted line next to line 36.

Kickbacks. You must include kickbacks, side commissions, push money, or similar payments you receive in your income on Form 1040, line 21, or on Schedule C or Schedule C-EZ (Form 1040), if from your self-employment activity.

Example. You sell cars and help arrange car insurance for buyers. Insurance brokers pay back part of their commissions to you for referring customers to them. You must include the kickbacks in your income.

Medical savings accounts (MSAs). In most cases, you do not include in income amounts you withdraw from your Archer MSA or Medicare Advantage MSA if you use the money to pay for qualified medical expenses. Generally, qualified medical expenses are those you can deduct on Schedule A (Form 1040), Itemized Deductions. For more information about qualified medical expenses, see chapter 21. For more information about Archer MSAs or Medicare Advantage MSAs, see Publication 969, Health Savings Accounts and Other Tax-Favored Health Plans.

Prizes and awards. If you win a prize in a lucky number drawing, television or radio quiz program, beauty contest, or other event, you must include it in your income. For example, if you win a $50 prize in a photography contest, you must report this income on Form 1040, line 21. If you refuse to accept a prize, do not include its value in your income.

Prizes and awards in goods or services must be included in your income at their fair market value.

Employee awards or bonuses. Cash awards or bonuses given to you by your employer for good work or suggestions generally must be included in your income as wages. However, certain noncash employee achievement awards can be excluded from income. See *Bonuses and awards* in chapter 5.

Pulitzer, Nobel, and similar prizes. If you were awarded a prize in recognition of accomplishments in religious, charitable, scientific, artistic, educational, literary, or civic fields, you generally must include the value of the prize in your income. However, you do not include this prize in your income if you meet all of the following requirements.

- You were selected without any action on your part to enter the contest or proceeding.
- You are not required to perform substantial future services as a condition to receiving the prize or award.
- The prize or award is transferred by the payer directly to a governmental unit or tax-exempt charitable organization as designated by you.

See Publication 525 for more information about the conditions that apply to the transfer.

Qualified tuition programs (QTPs). A qualified tuition program (also known as a 529 program) is a program set up to allow you 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. See Publication 970 for more information.

Railroad retirement annuities. The following types of payments are treated as pension or annuity income and are taxable under the rules explained in Publication 575, Pension and Annuity Income.

- Tier 1 railroad retirement benefits that are more than the social security equivalent benefit.
- Tier 2 benefits.
- Vested dual benefits.

Rewards. If you receive a reward for providing information, include it in your income.

Sale of home. You may be able to exclude from income all or part of any gain from the sale or exchange of your main home. See chapter 15.

Sale of personal items. If you sold an item you owned for personal use, such as a car, refrigerator, furniture, stereo, jewelry, or silverware, your gain is taxable as a capital gain. Report it as explained in the Instructions for Schedule D (Form 1040). You cannot deduct a loss.

However, if you sold an item you 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.

Example. You sold a painting on an online auction website for $100. You bought the painting for $20 at a garage sale years ago. Report your gain as a capital gain as explained in the Instructions for Schedule D (Form 1040).

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 you receive 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. See Publication 970 for more information on qualified scholarships and fellowship grants.

Payment for services. In most cases, you must include in income the part of any scholarship or fellowship that represents payment for past, present, or future teaching, research, or other services. This applies even if all candidates for a degree must perform the services to receive the degree.

For information about the rules that apply to a tax-free qualified tuition reduction provided to employees and their families by an educational institution, see Publication 970.

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

Prizes. Scholarship prizes won in a contest are not scholarships or fellowships if you do not have to use the prizes for educational purposes. You must include these amounts in your income on Form 1040, line 21, whether or not you use the amounts for educational purposes.

Stolen property. If you steal property, you must report its fair market value in your income in the year you steal it unless in the same year, you return it to its rightful owner.

Transporting school children. Do not include in your income a school board mileage allowance for taking children to and from school if you are not in the business of taking children to school. You cannot deduct expenses for providing this transportation.

Union benefits and dues. Amounts deducted from your pay for union dues, assessments, contributions, or other payments to a union cannot be excluded from your income.

You may be able to deduct some of these payments as a miscellaneous deduction subject to the 2%-of-AGI limit if they are related to your job and if you itemize deductions on Schedule A (Form 1040). For more information, see *Union Dues and Expenses* in chapter 28.

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

Utility rebates. If you are a customer of an electric utility company and you participate in the utility's energy conservation program, you may receive on your monthly electric bill either:

- A reduction in the purchase price of electricity furnished to you (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 your income.

Part Three.

Gains and Losses

The four chapters in this part discuss investment gains and losses, including how to figure your basis in property. A gain from selling or trading stocks, bonds, or other investment property may be taxed or it may be tax free, at least in part. A loss may or may not be deductible. These chapters also discuss gains from selling property you personally use — including the special rules for selling your home. Nonbusiness casualty and theft losses are discussed in chapter 25 in Part Five.

13. Basis of Property

Introduction

This chapter discusses how to figure your basis in property. It is divided into the following sections.

- Cost basis.
- Adjusted basis.
- Basis other than cost.

Your basis is the amount of your investment in property for tax purposes. Use the basis to figure gain or loss on the sale, exchange, or other disposition of property. Also use it to figure deductions for depreciation, amortization, depletion, and casualty losses.

If you use property for both business or investment purposes and for personal purposes, you must allocate the basis based on the use. Only the basis allocated to the business or investment use of the property can be depreciated.

Your original basis in property is adjusted (increased or decreased) by certain events. For example, if you make improvements to the property, increase your basis. If you take deductions for depreciation or casualty losses, or claim certain credits, reduce your basis.

RECORDS Keep accurate records of all items that affect the basis of your property. For more information on keeping records, see chapter 1.

Useful Items

You may want to see:

Publication

- ❑ **15-B** Employer's Tax Guide to Fringe Benefits
- ❑ **525** Taxable and Nontaxable Income
- ❑ **535** Business Expenses
- ❑ **537** Installment Sales
- ❑ **544** Sales and Other Dispositions of Assets
- ❑ **550** Investment Income and Expenses
- ❑ **551** Basis of Assets
- ❑ **946** How To Depreciate Property

Cost Basis

The basis of property you buy is usually its cost. The cost is the amount you pay in cash, debt obligations, other property, or services. Your cost also includes amounts you pay for the following items:

- Sales tax,
- Freight,
- Installation and testing,
- Excise taxes,
- Legal and accounting fees (when they must be capitalized),
- Revenue stamps,
- Recording fees, and
- Real estate taxes (if you assume liability for the seller).

In addition, the basis of real estate and business assets may include other items.

Loans with low or no interest. If you buy property on a time-payment plan that charges little or no interest, the basis of your property is your stated purchase price minus any amount considered to be unstated interest. You generally have unstated interest if your interest rate is less than the applicable federal rate.

For more information, see *Unstated Interest and Original Issue Discount (OID)* in Publication 537.

Real Property

Real property, also called real estate, is land and generally anything built on, growing on, or attached to land.

If you buy real property, certain fees and other expenses you pay are part of your cost basis in the property.

Lump sum purchase. If you buy buildings and the land on which they stand for a lump sum, allocate the cost basis among the land and the buildings. Allocate the cost basis according to the respective fair market values (FMVs) of the land and buildings at the time of purchase. Figure the basis of each asset by multiplying the lump sum by a fraction. The numerator is the FMV of that asset and the denominator is the FMV of the whole property at the time of purchase.

TIP *If you are not certain of the FMVs of the land and buildings, you can allocate the basis according to their assessed values for real estate tax purposes.*

Fair market value (FMV). FMV is the price at which the property would change hands between a willing buyer and a willing seller, neither having to buy or sell, and both having reasonable knowledge of all the necessary facts. Sales of similar property on or about the same date may be helpful in figuring the FMV of the property.

Assumption of mortgage. If you buy property and assume (or buy the property subject to) an existing mortgage on the property, your basis includes the amount you pay for the property plus the amount to be paid on the mortgage.

Settlement costs. Your basis includes the settlement fees and closing costs you paid for buying the property. (A fee for buying property is a cost that must be paid even if you buy the property for cash.) Do not include fees and costs for getting a loan on the property in your basis.

The following are some of the settlement fees or closing costs you can include in the basis of your property.

- Abstract fees (abstract of title fees).
- Charges for installing utility services.
- Legal fees (including fees for the title search and preparation of the sales contract and deed).
- Recording fees.
- Survey fees.
- Transfer taxes.
- Owner's title insurance.
- Any amounts the seller owes that you agree to pay, such as back taxes or interest, recording or mortgage fees, charges for improvements or repairs, and sales commissions.

Settlement costs do not include amounts placed in escrow for the future payment of items such as taxes and insurance.

Table 13-1. **Examples of Adjustments to Basis**

Increases to Basis	Decreases to Basis
• Capital improvements: Putting an addition on your home Replacing an entire roof Paving your driveway	• Exclusion from income of subsidies for energy conservation measures
Installing central air conditioning Rewiring your home	• Casualty or theft loss deductions and insurance reimbursements
• Assessments for local improvements: Water connections	
Extending utility service lines to the property	• Postponed gain from the sale of a home
Sidewalks	• Alternative motor vehicle credit (Form 8910)
Roads	• Alternative fuel vehicle refueling property credit (Form 8911)
	• Residential energy credits (Form 5695)
• Casualty losses: Restoring damaged property	• Depreciation and section 179 deduction
	• Nontaxable corporate distributions
• Legal fees: Cost of defending and perfecting a title Fees for getting a reduction of an assessment	• Certain canceled debt excluded from income
• Zoning costs	• Easements
	• Adoption tax benefits

The following are some of the settlement fees and closing costs you cannot include in the basis of property.

- Casualty insurance premiums.
- Rent for occupancy of the property before closing.
- Charges for utilities or other services related to occupancy of the property before closing.
- Charges connected with getting a loan, such as points (discount points, loan origination fees), mortgage insurance premiums, loan assumption fees, cost of a credit report, and fees for an appraisal required by a lender.
- Fees for refinancing a mortgage.

Real estate taxes. If you pay real estate taxes the seller owed on real property you bought, and the seller did not reimburse you, treat those taxes as part of your basis. You cannot deduct them as an expense.

If you reimburse the seller for taxes the seller paid for you, you can usually deduct that amount as an expense in the year of purchase. Do not include that amount in the basis of your property. If you did not reimburse the seller, you must reduce your basis by the amount of those taxes.

Points. If you pay points to get a loan (including a mortgage, second mortgage, line of credit, or a home equity loan), do not add the points to the basis of the related property. Generally, you deduct the points over the term of the loan. For more information on how to deduct points, see chapter 23.

Points on home mortgage. Special rules may apply to points you and the seller pay when you get a mortgage to buy your main home. If certain requirements are met, you can deduct the points in full for the year in which they are paid. Reduce the basis of your home by any seller-paid points.

Adjusted Basis

Before figuring gain or loss on a sale, exchange, or other disposition of property or figuring allowable depreciation, depletion, or amortization, you must usually make certain adjustments (increases and decreases) to the cost of the property. The result is the adjusted basis.

Increases to Basis

Increase the basis of any property by all items properly added to a capital account. Examples of items that increase basis are shown in Table 13-1. These include the items discussed below.

Improvements. Add to your basis in property the cost of improvements having a useful life of more than 1 year, that increase the value of the property, lengthen its life, or adapt it to a different use. For example, improvements include putting a recreation room in your unfinished basement, adding another bathroom or bedroom, putting up a fence, putting in new plumbing or wiring, installing a new roof, or paving your driveway.

Assessments for local improvements. Add to the basis of property assessments for improvements such as streets and sidewalks if they increase the value of the property assessed. Do not deduct them as taxes. However, you can deduct as taxes assessments for maintenance or repairs, or for meeting interest charges related to the improvements.

Example. Your city changes the street in front of your store into an enclosed pedestrian mall and assesses you and other affected property owners for the cost of the conversion. Add the assessment to your property's basis. In this example, the assessment is a depreciable asset.

Decreases to Basis

Decrease the basis of any property by all items that represent a return of capital for the period during which you held the property. Examples of items that decrease basis are shown in Table 13-1. These include the items discussed below.

Casualty and theft losses. If you have a casualty or theft loss, decrease the basis in your property by any insurance proceeds or other reimbursement and by any deductible loss not covered by insurance.

You must increase your basis in the property by the amount you spend on repairs that restore the property to its pre-casualty condition.

For more information on casualty and theft losses, see chapter 25.

Depreciation and section 179 deduction. Decrease the basis of your qualifying business property by any section 179 deduction you take and the depreciation you deducted, or could have deducted (including any special depreciation allowance), on your tax returns under the method of depreciation you selected.

For more information about depreciation and the section 179 deduction, see Publication 946 and the Instructions for Form 4562.

Example. You owned a duplex used as rental property that cost you $40,000, of which $35,000 was allocated to the building and $5,000 to the land. You added an improvement to the duplex that cost $10,000. In February last year, the duplex was damaged by fire. Up to that time, you had been allowed depreciation of $23,000. You sold some salvaged material for $1,300 and collected $19,700 from your insurance company. You deducted a casualty loss of $1,000 on your income tax return for last year. You spent $19,000 of the insurance proceeds for restoration of the duplex, which was completed this year. You must use the duplex's adjusted basis after the restoration to determine depreciation for the rest of the property's recovery period. Figure the adjusted basis of the duplex as follows:

Original cost of duplex			$35,000
Addition to duplex			10,000
Total cost of duplex			$45,000
Minus:	Depreciation		23,000
Adjusted basis before casualty			$22,000
Minus:	Insurance proceeds	$19,700	
	Deducted casualty loss	1,000	
	Salvage proceeds	1,300	22,000
Adjusted basis after casualty			$-0-
Add: Cost of restoring duplex			19,000
Adjusted basis after restoration			**$19,000**

Note. Your basis in the land is its original cost of $5,000.

Easements. The amount you receive for granting an easement is generally considered to be proceeds from the sale of an interest in real property. It reduces the basis of the affected part of the property. If the amount received is more than the basis of the part of the property affected by the easement, reduce your basis in that part to zero and treat the excess as a recognized gain.

If the gain is on a capital asset, see chapter 16 for information about how to report it. If the gain is on property used in a trade or business, see Publication 544 for information about how to report it.

Exclusion of subsidies for energy conservation measures. You can exclude from gross income any subsidy you received from a public utility company for the purchase or installation of an energy conservation measure for a dwelling unit. Reduce the basis of the property for which you received the subsidy by the excluded amount. For more information about this subsidy, see chapter 12.

Postponed gain from sale of home. If you postponed gain from the sale of your main home under rules in effect before May 7, 1997, you must reduce the basis of the home you acquired as a replacement by the amount of the postponed gain. For more information on the rules for the sale of a home, see chapter 15.

Basis Other Than Cost

There are many times when you cannot use cost as basis. In these cases, the fair market value or the adjusted basis of the property can be used. Fair market value (FMV) and adjusted basis were discussed earlier.

Property Received for Services

If you receive property for your services, include its FMV in income. The amount you include in income becomes your basis. If the services were performed for a price agreed on beforehand, it will be accepted as the FMV of the property if there is no evidence to the contrary.

Restricted property. If you receive property for your services and the property is subject to certain restrictions, your basis in the property is its FMV when it becomes substantially vested. However, this rule does not apply if you make an election to include in income the FMV of the property at the time it is transferred to you, less any amount you paid for it. Property is substantially vested when it is transferable or when it is not subject to a substantial risk of forfeiture (you do not have a good chance of losing it). For more information, see *Restricted Property* in Publication 525.

Bargain purchases. A bargain purchase is a purchase of an item for less than its FMV. If, as compensation for services, you buy goods or other property at less than FMV, include the difference between the purchase price and the property's FMV in your income. Your basis in the property is its FMV (your purchase price plus the amount you include in income).

If the difference between your purchase price and the FMV is a qualified employee discount, do not include the difference in income. However, your basis in the property is still its FMV. See *Employee Discounts* in Publication 15-B.

Taxable Exchanges

A taxable exchange is one in which the gain is taxable or the loss is deductible. A taxable gain or deductible loss also is known as a recognized gain or loss. If you receive property in exchange for other property in a taxable exchange, the basis of the property you receive is usually its FMV at the time of the exchange.

Involuntary Conversions

If you receive replacement property as a result of an involuntary conversion, such as a casualty, theft, or condemnation, figure the basis of the replacement property using the basis of the converted property.

Similar or related property. If you receive replacement property similar or related in service or use to the converted property, the replacement property's basis is the same as the converted property's basis on the date of the conversion, with the following adjustments.

1. Decrease the basis by the following.
   a. Any loss you recognize on the involuntary conversion.
   b. Any money you receive that you do not spend on similar property.
2. Increase the basis by the following.
   a. Any gain you recognize on the involuntary conversion.
   b. Any cost of acquiring the replacement property.

Money or property not similar or related. If you receive money or property not similar or related in service or use to the converted property, and you buy replacement property similar or related in service or use to the converted property, the basis of the replacement property is its cost decreased by the gain not recognized on the conversion.

Example. The state condemned your property. The adjusted basis of the property was $26,000 and the state paid you $31,000 for it. You realized a gain of $5,000 ($31,000 − $26,000). You bought replacement property similar in use to the converted property for $29,000. You recognize a gain of $2,000 ($31,000 − $29,000), the unspent part of the payment from the state. Your unrecognized gain is $3,000, the difference between the $5,000 realized gain and the $2,000 recognized gain. The basis of the replacement property is figured as follows:

Cost of replacement property	$29,000
Minus: Gain not recognized	3,000
Basis of replacement property	**$26,000**

Allocating the basis. If you buy more than one piece of replacement property, allocate your basis among the properties based on their respective costs.

Basis for depreciation. Special rules apply in determining and depreciating the basis of MACRS property acquired in an involuntary conversion. For information, see *What Is the Basis of Your Depreciable Property?* in chapter 1 of Publication 946.

Nontaxable Exchanges

A nontaxable exchange is an exchange in which you are not taxed on any gain and you cannot deduct any loss. If you receive property in a nontaxable exchange, its basis is generally the same as the basis of the property you transferred. See *Nontaxable Trades* in chapter 14.

Like-Kind Exchanges

The exchange of property for the same kind of property is the most common type of nontaxable exchange. To qualify as a like-kind exchange, the property traded and the property received must be both of the following.

- Qualifying property.
- Like-kind property.

The basis of the property you receive is generally the same as the adjusted basis of the property you gave up. If you trade property in a like-kind exchange and also pay money, the basis of the property received is the adjusted basis of the property you gave up increased by the money you paid.

Qualifying property. In a like-kind exchange, you must hold for investment or for productive use in your trade or business both the property you give up and the property you receive.

Like-kind property. There must be an exchange of like-kind property. Like-kind properties are properties of the same nature or character, even if they differ in grade or quality. The exchange of real estate for real estate and personal property for similar personal property are exchanges of like-kind property.

Example. You trade in an old truck used in your business with an adjusted basis of $1,700 for a new one costing $6,800. The dealer allows you $2,000 on the old truck, and you pay $4,800. This is a like-kind exchange. The basis of the new truck is $6,500 (the adjusted basis of the old one, $1,700, plus the amount you paid, $4,800).

If you sell your old truck to a third party for $2,000 instead of trading it in and then buy a new one from the dealer, you have a taxable gain of $300 on the sale (the $2,000 sale price minus the $1,700 adjusted basis). The basis of the new truck is the price you pay the dealer.

Partially nontaxable exchanges. A partially nontaxable exchange is an exchange in which you receive unlike property or money in addition to like-kind property. The basis of the property you receive is the same as the adjusted basis of the property you gave up, with the following adjustments.

1. Decrease the basis by the following amounts.
   a. Any money you receive.
   b. Any loss you recognize on the exchange.
2. Increase the basis by the following amounts.
   a. Any additional costs you incur.
   b. Any gain you recognize on the exchange.

If the other party to the exchange assumes your liabilities, treat the debt assumption as money you received in the exchange.

Allocation of basis. If you receive like-kind and unlike properties in the exchange, allocate the basis first to the unlike property, other than money, up to its FMV on the date of the exchange. The rest is the basis of the like-kind property.

More information. See *Like-Kind Exchanges* in chapter 1 of Publication 544 for more information.

Basis for depreciation. Special rules apply in determining and depreciating the basis of MACRS property acquired in a like-kind exchange. For information, see *What Is the Basis of Your Depreciable Property?* in chapter 1 of Publication 946.

Property Transferred From a Spouse

The basis of property transferred to you or transferred in trust for your benefit by your spouse is the same as your spouse's adjusted basis. The same rule applies to a transfer by your former spouse that is incident to divorce. However, for property transferred in trust, adjust your basis for any gain recognized by your spouse or former spouse if the liabilities assumed, plus the liabilities to which the property is subject, are more than the adjusted basis of the property transferred.

If the property transferred to you is a series E, series EE, or series I U.S. savings bond, the transferor must include in income the interest accrued to the date of transfer. Your basis in the bond immediately after the transfer is equal to the transferor's basis increased by the interest income includible in the transferor's income. For more information on these bonds, see chapter 7.

At the time of the transfer, the transferor must give you the records needed to determine the adjusted basis and holding period of the property as of the date of the transfer.

For more information about the transfer of property from a spouse, see chapter 14.

Property Received as a Gift

To figure the basis of property you receive as a gift, you must know its adjusted basis to the donor just before it was given to you, its FMV at the time it was given to you, and any gift tax paid on it.

FMV less than donor's adjusted basis. If the FMV of the property at the time of the gift is less than the donor's adjusted basis, your basis depends on whether you have a gain or a loss when you dispose of the property. Your basis for figuring gain is the same as the donor's adjusted basis plus or minus any required adjustments to basis while you held the property. Your basis for figuring loss is its FMV when you received the gift plus or minus any required adjustments to basis while you held the property. See *Adjusted Basis*, earlier.

Example. You received an acre of land as a gift. At the time of the gift, the land had an FMV of $8,000. The donor's adjusted basis was $10,000. After you received the property, no events occurred to increase or decrease your basis. If you later sell the property for $12,000, you will have a $2,000 gain because you must use the donor's adjusted basis at the time of the gift ($10,000) as your basis to figure gain. If you sell the property for $7,000, you will have a $1,000 loss because you must use the FMV at the time of the gift ($8,000) as your basis to figure loss.

If the sales price is between $8,000 and $10,000, you have neither gain nor loss.

Business property. If you hold the gift as business property, your basis for figuring any depreciation, depletion, or amortization deductions is the same as the donor's adjusted basis plus or minus any required adjustments to basis while you hold the property.

FMV equal to or greater than donor's adjusted basis. If the FMV of the property is equal to or greater than the donor's adjusted basis, your basis is the donor's adjusted basis at the time you received the gift. Increase your basis by all or part of any gift tax paid, depending on the date of the gift, explained later.

Also, for figuring gain or loss from a sale or other disposition or for figuring depreciation, depletion, or amortization deductions on business property, you must increase or decrease your basis (the donor's adjusted basis) by any required adjustments to basis while you held the property. See *Adjusted Basis*, earlier.

If you received a gift during the tax year, increase your basis in the gift (the donor's adjusted basis) by the part of the gift tax paid on it due to the net increase in value of the gift. Figure the increase by multiplying the gift tax paid by a fraction. The numerator of the fraction is the net increase in value of the gift and the denominator is the amount of the gift.

The net increase in value of the gift is the FMV of the gift minus the donor's adjusted basis. The amount of the gift is its value for gift tax purposes after reduction by any annual exclusion and marital or charitable deduction that applies to the gift. For information on the gift tax, see Publication 950, Introduction to Estate and Gift Taxes.

Example. In 2012, you received a gift of property from your mother that had an FMV of $50,000. Her adjusted basis was $20,000. The amount of the gift for gift tax purposes was $37,000 ($50,000 minus the $13,000 annual exclusion). She paid a gift tax of $7,540 on the property. Your basis is $26,107, figured as follows:

Fair market value	$50,000
Minus: Adjusted basis	−20,000
Net increase in value	$30,000
Gift tax paid	$7,540
Multiplied by ($30,000 ÷ $37,000)	× .81
Gift tax due to net increase in value	$6,107
Adjusted basis of property to your mother	+20,000
Your basis in the property	**$26,107**

Note. If you received a gift before 1977, your basis in the gift (the donor's adjusted basis) includes any gift tax paid on it. However, your basis cannot exceed the FMV of the gift at the time it was given to you.

Inherited Property

If you inherited property from a decedent who died before 2010, your basis in property you inherit from a decedent is generally one of the following.

- The FMV of the property at the date of the decedent's death.
- The FMV on the alternate valuation date if the personal representative for the estate elects to use alternate valuation.
- The value under the special-use valuation method for real property used in farming or a closely held business if elected for estate tax purposes.
- The decedent's adjusted basis in land to the extent of the value excluded from the decedent's taxable estate as a qualified conservation easement.

If a federal estate tax return does not have to be filed, your basis in the inherited property is its appraised value at the date of death for state inheritance or transmission taxes.

For more information, see the instructions to Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return.

Property inherited from a decedent who died in 2010. If you inherited property from a decedent who died in 2010, special rules may apply. For more information, see Publication 4895, Tax Treatment of a Property Acquired From a Decedent Dying in 2010.

Community property. In community property states (Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin), husband and wife are each usually considered to own half the community property. When either spouse dies, the total value of the community property, even the part belonging to the surviving spouse, generally becomes the basis of the entire property. For this rule to apply, at least half the value of the community property interest must be includible in the decedent's gross estate, whether or not the estate must file a return.

Example. You and your spouse owned community property that had a basis of $80,000. When your spouse died, half the FMV of the community interest was includible in your spouse's estate. The FMV of the community interest was $100,000. The basis of your half of the property after the death of your spouse is $50,000 (half of the $100,000 FMV). The basis of the other half to your spouse's heirs is also $50,000.

For more information about community property, see Publication 555, Community Property.

Property Changed From Personal to Business or Rental Use

If you hold property for personal use and then change it to business use or use it to produce rent, you can begin to depreciate the property at the time of the change. To do so, you must figure its basis for depreciation. An example of changing property held for personal use to business or rental use would be renting out your former personal residence.

Basis for depreciation. The basis for depreciation is the lesser of the following amounts.

- The FMV of the property on the date of the change.
- Your adjusted basis on the date of the change.

Example. Several years ago, you paid $160,000 to have your house built on a lot that cost $25,000. You paid $20,000 for permanent improvements to the house and claimed a $2,000 casualty loss deduction for damage to the house before changing the property to rental use last year. Because land is not depreciable, you include only the cost of the house when figuring the basis for depreciation.

Your adjusted basis in the house when you changed its use was $178,000 ($160,000 + $20,000 − $2,000). On the same date, your property had an FMV of $180,000, of which $15,000 was for the land and $165,000 was for the house. The basis for figuring depreciation on the house is its FMV on the date of the change ($165,000) because it is less than your adjusted basis ($178,000).

Sale of property. If you later sell or dispose of property changed to business or rental use, the basis you use will depend on whether you are figuring gain or loss.

Gain. The basis for figuring a gain is your adjusted basis in the property when you sell the property.

Example. Assume the same facts as in the previous example except that you sell the property at a gain after being allowed depreciation deductions of $37,500. Your adjusted basis for figuring gain is $165,500 ($178,000 + $25,000 (land) − $37,500).

Loss. Figure the basis for a loss starting with the smaller of your adjusted basis or the FMV of the property at the time of the change to business or rental use. Then make adjustments (increases and decreases) for the period after the change in the property's use, as discussed earlier under Adjusted Basis.

Example. Assume the same facts as in the previous example, except that you sell the property at a loss after being allowed depreciation deductions of $37,500. In this case, you would start with the FMV on the date of the change to rental use ($180,000), because it is less than the adjusted basis of $203,000 ($178,000 + $25,000 (land)) on that date. Reduce that amount ($180,000) by the depreciation deductions ($37,500). The basis for loss is $142,500 ($180,000 − $37,500).

Stocks and Bonds

The basis of stocks or bonds you buy generally is the purchase price plus any costs of purchase, such as commissions and recording or transfer fees. If you get stocks or bonds other than by purchase, your basis is usually determined by the FMV or the previous owner's adjusted basis, as discussed earlier.

You must adjust the basis of stocks for certain events that occur after purchase. For example, if you receive additional stock from nontaxable stock dividends or stock splits, reduce your basis for each share of stock by dividing the adjusted basis of the old stock by the number of shares of old and new stock. This rule applies only when the additional stock received is identical to the stock held. Also reduce your basis when you receive nontaxable distributions. They are a return of capital.

Example. In 2010 you bought 100 shares of XYZ stock for $1,000 or $10 a share. In 2011 you bought 100 shares of XYZ stock for $1,600 or $16 a share. In 2012 XYZ declared a 2-for-1 stock split. You now have 200 shares of stock with a basis of $5 a share and 200 shares with a basis of $8 a share.

Other basis. There are other ways to figure the basis of stocks or bonds depending on how you acquired them. For detailed information, see *Stocks and Bonds* under *Basis of Investment Property* in chapter 4 of Publication 550.

Identifying stocks or bonds sold. If you can adequately identify the shares of stock or the bonds you sold, their basis is the cost or other basis of the particular shares of stocks or bonds. If you buy and sell securities at various times in varying quantities and you cannot adequately identify the shares you sell, the basis of the securities you sell is the basis of the securities you acquired first. For more information about identifying securities you sell, see *Stocks and Bonds* under *Basis of Investment Property* in chapter 4 of Publication 550.

Mutual fund shares. If you sell mutual fund shares you acquired at various times and prices and left on deposit in an account kept by a custodian or agent, you can elect to use an average basis. For more information, see Publication 550.

Bond premium. If you buy a taxable bond at a premium and elect to amortize the premium, reduce the basis of the bond by the amortized premium you deduct each year. See *Bond Premium Amortization* in chapter 3 of Publication 550 for more information. Although you cannot deduct the premium on a tax-exempt bond, you must amortize the premium each year and reduce your basis in the bond by the amortized amount.

Original issue discount (OID) on debt instruments. You must increase your basis in an OID debt instrument by the OID you include in income for that instrument. See *Original Issue Discount (OID)* in chapter 7 and Publication 1212, Guide To Original Issue Discount (OID) Instruments.

Tax-exempt obligations. OID on tax-exempt obligations is generally not taxable. However, when you dispose of a tax-exempt obligation issued after September 3, 1982, and acquired after March 1, 1984, you must accrue OID on the obligation to determine its adjusted basis. The accrued OID is added to the basis of the obligation to determine your gain or loss. See chapter 4 of Publication 550.

14. Sale of Property

Reminder

Foreign income. If you are a U.S. citizen who sells property located outside the United States, you must report all gains and losses from the sale of that property on your tax return unless it is exempt by U.S. law. This is true whether you reside inside or outside the United States and whether or not you receive a Form 1099 from the payer.

Introduction

This chapter discusses the tax consequences of selling or trading investment property. It explains the following.

- What a sale or trade is.
- Figuring gain or loss.
- Nontaxable trades.
- Related party transactions.
- Capital gains or losses.

- Capital assets and noncapital assets.
- Holding period.
- Rollover of gain from publicly traded securities.

Other property transactions. Certain transfers of property are not discussed here. They are discussed in other IRS publications. These include the following.

- Sales of a main home, covered in chapter 15.
- Installment sales, covered in Publication 537, Installment Sales.
- Transactions involving business property, covered in Publication 544, Sales and Other Dispositions of Assets.
- Dispositions of an interest in a passive activity, covered in Publication 925, Passive Activity and At-Risk Rules.

Publication 550, Investment Income and Expenses (Including Capital Gains and Losses), provides a more detailed discussion about sales and trades of investment property. Publication 550 includes information about the rules covering nonbusiness bad debts, straddles, section 1256 contracts, puts and calls, commodity futures, short sales, and wash sales. It also discusses investment-related expenses.

Useful Items

You may want to see:

Publication

- ❑ **550** Investment Income and Expenses

Form (and Instructions)

- ❑ **Schedule D (Form 1040)** Capital Gains and Losses
- ❑ **8949** Sales and Other Dispositions of Capital Assets
- ❑ **8824** Like-Kind Exchanges

Sales and Trades

If you sold property such as stocks, bonds, or certain commodities through a broker during the year, you should receive, for each sale, a Form 1099-B, Proceeds From Broker and Barter Exchange Transactions, or substitute statement, from the broker. You should receive the statement by February 15 of the next year. It will show the gross proceeds from the sale. If you sold a covered security in 2012, your 1099-B (or substitute statement) will show your basis. Generally, a covered security is a security you acquired after 2010, with certain exceptions. See the Instructions for Form 8949. The IRS will also get a copy of Form 1099-B from the broker.

Use Form 1099-B (or substitute statement received from your broker) to complete Form 8949.

What Is a Sale or Trade?

This section explains what is a sale or trade. It also explains certain transactions and events that are treated as sales or trades.

A sale is generally a transfer of property for money or a mortgage, note, or other promise to pay money.

A trade is a transfer of property for other property or services and may be taxed in the same way as a sale.

Sale and purchase. Ordinarily, a transaction is not a trade when you voluntarily sell property for cash and immediately buy similar property to replace it. The sale and purchase are two separate transactions. But see *Like-kind exchanges* under *Nontaxable Trades*, later.

Redemption of stock. A redemption of stock is treated as a sale or trade and is subject to the capital gain or loss provisions unless the redemption is a dividend or other distribution on stock.

Dividend versus sale or trade. Whether a redemption is treated as a sale, trade, dividend, or other distribution depends on the circumstances in each case. Both direct and indirect ownership of stock will be considered. The redemption is treated as a sale or trade of stock if:

- The redemption is not essentially equivalent to a dividend (see chapter 8),
- There is a substantially disproportionate redemption of stock,
- There is a complete redemption of all the stock of the corporation owned by the shareholder, or
- The redemption is a distribution in partial liquidation of a corporation.

Redemption or retirement of bonds. A redemption or retirement of bonds or notes at their maturity is generally treated as a sale or trade.

In addition, a significant modification of a bond is treated as a trade of the original bond for a new bond. For details, see Regulations section 1.1001-3.

Surrender of stock. A surrender of stock by a dominant shareholder who retains ownership of more than half of the corporation's voting shares is treated as a contribution to capital rather than as an immediate loss deductible from taxable income. The surrendering shareholder must reallocate his or her basis in the surrendered shares to the shares he or she retains.

Worthless securities. Stocks, stock rights, and bonds (other than those held for sale by a securities dealer) that became completely worthless during the tax year are treated as though they were sold on the last day of the tax year. This affects whether your capital loss is long term or short term. See *Holding Period*, later.

Worthless securities also include securities that you abandon after March 12, 2008. To abandon a security, you must permanently surrender and relinquish all rights in the security and receive no consideration in exchange for it. All the facts and circumstances determine whether the transaction is properly characterized as an abandonment or other type of transaction, such as an actual sale or exchange, contribution to capital, dividend, or gift.

If you are a cash basis taxpayer and make payments on a negotiable promissory note that you issued for stock that became worthless, you can deduct these payments as losses in the years you actually make the payments. Do not deduct them in the year the stock became worthless.

How to report loss. Report worthless securities in Part I or Part II, whichever applies, of Form 8949. In column (a), enter "Worthless."

CAUTION *Report your worthless securities transactions on Form 8949 with the correct box checked for these transactions. See Form 8949 and the 2012 Instructions for Form 8949.*

TIP *For more information on Form 8949 and Schedule D (Form 1040), see Reporting Capital Gains and Losses in chapter 16. See also Schedule D (Form 1040), Form 8949, and their separate instructions.*

Filing a claim for refund. If you do not claim a loss for a worthless security on your original return for the year it becomes worthless, you can file a claim for a credit or refund due to the loss. You must use Form 1040X, Amended U.S. Individual Income Tax Return, to amend your return for the year the security became worthless. You must file it within 7 years from the date your original return for that year had to be filed, or 2 years from the date you paid the tax, whichever is later. For more information about filing a claim, see *Amended Returns and Claims for Refund* in chapter 1.

How To Figure Gain or Loss

You figure gain or loss on a sale or trade of property by comparing the amount you realize with the adjusted basis of the property.

Gain. If the amount you realize from a sale or trade is more than the adjusted basis of the property you transfer, the difference is a gain.

Loss. If the adjusted basis of the property you transfer is more than the amount you realize, the difference is a loss.

Adjusted basis. The adjusted basis of property is your original cost or other original basis properly adjusted (increased or decreased) for certain items. See chapter 13 for more information about determining the adjusted basis of property.

Amount realized. The amount you realize from a sale or trade of property is everything you receive for the property minus your expenses of sale (such as redemption fees, sales commissions, sales charges, or exit fees). Amount realized includes the money you receive plus the fair market value of any property or services you receive. If you received a note or other debt instrument for the property, see *How To Figure Gain or Loss* in chapter 4 of Publication 550 to figure the amount realized.

If you finance the buyer's purchase of your property and the debt instrument does not provide for adequate stated interest, the unstated interest that you must report as ordinary income will reduce the amount realized from the sale. For more information, see Publication 537.

Fair market value. Fair market value is the price at which the property would change hands between a buyer and a seller, neither being forced to buy or sell and both having reasonable knowledge of all the relevant facts.

Example. You trade A Company stock with an adjusted basis of $7,000 for B Company stock with a fair market value of $10,000, which is your amount realized. Your gain is $3,000 ($10,000 – $7,000).

Debt paid off. A debt against the property, or against you, that is paid off as a part of the transaction, or that is assumed by the buyer, must be included in the amount realized. This is true even if neither you nor the buyer is personally liable for the debt. For example, if you sell or trade property that is subject to a nonrecourse loan, the amount you realize generally includes the full amount of the note assumed by the buyer even if the amount of the note is more than the fair market value of the property.

Example. You sell stock that you had pledged as security for a bank loan of $8,000. Your basis in the stock is $6,000. The buyer pays off your bank loan and pays you $20,000 in cash. The amount realized is $28,000 ($20,000 + $8,000). Your gain is $22,000 ($28,000 – $6,000).

Payment of cash. If you trade property and cash for other property, the amount you realize is the fair market value of the property you receive. Determine your gain or loss by subtracting the cash you pay plus the adjusted basis of the property you trade in from the amount you realize. If the result is a positive number, it is a gain. If the result is a negative number, it is a loss.

No gain or loss. You may have to use a basis for figuring gain that is different from the basis used for figuring loss. In this case, you may have neither a gain nor a loss. See Basis Other Than Cost in chapter 13.

Nontaxable Trades

This section discusses trades that generally do not result in a taxable gain or deductible loss. For more information on nontaxable trades, see chapter 1 of Publication 544.

Like-kind exchanges. If you trade business or investment property for other business or investment property of a like kind, you do not pay tax on any gain or deduct any loss until you sell or dispose of the property you receive. To be nontaxable, a trade must meet all six of the following conditions.

1. The property must be business or investment property. You must hold both the property you trade and the property you receive for productive use in your trade or business or for investment. Neither property may be property used for personal purposes, such as your home or family car.
2. The property must not be held primarily for sale. The property you trade and the property you receive must not be property you sell to customers, such as merchandise.
3. The property must not be stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest, including partnership interests. However, see *Special rules for mutual ditch, reservoir, or irrigation company stock*, in chapter 4 of Publication 550 for an exception. Also, you can have a nontaxable trade of corporate stocks under a different rule, as discussed later.
4. There must be a trade of like property. The trade of real estate for real estate, or personal property for similar personal property, is a trade of like property. The trade of an apartment house for a store building, or a panel truck for a pickup truck, is a trade of like property. The trade of a piece of machinery for a store building is not a trade of like property. Real property located in the United States and real property located outside the United States are not like property. Also, personal property used predominantly within the United States and personal property used predominantly outside the United States are not like property.
5. The property to be received must be identified in writing within 45 days after the date you transfer the property given up in the trade.
6. The property to be received must be received by the earlier of:
   a. The 180th day after the date on which you transfer the property given up in the trade, or
   b. The due date, including extensions, for your tax return for the year in which the transfer of the property given up occurs.

If you trade property with a related party in a like-kind exchange, a special rule may apply. See Related Party Transactions, later in this chapter. Also, see chapter 1 of Publication 544 for more information on exchanges of business property and special rules for exchanges using qualified intermediaries or involving multiple properties.

Partly nontaxable exchange. If you receive money or unlike property in addition to like property, and the above six conditions are met, you have a partly nontaxable trade. You are taxed on any gain you realize, but only up to the amount of the money and the fair market value of the unlike property you receive. You cannot deduct a loss.

Like property and unlike property transferred. If you give up unlike property in addition to the like property, you must recognize gain or loss on the unlike property you give up. The gain or loss is the difference between the adjusted basis of the unlike property and its fair market value.

Like property and money transferred. If all of the above conditions (1) – (6) are met, you have a nontaxable trade even if you pay money in addition to the like property.

Basis of property received. To figure the basis of the property received, see Nontaxable Exchanges in chapter 13.

How to report. You must report the trade of like property on Form 8824. If you figure a recognized gain or loss on Form 8824, report it on Schedule D (Form 1040), or on Form 4797, Sales of Business Property, whichever applies. See the instructions for Line 22 in the Instructions for Form 8824.

For information on using Form 4797, see chapter 4 of Publication 544.

Corporate stocks. The following trades of corporate stocks generally do not result in a taxable gain or a deductible loss.

Corporate reorganizations. In some instances, a company will give you common stock for preferred stock, preferred stock for common stock, or stock in one corporation for stock in another corporation. If this is a result of a merger, recapitalization, transfer to a controlled corporation, bankruptcy, corporate division, corporate acquisition, or other corporate reorganization, you do not recognize gain or loss.

Stock for stock of the same corporation. You can exchange common stock for common stock or preferred stock for preferred stock in the same corporation without having a recognized gain or loss. This is true for a trade between two stockholders as well as a trade between a stockholder and the corporation.

Convertible stocks and bonds. You generally will not have a recognized gain or loss if you convert bonds into stock or preferred stock into common stock of the same corporation according to a conversion privilege in the terms of the bond or the preferred stock certificate.

Property for stock of a controlled corporation. If you transfer property to a corporation solely in exchange for stock in that corporation, and immediately after the trade you are in control of the corporation, you ordinarily will not recognize a gain or loss. This rule applies both to individuals and to groups who transfer property to a corporation. It does not apply if the corporation is an investment company.

For this purpose, to be in control of a corporation, you or your group of transferors must own, immediately after the exchange, at least 80% of the total combined voting power of all classes of stock entitled to vote and at least 80% of the outstanding shares of each class of nonvoting stock of the corporation.

If this provision applies to you, you may have to attach to your return a complete statement of all facts pertinent to the exchange. For details, see Regulations section 1.351-3.

Additional information. For more information on trades of stock, see *Nontaxable Trades* in chapter 4 of Publication 550.

Insurance policies and annuities. You will not have a recognized gain or loss if the insured or annuitant is the same under both contracts and you trade:

- A life insurance contract for another life insurance contract or for an endowment or annuity contract or for a qualified long-term care insurance contract,

- An endowment contract for another endowment contract that provides for regular payments beginning at a date no later than the beginning date under the old contract or for an annuity contract or for a qualified long-term insurance contract,
- An annuity contract for annuity contract or for a qualified long-term care insurance contract, or
- A qualified long-term care insurance contract for a qualified long-term care insurance contract.

You also may not have to recognize gain or loss on an exchange of a portion of an annuity contract for another annuity contract. For transfers completed before October 24, 2011, see Revenue Ruling 2003-76 in Internal Revenue Bulletin 2003-33 and Revenue Procedure 2008-24 in Internal Revenue Bulletin 2008-13. Revenue Ruling 2003-76 is available at *www.irs.gov/irb/2003-33_IRB/ar11.html*. Revenue Procedure 2008-24 is available at *www.irs.gov/irb/2008-13_IRB/ar13.html*. For transfers completed on or after October 24, 2011, see Revenue Ruling 2003-76, above, and Revenue Procedure 2011-38, in Internal Revenue Bulletin 2011-30. Revenue Procedure 2011-38 is available at *www.irs.gov/irb/2011-30_IRB/ar09.html*.

For tax years beginning after December 31, 2010, amounts received as an annuity for a period of 10 years or more, or for the lives of one or more individuals, under any portion of an annuity, endowment, or life insurance contract, are treated as a separate contract and are considered partial annuities. A portion of an annuity, endowment, or life insurance contract may be annuitized, provided that the annuitization period is for 10 years or more or for the lives of one or more individuals. The investment in the contract is allocated between the part of the contract from which amounts are received as an annuity and the part of the contract from which amounts are not received as an annuity.

Exchanges of contracts not included in this list, such as an annuity contract for an endowment contract, or an annuity or endowment contract for a life insurance contract, are taxable.

Demutualization of life insurance companies. If you received stock in exchange for your equity interest as a policyholder or an annuitant, you generally will not have a recognized gain or loss. See *Demutualization of Life Insurance Companies* in Publication 550.

U.S. Treasury notes or bonds. You can trade certain issues of U.S. Treasury obligations for other issues designated by the Secretary of the Treasury, with no gain or loss recognized on the trade. See *Savings bonds traded* in chapter 1 of Publication 550 for more information.

Transfers Between Spouses

Generally, no gain or loss is recognized on a transfer of property from an individual to (or in trust for the benefit of) a spouse, or if incident to a divorce, a former spouse. This nonrecognition rule does not apply in the following situations.

- The recipient spouse or former spouse is a nonresident alien.
- Property is transferred in trust and liability exceeds basis. Gain must be recognized to the extent the amount of the liabilities assumed by the trust, plus any liabilities on the property, exceed the adjusted basis of the property.

For other situations, see *Transfers Between Spouses* in chapter 4 of Publication 550.

Any transfer of property to a spouse or former spouse on which gain or loss is not recognized is treated by the recipient as a gift and is not considered a sale or exchange. The recipient's basis in the property will be the same as the adjusted basis of the giver immediately before the transfer. This carryover basis rule applies whether the adjusted basis of the transferred property is less than, equal to, or greater than either its fair market value at the time of transfer or any consideration paid by the recipient. This rule applies for purposes of determining loss as well as gain. Any gain recognized on a transfer in trust increases the basis.

A transfer of property is incident to a divorce if the transfer occurs within 1 year after the date on which the marriage ends, or if the transfer is related to the ending of the marriage.

Related Party Transactions

Special rules apply to the sale or trade of property between related parties.

Gain on sale or trade of depreciable property. Your gain from the sale or trade of property to a related party may be ordinary income, rather than capital gain, if the property can be depreciated by the party receiving it. See chapter 3 of Publication 544 for more information.

Like-kind exchanges. Generally, if you trade business or investment property for other business or investment property of a like kind, no gain or loss is recognized. See *Like-kind exchanges*, earlier, under *Nontaxable Trades*.

This rule also applies to trades of property between related parties, defined next under *Losses on sales or trades of property*. However, if either you or the related party disposes of the like property within 2 years after the trade, you both must report any gain or loss not recognized on the original trade on your return filed for the year in which the later disposition occurs. See *Related Party Transactions* in chapter 4 of Publication 550 for exceptions.

Losses on sales or trades of property. You cannot deduct a loss on the sale or trade of property, other than a distribution in complete liquidation of a corporation, if the transaction is directly or indirectly between you and the following related parties.

- Members of your family. This includes only your brothers and sisters, half-brothers and half-sisters, spouse, ancestors (parents, grandparents, etc.), and lineal descendants (children, grandchildren, etc.).
- A partnership in which you directly or indirectly own more than 50% of the capital interest or the profits interest.
- A corporation in which you directly or indirectly own more than 50% in value of the outstanding stock. (See *Constructive ownership of stock*, later.)
- A tax-exempt charitable or educational organization directly or indirectly controlled, in any manner or by any method, by you or by a member of your family, whether or not this control is legally enforceable.

In addition, a loss on the sale or trade of property is not deductible if the transaction is directly or indirectly between the following related parties.

- A grantor and fiduciary, or the fiduciary and beneficiary, of any trust.
- Fiduciaries of two different trusts, or the fiduciary and beneficiary of two different trusts, if the same person is the grantor of both trusts.
- A trust fiduciary and a corporation of which more than 50% in value of the outstanding stock is directly or indirectly owned by or for the trust, or by or for the grantor of the trust.
- A corporation and a partnership if the same persons own more than 50% in value of the outstanding stock of the corporation and more than 50% of the capital interest, or the profits interest, in the partnership.
- Two S corporations if the same persons own more than 50% in value of the outstanding stock of each corporation.
- Two corporations, one of which is an S corporation, if the same persons own more than 50% in value of the outstanding stock of each corporation.
- An executor and a beneficiary of an estate (except in the case of a sale or trade to satisfy a pecuniary bequest).
- Two corporations that are members of the same controlled group. (Under certain conditions, however, these losses are not disallowed but must be deferred.)
- Two partnerships if the same persons own, directly or indirectly, more than 50% of the capital interests or the profit interests in both partnerships.

Multiple property sales or trades. If you sell or trade to a related party a number of blocks of stock or pieces of property in a lump sum, you must figure the gain or loss separately for each block of stock or piece of property. The gain on each item may be taxable. However, you cannot deduct the loss on any item. Also, you cannot reduce gains from the sales of any of these items by losses on the sales of any of the other items.

Indirect transactions. You cannot deduct your loss on the sale of stock through your broker if, under a prearranged plan, a related party buys the same stock you had owned. This does not apply to a trade between related parties through an exchange that is purely coincidental and is not prearranged.

Constructive ownership of stock. In determining whether a person directly or indirectly owns any of the outstanding stock of a corporation, the following rules apply.

Rule 1. Stock directly or indirectly owned by or for a corporation, partnership, estate, or trust is considered owned proportionately by or for its shareholders, partners, or beneficiaries.

Rule 2. An individual is considered to own the stock directly or indirectly owned by or for his or her family. Family includes only brothers and sisters, half-brothers and half-sisters, spouse, ancestors, and lineal descendants.

Rule 3. An individual owning, other than by applying rule 2, any stock in a corporation is considered to own the stock directly or indirectly owned by or for his or her partner.

Rule 4. When applying rule 1, 2, or 3, stock constructively owned by a person under rule 1 is treated as actually owned by that person. But stock constructively owned by an individual under rule 2 or rule 3 is not treated as owned by that individual for again applying either rule 2 or rule 3 to make another person the constructive owner of the stock.

Property received from a related party. If you sell or trade at a gain property you acquired from a related party, you recognize the gain only to the extent it is more than the loss previously disallowed to the related party. This rule applies only if you are the original transferee and you acquired the property by purchase or exchange. This rule does not apply if the related party's loss was disallowed because of the wash sale rules described in chapter 4 of Publication 550 under *Wash Sales*.

If you sell or trade at a loss property you acquired from a related party, you cannot recognize the loss that was not allowed to the related party.

Example 1. Your brother sells you stock for $7,600. His cost basis is $10,000. Your brother cannot deduct the loss of $2,400. Later, you sell the same stock to an unrelated party for $10,500, realizing a gain of $2,900. Your reportable gain is $500 (the $2,900 gain minus the $2,400 loss not allowed to your brother).

Example 2. If, in *Example 1*, you sold the stock for $6,900 instead of $10,500, your recognized loss is only $700 (your $7,600 basis minus $6,900). You cannot deduct the loss that was not allowed to your brother.

Capital Gains and Losses

This section discusses the tax treatment of gains and losses from different types of investment transactions.

Character of gain or loss. You need to classify your gains and losses as either ordinary or capital gains or losses. You then need to classify your capital gains and losses as either short term or long term. If you have long-term gains and losses, you must identify your 28% rate gains and losses. If you have a net capital gain, you must also identify any unrecaptured section 1250 gain.

The correct classification and identification helps you figure the limit on capital losses and the correct tax on capital gains. Reporting capital gains and losses is explained in chapter 16.

Capital or Ordinary Gain or Loss

If you have a taxable gain or a deductible loss from a transaction, it may be either a capital gain or loss or an ordinary gain or loss, depending on the circumstances. Generally, a sale or trade of a capital asset (defined next) results in a capital gain or loss. A sale or trade of a noncapital asset generally results in ordinary gain or loss. Depending on the circumstances, a gain or loss on a sale or trade of property used in a trade or business may be treated as either capital or ordinary, as explained in Publication 544. In some situations, part of your gain or loss may be a capital gain or loss and part may be an ordinary gain or loss.

Capital Assets and Noncapital Assets

For the most part, everything you own and use for personal purposes, pleasure, or investment is a capital asset. Some examples are:

- Stocks or bonds held in your personal account,
- A house owned and used by you and your family,
- Household furnishings,
- A car used for pleasure or commuting,
- Coin or stamp collections,
- Gems and jewelry, and
- Gold, silver, or any other metal.

Any property you own is a capital asset, except the following noncapital assets.

1. Property held mainly for sale to customers or property that will physically become a part of the merchandise for sale to customers. For an exception, see *Capital Asset Treatment for Self-Created Musical Works*, later.
2. Depreciable property used in your trade or business, even if fully depreciated.
3. Real property used in your trade or business.
4. A copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property that is:
    a. Created by your personal efforts,
    b. Prepared or produced for you (in the case of a letter, memorandum, or similar property), or
    c. Acquired under circumstances (for example, by gift) entitling you to the basis of the person who created the property or for whom it was prepared or produced.

    For an exception to this rule, see *Capital Asset Treatment for Self-Created Musical Works*, later.
5. Accounts or notes receivable acquired in the ordinary course of a trade or business for services rendered or from the sale of property described in (1).
6. U.S. Government publications that you received from the government free or for less than the normal sales price, or that you acquired under circumstances entitling you to the basis of someone who received the publications free or for less than the normal sales price.
7. Certain commodities derivative financial instruments held by commodities derivatives dealers.
8. Hedging transactions, but only if the transaction is clearly identified as a hedging transaction before the close of the day on which it was acquired, originated, or entered into.
9. Supplies of a type you regularly use or consume in the ordinary course of your trade or business.

Investment Property

Investment property is a capital asset. Any gain or loss from its sale or trade is generally a capital gain or loss.

Gold, silver, stamps, coins, gems, etc. These are capital assets except when they are held for sale by a dealer. Any gain or loss you have from their sale or trade generally is a capital gain or loss.

Stocks, stock rights, and bonds. All of these (including stock received as a dividend) are capital assets except when held for sale by a securities dealer. However, if you own small business stock, see *Losses on Section 1244 (Small Business) Stock*, later, and *Losses on Small Business Investment Company Stock*, in chapter 4 of Publication 550.

Personal Use Property

Property held for personal use only, rather than for investment, is a capital asset, and you must report a gain from its sale as a capital gain. However, you cannot deduct a loss from selling personal use property.

Capital Asset Treatment for Self-Created Musical Works

You can elect to treat musical compositions and copyrights in musical works as capital assets when you sell or exchange them if:

- Your personal efforts created the property, or
- You acquired the property under circumstances (for example, by gift) entitling you to the basis of the person who created the property or for whom it was prepared or produced.

You must make a separate election for each musical composition (or copyright in a musical work) sold or exchanged during the tax year.

You must make the election on or before the due date (including extensions) of the income tax return for the tax year of the sale or exchange. You must make the election on Form 8949 by treating the sale or exchange as the sale or exchange of a capital asset, according to Form 8949, Schedule D (Form 1040), and their separate instructions.

TIP *For more information on Form 8949 and Schedule D (Form 1040), see* Reporting Capital Gains and Losses *in chapter 16. See also Schedule D (Form 1040), Form 8949, and their separate instructions.*

You can revoke the election if you have IRS approval. To get IRS approval, you must submit a request for a letter ruling under the appropriate IRS revenue procedure. See, for example, Rev. Proc. 2012-1, 2012-1 I.R.B. 1, available at *www.irs.gov/irb/2012-01_IRB/ar06.html*. Alternatively, you are granted an automatic 6-month extension from the due date of your income tax return (excluding extensions) to revoke the election, provided you timely file your income tax return, and within this 6-month extension period, you file Form 1040X that treats the sale or exchange as the sale or exchange of property that is not a capital asset.

Discounted Debt Instruments

Treat your gain or loss on the sale, redemption, or retirement of a bond or other debt instrument originally issued at a discount or bought at a discount as capital gain or loss, except as explained in the following discussions.

Short-term government obligations. Treat gains on short-term federal, state, or local government obligations (other than tax-exempt obligations) as ordinary income up to your ratable share of the acquisition discount. This treatment applies to obligations with a fixed maturity date not more than 1 year from the date of issue. Acquisition discount is the stated redemption price at maturity minus your basis in the obligation.

However, do not treat these gains as income to the extent you previously included the discount in income. See *Discount on Short-Term Obligations* in chapter 1 of Publication 550.

Short-term nongovernment obligations. Treat gains on short-term nongovernment obligations as ordinary income up to your ratable share of original issue discount (OID). This treatment applies to obligations with a fixed maturity date of not more than 1 year from the date of issue.

However, to the extent you previously included the discount in income, you do not have to include it in income again. See *Discount on Short-Term Obligations* in chapter 1 of Publication 550.

Tax-exempt state and local government bonds. If these bonds were originally issued at a discount before September 4, 1982, or you acquired them before March 2, 1984, treat your part of OID as tax-exempt interest. To figure your gain or loss on the sale or trade of these bonds, reduce the amount realized by your part of OID.

If the bonds were issued after September 3, 1982, and acquired after March 1, 1984, increase the adjusted basis by your part of OID to figure gain or loss. For more information on the basis of these bonds, see *Discounted Debt Instruments* in chapter 4 of Publication 550.

Any gain from market discount is usually taxable on disposition or redemption of tax-exempt bonds. If you bought the bonds before May 1, 1993, the gain from market discount is capital gain. If you bought the bonds after April 30, 1993, the gain is ordinary income.

You figure the market discount by subtracting the price you paid for the bond from the sum of the original issue price of the bond and the amount of accumulated OID from the date of issue that represented interest to any earlier holders. For more information, see *Market Discount Bonds* in chapter 1 of Publication 550.

A loss on the sale or other disposition of a tax-exempt state or local government bond is deductible as a capital loss.

Redeemed before maturity. If a state or local bond issued before June 9, 1980, is redeemed before it matures, the OID is not taxable to you.

If a state or local bond issued after June 8, 1980, is redeemed before it matures, the part of OID earned while you hold the bond is not taxable to you. However, you must report the unearned part of OID as a capital gain.

Example. On July 2, 2001, the date of issue, you bought a 20-year, 6% municipal bond for $800. The face amount of the bond was $1,000. The $200 discount was OID. At the time the bond was issued, the issuer had no intention of redeeming it before it matured. The bond was callable at its face amount beginning 10 years after the issue date.

The issuer redeemed the bond at the end of 11 years (July 2, 2012) for its face amount of $1,000 plus accrued annual interest of $60. The OID earned during the time you held the bond, $73, is not taxable. The $60 accrued annual interest also is not taxable. However, you must report the unearned part of OID ($127) as a capital gain.

Long-term debt instruments issued after 1954 and before May 28, 1969 (or before July 2, 1982, if a government instrument). If you sell, trade, or redeem for a gain one of these debt instruments, the part of your gain that is not more than your ratable share of the OID at the time of the sale or redemption is ordinary income. The rest of the gain is capital gain. If, however, there was an intention to call the debt instrument before maturity, all of your gain that is not more than the entire OID is treated as ordinary income at the time of the sale. This treatment of taxable gain also applies to corporate instruments issued after May 27, 1969, under a written commitment that was binding on May 27, 1969, and at all times thereafter.

Long-term debt instruments issued after May 27, 1969 (or after July 1, 1982, if a government instrument). If you hold one of these debt instruments, you must include a part of OID in your gross income each year you own the instrument. Your basis in that debt instrument is increased by the amount of OID that you have included in your gross income. See *Original Issue Discount (OID)* in chapter 7 for information about OID that you must report on your tax return.

If you sell or trade the debt instrument before maturity, your gain is a capital gain. However, if at the time the instrument was originally issued there was an intention to call it before its maturity, your gain generally is ordinary income to the extent of the entire OID reduced by any amounts of OID previously includible in your income. In this case, the rest of the gain is capital gain.

Market discount bonds. If the debt instrument has market discount and you chose to include the discount in income as it accrued, increase your basis in the debt instrument by the accrued discount to figure capital gain or loss on its disposition. If you did not choose to include the discount in income as it accrued, you must report gain as ordinary interest income up to the instrument's accrued market discount. The rest of the gain is capital gain. See *Market Discount Bonds* in chapter 1 of Publication 550.

A different rule applies to market discount bonds issued before July 19, 1984, and purchased by you before May 1, 1993. See *Market discount bonds* under *Discounted Debt Instruments* in chapter 4 of Publication 550.

Retirement of debt instrument. Any amount you receive on the retirement of a debt instrument is treated in the same way as if you had sold or traded that instrument.

Notes of individuals. If you hold an obligation of an individual issued with OID after March 1, 1984, you generally must include the OID in your income currently, and your gain or loss on its sale or retirement is generally capital gain or loss. An exception to this treatment applies if the obligation is a loan between individuals and all the following requirements are met.

- The lender is not in the business of lending money.
- The amount of the loan, plus the amount of any outstanding prior loans, is $10,000 or less.
- Avoiding federal tax is not one of the principal purposes of the loan.

If the exception applies, or the obligation was issued before March 2, 1984, you do not include the OID in your income currently. When you sell or redeem the obligation, the part of your gain that is not more than your accrued share of OID at that time is ordinary income. The rest of the gain, if any, is capital gain. Any loss on the sale or redemption is capital loss.

Deposit in Insolvent or Bankrupt Financial Institution

If you lose money you have on deposit in a bank, credit union, or other financial institution that becomes insolvent or bankrupt, you may be able to deduct your loss in one of three ways.

- Ordinary loss.
- Casualty loss.
- Nonbusiness bad debt (short-term capital loss).

For more information, see *Deposit in Insolvent or Bankrupt Financial Institution,* in chapter 4 of Publication 550.

Sale of Annuity

The part of any gain on the sale of an annuity contract before its maturity date that is based on interest accumulated on the contract is ordinary income.

Losses on Section 1244 (Small Business) Stock

You can deduct as an ordinary loss, rather than as a capital loss, your loss on the sale, trade, or worthlessness of section 1244 stock. Report the loss on Form 4797, line 10.

Any gain on section 1244 stock is a capital gain if the stock is a capital asset in your hands. Report the gain on Form 8949. See *Losses on Section 1244 (Small Business) Stock* in chapter 4 of Publication 550.

TIP *For more information on Form 8949 and Schedule D (Form 1040), see Reporting Capital Gains and Losses in chapter 16. See also Schedule D (Form 1040), Form 8949, and their separate instructions.*

Losses on Small Business Investment Company Stock

See *Losses on Small Business Investment Company Stock* in chapter 4 of Publication 550.

Holding Period

If you sold or traded investment property, you must determine your holding period for the property. Your holding period determines whether any capital gain or loss was a short-term or long-term capital gain or loss.

Long-term or short-term. If you hold investment property more than 1 year, any capital gain or loss is a long-term capital gain or loss. If you hold the property 1 year or less, any capital gain or loss is a short-term capital gain or loss.

To determine how long you held the investment property, begin counting on the date after the day you acquired the property. The day you disposed of the property is part of your holding period.

Example. If you bought investment property on February 7, 2011, and sold it on February 7, 2012, your holding period is not more than 1 year and you have a short-term capital gain or loss. If you sold it on February 8, 2012, your holding period is more than 1 year and you will have a long-term capital gain or loss.

Securities traded on established market. For securities traded on an established securities market, your holding period begins the day after the trade date you bought the securities, and ends on the trade date you sold them.

CAUTION *Do not confuse the trade date with the settlement date, which is the date by which the stock must be delivered and payment must be made.*

Example. You are a cash method, calendar year taxpayer. You sold stock at a gain on December 28, 2012. According to the rules of the stock exchange, the sale was closed by delivery of the stock 4 trading days after the sale, on January 3, 2013. You received payment of the sales price on that same day. Report your gain on your 2012 return, even though you received the payment in 2013. The gain is long term or short term depending on whether you held the stock more than 1 year. Your holding period ended on December 28. If you had sold the stock at a loss, you would also report it on your 2012 return.

U.S. Treasury notes and bonds. The holding period of U.S. Treasury notes and bonds sold at auction on the basis of yield starts the day after the Secretary of the Treasury, through news releases, gives notification of acceptance to successful bidders. The holding period of U.S. Treasury notes and bonds sold through an offering on a subscription basis at a specified yield starts the day after the subscription is submitted.

Automatic investment service. In determining your holding period for shares bought by the bank or other agent, full shares are considered bought first and any fractional shares are considered bought last. Your holding period starts on the day after the bank's purchase date. If a share was bought over more than one purchase date, your holding period for that share is a split holding period. A part of the share is considered to have been bought on each date that stock was bought by the bank with the proceeds of available funds.

Nontaxable trades. If you acquire investment property in a trade for other investment property and your basis for the new property is determined, in whole or in part, by your basis in the old property, your holding period for the new property begins on the day following the date you acquired the old property.

Property received as a gift. If you receive a gift of property and your basis is determined by the donor's adjusted basis, your holding period is considered to have started on the same day the donor's holding period started.

If your basis is determined by the fair market value of the property, your holding period starts on the day after the date of the gift.

Inherited property. Generally, if you inherited investment property, your capital gain or loss on any later disposition of that property is long-term capital gain or loss. This is true regardless of how long you actually held the property. However, if you inherited property from someone who died in 2010, see the information below.

Inherited property from someone who died in 2010. If you inherit investment property from a decedent who died in 2010, and the executor of the decedent's estate made the election to file Form 8939, refer to the information provided by the executor or see Publication 4895, Tax Treatment of Property Acquired From a Decedent Dying in 2010, to determine your holding period.

Real property bought. To figure how long you have held real property bought under an unconditional contract, begin counting on the day after you received title to it or on the day after you took possession of it and assumed the burdens and privileges of ownership, whichever happened first. However, taking delivery or possession of real property under an option agreement is not enough to start the holding period. The holding period cannot start until there is an actual contract of sale. The holding period of the seller cannot end before that time.

Real property repossessed. If you sell real property but keep a security interest in it, and then later repossess the property under the terms of the sales contract, your holding period for a later sale includes the period you held the property before the original sale and the period after the repossession. Your holding period does not include the time between the original sale and the repossession. That is, it does not include the period during which the first buyer held the property.

Stock dividends. The holding period for stock you received as a taxable stock dividend begins on the date of distribution.

The holding period for new stock you received as a nontaxable stock dividend begins on the same day as the holding period of the old stock. This rule also applies to stock acquired in a "spin-off," which is a distribution of stock or securities in a controlled corporation.

Nontaxable stock rights. Your holding period for nontaxable stock rights begins on the same day as the holding period of the underlying stock. The holding period for stock acquired through the exercise of stock rights begins on the date the right was exercised.

Nonbusiness Bad Debts

If someone owes you money that you cannot collect, you have a bad debt. You may be able to deduct the amount owed to you when you figure your tax for the year the debt becomes worthless.

Generally, nonbusiness bad debts are bad debts that did not come from operating your trade or business, and are deductible as short-term capital losses. To be deductible, nonbusiness bad debts must be totally worthless. You cannot deduct a partly worthless nonbusiness debt.

Genuine debt required. A debt must be genuine for you to deduct a loss. A debt is genuine if it arises from a debtor-creditor relationship based on a valid and enforceable obligation to repay a fixed or determinable sum of money.

Basis in bad debt required. To deduct a bad debt, you must have a basis in it—that is, you must have already included the amount in your income or loaned out your cash. For example, you cannot claim a bad debt deduction for court-ordered child support not paid to you by your former spouse. If you are a cash method taxpayer (as most individuals are), you generally cannot take a bad debt deduction for unpaid salaries, wages, rents, fees, interest, dividends, and similar items.

When deductible. You can take a bad debt deduction only in the year the debt becomes worthless. You do not have to wait until a debt is due to determine whether it is worthless. A debt becomes worthless when there is no longer any chance that the amount owed will be paid.

It is not necessary to go to court if you can show that a judgment from the court would be uncollectible. You must only show that you have taken reasonable steps to collect the debt. Bankruptcy of your debtor is generally good evidence of the worthlessness of at least a part of an unsecured and unpreferred debt.

How to report bad debts. Deduct nonbusiness bad debts as short-term capital losses on Form 8949.

CAUTION *Make sure you report your bad debt(s) (and any other short-term transactions for which you did not receive a Form 1099-B) on Form 8949, Part I, with box C checked.*

TIP *For more information on Form 8949 and Schedule D (Form 1040), see Reporting Capital Gains and Losses in chapter 16. See also Schedule D (Form 1040), Form 8949, and their separate instructions.*

For each bad debt, attach a statement to your return that contains:

- A description of the debt, including the amount, and the date it became due,
- The name of the debtor, and any business or family relationship between you and the debtor,
- The efforts you made to collect the debt, and
- Why you decided the debt was worthless. For example, you could show that the borrower has declared bankruptcy, or that legal action to collect would probably not result in payment of any part of the debt.

Filing a claim for refund. If you do not deduct a bad debt on your original return for the year it becomes worthless, you can file a claim for a credit or refund due to the bad debt. To do this, use Form 1040X to amend your return for the year the debt became worthless. You must file it within 7 years from the date your original return for that year had to be filed, or 2 years from the date you paid the tax, whichever is later. For more information about filing a claim, see *Amended Returns and Claims for Refund* in chapter 1.

Additional information. For more information, see *Nonbusiness Bad Debts* in Publication 550. For information on business bad debts, see chapter 10 of Publication 535, Business Expenses.

Wash Sales

You cannot deduct losses from sales or trades of stock or securities in a wash sale.

A wash sale occurs when you sell or trade stock or securities at a loss and within 30 days before or after the sale you:

1. Buy substantially identical stock or securities,
2. Acquire substantially identical stock or securities in a fully taxable trade,
3. Acquire a contract or option to buy substantially identical stock or securities, or
4. Acquire substantially identical stock for your individual retirement account (IRA) or Roth IRA.

If your loss was disallowed because of the wash sale rules, add the disallowed loss to the cost of the new stock or securities (except in (4) above). The result is your basis in the new stock or securities. This adjustment postpones the loss deduction until the disposition of the new stock or securities. Your holding period for the new stock or securities includes the holding period of the stock or securities sold.

For more information, see *Wash Sales*, in chapter 4 of Publication 550.

Rollover of Gain From Publicly Traded Securities

You may qualify for a tax-free rollover of certain gains from the sale of publicly traded securities. This means that if you buy certain replacement property and make the choice described in this section, you postpone part or all of your gain.

You postpone the gain by adjusting the basis of the replacement property as described in *Basis of replacement property*, later. This postpones your gain until the year you dispose of the replacement property.

You qualify to make this choice if you meet all the following tests.

- You sell publicly traded securities at a gain. Publicly traded securities are securities traded on an established securities market.
- Your gain from the sale is a capital gain.
- During the 60-day period beginning on the date of the sale, you buy replacement property. This replacement property must be either common stock of, or a partnership interest in a specialized small business investment company (SSBIC). This is any partnership or corporation licensed by the Small Business Administration under section 301(d) of the Small Business Investment Act of 1958, as in effect on May 13, 1993.

Amount of gain recognized. If you make the choice described in this section, you must recognize gain only up to the following amount.

- The amount realized on the sale, minus
- The cost of any common stock or partnership interest in an SSBIC that you bought during the 60-day period beginning on the date of sale (and did not previously take into account on an earlier sale of publicly traded securities).

If this amount is less than the amount of your gain, you can postpone the rest of your gain, subject to the limit described next. If this amount is equal to or more than the amount of your gain, you must recognize the full amount of your gain.

Limit on gain postponed. The amount of gain you can postpone each year is limited to the smaller of:

- $50,000 ($25,000 if you are married and file a separate return), or
- $500,000 ($250,000 if you are married and file a separate return), minus the amount of gain you postponed for all earlier years.

Basis of replacement property. You must subtract the amount of postponed gain from the basis of your replacement property.

How to report and postpone gain. See *How to report and postpone gain* under *Rollover of Gain From Publicly Traded Securities* in chapter 4 of Publication 550 for details.

15.

Selling Your Home

Reminders

Home sold with undeducted points. If you have not deducted all the points you paid to secure a mortgage on your old home, you may be able to deduct the remaining points in the year of the sale. See *Mortgage ending early* under *Points* in chapter 23.

Introduction

This chapter explains the tax rules that apply when you sell your main home. In most cases, your main home is the one in which you live most of the time.

If you sold your main home in 2012, you may be able to exclude from income any gain up to a limit of $250,000 ($500,000 on a joint return in most cases). See *Excluding the Gain*, later. Generally, if you can exclude all the gain, you do not need to report the sale on your tax return.

If you have gain that cannot be excluded, it is taxable. Report it on Form 8949, Sales and Other Dispositions of Capital Assets, and Schedule D (Form 1040). You may also have to complete Form 4797, Sales of Business Property. See *Reporting the Sale*, later.

If you have a loss on the sale, you generally cannot deduct it on your return. However, you may need to report it. See *Reporting the Sale*, later.

The following are main topics in this chapter.

- Figuring gain or loss.
- Basis.
- Excluding the gain.

- Ownership and use tests.
- Reporting the sale.

Other topics include the following.

- Business use or rental of home.
- Recapturing a federal mortgage subsidy.

Useful Items

You may want to see:

Publication

- ❏ **523** Selling Your Home
- ❏ **530** Tax Information for Homeowners
- ❏ **547** Casualties, Disasters, and Thefts

Form (and Instructions)

- ❏ **Schedule D (Form 1040)** Capital Gains and Losses
- ❏ **982** Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment)
- ❏ **8828** Recapture of Federal Mortgage Subsidy
- ❏ **8949** Sales and Other Dispositions of Capital Assets

Main Home

This section explains the term "main home." Usually, the home you live in most of the time is your main home and can be a:

- House,
- Houseboat,
- Mobile home,
- Cooperative apartment, or
- Condominium.

To exclude gain under the rules of this chapter, you in most cases must have owned and lived in the property as your main home for at least 2 years during the 5-year period ending on the date of sale.

Land. If you sell the land on which your main home is located, but not the house itself, you cannot exclude any gain you have from the sale of the land. However, if you sell vacant land used as part of your main home and that is adjacent to it, you may be able to exclude the gain from the sale under certain circumstances. See *Vacant land* under *Main Home* in Publication 523 for more information.

Example. You buy a piece of land and move your main home to it. Then you sell the land on which your main home was located. This sale is not considered a sale of your main home, and you cannot exclude any gain on the sale of the land.

More than one home. If you have more than one home, you can exclude gain only from the sale of your main home. You must include in income gain from the sale of any other home. If you have two homes and live in both of them, your main home is ordinarily the one you live in most of the time during the year.

Example 1. You own two homes, one in New York and one in Florida. From 2008 through 2012, you live in the New York home for 7 months and in the Florida residence for 5 months of each year. In the absence of facts and circumstances indicating otherwise, the New York home is your main home. You would be eligible to exclude the gain from the sale of the New York home but not of the Florida home in 2012.

Example 2. You own a house, but you live in another house that you rent. The rented house is your main home.

Example 3. You own two homes, one in Virginia and one in New Hampshire. In 2008 and 2009, you lived in the Virginia home. In 2010 and 2011, you lived in the New Hampshire home. In 2012, you lived again in the Virginia home. Your main home in 2008, 2009, and 2012 is the Virginia home. Your main home in 2010 and 2011 is the New Hampshire home. You would be eligible to exclude gain from the sale of either home (but not both) in 2012.

Property used partly as your main home. If you use only part of the property as your main home, the rules discussed in this publication apply only to the gain or loss on the sale of that part of the property. For details, see Business Use or Rental of Home, later.

Figuring Gain or Loss

To figure the gain or loss on the sale of your main home, you must know the selling price, the amount realized, and the adjusted basis. Subtract the adjusted basis from the amount realized to get your gain or loss.

Selling price
− Selling expenses
Amount realized

Amount realized
− Adjusted basis
Gain or loss

Selling Price

The selling price is the total amount you receive for your home. It includes money and the fair market value of any other property or any other services you receive and all notes, mortgages or other debts assumed by the buyer as part of the sale.

Payment by employer. You may have to sell your home because of a job transfer. If your employer pays you for a loss on the sale or for your selling expenses, do not include the payment as part of the selling price. Your employer will include it as wages in box 1 of your Form W-2, and you will include it in your income on Form 1040, line 7.

Option to buy. If you grant an option to buy your home and the option is exercised, add the amount you receive for the option to the selling price of your home. If the option is not exercised, you must report the amount as ordinary income in the year the option expires. Report this amount on Form 1040, line 21.

Form 1099-S. If you received Form 1099-S, Proceeds From Real Estate Transactions, box 2 (Gross proceeds) should show the total amount you received for your home.

However, box 2 will not include the fair market value of any services or property other than cash or notes you received or will receive. Instead, box 4 will be checked to indicate your receipt or expected receipt of these items.

Amount Realized

The amount realized is the selling price minus selling expenses.

Selling expenses. Selling expenses include:

- Commissions,
- Advertising fees,
- Legal fees, and
- Loan charges paid by the seller, such as loan placement fees or "points."

Adjusted Basis

While you owned your home, you may have made adjustments (increases or decreases) to the basis. This adjusted basis must be determined before you can figure gain or loss on the sale of your home. For information on how to figure your home's adjusted basis, see Determining Basis, later.

Amount of Gain or Loss

To figure the amount of gain or loss, compare the amount realized to the adjusted basis.

Gain on sale. If the amount realized is more than the adjusted basis, the difference is a gain and, except for any part you can exclude, in most cases is taxable.

Loss on sale. If the amount realized is less than the adjusted basis, the difference is a loss. A loss on the sale of your main home cannot be deducted.

Jointly owned home. If you and your spouse sell your jointly owned home and file a joint return, you figure your gain or loss as one taxpayer.

Separate returns. If you file separate returns, each of you must figure your own gain or loss according to your ownership interest in the home. Your ownership interest is generally determined by state law.

Joint owners not married. If you and a joint owner other than your spouse sell your jointly owned home, each of you must figure your own gain or loss according to your ownership interest in the home. Each of you applies the rules discussed in this chapter on an individual basis.

Dispositions Other Than Sales

Some special rules apply to other dispositions of your main home.

Foreclosure or repossession. If your home was foreclosed on or repossessed, you have a disposition. See Publication 4681, Canceled Debts, Foreclosures, Repossessions, and Abandonments, to determine if you have ordinary income, gain, or loss.

Abandonment. If you abandon your home, see Publication 4681 to determine if you have ordinary income, gain, or loss.

Trading (exchanging) homes. If you trade your old home for another home, treat the trade as a sale and a purchase.

Example. You owned and lived in a home with an adjusted basis of $41,000. A real estate dealer accepted your old home as a trade-in and allowed you $50,000 toward a new home priced at $80,000. This is treated as a sale of your old home for $50,000 with a gain of $9,000 ($50,000 – $41,000).

If the dealer had allowed you $27,000 and assumed your unpaid mortgage of $23,000 on your old home, your sales price would still be $50,000 (the $27,000 trade-in allowed plus the $23,000 mortgage assumed).

Transfer to spouse. If you transfer your home to your spouse or you transfer it to your former spouse incident to your divorce, you in most cases have no gain or loss. This is true even if you receive cash or other consideration for the home. As a result, the rules in this chapter do not apply.

More information. If you need more information, see *Transfer to spouse* in Publication 523 and *Property Settlements* in Publication 504, Divorced or Separated Individuals.

Involuntary conversion. You have a disposition when your home is destroyed or condemned and you receive other property or money in payment, such as insurance or a condemnation award. This is treated as a sale and you may be able to exclude all or part of any gain from the destruction or condemnation of your home, as explained later under *Special Situations*.

Determining Basis

You need to know your basis in your home to figure any gain or loss when you sell it. Your basis in your home is determined by how you got the home. Generally, your basis is its cost if you bought it or built it. If you got it in some other way (inheritance, gift, etc.), your basis is generally either its fair market value when you received it or the adjusted basis of the previous owner.

While you owned your home, you may have made adjustments (increases or decreases) to your home's basis. The result of these adjustments is your home's adjusted basis, which is used to figure gain or loss on the sale of your home. See *Adjusted Basis*, later.

You can find more information on basis and adjusted basis in chapter 13 of this publication and in Publication 523.

Cost As Basis

The cost of property is the amount you paid for it in cash, debt obligations, other property, or services.

Purchase. If you bought your home, your basis is its cost to you. This includes the purchase price and certain settlement or closing costs. In most cases, your purchase price includes your down payment and any debt, such as a first or second mortgage or notes you gave the seller in payment for the home. If you build, or contract to build, a new home, your purchase price can include costs of construction, as discussed in Publication 523.

Settlement fees or closing costs. When you bought your home, you may have paid settlement fees or closing costs in addition to the contract price of the property. You can include in your basis some of the settlement fees and closing costs you paid for buying the home, but not the fees and costs for getting a mortgage loan. A fee paid for buying the home is any fee you would have had to pay even if you paid cash for the home (that is, without the need for financing).

Chapter 13 lists some of the settlement fees and closing costs that you can include in the basis of property, including your home. It also lists some settlement costs that cannot be included in basis.

Also see Publication 523 for additional items and a discussion of basis other than cost.

Adjusted Basis

Adjusted basis is your cost or other basis increased or decreased by certain amounts. To figure your adjusted basis, you can use Worksheet 1 in Publication 523.

CAUTION *Do not use Worksheet 1 if you acquired an interest in your home from a decedent who died in 2010 and whose executor filed Form 8939, Allocation of Increase in Basis for Property Acquired From a Decedent.*

Increases to basis. These include the following.

- Additions and other improvements that have a useful life of more than 1 year.
- Special assessments for local improvements.
- Amounts you spent after a casualty to restore damaged property.

Improvements. These add to the value of your home, prolong its useful life, or adapt it to new uses. You add the cost of additions and other improvements to the basis of your property.

For example, putting a recreation room or another bathroom in your unfinished basement, putting up a new fence, putting in new plumbing or wiring, putting on a new roof, or paving your unpaved driveway are improvements. An addition to your house, such as a new deck, a sunroom, or a new garage, is also an improvement.

Repairs. These maintain your home in good condition but do not add to its value or prolong its life. You do not add their cost to the basis of your property.

Examples of repairs include repainting your house inside or outside, fixing your gutters or floors, repairing leaks or plastering, and replacing broken window panes.

Decreases to basis. These include the following.

- Discharge of qualified principal residence indebtedness that was excluded from income.
- Some or all of the cancellation of debt income that was excluded due to your bankruptcy or insolvency. For details, see Publication 4681.
- Gain you postponed from the sale of a previous home before May 7, 1997.
- Deductible casualty losses.
- Insurance payments you received or expect to receive for casualty losses.
- Payments you received for granting an easement or right-of-way.
- Depreciation allowed or allowable if you used your home for business or rental purposes.
- Residential energy credit (generally allowed from 1977 through 1987) claimed for the cost of energy improvements that you added to the basis of your home.
- Nonbusiness energy property credit (allowed beginning in 2006 but not for 2008) claimed for making certain energy saving improvements you added to the basis of your home.
- Residential energy efficient property credit (allowed beginning in 2006) claimed for making certain energy saving improvements you added to the basis of your home.
- Adoption credit you claimed for improvements added to the basis of your home.
- Nontaxable payments from an adoption assistance program of your employer you used for improvements you added to the basis of your home.
- Energy conservation subsidy excluded from your gross income because you received it (directly or indirectly) from a public utility after 1992 to buy or install any energy conservation measure. An energy conservation measure is an installation or modification primarily designed either to reduce consumption of electricity or natural gas or to improve the management of energy demand for a home.
- District of Columbia first-time homebuyer credit (allowed on the purchase of a principal residence in the District of Columbia beginning on August 5, 1997 and before January 1, 2012).
- General sales taxes (allowed beginning 2004 and ending before 2014) claimed as

an itemized deduction on Schedule A (Form 1040) that were imposed on the purchase of personal property, such as a houseboat used as your home or a mobile home.

Discharges of qualified principal residence indebtedness. You may be able to exclude from gross income a discharge of qualified principal residence indebtedness. This exclusion applies to discharges made after 2006 and before 2013. If you choose to exclude this income, you must reduce (but not below zero) the basis of the principal residence by the amount excluded from your gross income.

File Form 982 with your tax return. See the form's instructions for detailed information.

Principal residence. Your principal residence is the home where you ordinarily live most of the time. You can have only one principal residence at any one time. See *Main Home*, earlier.

Qualified principal residence indebtedness. This is debt you took out to buy, build, or substantially improve your principal residence. The debt must be secured by your principal residence, and it cannot be more than the cost of your principal residence plus improvements.

Amount eligible for the exclusion. The exclusion applies only to debt discharged after 2006 and before 2013. The maximum amount you can treat as qualified principal residence indebtedness is $2 million ($1 million if married filing separately). You cannot exclude from gross income discharge of qualified principal residence indebtedness if the discharge was for services performed for the lender or on account of any other factor not directly related to a decline in the value of your residence or to your financial condition.

RECORDS **Recordkeeping.** You should keep records to prove your home's adjusted basis. Ordinarily, you must keep records for 3 years after the due date for filing your return for the tax year in which you sold your home. But if you sold a home before May 7, 1997, and postponed tax on any gain, the basis of that home affects the basis of the new home you bought. Keep records proving the basis of both homes as long as they are needed for tax purposes.

The records you should keep include:

- Proof of the home's purchase price and purchase expenses,
- Receipts and other records for all improvements, additions, and other items that affect the home's adjusted basis,
- Any worksheets or other computations you used to figure the adjusted basis of the home you sold, the gain or loss on the sale, the exclusion, and the taxable gain,
- Any Form 982 you filed to report any discharge of qualified principal residence indebtedness,
- Any Form 2119, Sale of Your Home, you filed to postpone gain from the sale of a previous home before May 7, 1997, and
- Any worksheets you used to prepare Form 2119, such as the Adjusted Basis of Home Sold Worksheet or the Capital Improvements Worksheet from the Form 2119 instructions, or other source of computations.

Excluding the Gain

You may qualify to exclude from your income all or part of any gain from the sale of your main home. This means that, if you qualify, you will not have to pay tax on the gain up to the limit described under *Maximum Exclusion*, next. To qualify, you must meet the ownership and use tests described later.

You can choose not to take the exclusion by including the gain from the sale in your gross income on your tax return for the year of the sale.

You can use Worksheet 2 in Publication 523 to figure the amount of your exclusion and your taxable gain, if any.

CAUTION *If you have any taxable gain from the sale of your home, you may have to increase your withholding or make estimated tax payments. See Publication 505, Tax Withholding and Estimated Tax.*

Maximum Exclusion

You can exclude up to $250,000 of the gain (other than gain allocated to periods of nonqualified use) on the sale of your main home if all of the following are true.

- You meet the ownership test.
- You meet the use test.
- During the 2-year period ending on the date of the sale, you did not exclude gain from the sale of another home.

For details on gain allocated to periods of nonqualified use, see *Periods of nonqualified use*, later.

You may be able to exclude up to $500,000 of the gain (other than gain allocated to periods of nonqualified use) on the sale of your main home if you are married and file a joint return and meet the requirements listed in the discussion of the special rules for joint returns, later, under *Married Persons*.

Ownership and Use Tests

To claim the exclusion, you must meet the ownership and use tests. This means that during the 5-year period ending on the date of the sale, you must have:

- Owned the home for at least 2 years (the ownership test), and
- Lived in the home as your main home for at least 2 years (the use test).

Exception. If you owned and lived in the property as your main home for less than 2 years, you can still claim an exclusion in some cases. However, the maximum amount you may be able to exclude will be reduced. See *Reduced Maximum Exclusion*, later.

Example 1—home owned and occupied for at least 2 years. Mya bought and moved into her main home in September 2009. She sold the home at a gain on September 15, 2012. During the 5-year period ending on the date of sale (September 16, 2007–September 15, 2012), she owned and lived in the home for more than 2 years. She meets the ownership and use tests.

Example 2—ownership test met but use test not met. Ayden bought a home in 2007. After living in it for 6 months, he moved out. He never lived in the home again and sold it at a gain on June 28, 2012. He owned the home during the entire 5-year period ending on the date of sale (June 29, 2007–June 28, 2012). However, he did not live in it for the required 2 years. He meets the ownership test but not the use test. He cannot exclude any part of his gain on the sale unless he qualified for a reduced maximum exclusion (explained later).

Period of Ownership and Use

The required 2 years of ownership and use during the 5-year period ending on the date of the sale do not have to be continuous nor do they both have to occur at the same time.

You meet the tests if you can show that you owned and lived in the property as your main home for either 24 full months or 730 days (365 × 2) during the 5-year period ending on the date of sale.

Temporary absence. Short temporary absences for vacations or other seasonal absences, even if you rent out the property during the absences, are counted as periods of use. The following examples assume that the reduced maximum exclusion (discussed later) does not apply to the sales.

Example 1. David Johnson, who is single, bought and moved into his home on February 1, 2010. Each year during 2010 and 2011, David left his home for a 2-month summer vacation. David sold the house on March 1, 2012. Although the total time David used his home is less than 2 years (21 months), he meets the requirement and may exclude gain. The 2-month vacations are short temporary absences and are counted as periods of use in determining whether David used the home for the required 2 years.

Example 2. Professor Paul Beard, who is single, bought and moved into a house on August 28, 2009. He lived in it as his main home continuously until January 5, 2011, when he went abroad for a 1-year sabbatical leave. On February 6, 2012, 1 month after returning from the leave, Paul sold the house at a gain. Because his leave was not a short temporary absence, he cannot include the period of leave to meet the 2-year use test. He cannot exclude any part of his gain, because he did not use the residence for the required 2 years.

Ownership and use tests met at different times. You can meet the ownership and use tests during different 2-year periods. However, you must meet both tests during the 5-year period ending on the date of the sale.

Example. Beginning in 2001, Helen Jones lived in a rented apartment. The apartment building was later converted to condominiums, and she bought her same apartment on December 3, 2009. In 2010, Helen became ill and on April 14 of that year she moved to her daughter's home. On July 12, 2012, while still living in her daughter's home, she sold her condominium.

Helen can exclude gain on the sale of her condominium because she met the ownership and use tests during the 5-year period from July 13, 2007, to July 12, 2012, the date she sold the condominium. She owned her condominium from December 3, 2009, to July 12, 2012 (more than 2 years). She lived in the property from July 13, 2007 (the beginning of the 5-year period), to April 14, 2010 (more than 2 years).

The time Helen lived in her daughter's home during the 5-year period can be counted toward her period of ownership, and the time she lived in her rented apartment during the 5-year period can be counted toward her period of use.

Cooperative apartment. If you sold stock as a tenant-stockholder in a cooperative housing corporation, the ownership and use tests are met if, during the 5-year period ending on the date of sale, you:

- Owned the stock for at least 2 years, and
- Lived in the house or apartment that the stock entitles you to occupy as your main home for at least 2 years.

Exceptions to Ownership and Use Tests

The following sections contain exceptions to the ownership and use tests for certain taxpayers.

Exception for individuals with a disability. There is an exception to the use test if:

- You become physically or mentally unable to care for yourself, and
- You owned and lived in your home as your main home for a total of at least 1 year during the 5-year period before the sale of your home.

Under this exception, you are considered to live in your home during any time within the 5-year period that you own the home and live in a facility (including a nursing home) licensed by a state or political subdivision to care for persons in your condition.

If you meet this exception to the use test, you still have to meet the 2-out-of-5-year ownership test to claim the exclusion.

Previous home destroyed or condemned. For the ownership and use tests, you add the time you owned and lived in a previous home that was destroyed or condemned to the time you owned and lived in the replacement home on whose sale you wish to exclude gain. This rule applies if any part of the basis of the home you sold depended on the basis of the destroyed or condemned home. Otherwise, you must have owned and lived in the same home for 2 of the 5 years before the sale to qualify for the exclusion.

Members of the uniformed services or Foreign Service, employees of the intelligence community, or employees or volunteers of the Peace Corps. You can choose to have the 5-year test period for ownership and use suspended during any period you or your spouse serve on "qualified official extended duty" as a member of the uniformed services or Foreign Service of the United States, or as an employee of the intelligence community. You can choose to have the 5-year test period for ownership and use suspended during any period you or your spouse serve outside the United States either as an employee of the Peace Corps on "qualified official extended duty" or as an enrolled volunteer or volunteer leader of the Peace Corps. This means that you may be able to meet the 2-year use test even if, because of your service, you did not actually live in your home for at least the required 2 years during the 5-year period ending on the date of sale.

If this helps you qualify to exclude gain, you can choose to have the 5-year test period suspended by filing a return for the year of sale that does not include the gain.

For more information about the suspension of the 5-year test period, see *Members of the uniformed services or Foreign Service, employees of the intelligence community, or employees or volunteers of the Peace Corps* in Publication 523.

Married Persons

If you and your spouse file a joint return for the year of sale and one spouse meets the ownership and use tests, you can exclude up to $250,000 of the gain. (But see Special rules for joint returns, next.)

Special rules for joint returns. You can exclude up to $500,000 of the gain on the sale of your main home if all of the following are true.

- You are married and file a joint return for the year.
- Either you or your spouse meets the ownership test.
- Both you and your spouse meet the use test.
- During the 2-year period ending on the date of the sale, neither you nor your spouse excluded gain from the sale of another home.

If either spouse does not satisfy all these requirements, the maximum exclusion that can be claimed by the couple is the total of the maximum exclusions that each spouse would qualify for if not married and the amounts were figured separately. For this purpose, each spouse is treated as owning the property during the period that either spouse owned the property.

Example 1—one spouse sells a home. Emily sells her home in June 2012 for a gain of $300,000. She marries Jamie later in the year. She meets the ownership and use tests, but Jamie does not. Emily can exclude up to $250,000 of gain on a separate or joint return for 2012. The $500,000 maximum exclusion for certain joint returns does not apply because Jamie does not meet the use test.

Example 2—each spouse sells a home. The facts are the same as in Example 1 except that Jamie also sells a home in 2012 for a gain of $200,000 before he marries Emily. He meets the ownership and use tests on his home, but Emily does not. Emily can exclude $250,000 of gain and Jamie can exclude $200,000 of gain on the respective sales of their individual homes. However, Emily cannot use Jamie's unused exclusion to exclude more than $250,000 of gain. Therefore, Emily and Jamie must recognize $50,000 of gain on the sale of Emily's home. The $500,000 maximum exclusion for certain joint returns does not apply because Emily and Jamie do not both meet the use test for the same home.

Sale of main home by surviving spouse. If your spouse died and you did not remarry before the date of sale, you are considered to have owned and lived in the property as your main home during any period of time when your spouse owned and lived in it as a main home.

If you meet all of the following requirements, you may qualify to exclude up to $500,000 of any gain from the sale or exchange of your main home.

- The sale or exchange took place after 2008.
- The sale or exchange took place no more than 2 years after the date of death of your spouse.
- You have not remarried.
- You and your spouse met the use test at the time of your spouse's death.
- You or your spouse met the ownership test at the time of your spouse's death.
- Neither you nor your spouse excluded gain from the sale of another home during the last 2 years.

Example. Harry owned and used a house as his main home since 2008. Harry and Wilma married on July 1, 2012, and from that date they use Harry's house as their main home. Harry died on August 15, 2012, and Wilma inherited the property. Wilma sold the property on September 3, 2012, at which time she had not remarried. Although Wilma owned and used the house for less than 2 years, Wilma is considered to have satisfied the ownership and use tests because her period of ownership and use includes the period that Harry owned and used the property before death.

Home transferred from spouse. If your home was transferred to you by your spouse (or former spouse if the transfer was incident to divorce), you are considered to have owned it during any period of time when your spouse owned it.

Use of home after divorce. You are considered to have used property as your main home during any period when:

- You owned it, and
- Your spouse or former spouse is allowed to live in it under a divorce or separation instrument and uses it as his or her main home.

Reduced Maximum Exclusion

If you fail to meet the requirements to qualify for the $250,000 or $500,000 exclusion, you may still qualify for a reduced exclusion. This applies to those who:

- Fail to meet the ownership and use tests, or
- Have used the exclusion within 2 years of selling their current home.

In both cases, to qualify for a reduced exclusion, the sale of your main home must be due to one of the following reasons.

- A change in place of employment.
- Health.
- Unforeseen circumstances.

Unforeseen circumstances. The sale of your main home is because of an unforeseen circumstance if your primary reason for the sale is the occurrence of an event that you could not reasonably have anticipated before buying and occupying your main home.

See Publication 523 for more information and to use Worksheet 3 to figure your reduced maximum exclusion.

Business Use or Rental of Home

You may be able to exclude gain from the sale of a home you have used for business or to produce rental income. But you must meet the ownership and use tests.

Periods of nonqualified use. In most cases, gain from the sale or exchange of your main home will not qualify for the exclusion to the extent that the gains are allocated to periods of nonqualified use. Nonqualified use is any period in 2009 or later during which neither you nor your spouse (or your former spouse) used the property as a main home with the following exceptions.

Exceptions. A period of nonqualified use does not include:

1. Any portion of the 5-year period ending on the date of the sale or exchange after the last date you (or your spouse) use the property as a main home;
2. Any period (not to exceed an aggregate period of 10 years) during which you (or your spouse) are serving on qualified official extended duty:
   a. As a member of the uniformed services;
   b. As a member of the Foreign Service of the United States; or
   c. As an employee of the intelligence community; and
3. Any other period of temporary absence (not to exceed an aggregate period of 2 years) due to change of employment, health conditions, or such other unforeseen circumstances as may be specified by the IRS.

The gain resulting from the sale of the property is allocated between qualified and nonqualified use periods based on the amount of time the property was held for qualified and nonqualified use. Gain from the sale or exchange of a main home allocable to periods of qualified use will continue to qualify for the exclusion for the sale of your main home. Gain from the sale or exchange of property allocable to nonqualified use will not qualify for the exclusion.

Calculation. To figure the portion of the gain allocated to the period of nonqualified use, multiply the gain by the following fraction:

$$\frac{\text{Total nonqualified use during the period of ownership in 2009 or later}}{\text{Total period of ownership}}$$

This calculation can be found in Worksheet 2, line 10, in Publication 523.

Example 1. On May 26, 2006, Amy, who is unmarried for all years in this example, bought a house. She moved in on that date and lived in it until May 31, 2008, when she moved out of the house and put it up for rent. The house was rented from June 1, 2008, to March 31, 2010. Amy claimed depreciation deductions in 2008 through 2010 totaling $10,000. Amy moved back into the house on April 1, 2010, and lived there until she sold it on January 31, 2012, for a gain of $200,000. During the 5-year period ending on the date of the sale (January 31, 2007–January 31, 2012), Amy owned and lived in the house for more than 2 years as shown in the following table.

Five Year Period	Used as Home	Used as Rental
1/31/07 – 5/31/08	16 months	
6/1/08 – 3/31/10		22 months
4/1/10 – 1/31/12	22 months	
	38 months	22 months

During the period Amy owned the house (2,076 days), her period of nonqualified use was 455 days. Amy divides 455 by 2,076 and obtains a decimal (rounded to at least three decimal places) of 0.219. To figure her gain attributable to the period of nonqualified use, she multiplies $190,000 (the gain not attributable to the $10,000 depreciation deduction) by 0.219. Because the gain attributable to periods of nonqualified use is $41,610, Amy can exclude $148,390 of her gain.

Example 2. William owned and used a house as his main home from 2006 through 2009. On January 1, 2010, he moved to another state. He rented his house from that date until April 30, 2012, when he sold it. During the 5-year period ending on the date of sale (May 1, 2007–April 30, 2012), William owned and lived in the house for more than 2 years. He must report the sale on Form 4797 because it was rental property at the time of sale. Because the period of nonqualified use does not include any part of the 5-year period after the last date William lived in the house, he has no period of nonqualified use. Because he met the ownership and use tests, he can exclude gain up to $250,000. However, he cannot exclude the part of the gain equal to the depreciation he claimed or could have claimed for renting the house, as explained next.

Depreciation after May 6, 1997. If you were entitled to take depreciation deductions because you used your home for business purposes or as rental property, you cannot exclude the part of your gain equal to any depreciation allowed or allowable as a deduction for periods after May 6, 1997. If you can show by adequate records or other evidence that the depreciation allowed was less than the amount allowable, then you may limit the amount of gain recognized to the depreciation allowed. See Publication 544 for more information.

Property used partly for business or rental. If you used property partly as a home and partly for business or to produce rental income, see Publication 523.

Reporting the Sale

Do not report the 2012 sale of your main home on your tax return unless:

- You have a gain and do not qualify to exclude all of it,
- You have a gain and choose not to exclude it, or
- You received Form 1099-S.

If any of these conditions apply, report the entire gain or loss. For details on how to report the gain or loss, see the Instructions for Schedule D (Form 1040) and the Instructions for Form 8949.

If you used the home for business or to produce rental income, you may have to use Form 4797 to report the sale of the business or rental part (or the sale of the entire property if used entirely for business or rental). See *Business Use or Rental of Home* in Publication 523 and the Instructions for Form 4797.

Installment sale. Some sales are made under arrangements that provide for part or all of the selling price to be paid in a later year. These sales are called "installment sales." If you finance the buyer's purchase of your home yourself instead of having the buyer get a loan or mortgage from a bank, you probably have an installment sale. You may be able to report the part of the gain you cannot exclude on the installment basis.

Use Form 6252, Installment Sale Income, to report the sale. Enter your exclusion on line 15 of Form 6252.

Seller-financed mortgage. If you sell your home and hold a note, mortgage, or other financial agreement, the payments you receive in most cases consist of both interest and principal. You must separately report as interest income the interest you receive as part of each payment. If the buyer of your home uses the property as a main or second home, you must also report the name, address, and social security number (SSN) of the buyer on line 1 of Schedule B (Form 1040A or 1040). The buyer must give you his or her SSN, and you must give the buyer your SSN. Failure to meet these requirements may result in a $50 penalty for each failure. If either you or the buyer does not have and is not eligible to get an SSN, see *Social Security Number* in chapter 1.

More information. For more information on installment sales, see Publication 537, Installment Sales.

Special Situations

The situations that follow may affect your exclusion.

Sale of home acquired in a like-kind exchange. You cannot claim the exclusion if:

- You acquired your home in a like-kind exchange (also known as a section 1031 exchange), or your basis in your home is determined by reference to the basis of the home in the hands of the person who acquired the property in a like-kind exchange (for example, you received the home from that person as a gift), and
- You sold the home during the 5-year period beginning with the date your home was acquired in the like-kind exchange.

Gain from a like-kind exchange is not taxable at the time of the exchange. This means that gain will not be taxed until you sell or otherwise dispose of the property you receive. To defer gain from a like-kind exchange, you must have exchanged business or investment property for business or investment property of a like kind. For more information about like-kind exchanges, see Publication 544, Sales and Other Dispositions of Assets.

Home relinquished in a like-kind exchange. If you use your main home partly for business or rental purposes and then exchange the home for another property, see Publication 523.

Expatriates. You cannot claim the exclusion if the expatriation tax applies to you. The expatriation tax applies to certain U.S. citizens who have renounced their citizenship (and to certain long-term residents who have ended their residency). For more information about the expatriation tax, see *Expatriation Tax* in chapter 4 of Publication 519, U.S. Tax Guide for Aliens.

Home destroyed or condemned. If your home was destroyed or condemned, any gain (for example, because of insurance proceeds you received) qualifies for the exclusion.

Any part of the gain that cannot be excluded (because it is more than the maximum exclusion) can be postponed under the rules explained in:

- Publication 547, in the case of a home that was destroyed, or
- Publication 544, chapter 1, in the case of a home that was condemned.

Sale of remainder interest. Subject to the other rules in this chapter, you can choose to exclude gain from the sale of a remainder interest in your home. If you make this choice, you cannot choose to exclude gain from your sale of any other interest in the home that you sell separately.

Exception for sales to related persons. You cannot exclude gain from the sale of a remainder interest in your home to a related person. Related persons include your brothers, sisters, half-brothers, half-sisters, spouse, ancestors (parents, grandparents, etc.), and lineal descendants (children, grandchildren, etc.). Related persons also include certain corporations, partnerships, trusts, and exempt organizations.

Recapturing (Paying Back) a Federal Mortgage Subsidy

If you financed your home under a federally subsidized program (loans from tax-exempt qualified mortgage bonds or loans with mortgage credit certificates), you may have to recapture all or part of the benefit you received from that program when you sell or otherwise dispose of your home. You recapture the benefit by increasing your federal income tax for the year of the sale. You may have to pay this recapture tax even if you can exclude your gain from income under the rules discussed earlier; that exclusion does not affect the recapture tax.

Loans subject to recapture rules. The recapture applies to loans that:

1. Came from the proceeds of qualified mortgage bonds, or
2. Were based on mortgage credit certificates.

The recapture also applies to assumptions of these loans.

When recapture applies. Recapture of the federal mortgage subsidy applies only if you meet both of the following conditions.

- You sell or otherwise dispose of your home at a gain within the first 9 years after the date you close your mortgage loan.
- Your income for the year of disposition is more than that year's adjusted qualifying income for your family size for that year (related to the income requirements a person must meet to qualify for the federally subsidized program).

When recapture does not apply. Recapture does not apply in any of the following situations.

- Your mortgage loan was a qualified home improvement loan (QHIL) of not more than $15,000 used for alterations, repairs, and improvements that protect or improve the basic livability or energy efficiency of your home.
- Your mortgage loan was a QHIL of not more than $150,000 in the case of a QHIL used to repair damage from Hurricane Katrina to homes in the hurricane disaster area; a QHIL funded by a qualified mortgage bond that is a qualified Gulf Opportunity Zone Bond; or a QHIL for an owner-occupied home in the Gulf Opportunity Zone (GO Zone), Rita GO Zone, or Wilma GO Zone. For more information, see Publication 4492, Information for Taxpayers Affected by Hurricanes Katrina, Rita, and Wilma. Also see Publication 4492-B, Information for Affected Taxpayers in the Midwestern Disaster Areas.
- The home is disposed of as a result of your death.
- You dispose of the home more than 9 years after the date you closed your mortgage loan.
- You transfer the home to your spouse, or to your former spouse incident to a divorce, where no gain is included in your income.
- You dispose of the home at a loss.
- Your home is destroyed by a casualty, and you replace it on its original site within 2 years after the end of the tax year when the destruction happened. The replacement period is extended for main homes destroyed in a federally declared disaster area, a Midwestern disaster area, the Kansas disaster area, and the Hurricane Katrina disaster area. For more information, see *Replacement Period* in Publication 547.
- You refinance your mortgage loan (unless you later meet the conditions listed previously under *When recapture applies*).

Notice of amounts. At or near the time of settlement of your mortgage loan, you should receive a notice that provides the federally subsidized amount and other information you will need to figure your recapture tax.

How to figure and report the recapture. The recapture tax is figured on Form 8828. If you sell your home and your mortgage is subject to recapture rules, you must file Form 8828 even if you do not owe a recapture tax. Attach Form 8828 to your Form 1040. For more information, see Form 8828 and its instructions.

16. Reporting Gains and Losses

Introduction

This chapter discusses how to report capital gains and losses from sales, exchanges, and other dispositions of investment property on Form 8949 and Schedule D (Form 1040). The discussion includes the following topics.

- How to report short-term gains and losses.
- How to report long-term gains and losses.
- How to figure capital loss carryovers.

- How to figure your tax on a net capital gain.

If you sell or otherwise dispose of property used in a trade or business or for the production of income, see Publication 544, Sales and Other Dispositions of Assets, before completing Schedule D (Form 1040).

Useful Items

You may want to see:

Publication

- ❑ **537** Installment Sales
- ❑ **544** Sales and Other Dispositions of Assets
- ❑ **550** Investment Income and Expenses

Form (and Instructions)

- ❑ **8949** Sales and Other Dispositions of Capital Assets
- ❑ **Schedule D (Form 1040)** Capital Gains and Losses
- ❑ **4797** Sales of Business Property
- ❑ **6252** Installment Sale Income
- ❑ **8582** Passive Activity Loss Limitations

Reporting Capital Gains and Losses

Report capital gains and losses on Form 8949. Complete Form 8949 before you complete line 1, 2, 3, 8, 9, or 10 of Schedule D (Form 1040).

Use Form 8949 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, and
- Nonbusiness bad debts.

Use Schedule D (Form 1040):

- To figure the overall gain or loss from transactions reported on Form 8949, and
- To report capital gain distributions not reported directly on Form 1040, line 13 (or effectively connected capital gain distributions not reported directly on Form 1040NR, line 14).

On Form 8949, enter all sales and exchanges of capital assets, including stocks, bonds, etc., and real estate (if not reported on Form 4684, 4797, 6252, 6781, or 8824). Include these transactions even if you did not receive a Form 1099-B or 1099-S (or substitute statement) for the transaction. Report short-term gains or losses in Part I. Report long-term gains or losses in Part II. Use as many Forms 8949 as you need.

Exceptions to filing Form 8949 and Schedule D (Form 1040). There are certain situations where you may not have to file Form 8949 and/or Schedule D (Form 1040).

Exception 1. You do not have to file Form 8949 or Schedule D (Form 1040) if both of the following apply.

1. You have no capital losses, and your only capital gains are capital gain distributions from Form(s) 1099-DIV, box 2a (or substitute statements).
2. None of the Form(s) 1099-DIV (or substitute statements) have an amount in box 2b (unrecaptured section 1250 gain), box 2c (section 1202 gain), or box 2d (collectibles (28%) gain).

If both the above statements apply, report your capital gain distributions directly on line 13 of Form 1040 and check the box on line 13. Also use the Qualified Dividends and Capital Gain Tax Worksheet in the Form 1040 instructions to figure your tax.

You can report your capital gain distributions on line 10 of Form 1040A, instead of on Form 1040, if both the following are true.

- None of the Forms 1099-DIV (or substitute statements) you received have an amount in box 2b, 2c, or 2d.
- You do not have to file Form 1040 for any other capital gains or losses.

Exception 2. You must file Schedule D (Form 1040), but generally do not have to file Form 8949, if *Exception 1* does not apply and your only capital gains and losses are:

- Capital gain distributions,
- A capital loss carryover from 2011,
- A gain from Form 2439 or 6252 or Part I of Form 4797,
- A gain or loss from Form 4684, 6781, or 8824, or
- A gain or loss from a partnership, S corporation, estate, or trust.

Installment sales. You cannot use the installment method to report a gain from the sale of stock or securities traded on an established securities market. You must report the entire gain in the year of sale (the year in which the trade date occurs).

Passive activity gains and losses. If you have gains or losses from a passive activity, you may also have to report them on Form 8582. In some cases, the loss may be limited under the passive activity rules. Refer to Form 8582 and its separate instructions for more information about reporting capital gains and losses from a passive activity.

Form 1099-B transactions. If you sold property, such as stocks, bonds, or certain commodities, through a broker, you should receive Form 1099-B or substitute statement from the broker. Use the Form 1099-B or the substitute statement to complete Form 8949. If you sold a covered security in 2012, your broker will send you a Form 1099-B (or substitute statement) that shows your basis. This will help you complete Form 8949. Generally, a covered security is a security you acquired after 2010, with certain exceptions explained in the Instructions for Form 8949.

Report the gross proceeds shown in box 2a of Form 1099-B as the sales price in column (d) of either Part I or Part II of Form 8949, whichever applies. However, if the broker advises you, in box 2a of Form 1099-B, that gross proceeds (sales price) less commissions and option premiums were reported to the IRS, enter that net sales price in column (d) of either Part I or Part II of Form 8949, whichever applies.

Include in column (g) any expense of sale, such as broker's fees, commissions, state and local transfer taxes, and option premiums, unless you reported the net sales price in column (d). If you include an expense of sale in column (g), enter "E" in column (f).

Form 1099-CAP transactions. If a corporation in which you own stock has had a change in control or a substantial change in capital structure, you should receive Form 1099-CAP or a substitute statement from the corporation. Use the Form 1099-CAP or substitute statement to fill in Form 8949. If your computations show that you would have a loss because of the change, do not enter any amounts on Form 8949 or Schedule D (Form 1040). You cannot claim a loss on Schedule D (Form 1040) as a result of this transaction.

Report the aggregate amount received shown in box 2 of Form 1099-CAP as the sales price in column (d) of either Part I or Part II of Form 8949, whichever applies.

Form 1099-S transactions. If you sold or traded reportable real estate, you generally should receive from the real estate reporting person a Form 1099-S showing the gross proceeds.

"Reportable real estate" is defined as any present or future ownership interest in any of the following:

- Improved or unimproved land, including air space,
- Inherently permanent structures, including any residential, commercial, or industrial building,
- A condominium unit and its accessory fixtures and common elements, including land, and
- Stock in a cooperative housing corporation (as defined in section 216 of the Internal Revenue Code).

A "real estate reporting person" could include the buyer's attorney, your attorney, the title or escrow company, a mortgage lender, your broker, the buyer's broker, or the person acquiring the biggest interest in the property.

Your Form 1099-S will show the gross proceeds from the sale or exchange in box 2. See the Instructions for Form 8949 and the Instructions for Schedule D (Form 1040) for how to report these transactions and include them in Part I or Part II of Form 8949 as appropriate. However, report like-kind exchanges on Form 8824 instead.

It is unlawful for any real estate reporting person to separately charge you for complying with the requirement to file Form 1099-S.

Nominees. If you receive gross proceeds as a nominee (that is, the gross proceeds are in your name but actually belong to someone else), see the Instructions for Form 8949 for how to report these amounts on Form 8949.

File Form 1099-B or Form 1099-S with the IRS. If you received gross proceeds as a nominee in 2012, you must file a Form 1099-B or Form 1099-S for those proceeds with the IRS. Send the Form 1099-B or Form 1099-S with a Form 1096, Annual Summary and Transmittal of U.S. Information Returns, to your Internal Revenue Service Center by February 28, 2013 (April 1, 2013, if you file Form 1099-B or Form 1099-S electronically). Give the actual owner of the proceeds Copy B of the Form 1099-B or Form 1099-S by February 15, 2013. On Form 1099-B, you should be listed as the "Payer." The other owner should be listed as the "Recipient." On Form 1099-S, you should be listed as the "Filer." The other owner should be listed as the "Transferor." You do not, however, have to file a Form 1099-B or Form 1099-S to show proceeds for your spouse. For more information about the reporting requirements and the penalties for failure to file (or furnish) certain information returns, see the General Instructions for Certain Information Returns. If you are filing electronically see Publication 1220.

Sale of property bought at various times. If you sell a block of stock or other property that you bought at various times, report the short-term gain or loss from the sale on one line in Part I of Form 8949, and the long-term gain or loss on one line in Part II of Form 8949. Write "Various" in column (b) for the "Date acquired."

Sale expenses. On Form 8949, include in column (g) any expense of sale, such as broker's fees, commissions, state and local transfer taxes, and option premiums, unless you reported the net sales price in column (d). If you include an expense of sale in column (g), enter "E" in column (f).

For more information about adjustments to basis, see chapter 13.

Short-term gains and losses. Capital gain or loss on the sale or trade of investment property held 1 year or less is a short-term capital gain or loss. You report it in Part I of Form 8949.

You combine your share of short-term capital gain or loss from partnerships, S corporations, estates, and trusts, and any short-term capital loss carryover, with your other short-term capital gains and losses to figure your net short-term capital gain or loss on line 7 of Schedule D (Form 1040).

Long-term gains and losses. A capital gain or loss on the sale or trade of investment property held more than 1 year is a long-term capital gain or loss. You report it in Part II of Form 8949.

You report the following in Part II of Schedule D (Form 1040):

- Undistributed long-term capital gains from a mutual fund (or other regulated investment company) or real estate investment trust (REIT),
- Your share of long-term capital gains or losses from partnerships, S corporations, estates, and trusts,
- All capital gain distributions from mutual funds and REITs not reported directly on line 10 of Form 1040A or line 13 of Form 1040, and
- Long-term capital loss carryovers.

The result after combining these items with your other long-term capital gains and losses is your net long-term capital gain or loss (Schedule D (Form 1040), line 15).

Total net gain or loss. To figure your total net gain or loss, combine your net short-term capital gain or loss (Schedule D (Form 1040), line 7) with your net long-term capital gain or loss (Schedule D (Form 1040), line 15). Enter the result on Schedule D (Form 1040), Part III, line 16. If your losses are more than your gains, see *Capital Losses*, next. If both lines 15 and 16 of Schedule D (Form 1040) are gains and your Taxable Income on your Form 1040 is more than zero, see *Capital Gain Tax Rates*, later.

Capital Losses

If your capital losses are more than your capital gains, you can claim a capital loss deduction. Report the amount of the deduction on line 13 of Form 1040, in parentheses.

Limit on deduction. Your allowable capital loss deduction, figured on Schedule D (Form 1040), is the lesser of:

- $3,000 ($1,500 if you are married and file a separate return), or
- Your total net loss as shown on line 16 of Schedule D (Form 1040).

You can use your total net loss to reduce your income dollar for dollar, up to the $3,000 limit.

Capital loss carryover. If you have a total net loss on line 16 of Schedule D (Form 1040) that is more than the yearly limit on capital loss deductions, you can carry over the unused part to the next year and treat it as if you had incurred it in that next year. If part of the loss is still unused, you can carry it over to later years until it is completely used up.

When you figure the amount of any capital loss carryover to the next year, you must take the current year's allowable deduction into account, whether or not you claimed it and whether or not you filed a return for the current year.

When you carry over a loss, it remains long term or short term. A long-term capital loss you carry over to the next tax year will reduce that year's long-term capital gains before it reduces that year's short-term capital gains.

Figuring your carryover. The amount of your capital loss carryover is the amount of your total net loss that is more than the lesser of:

1. Your allowable capital loss deduction for the year, or
2. Your taxable income increased by your allowable capital loss deduction for the year and your deduction for personal exemptions.

If your deductions are more than your gross income for the tax year, use your negative taxable income in computing the amount in item (2).

Complete the Capital Loss Carryover Worksheet in the Instructions for Schedule D or Publication 550 to determine the part of your capital loss for 2012 that you can carry over to 2013.

Example. Bob and Gloria sold securities in 2012. The sales resulted in a capital loss of $7,000. They had no other capital transactions. Their taxable income was $26,000. On their joint 2012 return, they can deduct $3,000. The unused part of the loss, $4,000 ($7,000 − $3,000), can be carried over to 2013.

If their capital loss had been $2,000, their capital loss deduction would have been $2,000. They would have no carryover.

Use short-term losses first. When you figure your capital loss carryover, use your short-term capital losses first, even if you incurred them after a long-term capital loss. If you have not reached the limit on the capital loss deduction after using the short-term capital losses, use the long-term capital losses until you reach the limit.

Decedent's capital loss. A capital loss sustained by a decedent during his or her last tax year (or carried over to that year from an earlier year) can be deducted only on the final income tax return filed for the decedent. The capital loss limits discussed earlier still apply in this situation. The decedent's estate cannot deduct any of the loss or carry it over to following years.

Joint and separate returns. If you and your spouse once filed separate returns and are now filing a joint return, combine your separate capital loss carryovers. However, if you and your spouse once filed a joint return and are now filing separate returns, any capital loss carryover from the joint return can be deducted only on the return of the spouse who actually had the loss.

Capital Gain Tax Rates

The tax rates that apply to a net capital gain are generally lower than the tax rates that apply to other income. These lower rates are called the maximum capital gain rates.

The term "net capital gain" means the amount by which your net long-term capital gain for the year is more than your net short-term capital loss.

For 2012, the maximum capital gain rates are 0%, 15%, 25%, or 28%. See Table 16-1 for details.

TIP *If you figure your tax using the maximum capital gain rate and the regular tax computation results in a lower tax, the regular tax computation applies.*

Example. All of your net capital gain is from selling collectibles, so the capital gain rate would be 28%. Because you are single and your taxable income is $25,000, none of your taxable income will be taxed above the 15% rate. The 28% rate does not apply.

Investment interest deducted. If you claim a deduction for investment interest, you may have to reduce the amount of your net capital gain that is eligible for the capital gain tax rates. Reduce it by the amount of the net capital gain you choose to include in investment income when figuring the limit on your investment interest deduction. This is done on the Schedule D Tax Worksheet or the Qualified Dividends and Capital Gain Tax Worksheet. For more information

Table 16-1. **What Is Your Maximum Capital Gain Rate?**

IF your net capital gain is from ...	**THEN your maximum capital gain rate is ...**
a collectibles gain	**28%**
an eligible gain on qualified small business stock minus the section 1202 exclusion	**28%**
an unrecaptured section 1250 gain	**25%**
other gain[1] and the regular tax rate that would apply is 25% or higher	**15%**
other gain[1] and the regular tax rate that would apply is lower than 25%	**0%**

[1] Other gain means any gain that is not collectibles gain, gain on qualified small business stock, or unrecaptured section 1250 gain.

about the limit on investment interest, see *Interest Expenses* in chapter 3 of Publication 550.

Collectibles gain or loss. This is gain or loss from the sale or trade of a work of art, rug, antique, metal (such as gold, silver, and platinum bullion), gem, stamp, coin, or alcoholic beverage held more than 1 year.

Collectibles gain includes gain from sale of an interest in a partnership, S corporation, or trust due to unrealized appreciation of collectibles.

Gain on qualified small business stock. If you realized a gain from qualified small business stock that you held more than 5 years, you generally can exclude up to 50% of your gain from income. The exclusion can be up to 75% for stock acquired after February 17, 2009 (100% for stock acquired after September 27, 2010, and before January 1, 2012). The exclusion can be up to 60% for certain empowerment zone business stock. The eligible gain minus your section 1202 exclusion is a 28% rate gain. See *Gains on Qualified Small Business Stock* in chapter 4 of Publication 550.

Unrecaptured section 1250 gain. Generally, this is any part of your capital gain from selling section 1250 property (real property) that is due to depreciation (but not more than your net section 1231 gain), reduced by any net loss in the 28% group. Use the Unrecaptured Section 1250 Gain Worksheet in the Schedule D (Form 1040) instructions to figure your unrecaptured section 1250 gain. For more information about section 1250 property and section 1231 gain, see chapter 3 of Publication 544.

Tax computation using maximum capital gains rates. Use the Qualified Dividends and Capital Gain Tax Worksheet or the Schedule D Tax Worksheet (whichever applies) to figure your tax if you have qualified dividends or net capital gain. You have net capital gain if Schedule D (Form 1040), lines 15 and 16, are both gains.

Schedule D Tax Worksheet. Use the Schedule D Tax Worksheet in the Schedule D (Form 1040) instructions to figure your tax if:

- You have to file Schedule D (Form 1040), and
- Schedule D (Form 1040), line 18 (28% rate gain) or line 19 (unrecaptured section 1250 gain), is more than zero.

Qualified Dividends and Capital Gain Tax Worksheet. If you do not have to use the Schedule D Tax Worksheet (as explained above) and any of the following apply, use the Qualified Dividends and Capital Gain Tax Worksheet in the instructions for Form 1040 or Form 1040A (whichever you file) to figure your tax.

- You received qualified dividends. (See *Qualified Dividends* in chapter 8.)
- You do not have to file Schedule D (Form 1040) and you received capital gain distributions. (See *Exceptions to filing Form 8949 and Schedule D (Form 1040)*, earlier.)
- Schedule D (Form 1040), lines 15 and 16, are both more than zero.

Alternative minimum tax. These capital gain rates are also used in figuring alternative minimum tax.

Part Four.

Adjustments to Income

The three chapters in this part discuss some of the adjustments to income that you can deduct in figuring your adjusted gross income. These chapters cover:

- *Contributions you make to traditional individual retirement arrangements (IRAs) — chapter 17,*
- *Alimony you pay — chapter 18, and*
- *Student loan interest you pay — chapter 19.*

Other adjustments to income are discussed elsewhere. See Table V below.

Table V. **Other Adjustments to Income**

Use this table to find information about other adjustments to income not covered in this part of the publication.

IF you are looking for more information about the deduction for...	**THEN see...**
Certain business expenses of reservists, performing artists, and fee-basis officials	*Chapter 26*.
Contributions to a health savings account	Publication 969, Health Savings Accounts and Other Tax-Favored Health Plans.
Moving expenses	Publication 521, Moving Expenses.
Part of your self-employment tax	*Chapter 22*.
Self-employed health insurance	*Chapter 21*.
Payments to self-employed SEP, SIMPLE, and qualified plans	Publication 560, Retirement Plans for Small Business (SEP, SIMPLE, and Qualified Plans).
Penalty on the early withdrawal of savings	*Chapter 7*.
Contributions to an Archer MSA	Publication 969.
Reforestation amortization or expense	Chapters 7 and 8 of Publication 535, Business Expenses.
Contributions to Internal Revenue Code section 501(c)(18)(D) pension plans	Publication 525, Taxable and Nontaxable Income.
Expenses from the rental of personal property	*Chapter 12*.
Certain required repayments of supplemental unemployment benefits (sub-pay)	*Chapter 12*.
Foreign housing costs	Chapter 4 of Publication 54, Tax Guide for U.S. Citizens and Resident Aliens Abroad.
Jury duty pay given to your employer	*Chapter 12*.
Contributions by certain chaplains to Internal Revenue Code section 403(b) plans	Publication 517, Social Security and Other Information for Members of the Clergy and Religious Workers.
Attorney fees and certain costs for actions involving certain unlawful discrimination claims or awards to whistleblowers	Publication 525.
Domestic production activities deduction	Form 8903, Domestic Production Activities Deduction.

17. Individual Retirement Arrangements (IRAs)

What's New for 2012

Modified AGI limit for traditional IRA contributions increased. For 2012, if you were covered by a retirement plan at work, your deduction for contributions to a traditional IRA is reduced (phased out) if your modified AGI is:

- More than $92,000 but less than $112,000 for a married couple filing a joint return or a qualifying widow(er),
- More than $58,000 but less than $68,000 for a single individual or head of household, or
- Less than $10,000 for a married individual filing a separate return.

If you either lived with your spouse or file a joint return, and your spouse was covered by a retirement plan at work, but you were not, your deduction is phased out if your modified AGI is more than $173,000 but less than $183,000. If your modified AGI is $183,000 or more, you cannot take a deduction for contributions to a traditional IRA. See *How Much Can You Deduct*, later.

Modified AGI limit for Roth IRA contributions increased. For 2012, your Roth IRA contribution limit is reduced (phased out) in the following situations.

- Your filing status is married filing jointly or qualifying widow(er) and your modified AGI is at least $173,000. You cannot make a Roth IRA contribution if your modified AGI is $183,000 or more.
- Your filing status is single, head of household, or married filing separately and you did not live with your spouse at any time in 2012 and your modified AGI is at least $110,000. You cannot make a Roth IRA contribution if your modified AGI is $125,000 or more.
- Your filing status is married filing separately, you lived with your spouse at any time during the year, and your modified AGI is more than -0-. You cannot make a Roth IRA contribution if your modified AGI is $10,000 or more.

See *Can You Contribute to a Roth IRA*, later.

Qualified charitable distributions (QCD). The provision that excludes up to $100,000 of qualified charitable distributions (QCD) from income has been extended. You can elect to treat a QCD made in January 2013 as if it were made in 2012. Additionally, any portion of a distribution from an IRA in December 2012 contributed as cash (or cash equivalent) to a charity before February 1, 2013 can be treated as a QCD for 2012 if it meets certain requirements. Both these transactions can count towards your minimum required distributions for 2012. See Pub. 590 for more information.

Airline payments. On February 14, 2012, the FAA Modernization and Reform Act was signed into law. This new law allows qualified airline employees to roll over up to 90% of all airline payments received to a traditional IRA. It would also allow qualified airline employees who previously rolled over any airline payments to a Roth IRA to transfer a portion of the rollover contribution (including any allocable income or (loss)) as a rollover contribution to a traditional IRA, limited to 90% of all airline payments received. Generally, the rollover contribution to the traditional IRA must be made within 180 days from the date you received the airline payment, or before August 14, 2012, whichever is later. For more information, see Publication 590.

What's New for 2013

Traditional IRA contribution and deduction limit. The contribution limit to your traditional IRA for 2013 will be increased to the smaller of the following amounts:

- $5,500, or
- Your taxable compensation for the year.

If you were age 50 or older before 2014, the most that can be contributed to your traditional IRA for 2013 will be the smaller of the following amounts:

- $6,500, or
- Your taxable compensation for the year.

For more information, see *How Much Can Be Contributed?* later.

Roth IRA contribution limit. If contributions on your behalf are made only to Roth IRAs, your contribution limit for 2013 will generally be the lesser of:

- $5,500, or
- Your taxable compensation for the year.

If you were age 50 or older before 2014 and contributions on your behalf were made only to Roth IRAs, your contribution limit for 2013 will generally be the lesser of:

- $6,500, or
- Your taxable compensation for the year.

However, if your modified adjusted gross income (AGI) is above a certain amount, your contribution limit may be reduced.

For more information, see *How Much Can Be Contributed?* under *Can You Contribute to a Roth IRA?* later.

Modified AGI limit for traditional IRA contributions increased. For 2013, if you are covered by a retirement plan at work, your deduction for contributions to a traditional IRA is reduced (phased out) if your modified AGI is:

- More than $95,000 but less than $115,000 for a married couple filing a joint return or a qualifying widow(er),
- More than $59,000 but less than $69,000 for a single individual or head of household, or
- Less than $10,000 for a married individual filing a separate return.

If you either live with your spouse or file a joint return, and your spouse is covered by a retirement plan at work, but you are not, your deduction is phased out if your modified AGI is more than $178,000 but less than $188,000. If your modified AGI is $188,000 or more, you cannot take a deduction for contributions to a traditional IRA.

Modified AGI limit for Roth IRA contributions increased. For 2013, your Roth IRA contribution limit is reduced (phased out) in the following situations.

- Your filing status is married filing jointly or qualifying widow(er) and your modified AGI is at least $178,000. You cannot make a Roth IRA contribution if your modified AGI is $188,000 or more.
- Your filing status is single, head of household, or married filing separately and you did not live with your spouse at any time in 2013 and your modified AGI is at least $112,000. You cannot make a Roth IRA contribution if your modified AGI is $127,000 or more.
- Your filing status is married filing separately, you lived with your spouse at any time during the year, and your modified AGI is more than -0-. You cannot make a Roth IRA contribution if your modified AGI is $10,000 or more.

Reminders

Rollovers or conversions to a Roth IRA in 2010. If you rolled over or converted an amount to your Roth IRA in 2010 that you did not elect to include in income for 2010, you are required to include your 2010 rollover or conversion in income for 2011 and 2012. See Publication 590 for information on how much to include in your income for 2012.

Contributions to both traditional and Roth IRAs. For information on your combined contribution limit if you contribute to both traditional and Roth IRAs, see *Roth IRAs and traditional IRAs* under *How Much Can Be Contributed?* in *Roth IRAs*, later.

Statement of required minimum distribution. If a minimum distribution from your IRA is required, the trustee, custodian, or issuer that held the IRA at the end of the preceding year must either report the amount of the required minimum distribution to you, or offer to calculate it for you. The report or offer must include the date by which the amount must be distributed.

The report is due January 31 of the year in which the minimum distribution is required. It can be provided with the year-end fair market value statement that you normally get each year. No report is required for IRAs of owners who have died.

IRA interest. Although interest earned from your IRA is generally not taxed in the year earned, it is not tax-exempt interest. Tax on your traditional IRA is generally deferred until you take a distribution. Do not report this interest on your tax return as tax-exempt interest.

Form 8606. To designate contributions as nondeductible, you must file Form 8606, Nondeductible IRAs.

Disaster-related tax relief. Special rules apply to the use of retirement funds (including IRAs) by qualified individuals who suffered an economic loss as a result of the severe storms in the Midwestern disaster areas in 2008. For more information on these special rules see *Tax Relief for Midwestern Disaster Areas* in chapter 4 of Publication 590.

TIP *The term "50 or older" is used several times in this chapter. It refers to an IRA owner who is age 50 or older by the end of the tax year.*

Introduction

An individual retirement arrangement (IRA) is a personal savings plan that gives you tax advantages for setting aside money for your retirement.

This chapter discusses the following topics.

- The rules for a traditional IRA (any IRA that is not a Roth or SIMPLE IRA).
- The Roth IRA, which features nondeductible contributions and tax-free distributions.

Simplified Employee Pensions (SEPs) and Savings Incentive Match Plans for Employees (SIMPLEs) are not discussed in this chapter. For more information on these plans and employees' SEP IRAs and SIMPLE IRAs that are part of these plans, see Publications 560 and 590.

For information about contributions, deductions, withdrawals, transfers, rollovers, and other transactions, see Publication 590.

Useful Items

You may want to see:

Publication

- ❑ **560** Retirement Plans for Small Business
- ❑ **590** Individual Retirement Arrangements (IRAs)

Form (and Instructions)

- ❑ **5329** Additional Taxes on Qualified Plans (including IRAs) and Other Tax-Favored Accounts
- ❑ **8606** Nondeductible IRAs

Traditional IRAs

In this chapter, the original IRA (sometimes called an ordinary or regular IRA) is referred to as a "traditional IRA." A traditional IRA is any IRA that is not a Roth IRA or a SIMPLE IRA.Two advantages of a traditional IRA are:

- You may be able to deduct some or all of your contributions to it, depending on your circumstances, and
- Generally, amounts in your IRA, including earnings and gains, are not taxed until they are distributed.

Who Can Open a Traditional IRA?

You can open and make contributions to a traditional IRA if:

- You (or, if you file a joint return, your spouse) received taxable compensation during the year, and
- You were not age 70½ by the end of the year.

What is compensation? Generally, compensation is what you earn from working. Compensation includes wages, salaries, tips, professional fees, bonuses, and other amounts you receive for providing personal services. The IRS treats as compensation any amount properly shown in box 1 (Wages, tips, other compensation) of Form W-2, Wage and Tax Statement, provided that amount is reduced by any amount properly shown in box 11 (Nonqualified plans).

Scholarship and fellowship payments are compensation for this purpose only if shown in box 1 of Form W-2.

Compensation also includes commissions and taxable alimony and separate maintenance payments.

Self-employment income. If you are self-employed (a sole proprietor or a partner), compensation is the net earnings from your trade or business (provided your personal services are a material income-producing factor) reduced by the total of:

- The deduction for contributions made on your behalf to retirement plans, and
- The deductible part of your self-employment tax.

Compensation includes earnings from self-employment even if they are not subject to self-employment tax because of your religious beliefs.

Nontaxable combat pay. For IRA purposes, if you were a member of the U.S. Armed Forces, your compensation includes any nontaxable combat pay you receive.

What is not compensation? Compensation does not include any of the following items.

- Earnings and profits from property, such as rental income, interest income, and dividend income.
- Pension or annuity income.
- Deferred compensation received (compensation payments postponed from a past year).
- Income from a partnership for which you do not provide services that are a material income-producing factor.
- Conservation Reserve Program (CRP) payments reported on Schedule SE (Form 1040), line 1b.
- Any amounts (other than combat pay) you exclude from income, such as foreign earned income and housing costs.

When and How Can a Traditional IRA Be Opened?

You can open a traditional IRA at any time. However, the time for making contributions for any year is limited. See *When Can Contributions Be Made*, later.

You can open different kinds of IRAs with a variety of organizations. You can open an IRA at a bank or other financial institution or with a mutual fund or life insurance company. You can also open an IRA through your stockbroker. Any IRA must meet Internal Revenue Code requirements.

Kinds of traditional IRAs. Your traditional IRA can be an individual retirement account or annuity. It can be part of either a simplified employee pension (SEP) or an employer or employee association trust account.

How Much Can Be Contributed?

There are limits and other rules that affect the amount that can be contributed to a traditional IRA. These limits and other rules are explained below.

Community property laws. Except as discussed later under *Spousal IRA limit*, each spouse figures his or her limit separately, using his or her own compensation. This is the rule even in states with community property laws.

Brokers' commissions. Brokers' commissions paid in connection with your traditional IRA are subject to the contribution limit.

Trustees' fees. Trustees' administrative fees are not subject to the contribution limit.

Qualified reservist repayments. If you are (or were) a member of a reserve component and you were ordered or called to active duty after September 11, 2001, you may be able to contribute (repay) to an IRA amounts equal to any qualified reservist distributions you received. You can make these repayment contributions even if they would cause your total contributions to the IRA to be more than the general limit on contributions. To be eligible to make these repayment contributions, you must have received a qualified reservist distribution from an IRA or from a section 401(k) or 403(b) plan or similar arrangement.

For more information, see *Qualified reservist repayments* under *How Much Can Be Contributed?* in chapter 1 of Publication 590.

Contributions on your behalf to a traditional IRA reduce your limit for contributions to a Roth IRA. (See Roth IRAs, later.)

General limit. For 2012, the most that can be contributed to your traditional IRA generally is the smaller of the following amounts.

- $5,000 ($6,000 if you are 50 or older).
- Your taxable compensation (defined earlier) for the year.

This is the most that can be contributed regardless of whether the contributions are to one or more traditional IRAs or whether all or part of the contributions are nondeductible. (See *Nondeductible Contributions*, later.) Qualified reservist repayments do not affect this limit.

Example 1. Betty, who is 34 years old and single, earned $24,000 in 2012. Her IRA contributions for 2012 are limited to $5,000.

Example 2. John, an unmarried college student working part time, earned $3,500 in 2012. His IRA contributions for 2012 are limited to $3,500, the amount of his compensation.

Spousal IRA limit. For 2012, if you file a joint return and your taxable compensation is less than that of your spouse, the most that can be contributed for the year to your IRA is the smaller of the following amounts.

1. $5,000 ($6,000 if you are 50 or older).
2. The total compensation includible in the gross income of both you and your spouse for the year, reduced by the following two amounts.
   a. Your spouse's IRA contribution for the year to a traditional IRA.
   b. Any contribution for the year to a Roth IRA on behalf of your spouse.

This means that the total combined contributions that can be made for the year to your IRA and your spouse's IRA can be as much as $10,000 ($11,000 if only one of you is 50 or older, or $12,000 if both of you are 50 or older).

When Can Contributions Be Made?

As soon as you open your traditional IRA, contributions can be made to it through your chosen sponsor (trustee or other administrator). Contributions must be in the form of money (cash, check, or money order). Property cannot be contributed.

Contributions must be made by due date. Contributions can be made to your traditional IRA for a year at any time during the year or by the due date for filing your return for that year, not including extensions.

Age $70^{1}/_{2}$ rule. Contributions cannot be made to your traditional IRA for the year in which you reach age $70^{1}/_{2}$ or for any later year.

You attain age $70^{1}/_{2}$ on the date that is 6 calendar months after the 70th anniversary of your birth. If you were born on or before June 30, 1942, you cannot contribute for 2012 or any later year.

Designating year for which contribution is made. If an amount is contributed to your traditional IRA between January 1 and April 15, you should tell the sponsor which year (the current year or the previous year) the contribution is for. If you do not tell the sponsor which year it is for, the sponsor can assume, and report to the IRS, that the contribution is for the current year (the year the sponsor received it).

Filing before a contribution is made. You can file your return claiming a traditional IRA contribution before the contribution is actually made. Generally, the contribution must be made by the due date of your return, not including extensions.

Contributions not required. You do not have to contribute to your traditional IRA for every tax year, even if you can.

How Much Can You Deduct?

Generally, you can deduct the lesser of:

- The contributions to your traditional IRA for the year, or
- The general limit (or the spousal IRA limit, if it applies).

However, if you or your spouse was covered by an employer retirement plan, you may not be able to deduct this amount. See *Limit If Covered by Employer Plan*, later.

You may be able to claim a credit for contributions to your traditional IRA. For more information, see chapter 36.

Trustees' fees. Trustees' administrative fees that are billed separately and paid in connection with your traditional IRA are not deductible as IRA contributions. However, they may be deductible as a miscellaneous itemized deduction on Schedule A (Form 1040). See chapter 28.

Brokers' commissions. Brokers' commissions are part of your IRA contribution and, as such, are deductible subject to the limits.

Full deduction. If neither you nor your spouse was covered for any part of the year by an employer retirement plan, you can take a deduction for total contributions to one or more traditional IRAs of up to the lesser of:

- $5,000 ($6,000 if you are age 50 or older in 2012).
- 100% of your compensation.

This limit is reduced by any contributions made to a 501(c)(18) plan on your behalf.

Spousal IRA. In the case of a married couple with unequal compensation who file a joint return, the deduction for contributions to the traditional IRA of the spouse with less compensation is limited to the lesser of the following amounts.

1. $5,000 ($6,000 if the spouse with the lower compensation is age 50 or older in 2012).
2. The total compensation includible in the gross income of both spouses for the year reduced by the following three amounts.
   a. The IRA deduction for the year of the spouse with the greater compensation.
   b. Any designated nondeductible contribution for the year made on behalf of the spouse with the greater compensation.
   c. Any contributions for the year to a Roth IRA on behalf of the spouse with the greater compensation.

This limit is reduced by any contributions to a 501(c)(18) plan on behalf of the spouse with the lesser compensation.

Note. If you were divorced or legally separated (and did not remarry) before the end of the year, you cannot deduct any contributions to your spouse's IRA. After a divorce or legal separation, you can deduct only contributions to your own IRA. Your deductions are subject to the rules for single individuals.

Covered by an employer retirement plan. If you or your spouse was covered by an employer retirement plan at any time during the year for which contributions were made, your deduction may be further limited. This is discussed later under *Limit If Covered by Employer Plan*. Limits on the amount you can deduct do not affect the amount that can be contributed. See *Nondeductible Contributions*, later.

Are You Covered by an Employer Plan?

The Form W-2 you receive from your employer has a box used to indicate whether you were covered for the year. The “Retirement plan” box should be checked if you were covered.

Reservists and volunteer firefighters should also see *Situations in Which You Are Not Covered by an Employer Plan*, later.

If you are not certain whether you were covered by your employer's retirement plan, you should ask your employer.

Federal judges. For purposes of the IRA deduction, federal judges are covered by an employer retirement plan.

For Which Year(s) Are You Covered by an Employer Plan?

Special rules apply to determine the tax years for which you are covered by an employer plan. These rules differ depending on whether the plan is a defined contribution plan or a defined benefit plan.

Tax year. Your tax year is the annual accounting period you use to keep records and report income and expenses on your income tax return. For almost all people, the tax year is the calendar year.

Defined contribution plan. Generally, you are covered by a defined contribution plan for a tax year if amounts are contributed or allocated to your account for the plan year that ends with or within that tax year.

A defined contribution plan is a plan that provides for a separate account for each person covered by the plan. Types of defined contribution plans include profit-sharing plans, stock bonus plans, and money purchase pension plans.

Defined benefit plan. If you are eligible to participate in your employer's defined benefit plan for the plan year that ends within your tax year, you are covered by the plan. This rule applies even if you:

- Declined to participate in the plan,
- Did not make a required contribution, or
- Did not perform the minimum service required to accrue a benefit for the year.

A defined benefit plan is any plan that is not a defined contribution plan. Defined benefit plans include pension plans and annuity plans.

No vested interest. If you accrue a benefit for a plan year, you are covered by that plan even if you have no vested interest in (legal right to) the accrual.

Situations in Which You Are Not Covered by an Employer Plan

Unless you are covered under another employer plan, you are not covered by an employer plan if you are in one of the situations described below.

Social security or railroad retirement. Coverage under social security or railroad retirement is not coverage under an employer retirement plan.

Benefits from a previous employer's plan. If you receive retirement benefits from a previous employer's plan, you are not covered by that plan.

Reservists. If the only reason you participate in a plan is because you are a member of a reserve unit of the armed forces, you may not be covered by the plan. You are not covered by the plan if both of the following conditions are met.

1. The plan you participate in is established for its employees by:
   a. The United States,
   b. A state or political subdivision of a state, or
   c. An instrumentality of either (a) or (b) above.
2. You did not serve more than 90 days on active duty during the year (not counting duty for training).

Volunteer firefighters. If the only reason you participate in a plan is because you are a volunteer firefighter, you may not be covered by the plan. You are not covered by the plan if both of the following conditions are met.

1. The plan you participate in is established for its employees by:
   a. The United States,
   b. A state or political subdivision of a state, or
   c. An instrumentality of either (a) or (b) above.
2. Your accrued retirement benefits at the beginning of the year will not provide more than $1,800 per year at retirement.

Limit If Covered by Employer Plan

If either you or your spouse was covered by an employer retirement plan, you may be entitled to only a partial (reduced) deduction or no deduction at all, depending on your income and your filing status.

Your deduction begins to decrease (phase out) when your income rises above a certain amount and is eliminated altogether when it reaches a higher amount. These amounts vary depending on your filing status.

Table 17-1. **Effect of Modified AGI[1] on Deduction if You Are Covered by Retirement Plan at Work**

If you are covered by a retirement plan at work, use this table to determine if your modified AGI affects the amount of your deduction.

IF your filing status is...	AND your modified AGI is...	THEN you can take...
single	$58,000 or less	a full deduction.
or	more than $58,000 but less than $68,000	a partial deduction.
head of household	$68,000 or more	no deduction.
married filing jointly	$92,000 or less	a full deduction.
or	more than $92,000 but less than $112,000	a partial deduction.
qualifying widow(er)	$112,000 or more	no deduction.
married filing separately[2]	less than $10,000	a partial deduction.
	$10,000 or more	no deduction.

[1]Modified AGI (adjusted gross income). See *Modified adjusted gross income (AGI)*.

[2]If you did not live with your spouse at any time during the year, your filing status is considered Single for this purpose (therefore, your IRA deduction is determined under the "Single" column).

To determine if your deduction is subject to phaseout, you must determine your modified adjusted gross income (AGI) and your filing status. See *Filing status* and *Modified adjusted gross income (AGI)*, later. Then use Table 17-1 or 17-2 to determine if the phaseout applies.

Social security recipients. Instead of using Table 17-1 or Table 17-2, use the worksheets in Appendix B of Publication 590 if, for the year, all of the following apply.

- You received social security benefits.
- You received taxable compensation.
- Contributions were made to your traditional IRA.
- You or your spouse was covered by an employer retirement plan.

Use those worksheets to figure your IRA deduction, your nondeductible contribution, and the taxable portion, if any, of your social security benefits.

Deduction phaseout. If you were covered by an employer retirement plan and you did not receive any social security retirement benefits, your IRA deduction may be reduced or eliminated depending on your filing status and modified AGI as shown in Table 17-1.

If your spouse is covered. If you are not covered by an employer retirement plan, but your spouse is, and you did not receive any social security benefits, your IRA deduction may be reduced or eliminated entirely depending on your filing status and modified AGI as shown in Table 17-2.

Filing status. Your filing status depends primarily on your marital status. For this purpose, you need to know if your filing status is single or head of household, married filing jointly or qualifying widow(er), or married filing separately. If you need more information on filing status, see chapter 2.

Lived apart from spouse. If you did not live with your spouse at any time during the year and you file a separate return, your filing status, for this purpose, is single.

Modified adjusted gross income (AGI). How you figure your modified AGI depends on whether you are filing Form 1040 or Form 1040A. If you made contributions to your IRA for 2012 and received a distribution from your IRA in 2012, see Publication 590. You may be able to use Worksheet 17-1 to figure your modified AGI.

CAUTION

Do not assume that your modified AGI is the same as your compensation. Your modified AGI may include income in addition to your compensation (discussed earlier), such as interest, dividends, and income from IRA distributions.

Form 1040. If you file Form 1040, refigure the amount on the page 1 "adjusted gross income" line without taking into account any of the following eight amounts.

- IRA deduction.
- Student loan interest deduction.

Table 17-2. **Effect of Modified AGI[1] on Deduction if You Are NOT Covered by Retirement Plan at Work**

If you are not covered by a retirement plan at work, use this table to determine if your modified AGI affects the amount of your deduction.

IF your filing status is...	AND your modified AGI is...	THEN you can take...
single, head of household, or **qualifying widow(er)**	any amount	a full deduction.
married filing jointly or **separately** with a spouse who ***is not*** covered by a plan at work	any amount	a full deduction.
married filing jointly with a spouse who ***is*** covered by a plan at work	$173,000 or less	a full deduction.
	more than $173,000 but less than $183,000	a partial deduction.
	$183,000 or more	no deduction.
married filing separately with a spouse who ***is*** covered by a plan at work[2]	less than $10,000	a partial deduction.
	$10,000 or more	no deduction.

[1]Modified AGI (adjusted gross income). See *Modified adjusted gross income (AGI)*.

[2]You are entitled to the full deduction if you did not live with your spouse at any time during the year.

- Tuition and fees deduction.
- Domestic production activities deduction.
- Foreign earned income exclusion.
- Foreign housing exclusion or deduction.
- Exclusion of qualified savings bond interest shown on Form 8815, Exclusion of Interest From Series EE and I U.S. Savings Bonds Issued After 1989.
- Exclusion of employer-provided adoption benefits shown on Form 8839, Qualified Adoption Expenses.

This is your modified AGI.

Form 1040A. If you file Form 1040A, refigure the amount on the page 1 "adjusted gross income" line without taking into account any of the following amounts.

- IRA deduction.
- Student loan interest deduction.
- Tuition and fees deduction.
- Exclusion of qualified savings bond interest shown on Form 8815.

This is your modified AGI.

Both contributions for 2012 and distributions in 2012. If all three of the following apply, any IRA distributions you received in 2012 may be partly tax free and partly taxable.

- You received distributions in 2012 from one or more traditional IRAs.
- You made contributions to a traditional IRA for 2012.
- Some of those contributions may be nondeductible contributions.

If this is your situation, you must figure the taxable part of the traditional IRA distribution before you can figure your modified AGI. To do this, you can use Worksheet 1-5, Figuring the Taxable Part of Your IRA Distribution, in Publication 590.

If at least one of the above does not apply, figure your modified AGI using Worksheet 17-1, later.

How to figure your reduced IRA deduction. You can figure your reduced IRA deduction for either Form 1040 or Form 1040A by using the worksheets in chapter 1 of Publication 590. Also, the instructions for Form 1040 and Form 1040A include similar worksheets that you may be able to use instead.

Reporting Deductible Contributions

If you file Form 1040, enter your IRA deduction on line 32 of that form. If you file Form 1040A, enter your IRA deduction on line 17. You cannot deduct IRA contributions on Form 1040EZ.

Nondeductible Contributions

Although your deduction for IRA contributions may be reduced or eliminated, contributions can be made to your IRA up to the general limit or, if it applies, the spousal IRA limit. The difference between your total permitted contributions and your IRA deduction, if any, is your nondeductible contribution.

Example. Mike is 28 years old and single. In 2012, he was covered by a retirement plan at work. His salary was $57,312. His modified AGI was $69,000. Mike made a $5,000 IRA contribution for 2012. Because he was covered by a retirement plan and his modified AGI was over $68,000, he cannot deduct his $5,000 IRA contribution. He must designate this contribution as a nondeductible contribution by reporting it on Form 8606, as explained next.

Form 8606. To designate contributions as nondeductible, you must file Form 8606.

You do not have to designate a contribution as nondeductible until you file your tax return. When you file, you can even designate otherwise deductible contributions as nondeductible.

You must file Form 8606 to report nondeductible contributions even if you do not have to file a tax return for the year.

Worksheet 17-1. **Figuring Your Modified AGI**

Keep for Your Records

Use this worksheet to figure your modified adjusted gross income for traditional IRA purposes.

1.	Enter your adjusted gross income (AGI) from Form 1040, line 38, or Form 1040A, line 22, figured without taking into account the amount from Form 1040, line 32, or Form 1040A, line 17	**1.** ________
2.	Enter any student loan interest deduction from Form 1040, line 33, or Form 1040A, line 18	**2.** ________
3.	Enter any tuition and fees deduction from Form 1040, line 34, or Form 1040A, line 19	**3.** ________
4.	Enter any domestic production activities deduction from Form 1040, line 35	**4.** ________
5.	Enter any foreign earned income and/or housing exclusion from Form 2555, line 45, or Form 2555-EZ, line 18	**5.** ________
6.	Enter any foreign housing deduction from Form 2555, line 50	**6.** ________
7.	Enter any excludable savings bond interest from Form 8815, line 14	**7.** ________
8.	Enter any excluded employer-provided adoption benefits from Form 8839, line 24	**8.** ________
9.	Add lines 1 through 8. This is your **Modified AGI** for traditional IRA purposes	**9.** ________

A Form 8606 is not used for the year that you make a rollover from a qualified retirement plan to a traditional IRA and the rollover includes nontaxable amounts. In those situations, a Form 8606 is completed for the year you take a distribution from that IRA. See Form 8606 under Distributions Fully or Partly Taxable*, later.*

Failure to report nondeductible contributions. If you do not report nondeductible contributions, all of the contributions to your traditional IRA will be treated as deductible contributions when withdrawn. All distributions from your IRA will be taxed unless you can show, with satisfactory evidence, that nondeductible contributions were made.

Penalty for overstatement. If you overstate the amount of nondeductible contributions on your Form 8606 for any tax year, you must pay a penalty of $100 for each overstatement, unless it was due to reasonable cause.

Penalty for failure to file Form 8606. You will have to pay a $50 penalty if you do not file a required Form 8606, unless you can prove that the failure was due to reasonable cause.

Tax on earnings on nondeductible contributions. As long as contributions are within the contribution limits, none of the earnings or gains on contributions (deductible or nondeductible) will be taxed until they are distributed. See *When Can You Withdraw or Use IRA Assets*, later.

Cost basis. You will have a cost basis in your traditional IRA if you made any nondeductible contributions. Your cost basis is the sum of the nondeductible contributions to your IRA minus any withdrawals or distributions of nondeductible contributions.

Inherited IRAs

If you inherit a traditional IRA, you are called a beneficiary. A beneficiary can be any person or entity the owner chooses to receive the benefits of the IRA after he or she dies. Beneficiaries of a traditional IRA must include in their gross income any taxable distributions they receive.

Inherited from spouse. If you inherit a traditional IRA from your spouse, you generally have the following three choices. You can:

1. Treat it as your own IRA by designating yourself as the account owner.
2. Treat it as your own by rolling it over into your IRA, or to the extent it is taxable, into a:
   a. Qualified employer plan,
   b. Qualified employee annuity plan (section 403(a) plan),
   c. Tax-sheltered annuity plan (section 403(b) plan), or
   d. Deferred compensation plan of a state or local government (section 457 plan).
3. Treat yourself as the beneficiary rather than treating the IRA as your own.

Treating it as your own. You will be considered to have chosen to treat the IRA as your own if:

- Contributions (including rollover contributions) are made to the inherited IRA, or
- You do not take the required minimum distribution for a year as a beneficiary of the IRA.

You will only be considered to have chosen to treat the IRA as your own if:

- You are the sole beneficiary of the IRA, and
- You have an unlimited right to withdraw amounts from it.

However, if you receive a distribution from your deceased spouse's IRA, you can roll that distribution over into your own IRA within the 60-day time limit, as long as the distribution is not a required distribution, even if you are not the sole beneficiary of your deceased spouse's IRA.

Inherited from someone other than spouse. If you inherit a traditional IRA from anyone other than your deceased spouse, you cannot treat the inherited IRA as your own. This means that you cannot make any contributions to the IRA. It also means you cannot roll over any amounts into or out of the inherited IRA. However, you can make a trustee-to-trustee transfer as long as the IRA into which amounts are being moved is set up and maintained in the name of the deceased IRA owner for the benefit of you as beneficiary.

For more information, see the discussion of inherited IRAs under *Rollover From One IRA Into Another,* later.

Can You Move Retirement Plan Assets?

You can transfer, tax free, assets (money or property) from other retirement plans (including traditional IRAs) to a traditional IRA. You can make the following kinds of transfers.

- Transfers from one trustee to another.
- Rollovers.
- Transfers incident to a divorce.

Transfers to Roth IRAs. Under certain conditions, you can move assets from a traditional IRA or from a designated Roth account to a Roth IRA. You can also move assets from a qualified retirement plan to a Roth IRA. See *Can You Move Amounts Into a Roth IRA?* under *Roth IRAs,* later.

Trustee-to-Trustee Transfer

A transfer of funds in your traditional IRA from one trustee directly to another, either at your request or at the trustee's request, is not a rollover. Because there is no distribution to you, the transfer is tax free. Because it is not a rollover, it is not affected by the 1-year waiting period required between rollovers, discussed later under *Rollover From One IRA Into Another*. For information about direct transfers to IRAs from retirement plans other than IRAs, see Publication 590.

Rollovers

Generally, a rollover is a tax-free distribution to you of cash or other assets from one retirement plan that you contribute (roll over) to another retirement plan. The contribution to the second retirement plan is called a "rollover contribution."

Note. An amount rolled over tax free from one retirement plan to another is generally includible in income when it is distributed from the second plan.

Kinds of rollovers to a traditional IRA. You can roll over amounts from the following plans into a traditional IRA:

- A traditional IRA,
- An employer's qualified retirement plan for its employees,
- A deferred compensation plan of a state or local government (section 457 plan), or
- A tax-sheltered annuity plan (section 403(b) plan).

Treatment of rollovers. You cannot deduct a rollover contribution, but you must report the rollover distribution on your tax return as discussed later under *Reporting rollovers from IRAs* and under *Reporting rollovers from employer plans*.

Kinds of rollovers from a traditional IRA. You may be able to roll over, tax free, a distribution from your traditional IRA into a qualified plan. These plans include the federal Thrift Savings Fund (for federal employees), deferred compensation plans of state or local governments (section 457 plans), and tax-sheltered annuity plans (section 403(b) plans). The part of the distribution that you can roll over is the part that would otherwise be taxable (includible in your income). Qualified plans may, but are not required to, accept such rollovers.

Time limit for making a rollover contribution. You generally must make the rollover contribution by the 60th day after the day you receive the distribution from your traditional IRA or your employer's plan.

The IRS may waive the 60-day requirement where the failure to do so would be against equity or good conscience, such as in the event of a casualty, disaster, or other event beyond your reasonable control. For more information, see Publication 590.

Extension of rollover period. If an amount distributed to you from a traditional IRA or a qualified employer retirement plan is a frozen deposit at any time during the 60-day period allowed for a rollover, special rules extend the rollover period. For more information, see Publication 590.

More information. For more information on rollovers, see Publication 590.

Rollover From One IRA Into Another

You can withdraw, tax free, all or part of the assets from one traditional IRA if you reinvest them within 60 days in the same or another traditional IRA. Because this is a rollover, you cannot deduct the amount that you reinvest in an IRA.

Waiting period between rollovers. Generally, if you make a tax-free rollover of any part of a distribution from a traditional IRA, you cannot, within a 1-year period, make a tax-free rollover of any later distribution from that same IRA. You also cannot make a tax-free rollover of any amount distributed, within the same 1-year period, from the IRA into which you made the tax-free rollover.

The 1-year period begins on the date you receive the IRA distribution, not on the date you roll it over into an IRA.

Example. You have two traditional IRAs, IRA-1 and IRA-2. You make a tax-free rollover of a distribution from IRA-1 into a new traditional IRA (IRA-3). You cannot, within 1 year of the distribution from IRA-1, make a tax-free rollover of any distribution from either IRA-1 or IRA-3 into another traditional IRA.

However, the rollover from IRA-1 into IRA-3 does not prevent you from making a tax-free rollover from IRA-2 into any other traditional IRA. This is because you have not, within the last year, rolled over, tax free, any distribution from IRA-2 or made a tax-free rollover into IRA-2.

Exception. For an exception for distributions from failed financial institutions, see Publication 590.

Partial rollovers. If you withdraw assets from a traditional IRA, you can roll over part of the withdrawal tax free and keep the rest of it. The amount you keep will generally be taxable (except for the part that is a return of nondeductible contributions). The amount you keep may be subject to the 10% additional tax on early distributions, discussed later under *What Acts Result in Penalties or Additional Taxes*.

Required distributions. Amounts that must be distributed during a particular year under the required distribution rules (discussed later) are not eligible for rollover treatment.

Inherited IRAs. If you inherit a traditional IRA from your spouse, you generally can roll it over, or you can choose to make the inherited IRA your own. See *Treating it as your own*, earlier.

Not inherited from spouse. If you inherit a traditional IRA from someone other than your spouse, you cannot roll it over or allow it to receive a rollover contribution. You must withdraw the IRA assets within a certain period. For more information, see Publication 590.

Reporting rollovers from IRAs. Report any rollover from one traditional IRA to the same or another traditional IRA on lines 15a and 15b, Form 1040, or lines 11a and 11b, Form 1040A, as follows.

Enter the total amount of the distribution on Form 1040, line 15a, or Form 1040A, line 11a. If the total amount on Form 1040, line 15a, or Form 1040A, line 11a, was rolled over, enter zero on Form 1040, line 15b, or Form 1040A, line 11b. If the total distribution was not rolled over, enter the taxable portion of the part that was not rolled over on Form 1040, line 15b, or Form 1040A, line 11b. Put “Rollover” next to Form 1040, line 15b, or Form 1040A, line 11b. See your tax return instructions.

If you rolled over the distribution into a qualified plan (other than an IRA) or you make the rollover in 2013, attach a statement explaining what you did.

Rollover From Employer's Plan Into an IRA

You can roll over into a traditional IRA all or part of an eligible rollover distribution you receive from your (or your deceased spouse's):

- Employer's qualified pension, profit-sharing, or stock bonus plan;
- Annuity plan;
- Tax-sheltered annuity plan (section 403(b) plan); or
- Governmental deferred compensation plan (section 457 plan).

A qualified plan is one that meets the requirements of the Internal Revenue Code.

Eligible rollover distribution. Generally, an eligible rollover distribution is any distribution of all or part of the balance to your credit in a qualified retirement plan except the following.

1. A required minimum distribution (explained later under *When Must You Withdraw IRA Assets? (Required Minimum Distributions)*).
2. A hardship distribution.
3. Any of a series of substantially equal periodic distributions paid at least once a year over:
    a. Your lifetime or life expectancy,
    b. The lifetimes or life expectancies of you and your beneficiary, or
    c. A period of 10 years or more.
4. Corrective distributions of excess contributions or excess deferrals, and any income allocable to the excess, or of excess annual additions and any allocable gains.
5. A loan treated as a distribution because it does not satisfy certain requirements either when made or later (such as upon default), unless the participant's accrued benefits are reduced (offset) to repay the loan.
6. Dividends on employer securities.
7. The cost of life insurance coverage.

TIP *Any nontaxable amounts that you roll over into your traditional IRA become part of your basis (cost) in your IRAs. To recover your basis when you take distributions from your IRA, you must complete Form 8606 for the year of the distribution. See Form 8606 under* Distributions Fully or Partly Taxable*, later.*

Rollover by nonspouse beneficiary. A direct transfer from a deceased employee's qualified pension, profit-sharing, or stock bonus plan; annuity plan; tax-sheltered annuity (section 403(b)) plan; or governmental deferred compensation (section 457) plan to an IRA set up to receive the distribution on your behalf can be treated as an eligible rollover distribution if you are the designated beneficiary of the plan and not the employee's spouse. The IRA is treated as an inherited IRA. For more information about inherited IRAs, see *Inherited IRAs*, earlier.

Reporting rollovers from employer plans. Enter the total distribution (before income tax or other deductions were withheld) on Form 1040, line 16a, or Form 1040A, line 12a. This amount should be shown in box 1 of Form 1099-R. From this amount, subtract any contributions (usually shown in box 5 of Form 1099-R) that were taxable to you when made. From that result, subtract the amount that was rolled over either directly or within 60 days of receiving the distribution. Enter the remaining amount, even if zero, on Form 1040, line 16b, or Form 1040A, line 12b. Also, enter "Rollover" next to Form 1040, line 16b, or Form 1040A, line 12b.

Transfers Incident to Divorce

If an interest in a traditional IRA is transferred from your spouse or former spouse to you by a divorce or separate maintenance decree or a written document related to such a decree, the interest in the IRA, starting from the date of the transfer, is treated as your IRA. The transfer is tax free. For detailed information, see Publication 590.

Converting From Any Traditional IRA to a Roth IRA

Allowable conversions. You can withdraw all or part of the assets from a traditional IRA and reinvest them (within 60 days) in a Roth IRA. The amount that you withdraw and timely contribute (convert) to the Roth IRA is called a conversion contribution. If properly (and timely) rolled over, the 10% additional tax on early distributions will not apply. However, a part or all of the conversion contribution from your traditional IRA is included in your gross income.

Required distributions. You cannot convert amounts that must be distributed from your traditional IRA for a particular year (including the calendar year in which you reach age $70^{1}/_{2}$) under the required distribution rules (discussed later).

Income. You must include in your gross income distributions from a traditional IRA that you would have had to include in income if you had not converted them into a Roth IRA. These amounts are normally included in income on your return for the year that you converted them from a traditional IRA to a Roth IRA.

However, for 2010 conversions, any amounts you must include in income are included in income in equal amounts in 2011 and 2012 unless you elected to include the entire amount in income in 2010. See *Special rules for 2010 conversions from traditional IRAs to Roth IRAs* in Publication 590 for more information.

You do not include in gross income any part of a distribution from a traditional IRA that is a return of your basis, as discussed later.

You must file Form 8606 to report 2012 conversions from traditional, SEP, or SIMPLE IRAs to a Roth IRA in 2012 (unless you recharacterized the entire amount) and to figure the amount to include in income.

If you must include any amount in your gross income, you may have to increase your withholding or make estimated tax payments. See chapter 4.

Recharacterizations

You may be able to treat a contribution made to one type of IRA as having been made to a different type of IRA. This is called recharacterizing the contribution. More detailed information is in Publication 590.

How to recharacterize a contribution. To recharacterize a contribution, you generally must have the contribution transferred from the first IRA (the one to which it was made) to the second IRA in a trustee-to-trustee transfer. If the transfer is made by the due date (including extensions) for your tax return for the year during which the contribution was made, you can elect to treat the contribution as having been originally made to the second IRA instead of to the first IRA. If you recharacterize your contribution, you must do all three of the following.

- Include in the transfer any net income allocable to the contribution. If there was a loss, the net income you must transfer may be a negative amount.
- Report the recharacterization on your tax return for the year during which the contribution was made.
- Treat the contribution as having been made to the second IRA on the date that it was actually made to the first IRA.

No deduction allowed. You cannot deduct the contribution to the first IRA. Any net income you transfer with the recharacterized contribution is treated as earned in the second IRA.

Required notifications. To recharacterize a contribution, you must notify both the trustee of the first IRA (the one to which the contribution was actually made) and the trustee of the second IRA (the one to which the contribution is being moved) that you have elected to treat the contribution as having been made to the second IRA rather than the first. You must make the notifications by the date of the transfer. Only one notification is required if both IRAs are maintained by the same trustee. The notification(s) must include all of the following information.

- The type and amount of the contribution to the first IRA that is to be recharacterized.
- The date on which the contribution was made to the first IRA and the year for which it was made.
- A direction to the trustee of the first IRA to transfer in a trustee-to-trustee transfer the amount of the contribution and any net income (or loss) allocable to the contribution to the trustee of the second IRA.
- The name of the trustee of the first IRA and the name of the trustee of the second IRA.
- Any additional information needed to make the transfer.

Reporting a recharacterization. If you elect to recharacterize a contribution to one IRA as a contribution to another IRA, you must report the recharacterization on your tax return as directed by Form 8606 and its instructions. You must treat the contribution as having been made to the second IRA.

When Can You Withdraw or Use IRA Assets?

There are rules limiting use of your IRA assets and distributions from it. Violation of the rules generally results in additional taxes in the year of violation. See *What Acts Result in Penalties or Additional Taxes*, later.

Contributions returned before the due date of return. If you made IRA contributions in 2012, you can withdraw them tax free by the due date of your return. If you have an extension of time to file your return, you can withdraw them tax free by the extended due date. You can do this if, for each contribution you withdraw, both of the following conditions apply.

- You did not take a deduction for the contribution.
- You withdraw any interest or other income earned on the contribution. You can take into account any loss on the contribution while it was in the IRA when calculating the amount that must be withdrawn. If there was a loss, the net income earned on the contribution may be a negative amount.

Note. To calculate the amount you must withdraw, see Publication 590.

Earnings includible in income. You must include in income any earnings on the contributions you withdraw. Include the earnings in income for the year in which you made the contributions, not in the year in which you withdraw them.

CAUTION *Generally, except for any part of a withdrawal that is a return of nondeductible contributions (basis), any withdrawal of your contributions after the due date (or extended due date) of your return will be treated as a taxable distribution. Excess contributions can also be recovered tax free as discussed under* What Acts Result in Penalties or Additional Taxes*, later.*

Early distributions tax. The 10% additional tax on distributions made before you reach age 59½ does not apply to these tax-free withdrawals of your contributions. However, the distribution of interest or other income must be reported on Form 5329 and, unless the distribution qualifies as an exception to the age 59½ rule, it will be subject to this tax.

When Must You Withdraw IRA Assets? (Required Minimum Distributions)

You cannot keep funds in a traditional IRA indefinitely. Eventually they must be distributed. If there are no distributions, or if the distributions are not large enough, you may have to pay a 50% excise tax on the amount not distributed as required. See *Excess Accumulations (Insufficient Distributions)*, later. The requirements for distributing IRA funds differ depending on whether you are the IRA owner or the beneficiary of a decedent's IRA.

Required minimum distribution. The amount that must be distributed each year is referred to as the required minimum distribution.

Required distributions not eligible for rollover. Amounts that must be distributed (required minimum distributions) during a particular year are not eligible for rollover treatment.

IRA owners. If you are the owner of a traditional IRA, you must generally start receiving distributions from your IRA by April 1 of the year following the year in which you reach age 70½. April 1 of the year following the year in which you reach age 70½ is referred to as the required beginning date.

Distributions by the required beginning date. You must receive at least a minimum amount for each year starting with the year you reach age 70½ (your 70½ year). If you do not (or did not) receive that minimum amount in your 70½ year, then you must receive distributions for your 70½ year by April 1 of the next year.

If an IRA owner dies after reaching age 70½, but before April 1 of the next year, no minimum distribution is required because death occurred before the required beginning date.

CAUTION *Even if you begin receiving distributions before you attain age 70½, you must begin calculating and receiving required minimum distributions by your required beginning date.*

Distributions after the required beginning date. The required minimum distribution for any year after the year you turn 70½ must be made by December 31 of that later year.

Beneficiaries. If you are the beneficiary of a decedent's traditional IRA, the requirements for distributions from that IRA generally depend on whether the IRA owner died before or after the required beginning date for distributions.

More information. For more information, including how to figure your minimum required distribution each year and how to figure your required distribution if you are a beneficiary of a decedent's IRA, see Publication 590.

Are Distributions Taxable?

In general, distributions from a traditional IRA are taxable in the year you receive them.

Exceptions. Exceptions to distributions from traditional IRAs being taxable in the year you receive them are:

- Rollovers,
- Qualified charitable distributions (QCD), discussed later,
- Tax-free withdrawals of contributions, discussed earlier, and
- The return of nondeductible contributions, discussed later under *Distributions Fully or Partly Taxable*.

Although a conversion of a traditional IRA is considered a rollover for Roth IRA purposes, it is not an exception to the rule that distributions from a traditional IRA are taxable in the year you receive them. Conversion distributions are includible in your gross income subject to this rule and the special rules for conversions explained in Publication 590.

Qualified charitable distributions (QCD). A QCD is generally a nontaxable distribution made directly by the trustee of your IRA to an organization eligible to receive tax-deductible contributions. Special rules apply if you made a qualified charitable distribution in January 2013 that you elected to treat as made in 2012, or if you took a distribution in December 2012 and contributed any portion of it to a charity before February 1, 2013. Both these transactions can count towards your minimum required distributions for 2012. See *Qualified Charitable Distributions* in Publication 590 for more information.

Ordinary income. Distributions from traditional IRAs that you include in income are taxed as ordinary income.

No special treatment. In figuring your tax, you cannot use the 10-year tax option or capital gain treatment that applies to lump-sum distributions from qualified retirement plans.

Distributions Fully or Partly Taxable

Distributions from your traditional IRA may be fully or partly taxable, depending on whether your IRA includes any nondeductible contributions.

Fully taxable. If only deductible contributions were made to your traditional IRA (or IRAs, if you have more than one), you have no basis in your IRA. Because you have no basis in your IRA, any distributions are fully taxable when received. See Reporting taxable distributions on your return, later.

Partly taxable. If you made nondeductible contributions or rolled over any after-tax amounts to any of your traditional IRAs, you have a cost basis (investment in the contract) equal to the amount of those contributions. These nondeductible contributions are not taxed when they are distributed to you. They are a return of your investment in your IRA.

Only the part of the distribution that represents nondeductible contributions and rolled over after-tax amounts (your cost basis) is tax free. If nondeductible contributions have been made or after-tax amounts have been rolled over to your IRA, distributions consist partly of nondeductible contributions (basis) and partly of deductible contributions, earnings, and gains (if there are any). Until all of your basis has been distributed, each distribution is partly nontaxable and partly taxable.

Form 8606. You must complete Form 8606 and attach it to your return if you receive a distribution from a traditional IRA and have ever made nondeductible contributions or rolled over after-tax amounts to any of your traditional IRAs. Using the form, you will figure the nontaxable distributions for 2012 and your total IRA basis for 2012 and earlier years.

Note. If you are required to file Form 8606, but you are not required to file an income tax return, you still must file Form 8606. Send it to the IRS at the time and place you would otherwise file an income tax return.

Distributions reported on Form 1099-R. If you receive a distribution from your traditional IRA, you will receive Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc., or a similar statement. IRA distributions are shown in boxes 1 and 2a of Form 1099-R. A number or letter code in box 7 tells you what type of distribution you received from your IRA.

Withholding. Federal income tax is withheld from distributions from traditional IRAs unless you choose not to have tax withheld. See chapter 4.

IRA distributions delivered outside the United States. In general, if you are a U.S. citizen or resident alien and your home address is outside the United States or its possessions, you cannot choose exemption from withholding on distributions from your traditional IRA.

Reporting taxable distributions on your return. Report fully taxable distributions, including early distributions on Form 1040, line 15b, or Form 1040A, line 11b (no entry is required on Form 1040, line 15a, or Form 1040A, line 11a). If only part of the distribution is taxable, enter the total amount on Form 1040, line 15a, or Form 1040A, line 11a, and the taxable part on Form 1040, line 15b, or Form 1040A, line 11b. You cannot report distributions on Form 1040EZ.

What Acts Result in Penalties or Additional Taxes?

The tax advantages of using traditional IRAs for retirement savings can be offset by additional taxes and penalties if you do not follow the rules.

There are additions to the regular tax for using your IRA funds in prohibited transactions. There are also additional taxes for the following activities.

- Investing in collectibles.
- Making excess contributions.
- Taking early distributions.
- Allowing excess amounts to accumulate (failing to take required distributions).

There are penalties for overstating the amount of nondeductible contributions and for failure to file a Form 8606, if required.

Prohibited Transactions

Generally, a prohibited transaction is any improper use of your traditional IRA by you, your beneficiary, or any disqualified person.

Disqualified persons include your fiduciary and members of your family (spouse, ancestor, lineal descendent, and any spouse of a lineal descendent).

The following are examples of prohibited transactions with a traditional IRA.

- Borrowing money from it.
- Selling property to it.
- Receiving unreasonable compensation for managing it.
- Using it as security for a loan.
- Buying property for personal use (present or future) with IRA funds.

Effect on an IRA account. Generally, if you or your beneficiary engages in a prohibited transaction in connection with your traditional IRA account at any time during the year, the account stops being an IRA as of the first day of that year.

Effect on you or your beneficiary. If your account stops being an IRA because you or your beneficiary engaged in a prohibited transaction, the account is treated as distributing all its assets to you at their fair market values on the first day of the year. If the total of those values is more than your basis in the IRA, you will have a taxable gain that is includible in your income. For information on figuring your gain and reporting it in income, see *Are Distributions Taxable*, earlier. The distribution may be subject to additional taxes or penalties.

Taxes on prohibited transactions. If someone other than the owner or beneficiary of a traditional IRA engages in a prohibited transaction, that person may be liable for certain taxes. In general, there is a 15% tax on the amount of the prohibited transaction and a 100% additional tax if the transaction is not corrected.

More information. For more information on prohibited transactions, see Publication 590.

Investment in Collectibles

If your traditional IRA invests in collectibles, the amount invested is considered distributed to you in the year invested. You may have to pay the 10% additional tax on early distributions, discussed later.

Collectibles. These include:

- Artworks,
- Rugs,
- Antiques,
- Metals,

- Gems,
- Stamps,
- Coins,
- Alcoholic beverages, and
- Certain other tangible personal property.

Exception. Your IRA can invest in one, one-half, one-quarter, or one-tenth ounce U.S. gold coins, or one-ounce silver coins minted by the Treasury Department. It can also invest in certain platinum coins and certain gold, silver, palladium, and platinum bullion.

Excess Contributions

Generally, an excess contribution is the amount contributed to your traditional IRA(s) for the year that is more than the smaller of:

- The maximum deductible amount for the year. For 2012, this is $5,000 ($6,000 if you are 50 or older), or
- Your taxable compensation for the year.

Tax on excess contributions. In general, if the excess contributions for a year are not withdrawn by the date your return for the year is due (including extensions), you are subject to a 6% tax. You must pay the 6% tax each year on excess amounts that remain in your traditional IRA at the end of your tax year. The tax cannot be more than 6% of the combined value of all your IRAs as of the end of your tax year.

Excess contributions withdrawn by due date of return. You will not have to pay the 6% tax if you withdraw an excess contribution made during a tax year and you also withdraw interest or other income earned on the excess contribution. You must complete your withdrawal by the date your tax return for that year is due, including extensions.

How to treat withdrawn contributions. Do not include in your gross income an excess contribution that you withdraw from your traditional IRA before your tax return is due if both the following conditions are met.

- No deduction was allowed for the excess contribution.
- You withdraw the interest or other income earned on the excess contribution.

You can take into account any loss on the contribution while it was in the IRA when calculating the amount that must be withdrawn. If there was a loss, the net income you must withdraw may be a negative amount.

How to treat withdrawn interest or other income. You must include in your gross income the interest or other income that was earned on the excess contribution. Report it on your return for the year in which the excess contribution was made. Your withdrawal of interest or other income may be subject to an additional 10% tax on early distributions, discussed later.

Excess contributions withdrawn after due date of return. In general, you must include all distributions (withdrawals) from your traditional IRA in your gross income. However, if the following conditions are met, you can withdraw excess contributions from your IRA and not include the amount withdrawn in your gross income.

- Total contributions (other than rollover contributions) for 2012 to your IRA were not more than $5,000 ($6,000 if you are 50 or older).
- You did not take a deduction for the excess contribution being withdrawn.

The withdrawal can take place at any time, even after the due date, including extensions, for filing your tax return for the year.

Excess contribution deducted in an earlier year. If you deducted an excess contribution in an earlier year for which the total contributions were not more than the maximum deductible amount for that year (see the following table), you can still remove the excess from your traditional IRA and not include it in your gross income. To do this, file Form 1040X for that year and do not deduct the excess contribution on the amended return. Generally, you can file an amended return within 3 years after you filed your return, or 2 years from the time the tax was paid, whichever is later.

Year(s)	Contribution limit	Contribution limit if age 50 or older at the end of the year
2008 through 2011	$5,000	$6,000
2006 or 2007	$4,000	$5,000
2005	$4,000	$4,500
2002 through 2004	$3,000	$3,500
1997 through 2001	$2,000	—
before 1997	$2,250	—

Excess due to incorrect rollover information. If an excess contribution in your traditional IRA is the result of a rollover and the excess occurred because the information the plan was required to give you was incorrect, you can withdraw the excess contribution. The limits mentioned above are increased by the amount of the excess that is due to the incorrect information. You will have to amend your return for the year in which the excess occurred to correct the reporting of the rollover amounts in that year. Do not include in your gross income the part of the excess contribution caused by the incorrect information.

Early Distributions

You must include early distributions of taxable amounts from your traditional IRA in your gross income. Early distributions are also subject to an additional 10% tax. See the discussion of Form 5329 under *Reporting Additional Taxes*, later, to figure and report the tax.

Early distributions defined. Early distributions generally are amounts distributed from your traditional IRA account or annuity before you are age $59\frac{1}{2}$.

Age $59\frac{1}{2}$ rule. Generally, if you are under age $59\frac{1}{2}$, you must pay a 10% additional tax on the distribution of any assets (money or other property) from your traditional IRA. Distributions before you are age $59\frac{1}{2}$ are called early distributions.

The 10% additional tax applies to the part of the distribution that you have to include in gross income. It is in addition to any regular income tax on that amount.

Exceptions. There are several exceptions to the age $59\frac{1}{2}$ rule. Even if you receive a distribution before you are age $59\frac{1}{2}$, you may not have to pay the 10% additional tax if you are in one of the following situations.

- You have unreimbursed medical expenses that are more than 7.5% of your adjusted gross income.
- The distributions are not more than the cost of your medical insurance due to a period of unemployment.
- You are totally and permanently disabled.
- You are the beneficiary of a deceased IRA owner.
- You are receiving distributions in the form of an annuity.
- The distributions are not more than your qualified higher education expenses.
- You use the distributions to buy, build, or rebuild a first home.
- The distribution is due to an IRS levy of the qualified plan.
- The distribution is a qualified reservist distribution.

Most of these exceptions are explained in Publication 590.

Note. Distributions that are timely and properly rolled over, as discussed earlier, are not subject to either regular income tax or the 10% additional tax. Certain withdrawals of excess contributions after the due date of your return are also tax free and therefore not subject to the 10% additional tax. (See *Excess contributions withdrawn after due date of return*, earlier.) This also applies to transfers incident to divorce, as discussed earlier.

Receivership distributions. Early distributions (with or without your consent) from savings institutions placed in receivership are subject to this tax unless one of the exceptions listed earlier applies. This is true even if the distribution is from a receiver that is a state agency.

Additional 10% tax. The additional tax on early distributions is 10% of the amount of the early distribution that you must include in your gross income. This tax is in addition to any regular income tax resulting from including the distribution in income.

Nondeductible contributions. The tax on early distributions does not apply to the part of a distribution that represents a return of your nondeductible contributions (basis).

More information. For more information on early distributions, see Publication 590.

Excess Accumulations (Insufficient Distributions)

You cannot keep amounts in your traditional IRA indefinitely. Generally, you must begin receiving distributions by April 1 of the year following the year in which you reach age $70^1/_2$. The required minimum distribution for any year after the year in which you reach age $70^1/_2$ must be made by December 31 of that later year.

Tax on excess. If distributions are less than the required minimum distribution for the year, you may have to pay a 50% excise tax for that year on the amount not distributed as required.

Request to waive the tax. If the excess accumulation is due to reasonable error, and you have taken, or are taking, steps to remedy the insufficient distribution, you can request that the tax be waived. If you believe you qualify for this relief, attach a statement of explanation and complete Form 5329 as instructed under *Waiver of tax* in the Instructions for Form 5329.

Exemption from tax. If you are unable to take required distributions because you have a traditional IRA invested in a contract issued by an insurance company that is in state insurer delinquency proceedings, the 50% excise tax does not apply if the conditions and requirements of Revenue Procedure 92-10 are satisfied.

More information. For more information on excess accumulations, see Publication 590.

Reporting Additional Taxes

Generally, you must use Form 5329 to report the tax on excess contributions, early distributions, and excess accumulations. If you must file Form 5329, you cannot use Form 1040A or Form 1040EZ.

Filing a tax return. If you must file an individual income tax return, complete Form 5329 and attach it to your Form 1040. Enter the total additional taxes due on Form 1040, line 58.

Not filing a tax return. If you do not have to file a tax return but do have to pay one of the additional taxes mentioned earlier, file the completed Form 5329 with the IRS at the time and place you would have filed your Form 1040. Be sure to include your address on page 1 and your signature and date on page 2. Enclose, but do not attach, a check or money order payable to the United States Treasury for the tax you owe, as shown on Form 5329. Enter your social security number and "2012 Form 5329" on your check or money order.

Form 5329 not required. You do not have to use Form 5329 if either of the following situations exists.

- Distribution code 1 (early distribution) is correctly shown in box 7 of Form 1099-R. If you do not owe any other additional tax on a distribution, multiply the taxable part of the early distribution by 10% and enter the result on Form 1040, line 58. Put "No" to the left of the line to indicate that you do not have to file Form 5329. However, if you owe this tax and also owe any other additional tax on a distribution, do not enter this 10% additional tax directly on your Form 1040. You must file Form 5329 to report your additional taxes.
- If you rolled over part or all of a distribution from a qualified retirement plan, the part rolled over is not subject to the tax on early distributions.

Roth IRAs

Regardless of your age, you may be able to establish and make nondeductible contributions to a retirement plan called a Roth IRA.

Contributions not reported. You do not report Roth IRA contributions on your return.

What Is a Roth IRA?

A Roth IRA is an individual retirement plan that, except as explained in this chapter, is subject to the rules that apply to a traditional IRA (defined earlier). It can be either an account or an annuity. Individual retirement accounts and annuities are described in Publication 590.

To be a Roth IRA, the account or annuity must be designated as a Roth IRA when it is opened. A deemed IRA can be a Roth IRA, but neither a SEP IRA nor a SIMPLE IRA can be designated as a Roth IRA.

Unlike a traditional IRA, you cannot deduct contributions to a Roth IRA. But, if you satisfy the requirements, qualified distributions (discussed later) are tax free. Contributions can be made to your Roth IRA after you reach age $70^1/_2$ and you can leave amounts in your Roth IRA as long as you live.

When Can a Roth IRA Be Opened?

You can open a Roth IRA at any time. However, the time for making contributions for any year is limited. See *When Can You Make Contributions*, later, under *Can You Contribute to a Roth IRA*.

Can You Contribute to a Roth IRA?

Generally, you can contribute to a Roth IRA if you have taxable compensation (defined later) and your modified AGI (defined later) is less than:

- $183,000 for married filing jointly or qualifying widow(er),
- $125,000 for single, head of household, or married filing separately and you did not live with your spouse at any time during the year, or
- $10,000 for married filing separately and you lived with your spouse at any time during the year.

TIP *You may be eligible to claim a credit for contributions to your Roth IRA. For more information, see chapter 36.*

Is there an age limit for contributions? Contributions can be made to your Roth IRA regardless of your age.

Can you contribute to a Roth IRA for your spouse? You can contribute to a Roth IRA for your spouse provided the contributions satisfy the spousal IRA limit (discussed in *How Much Can Be Contributed?* under *Traditional IRAs*), you file jointly, and your modified AGI is less than $183,000.

Compensation. Compensation includes wages, salaries, tips, professional fees, bonuses, and other amounts received for providing personal services. It also includes commissions, self-employment income, nontaxable combat pay, military differential pay, and taxable alimony and separate maintenance payments.

Modified AGI. Your modified AGI for Roth IRA purposes is your adjusted gross income (AGI) as shown on your return modified as follows.

1. Subtract the following.
   a. Roth IRA conversions included on Form 1040, line 15b, or Form 1040A, line 11b.
   b. Roth IRA rollovers from qualified retirement plans included on Form 1040, line 16b, or Form 1040A, line 12b.
2. Add the following deductions and exclusions:
   a. Traditional IRA deduction,
   b. Student loan interest deduction,
   c. Tuition and fees deduction,
   d. Domestic production activities deduction,
   e. Foreign earned income exclusion,
   f. Foreign housing exclusion or deduction,
   g. Exclusion of qualified savings bond interest shown on Form 8815, and
   h. Exclusion of employer-provided adoption benefits shown on Form 8839.

You can use Worksheet 17-2 to figure your modified AGI.

How Much Can Be Contributed?

The contribution limit for Roth IRAs generally depends on whether contributions are made only to Roth IRAs or to both traditional IRAs and Roth IRAs.

Roth IRAs only. If contributions are made only to Roth IRAs, your contribution limit generally is the lesser of the following amounts.

- $5,000 ($6,000 if you are 50 or older in 2012).
- Your taxable compensation.

However, if your modified AGI is above a certain amount, your contribution limit may be reduced, as explained later under *Contribution limit reduced*.

Roth IRAs and traditional IRAs. If contributions are made to both Roth IRAs and traditional IRAs established for your benefit, your contribution limit for Roth IRAs generally is the same as your limit would be if contributions were made only to Roth IRAs, but then reduced

Worksheet 17-2. **Modified Adjusted Gross Income for Roth IRA Purposes** *Keep for Your Records*

Use this worksheet to figure your modified adjusted gross income for Roth IRA purposes.

1.	Enter your adjusted gross income from Form 1040, line 38, or Form 1040A, line 22	**1.** ______
2.	Enter any income resulting from the conversion of an IRA (other than a Roth IRA) to a Roth IRA and a rollover from a qualified retirement plan to a Roth IRA	**2.** ______
3.	Subtract line 2 from line 1	**3.** ______
4.	Enter any traditional IRA deduction from Form 1040, line 32, or Form 1040A, line 17	**4.** ______
5.	Enter any student loan interest deduction from Form 1040, line 33, or Form 1040A, line 18	**5.** ______
6.	Enter any tuition and fees deduction from Form 1040, line 34, or Form 1040A, line 19	**6.** ______
7.	Enter any domestic production activities deduction from Form 1040, line 35	**7.** ______
8.	Enter any foreign earned income and/or housing exclusion from Form 2555, line 45, or Form 2555-EZ, line 18	**8.** ______
9.	Enter any foreign housing deduction from Form 2555, line 50	**9.** ______
10.	Enter any excludable savings bond interest from Form 8815, line 14	**10.** ______
11.	Enter any excluded employer-provided adoption benefits from Form 8839, line 24	**11.** ______
12.	Add the amounts on lines 3 through 11	**12.** ______
13.	Enter: • $183,000 if married filing jointly or qualifying widow(er) • $10,000 if married filing separately and you lived with your spouse at any time during the year • $125,000 for all others	**13.** ______

Is the amount on line 12 more than the amount on line 13?
If yes, then see the ***Note*** below.
If no, then the amount on line 12 is your ***modified AGI*** for Roth IRA purposes.

Note. If the amount on line 12 is more than the amount on line 13 and you have other income or loss items, such as social security income or passive activity losses, that are subject to AGI-based phaseouts, you can refigure your AGI solely for the purpose of figuring your modified AGI for Roth IRA purposes. (If you receive social security benefits, use *Worksheet 1* in *Appendix B* of Publication 590 to refigure your AGI.) Then go to list item (2) under *Modified AGI* or line 3 above in this *Worksheet 17-2* to refigure your modified AGI. If you do not have other income or loss items subject to AGI-based phaseouts, your modified AGI for Roth IRA purposes is the amount on line 12.

Table 17-3. **Effect of Modified AGI on Roth IRA Contribution**

This table shows whether your contribution to a Roth IRA is affected by the amount of your modified adjusted gross income (modified AGI).

IF you have taxable compensation and your filing status is...	**AND your modified AGI is...**	**THEN...**
married filing jointly, or **qualifying widow(er)**	less than $173,000	you can contribute up to $5,000 ($6,000 if you are 50 or older in 2012).
	at least $173,000 but less than $183,000	the amount you can contribute is reduced as explained under *Contribution limit reduced* in chapter 2 of Publication 590.
	$183,000 or more	you cannot contribute to a Roth IRA.
married filing separately and you lived with your spouse at any time during the year	zero (-0-)	you can contribute up to $5,000 ($6,000 if you are 50 or older in 2012).
	more than zero (-0-) but less than $10,000	the amount you can contribute is reduced as explained under *Contribution limit reduced* in chapter 2 of Publication 590.
	$10,000 or more	you cannot contribute to a Roth IRA.
single, head of household, or **married filing separately** and you did not live with your spouse at any time during the year	less than $110,000	you can contribute up to $5,000 ($6,000 if you are 50 or older in 2012).
	at least $110,000 but less than $125,000	the amount you can contribute is reduced as explained under *Contribution limit reduced* in chapter 2 of Publication 590.
	$125,000 or more	you cannot contribute to a Roth IRA.

by all contributions for the year to all IRAs other than Roth IRAs. Employer contributions under a SEP or SIMPLE IRA plan do not affect this limit.

This means that your contribution limit is generally the lesser of the following amounts.

- $5,000 ($6,000 if you are 50 or older in 2012) minus all contributions (other than employer contributions under a SEP or SIMPLE IRA plan) for the year to all IRAs other than Roth IRAs.
- Your taxable compensation minus all contributions (other than employer contributions under a SEP or SIMPLE IRA plan) for the year to all IRAs other than Roth IRAs.

However, if your modified AGI is above a certain amount, your contribution limit may be reduced, as explained next under *Contribution limit reduced*.

Contribution limit reduced. If your modified AGI is above a certain amount, your contribution limit is gradually reduced. Use Table 17-3 to determine if this reduction applies to you.

Figuring the reduction. If the amount you can contribute to your Roth IRA is reduced, see Publication 590 for how to figure the reduction.

When Can You Make Contributions?

You can make contributions to a Roth IRA for a year at any time during the year or by the due date of your return for that year (not including extensions).

TIP *You can make contributions for 2012 by the due date (not including extensions) for filing your 2012 tax return.*

What if You Contribute Too Much?

A 6% excise tax applies to any excess contribution to a Roth IRA.

Excess contributions. These are the contributions to your Roth IRAs for a year that equal the total of:

1. Amounts contributed for the tax year to your Roth IRAs (other than amounts properly and timely rolled over from a Roth IRA or properly converted from a traditional IRA or rolled over from a qualified retirement plan, as described later) that are more than your contribution limit for the year, plus
2. Any excess contributions for the preceding year, reduced by the total of:
   a. Any distributions out of your Roth IRAs for the year, plus
   b. Your contribution limit for the year minus your contributions to all your IRAs for the year.

Withdrawal of excess contributions. For purposes of determining excess contributions, any contribution that is withdrawn on or before the due date (including extensions) for filing your tax return for the year is treated as an amount not contributed. This treatment applies only if any earnings on the contributions are also withdrawn. The earnings are considered to have been earned and received in the year the excess contribution was made.

Applying excess contributions. If contributions to your Roth IRA for a year were more than the limit, you can apply the excess contribution in one year to a later year if the contributions for that later year are less than the maximum allowed for that year.

Can You Move Amounts Into a Roth IRA?

You may be able to convert amounts from either a traditional, SEP, or SIMPLE IRA into a Roth IRA. You may be able to roll amounts over from a qualified retirement plan to a Roth IRA. You may be able to recharacterize contributions made to one IRA as having been made directly to a different IRA. You can roll amounts over from a designated Roth account or from one Roth IRA to another Roth IRA.

Conversions

You can convert a traditional IRA to a Roth IRA. The conversion is treated as a rollover, regardless of the conversion method used. Most of the rules for rollovers, described earlier under *Rollover From One IRA Into Another* under *Traditional IRAs*, apply to these rollovers. However, the 1-year waiting period does not apply.

Conversion methods. You can convert amounts from a traditional IRA to a Roth IRA in any of the following ways.

- ***Rollover***. You can receive a distribution from a traditional IRA and roll it over (contribute it) to a Roth IRA within 60 days after the distribution.
- ***Trustee-to-trustee transfer***. You can direct the trustee of the traditional IRA to transfer an amount from the traditional IRA to the trustee of the Roth IRA.
- ***Same trustee transfer***. If the trustee of the traditional IRA also maintains the Roth IRA, you can direct the trustee to transfer an amount from the traditional IRA to the Roth IRA.

Same trustee. Conversions made with the same trustee can be made by redesignating the traditional IRA as a Roth IRA, rather than opening a new account or issuing a new contract.

Special rules for 2010 conversions to Roth IRAs. For any conversions from a traditional, SEP, or SIMPLE IRA to a Roth IRA in 2010, any amounts required to be included in income are generally included in income in equal amounts in 2011 and 2012 unless you elected to include the entire amount in income in 2010. You may be required to include an amount other than half of a 2010 conversion from a traditional, SEP, or SIMPLE IRA to a Roth IRA in income in 2012 if you also took a Roth IRA distribution in 2010 or 2011. See Publication 590 for more information on the amount to include in income in 2012 from a 2010 conversion to a Roth IRA.

Rollover from a qualified retirement plan into a Roth IRA. You can roll over into a Roth IRA all or part of an eligible rollover distribution you receive from your (or your deceased spouse's):

- Employer's qualified pension, profit-sharing, or stock bonus plan;
- Annuity plan;
- Tax-sheltered annuity plan (section 403(b) plan); or
- Governmental deferred compensation plan (section 457 plan).

Any amount rolled over is subject to the same rules as those for converting a traditional IRA into a Roth IRA. Also, the rollover contribution must meet the rollover requirements that apply to the specific type of retirement plan.

Income. You must include in your gross income distributions from a qualified retirement plan that you would have had to include in income if you had not rolled them over into a Roth IRA. You do not include in gross income any part of a distribution from a qualified retirement plan that is a return of contributions (after-tax contributions) to the plan that were taxable to you when paid.

These amounts are normally included in income on your return for the year you rolled them over from the employer plan to a Roth IRA. For 2010 rollovers special rules apply. See *Special rules for 2010 rollovers from qualified retirement plans to Roth IRAs* next.

Special rules for 2010 rollovers from qualified retirement plans to Roth IRAs. For any rollovers from qualified retirement plans to a Roth IRA in 2010, any amounts that are required to be included in income are generally included in income in equal amounts in 2011 and 2012 unless you elected to include the entire amount in income in 2010. You may be required to include an amount other than half of a 2010 rollover from a qualified employer plan to a Roth IRA in income in 2012 if you also took a Roth IRA distribution in 2010 or 2011. See Publication 590 for more information on the amount to include in income in 2012 from a 2010 rollover.

CAUTION *If you must include any amount in your gross income, you may have to increase your withholding or make estimated tax payments. See Publication 505, Tax Withholding and Estimated Tax.*

For more information, see *Rollover From Employer's Plan Into a Roth IRA* in chapter 2 of Publication 590.

Converting from a SIMPLE IRA. Generally, you can convert an amount in your SIMPLE IRA to a Roth IRA under the same rules explained earlier under *Converting From Any Traditional IRA to a Roth IRA* under *Traditional IRAs*.

However, you cannot convert any amount distributed from the SIMPLE IRA during the 2-year period beginning on the date you first participated in any SIMPLE IRA plan maintained by your employer.

More information. For more detailed information on conversions, see Publication 590.

Rollover From a Roth IRA

You can withdraw, tax free, all or part of the assets from one Roth IRA if you contribute them within 60 days to another Roth IRA. Most of the rules for rollovers, explained earlier under *Rollover From One IRA Into Another* under *Traditional IRAs*, apply to these rollovers.

Rollover from designated Roth account. A rollover from a designated Roth account can only be made to another designated Roth account or to a Roth IRA. For more information about designated Roth accounts, see chapter 10.

Are Distributions Taxable?

You do not include in your gross income qualified distributions or distributions that are a return of your regular contributions from your Roth IRA(s). You also do not include distributions from your Roth IRA that you roll over tax free into another Roth IRA. You may have to include part of other distributions in your income. See *Ordering rules for distributions*, later.

What are qualified distributions? A qualified distribution is any payment or distribution from your Roth IRA that meets the following requirements.

1. It is made after the 5-year period beginning with the first taxable year for which a contribution was made to a Roth IRA set up for your benefit, and
2. The payment or distribution is:
   a. Made on or after the date you reach age 59½,
   b. Made because you are disabled,
   c. Made to a beneficiary or to your estate after your death, or
   d. To pay up to $10,000 (lifetime limit) of certain qualified first-time homebuyer amounts. See Publication 590 for more information.

Additional tax on distributions of conversion and certain rollover contributions within 5-year period. If, within the 5-year period starting with the first day of your tax year in which you convert an amount from a traditional IRA or rollover an amount from a qualified retirement plan to a Roth IRA, you take a distribution from a Roth IRA, you may have to pay the 10% additional tax on early distributions. You generally must pay the 10% additional tax on any amount attributable to the part of the amount converted or rolled over (the conversion or rollover contribution) that you had to include in income. A separate 5-year period applies to each conversion and rollover. See *Ordering rules for distributions*, later, to determine the amount, if any, of the distribution that is attributable to the part of the conversion or rollover contribution that you had to include in income.

Additional tax on other early distributions. Unless an exception applies, you must pay the 10% additional tax on the taxable part of any distributions that are not qualified distributions. See Publication 590 for more information.

Ordering rules for distributions. If you receive a distribution from your Roth IRA that is not a qualified distribution, part of it may be taxable. There is a set order in which contributions (including conversion contributions and rollover contributions from qualified retirement plans) and earnings are considered to be distributed from your Roth IRA. Regular contributions are distributed first. See Publication 590 for more information.

Must you withdraw or use Roth IRA assets? You are not required to take distributions from your Roth IRA at any age. The minimum distribution rules that apply to traditional IRAs do not apply to Roth IRAs while the owner is alive. However, after the death of a Roth IRA owner, certain of the minimum distribution rules that apply to traditional IRAs also apply to Roth IRAs.

More information. For more detailed information on Roth IRAs, see Publication 590.

18.

Alimony

Introduction

This chapter discusses the rules that apply if you pay or receive alimony. It covers the following topics.

- What payments are alimony.
- What payments are not alimony, such as child support.
- How to deduct alimony you paid.
- How to report alimony you received as income.
- Whether you must recapture the tax benefits of alimony. Recapture means adding back in your income all or part of a deduction you took in a prior year.

Alimony is a payment to or for a spouse or former spouse under a divorce or separation instrument. It does not include voluntary payments that are not made under a divorce or separation instrument.

Alimony is deductible by the payer and must be included in the spouse's or former spouse's income. Although this chapter is generally written for the payer of the alimony, the recipient can use the information to determine whether an amount received is alimony.

To be alimony, a payment must meet certain requirements. Different requirements generally apply to payments under instruments executed after 1984 and to payments under instruments executed before 1985. This chapter discusses the rules for payments under instruments executed after 1984. If you need the rules for payments under pre-1985 instruments, get and keep a copy of the 2004 version of Publication 504. That was the last year the information on pre-1985 instruments was included in Publication 504.

Use Table 18-1 in this chapter as a guide to determine whether certain payments are considered alimony.

Definitions. The following definitions apply throughout this chapter.

Spouse or former spouse. Unless otherwise stated, the term "spouse" includes former spouse.

Divorce or separation instrument. The term "divorce or separation instrument" means:

- A decree of divorce or separate maintenance or a written instrument incident to that decree,
- A written separation agreement, or
- A decree or any type of court order requiring a spouse to make payments for the support or maintenance of the other spouse. This includes a temporary decree, an interlocutory (not final) decree, and a decree of alimony *pendente lite* (while awaiting action on the final decree or agreement).

Useful Items

You may want to see:

Publication

❏ **504** Divorced or Separated Individuals

General Rules

The following rules apply to alimony regardless of when the divorce or separation instrument was executed.

Payments not alimony. Not all payments under a divorce or separation instrument are alimony. Alimony does not include:

- Child support,
- Noncash property settlements,
- Payments that are your spouse's part of community income as explained under *Community Property* in Publication 504,
- Payments to keep up the payer's property, or
- Use of the payer's property.

Payments to a third party. Cash payments, checks, or money orders to a third party on behalf of your spouse under the terms of your divorce or separation instrument can be alimony, if they otherwise qualify. These include payments for your spouse's medical expenses, housing costs (rent, utilities, etc.), taxes, tuition, etc. The payments are treated as received by your spouse and then paid to the third party.

Life insurance premiums. Alimony includes premiums you must pay under your divorce or separation instrument for insurance on your life to the extent your spouse owns the policy.

Payments for jointly-owned home. If your divorce or separation instrument states that you must pay expenses for a home owned by you and your spouse, some of your payments may be alimony.

Mortgage payments. If you must pay all the mortgage payments (principal and interest) on a jointly-owned home, and they otherwise qualify as alimony, you can deduct one-half of the total payments as alimony. If you itemize deductions and the home is a qualified home, you can claim one-half of the interest in figuring your deductible interest. Your spouse must report one-half of the payments as alimony received. If your spouse itemizes deductions and the home is a qualified home, he or she can claim one-half of the interest on the mortgage in figuring deductible interest.

Taxes and insurance. If you must pay all the real estate taxes or insurance on a home held as tenants in common, you can deduct one-half of these payments as alimony. Your spouse must report one-half of these payments as alimony received. If you and your spouse itemize deductions, you can each claim one-half of the real estate taxes and none of the home insurance.

If your home is held as tenants by the entirety or joint tenants, none of your payments for taxes or insurance are alimony. But if you itemize deductions, you can claim all of the real estate taxes and none of the home insurance.

Other payments to a third party. If you made other third-party payments, see Publication 504 to see whether any part of the payments qualifies as alimony.

Instruments Executed After 1984

The following rules for alimony apply to payments under divorce or separation instruments executed after 1984.

Exception for instruments executed before 1985. There are two situations where the rules for instruments executed after 1984 apply to instruments executed before 1985.

1. A divorce or separation instrument executed before 1985 and then modified after 1984 to specify that the after-1984 rules will apply.
2. A temporary divorce or separation instrument executed before 1985 and incorporated into, or adopted by, a final decree executed after 1984 that:
   a. Changes the amount or period of payment, or
   b. Adds or deletes any contingency or condition.

For the rules for alimony payments under pre-1985 instruments not meeting these exceptions, get the 2004 version of Publication 504 at www.irs.gov/pub504.

Example 1. In November 1984, you and your former spouse executed a written separation agreement. In February 1985, a decree of divorce was substituted for the written separation agreement. The decree of divorce did not change the terms for the alimony you pay your former spouse. The decree of divorce is treated as executed before 1985. Alimony payments under this decree are not subject to the rules for payments under instruments executed after 1984.

Example 2. Assume the same facts as in *Example 1* except that the decree of divorce changed the amount of the alimony. In this example, the decree of divorce is not treated as executed before 1985. The alimony payments are subject to the rules for payments under instruments executed after 1984.

Alimony requirements. A payment to or for a spouse under a divorce or separation instrument is alimony if the spouses do not file a joint return with each other and all the following requirements are met.

- The payment is in cash.
- The instrument does not designate the payment as not alimony.
- Spouses legally separated under a decree of divorce or separate maintenance are not members of the same household.
- There is no liability to make any payment (in cash or property) after the death of the recipient spouse.
- The payment is not treated as child support.

Each of these requirements is discussed below.

Cash payment requirement. Only cash payments, including checks and money orders, qualify as alimony. The following do not qualify as alimony.

- Transfers of services or property (including a debt instrument of a third party or an annuity contract).
- Execution of a debt instrument by the payer.
- The use of the payer's property.

Payments to a third party. Cash payments to a third party under the terms of your divorce or separation instrument can qualify as cash payments to your spouse. See *Payments to a third party* under *General Rules*, earlier.

Also, cash payments made to a third party at the written request of your spouse may qualify as alimony if all the following requirements are met.

- The payments are in lieu of payments of alimony directly to your spouse.
- The written request states that both spouses intend the payments to be treated as alimony.
- You receive the written request from your spouse before you file your return for the year you made the payments.

Payments designated as not alimony. You and your spouse can designate that otherwise qualifying payments are not alimony. You do this by including a provision in your divorce or separation instrument that states the payments are not deductible as alimony by you and are excludable from your spouse's income. For this purpose, any instrument (written statement), signed by both of you that makes this designation and that refers to a previous written separation agreement, is treated as a written separation agreement (and therefore a divorce or separation instrument). If you are subject to temporary support orders, the designation must be made in the original or a later temporary support order.

Your spouse can exclude the payments from income only if he or she attaches a copy of the instrument designating them as not alimony to his or her return. The copy must be attached each year the designation applies.

Spouses cannot be members of the same household. Payments to your spouse while you are members of the same household are not alimony if you are legally separated under a decree of divorce or separate maintenance. A home you formerly shared is considered one household, even if you physically separate yourselves in the home.

You are not treated as members of the same household if one of you is preparing to leave the household and does leave no later than 1 month after the date of the payment.

Exception. If you are not legally separated under a decree of divorce or separate maintenance, a payment under a written separation agreement, support decree, or other court order may qualify as alimony even if you are members of the same household when the payment is made.

Payments after death of recipient spouse. If any part of payments you make must continue to be made for any period after your spouse's death, that part of your payments is not alimony, whether made before or after the death. If all of the payments would continue, then none of the payments made before or after the death are alimony.

The divorce or separation instrument does not have to expressly state that the payments cease upon the death of your spouse if, for example, the liability for continued payments would end under state law.

Example. You must pay your former spouse $10,000 in cash each year for 10 years. Your divorce decree states that the payments will end upon your former spouse's death. You must also pay your former spouse or your former spouse's estate $20,000 in cash each year for 10 years. The death of your spouse would not terminate these payments under state law.

The $10,000 annual payments may qualify as alimony. The $20,000 annual payments that do not end upon your former spouse's death are not alimony.

Substitute payments. If you must make any payments in cash or property after your spouse's death as a substitute for continuing otherwise qualifying payments before the death, the otherwise qualifying payments are not alimony. To the extent that your payments begin, accelerate, or increase because of the death of your spouse, otherwise qualifying payments you made may be treated as payments that were not alimony. Whether or not such payments will be treated as not alimony depends on all the facts and circumstances.

Example 1. Under your divorce decree, you must pay your former spouse $30,000 annually. The payments will stop at the end of 6

Table 18-1. Alimony Requirements (Instruments Executed After 1984)

Payments ARE alimony if all of the following are true:	Payments are NOT alimony if any of the following are true:
Payments are required by a divorce or separation instrument.	Payments are not required by a divorce or separation instrument.
Payer and recipient spouse do not file a joint return with each other.	Payer and recipient spouse file a joint return with each other.
Payment is in cash (including checks or money orders).	Payment is: • Not in cash, • A noncash property settlement, • Spouse's part of community income, or • To keep up the payer's property.
Payment is not designated in the instrument as not alimony.	Payment is designated in the instrument as not alimony.
Spouses legally separated under a decree of divorce or separate maintenance are not members of the same household.	Spouses legally separated under a decree of divorce or separate maintenance are members of the same household.
Payments are not required after death of the recipient spouse.	Payments are required after death of the recipient spouse.
Payment is not treated as child support.	Payment is treated as child support.
These payments are deductible by the payer and includible in income by the recipient.	*These payments are neither deductible by the payer nor includible in income by the recipient.*

years or upon your former spouse's death, if earlier.

Your former spouse has custody of your minor children. The decree provides that if any child is still a minor at your spouse's death, you must pay $10,000 annually to a trust until the youngest child reaches the age of majority. The trust income and corpus (principal) are to be used for your children's benefit.

These facts indicate that the payments to be made after your former spouse's death are a substitute for $10,000 of the $30,000 annual payments. Of each of the $30,000 annual payments, $10,000 is not alimony.

Example 2. Under your divorce decree, you must pay your former spouse $30,000 annually. The payments will stop at the end of 15 years or upon your former spouse's death, if earlier. The decree provides that if your former spouse dies before the end of the 15-year period, you must pay the estate the difference between $450,000 ($30,000 × 15) and the total amount paid up to that time. For example, if your spouse dies at the end of the tenth year, you must pay the estate $150,000 ($450,000 − $300,000).

These facts indicate that the lump-sum payment to be made after your former spouse's death is a substitute for the full amount of the $30,000 annual payments. None of the annual payments are alimony. The result would be the same if the payment required at death were to be discounted by an appropriate interest factor to account for the prepayment.

Child support. A payment that is specifically designated as child support or treated as specifically designated as child support under your divorce or separation instrument is not alimony. The amount of child support may vary over time. Child support payments are not deductible by the payer and are not taxable to the recipient.

A payment will be treated as specifically designated as child support to the extent that the payment is reduced either:

- On the happening of a contingency relating to your child, or
- At a time that can be clearly associated with the contingency.

A payment may be treated as specifically designated as child support even if other separate payments are specifically designated as child support.

Contingency relating to your child. A contingency relates to your child if it depends on any event relating to that child. It does not matter whether the event is certain or likely to occur. Events relating to your child include the child's:

- Becoming employed,
- Dying,
- Leaving the household,
- Leaving school,
- Marrying, or
- Reaching a specified age or income level.

Clearly associated with a contingency. Payments that would otherwise qualify as alimony are presumed to be reduced at a time clearly associated with the happening of a contingency relating to your child only in the following situations.

- The payments are to be reduced not more than 6 months before or after the date the child will reach 18, 21, or local age of majority.
- The payments are to be reduced on two or more occasions that occur not more than 1 year before or after a different one of your children reaches a certain age from 18 to 24. This certain age must be the same for each child, but need not be a whole number of years.

In all other situations, reductions in payments are not treated as clearly associated with the happening of a contingency relating to your child.

Either you or the IRS can overcome the presumption in the two situations above. This is done by showing that the time at which the payments are to be reduced was determined independently of any contingencies relating to your children. For example, if you can show that the period of alimony payments is customary in the local jurisdiction, such as a period equal to one-half of the duration of the marriage, you can overcome the presumption and may be able to treat the amount as alimony.

How To Deduct Alimony Paid

You can deduct alimony you paid, whether or not you itemize deductions on your return. You must file Form 1040. You cannot use Form 1040A or Form 1040EZ.

Enter the amount of alimony you paid on Form 1040, line 31a. In the space provided on line 31b, enter your spouse's social security number (SSN) or individual taxpayer identification number (ITIN).

If you paid alimony to more than one person, enter the SSN or ITIN of one of the recipients. Show the SSN or ITIN and amount paid to each other recipient on an attached statement. Enter your total payments on line 31a.

You must provide your spouse's SSN or ITIN. If you do not, your deduction may be disallowed. For more information on SSNs and ITINs, see Social Security Number (SSN) *in chapter 1.*

How To Report Alimony Received

Report alimony you received as income on Form 1040, line 11. You cannot use Form 1040A or Form 1040EZ.

You must give the person who paid the alimony your SSN or ITIN. If you do not, you may have to pay a $50 penalty.

Recapture Rule

If your alimony payments decrease or end during the first 3 calendar years, you may be subject to the recapture rule. If you are subject to this rule, you have to include in income in the third year part of the alimony payments you previously deducted. Your spouse can deduct in the third year part of the alimony payments he or she previously included in income.

The 3-year period starts with the first calendar year you make a payment qualifying as alimony under a decree of divorce or separate maintenance or a written separation agreement. Do not include any time in which payments were being made under temporary support orders. The second and third years are the next 2 calendar years, whether or not payments are made during those years.

The reasons for a reduction or end of alimony payments that can require a recapture include:

- A change in your divorce or separation instrument,
- A failure to make timely payments,
- A reduction in your ability to provide support, or
- A reduction in your spouse's support needs.

When to apply the recapture rule. You are subject to the recapture rule in the third year if the alimony you pay in the third year decreases by more than $15,000 from the second year or the alimony you pay in the second and third years decreases significantly from the alimony you pay in the first year.

When you figure a decrease in alimony, do not include the following amounts.

- Payments made under a temporary support order.
- Payments required over a period of at least 3 calendar years that vary because they are a fixed part of your income from a business or property, or from compensation for employment or self-employment.
- Payments that decrease because of the death of either spouse or the remarriage of the spouse receiving the payments before the end of the third year.

Figuring the recapture. You can use Worksheet 1 in Publication 504 to figure recaptured alimony.

Including the recapture in income. If you must include a recapture amount in income, show it on Form 1040, line 11 ("Alimony received"). Cross out "received" and enter "recapture." On the dotted line next to the amount, enter your spouse's last name and SSN or ITIN.

Deducting the recapture. If you can deduct a recapture amount, show it on Form 1040, line 31a ("Alimony paid"). Cross out "paid" and enter "recapture." In the space provided, enter your spouse's SSN or ITIN.

19. Education-Related Adjustments

What's New

The amount of your student loan interest deduction for 2012 is gradually reduced (phased out) if your modified adjusted gross income (MAGI) is between $60,000 and $75,000 ($125,000 and $155,000 if filing a joint return). You cannot take a deduction if your MAGI is $75,000 or more ($155,000 or more if you file a joint return). This is an increase from the 2011 limits of $60,000 and $75,000 ($120,000 and $150,000 if filing a joint return). See chapter 4 of Publication 970 for more information.

Introduction

This chapter discusses the education-related adjustment you can deduct in figuring your adjusted gross income.

This chapter covers the student loan interest deduction, tuition and fees deduction, and the deduction for educator expenses.

Useful Items

You may want to see:

Publication

- ❑ **970** Tax Benefits for Education

Student Loan Interest Deduction

Generally, personal interest you pay, other than certain mortgage interest, is not deductible on your tax return. However, if your modified adjusted gross income (MAGI) is less than $75,000 ($155,000 if filing a joint return) there is a special deduction allowed for paying interest on a student loan (also known as an education loan) used for higher education. For most taxpayers, MAGI is the adjusted gross income as figured on their federal income tax return before subtracting any deduction for student loan interest. This deduction can reduce the amount of your income subject to tax by up to $2,500 in 2012. Table 19-1 summarizes the features of the student loan interest deduction.

Table 19-1. Student Loan Interest Deduction at a Glance
Do not rely on this table alone. Refer to the text for more details.

Feature	Description
Maximum benefit	You can reduce your income subject to tax by up to $2,500.
Loan qualifications	Your student loan: • must have been taken out solely to pay qualified education expenses, and • cannot be from a related person or made under a qualified employer plan.
Student qualifications	The student must be: • you, your spouse, or your dependent, and • enrolled at least half-time in a program leading to a degree, certificate, or other recognized educational credential at an eligible educational institution.
Time limit on deduction	You can deduct interest paid during the remaining period of your student loan.
Phaseout	The amount of your deduction depends on your income level.

Student Loan Interest Defined

Student loan interest is interest you paid during the year on a qualified student loan. It includes both required and voluntary interest payments.

Qualified Student Loan

This is a loan you took out solely to pay qualified education expenses (defined later) that were:

- For you, your spouse, or a person who was your dependent (defined in chapter 3) when you took out the loan,
- Paid or incurred within a reasonable period of time before or after you took out the loan, and
- For education provided during an academic period when the student is an eligible student.

Loans from the following sources are not qualified student loans.

- A related person.
- A qualified employer plan.

Exceptions. For purposes of the student loan interest deduction, the following are exceptions to the general rules for dependents.

- An individual can be your dependent even if you are the dependent of another taxpayer.

- An individual can be your dependent even if the individual files a joint return with a spouse.
- An individual can be your dependent even if the individual had gross income for the year that was equal to or more than the exemption amount for the year ($3,800 for 2012).

Reasonable period of time. Qualified education expenses are treated as paid or incurred within a reasonable period of time before or after you take out the loan if they are paid with the proceeds of student loans that are part of a federal postsecondary education loan program.

Even if not paid with the proceeds of that type of loan, the expenses are treated as paid or incurred within a reasonable period of time if both of the following requirements are met.

- The expenses relate to a specific academic period.
- The loan proceeds are disbursed within a period that begins 90 days before the start of that academic period and ends 90 days after the end of that academic period.

If neither of the above situations applies, the reasonable period of time is determined based on all the relevant facts and circumstances.

Academic period. An academic period includes a semester, trimester, quarter, or other period of study (such as a summer school session) as reasonably determined by an educational institution. In the case of an educational institution that uses credit hours or clock hours and does not have academic terms, each payment period can be treated as an academic period.

Eligible student. This is a student who was enrolled at least half-time in a program leading to a degree, certificate, or other recognized educational credential.

Enrolled at least half-time. A student was enrolled at least half-time if the student was taking at least half the normal full-time work load for his or her course of study.

The standard for what is half of the normal full-time work load is determined by each eligible educational institution. However, the standard may not be lower than any of those established by the Department of Education under the Higher Education Act of 1965.

Related person. You cannot deduct interest on a loan you get from a related person. Related persons include:

- Your spouse,
- Your brothers and sisters,
- Your half brothers and half sisters,
- Your ancestors (parents, grandparents, etc.),
- Your lineal descendants (children, grandchildren, etc.), and
- Certain corporations, partnerships, trusts, and exempt organizations.

Qualified employer plan. You cannot deduct interest on a loan made under a qualified employer plan or under a contract purchased under such a plan.

Qualified Education Expenses

For purposes of the student loan interest deduction, these expenses are the total costs of attending an eligible educational institution, including graduate school. They include amounts paid for the following items.

- Tuition and fees.
- Room and board.
- Books, supplies, and equipment.
- Other necessary expenses (such as transportation).

The cost of room and board qualifies only to the extent that it is not more than:

- The allowance for room and board, as determined by the eligible educational institution, that was included in the cost of attendance (for federal financial aid purposes) for a particular academic period and living arrangement of the student, or
- If greater, the actual amount charged if the student is residing in housing owned or operated by the eligible educational institution.

Eligible educational institution. An eligible educational institution is any college, university, vocational school, or other postsecondary educational institution eligible to participate in a student aid program administered by the Department of Education. It includes virtually all accredited public, nonprofit, and proprietary (privately owned profit-making) postsecondary institutions.

Certain educational institutions located outside the United States also participate in the U.S. Department of Education's Federal Student Aid (FSA) programs.

For purposes of the student loan interest deduction, an eligible educational institution also includes an institution conducting an internship or residency program leading to a degree or certificate from an institution of higher education, a hospital, or a health care facility that offers postgraduate training.

An educational institution must meet the above criteria only during the academic period(s) for which the student loan was incurred. The deductibility of interest on the loan is not affected by the institution's subsequent loss of eligibility.

TIP *The educational institution should be able to tell you if it is an eligible educational institution.*

Adjustments to qualified education expenses. You must reduce your qualified education expenses by certain tax-free items (such as the tax-free part of scholarships and fellowships). See chapter 4 of Publication 970 for details.

Include as Interest

In addition to simple interest on the loan, certain loan origination fees, capitalized interest, interest on revolving lines of credit, and interest on refinanced student loans can be student loan interest if all other requirements are met.

Loan origination fee. In general, this is a one-time fee charged by the lender when a loan is made. To be deductible as interest, the fee must be for the use of money rather than for property or services (such as commitment fees or processing costs) provided by the lender. A loan origination fee treated as interest accrues over the life of the loan.

Capitalized interest. This is unpaid interest on a student loan that is added by the lender to the outstanding principal balance of the loan.

Interest on revolving lines of credit. This interest, which includes interest on credit card debt, is student loan interest if the borrower uses the line of credit (credit card) only to pay qualified education expenses. See *Qualified Education Expenses*, earlier.

Interest on refinanced student loans. This includes interest on both:

- Consolidated loans—loans used to refinance more than one student loan of the same borrower, and
- Collapsed loans—two or more loans of the same borrower that are treated by both the lender and the borrower as one loan.

CAUTION *If you refinance a qualified student loan for more than your original loan and you use the additional amount for any purpose other than qualified education expenses, you cannot deduct any interest paid on the refinanced loan.*

Voluntary interest payments. These are payments made on a qualified student loan during a period when interest payments are not required, such as when the borrower has been granted a deferment or the loan has not yet entered repayment status.

Do Not Include as Interest

You cannot claim a student loan interest deduction for any of the following items.

- Interest you paid on a loan if, under the terms of the loan, you are not legally obligated to make interest payments.
- Loan origination fees that are payments for property or services provided by the lender, such as commitment fees or processing costs.
- Interest you paid on a loan to the extent payments were made through your participation in the National Health Service Corps Loan Repayment Program (the "NHSC Loan Repayment Program") or certain other loan repayment assistance programs. For more information, see *Student Loan Repayment Assistance* in chapter 5 of Publication 970.

Can You Claim the Deduction

Generally, you can claim the deduction if all four of the following requirements are met.

- Your filing status is any filing status except married filing separately.
- No one else is claiming an exemption for you on his or her tax return.
- You are legally obligated to pay interest on a qualified student loan.
- You paid interest on a qualified student loan.

Interest paid by others. If you are the person legally obligated to make interest payments and someone else makes a payment of interest on your behalf, you are treated as receiving the payments from the other person and, in turn, paying the interest. See chapter 4 of Publication 970 for more information.

No Double Benefit Allowed

You cannot deduct as interest on a student loan any amount that is an allowable deduction under any other provision of the tax law (for example, home mortgage interest).

How Much Can You Deduct

Your student loan interest deduction for 2012 is generally the smaller of:

- $2,500, or
- The interest you paid in 2012.

However, the amount determined above is phased out (gradually reduced) if your MAGI is between $60,000 and $75,000 ($125,000 and $155,000 if you file a joint return). You cannot take a student loan interest deduction if your MAGI is $75,000 or more ($155,000 or more if you file a joint return). For details on figuring your MAGI, see chapter 4 of Publication 970.

How Do You Figure the Deduction

Generally, you figure the deduction using the Student Loan Interest Deduction Worksheet in the Form 1040 or Form 1040A instructions. However, if you are filing Form 2555, 2555-EZ, or 4563, or you are excluding income from sources within Puerto Rico, you must complete Worksheet 4-1 in chapter 4 of Publication 970.

To help you figure your student loan interest deduction, you should receive Form 1098-E, Student Loan Interest Statement. Generally, an institution (such as a bank or governmental agency) that received interest payments of $600 or more during 2012 on one or more qualified student loans must send Form 1098-E (or acceptable substitute) to each borrower by January 31, 2013.

For qualified student loans taken out before September 1, 2004, the institution is required to include on Form 1098-E only payments of stated interest. Other interest payments, such as certain loan origination fees and capitalized interest, may not appear on the form you receive. However, if you pay qualifying interest that is not included on Form 1098-E, you can also deduct those amounts. For information on allocating payments between interest and principal, see chapter 4 of Publication 970.

To claim the deduction, enter the allowable amount on Form 1040, line 33, or Form 1040A, line 18.

Tuition and Fees Deduction

You may be able to deduct qualified education expenses paid during the year for yourself, your spouse, or your dependent(s). You cannot claim this deduction if your filing status is married filing separately or if another person can claim an exemption for you as a dependent on his or her tax return. The qualified expenses must be for higher education, as explained later under *What Expenses Qualify*.

The tuition and fees deduction can reduce the amount of your income subject to tax by up to $4,000.

Table 19-2 summarizes the features of the tuition and fees deduction.

TIP *You may be able to take a credit for your education expenses instead of a deduction. You can choose the one that will give you the lower tax. See chapter 34, Education Credits, for details about the credits.*

Can You Claim the Deduction

The following rules will help you determine if you can claim the tuition and fees deduction.

Who Can Claim the Deduction

Generally, you can claim the tuition and fees deduction if all three of the following requirements are met.

1. You paid qualified education expenses of higher education in 2012 for academic periods beginning in 2012 and those beginning in the first three months of 2013.
2. You paid the education expenses for an eligible student.
3. The eligible student is yourself, your spouse, or your dependent for whom you claim an exemption (defined in chapter 3) on your tax return.

Qualified education expenses are defined under *What Expenses Qualify*. Eligible students are defined later under *Who Is an Eligible Student*.

Who Cannot Claim the Deduction

You cannot claim the tuition and fees deduction if any of the following apply.

- Your filing status is married filing separately.
- Another person can claim an exemption for you as a dependent on his or her tax return. You cannot take the deduction even if the other person does not actually claim that exemption.
- Your modified adjusted gross income (MAGI) is more than $80,000 ($160,000 if filing a joint return).
- You (or your spouse) were a nonresident alien for any part of 2012 and the nonresident alien did not elect to be treated as a resident alien for tax purposes. More information on nonresident aliens can be found in Publication 519, U.S. Tax Guide for Aliens.
- You or anyone else claims an American opportunity or lifetime learning credit in 2012 with respect to expenses of the student for whom the qualified education expenses were paid. However, a state tax credit will not disqualify you from claiming a tuition and fees deduction.

What Expenses Qualify

The tuition and fees deduction is based on qualified education expenses you pay for yourself, your spouse, or a dependent for whom you

Table 19-2. Tuition and Fees Deduction at a Glance
Do not rely on this table alone. Refer to the text for more details.

Question	Answer
What is the maximum benefit?	You can reduce your income subject to tax by up to $4,000.
Where is the deduction taken?	As an adjustment to income on Form 1040, line 34, or Form 1040A, line 19.
For whom must the expenses be paid?	A student enrolled in an eligible educational institution who is either: you, your spouse, or your dependent for whom you claim an exemption.
What tuition and fees are deductible?	Tuition and fees required for enrollment or attendance at an eligible postsecondary educational institution, but not including personal, living, or family expenses, such as room and board.

claim an exemption on your tax return. Generally, the deduction is allowed for qualified education expenses paid in 2012 in connection with enrollment at an institution of higher education during 2012 or for an academic period (defined earlier under *Student Loan Interest Deduction*) beginning in 2012 or in the first 3 months of 2013.

Payments with borrowed funds. You can claim a tuition and fees deduction for qualified education expenses paid with the proceeds of a loan. Use the expenses to figure the deduction for the year in which the expenses are paid, not the year in which the loan is repaid. Treat loan payments sent directly to the educational institution as paid on the date the institution credits the student's account.

Student withdraws from class(es). You can claim a tuition and fees deduction for qualified education expenses not refunded when a student withdraws.

Qualified Education Expenses

For purposes of the tuition and fees deduction, qualified education expenses are tuition and certain related expenses required for enrollment or attendance at an eligible educational institution.

Eligible educational institution. An eligible educational institution is any college, university, vocational school, or other postsecondary educational institution eligible to participate in a student aid program administered by the U.S. Department of Education. It includes virtually all accredited public, nonprofit, and proprietary (privately owned profit-making) postsecondary institutions. The educational institution should be able to tell you if it is an eligible educational institution.

Certain educational institutions located outside the United States also participate in the U.S. Department of Education's Federal Student Aid (FSA) programs.

Academic period. An academic period is any quarter, semester, trimester, or any other period of study as reasonably determined by an eligible educational institution. If an eligible educational institution uses credit hours and does not have academic terms, each payment period may be treated as an academic period.

Related expenses. Student-activity fees and expenses for course-related books, supplies, and equipment are included in qualified education expenses for the tuition and fees deduction **only** if the fees and expenses must be paid to the institution as a condition of enrollment or attendance.

Prepaid expenses. Qualified education expenses paid in 2012 for an academic period that begins in the first three months of 2013 can be used in figuring the tuition and fees deduction. See *Academic period,* earlier. For example, if you pay $2,000 in December 2012 for qualified tuition for the 2013 winter quarter that begins in January 2013, you can use that $2,000 in figuring the tuition and fees deduction for 2012 only if you meet all the other requirements.

CAUTION

You cannot use any amount you paid in 2011 or 2013 to figure the qualified education expenses you use to figure your 2012 tuition and fees deduction.

No Double Benefit Allowed

You cannot do any of the following.

- Deduct qualified education expenses you deduct under any other provision of the law, for example, as a business expense.
- Deduct qualified education expenses for a student on your income tax return if you or anyone else claims an American opportunity or lifetime learning credit for that same student for the same year.
- Deduct qualified education expenses that have been used to figure the tax-free portion of a distribution from a Coverdell education savings account (ESA) or a qualified tuition program (QTP). For a QTP, this applies only to the amount of tax-free earnings that were distributed, not to the recovery of contributions to the program. See *Figuring the Taxable Portion of a Distribution* in chapter 7 (Coverdell ESA) and chapter 8 (QTP) of Publication 970.
- Deduct qualified education expenses that have been paid with tax-free interest on U.S. savings bonds (Form 8815). See *Figuring the Tax-Free Amount* in chapter 10 of Publication 970.
- Deduct qualified education expenses that have been paid with tax-free educational assistance such as a scholarship, grant, or employer-provided educational assistance. See *Adjustments to qualified education expenses,* later.

Adjustments to qualified education expenses. For each student, reduce the qualified education expenses paid by or on behalf of that student under the following rules. The result is the amount of adjusted qualified education expenses for each student.

Tax-free educational assistance. For tax-free educational assistance you received in 2012, reduce the qualified educational expenses for each academic period by the amount of tax-free educational assistance to that academic period. See *Academic period,* earlier.

This includes:

- The tax-free part of scholarships and fellowships (see chapter 1 of Publication 970),
- Pell grants (see chapter 1 of Publication 970),
- Employer-provided educational assistance (see chapter 11 of Publication 970),
- Veterans' educational assistance (see chapter 1 of Publication 970), and
- Any other nontaxable (tax-free) payments (other than gifts or inheritances) received as educational assistance.

Generally, any scholarship or fellowship you receive is treated as tax-free educational assistance. However, a scholarship or fellowship is not treated as tax-free educational assistance to the extent you include it in gross income (if you are required to file a tax return) for the year the scholarship or fellowship is received and either:

- The scholarship or fellowship (or any part of it) **must** be applied (by its terms) to expenses (such as room and board) other than qualified education expenses as defined in *Qualified education expenses* in Pub. 970, chapter 1.
- The scholarship or fellowship (or any part of it) **may** be applied (by its terms) to expenses (such as room and board) other than qualified education expenses as defined in *Qualified education expenses* in Pub. 970, chapter 1.

TIP

You may be able to increase the combined value of your tuition and fees deduction and certain educational assistance if you include some or all of the educational assistance in income in the year it is received. For details, see Adjustments to Qualified Education Expenses *in chapter 6 of Pub. 970.*

Some tax-free educational assistance received in 2012 may be treated as a refund of qualified education expenses paid in 2012. This tax-free educational assistance is any tax-free educational assistance received by you or anyone else after 2012 for qualified education expenses paid on behalf of a student in 2012 (or attributable to enrollment at an eligible educational institution during 2012).

If this tax-free educational assistance is received after 2012 but before you file your 2012 income tax return, see *Refunds received after 2012 but before your income tax return is filed,* later. If this tax-free educational assistance is received after 2012 and after you file your 2012 income tax return, see *Refunds received after 2012 and after your income tax return is filed,* later.

Refunds. A refund of qualified education expenses may reduce adjusted qualified education expenses for the tax year or may require you to include some or all of the refund in your gross income for the year the refund is received. See chapter 6 of Pub. 970 for more information. Some tax-free educational assistance received after 2012 may be treated as a refund. See *Tax-free educational assistance,* earlier.

Refunds received in 2012. For each student, figure the adjusted qualified education expenses for 2012 by adding all the qualified education expenses paid in 2012 and subtracting any refunds of those expenses received from the eligible educational institution during 2012.

Refunds received after 2012 but before your income tax return is filed. If you receive a refund after 2012 of qualified education expenses you paid in 2012 and the refund is received before you file your 2012 income tax return, reduce the amount of qualified education expenses for 2012 by the amount of the refund.

Refunds received after 2012 and after your income tax return is filed. If you receive a refund after 2012 of qualified education expenses you paid in 2012 and the refund is received after you file your 2012 income tax

Table 19-3. Who Can Claim a Dependent's Expenses
Do not rely on this table alone. See Who Can Claim a Dependent's Expenses *in chapter 6 of Publication 970.*

IF your dependent is an eligible student and you...	AND...	THEN...
claim an exemption for your dependent	**you** paid all qualified education expenses for your dependent	only **you** can deduct the qualified education expenses that you paid. Your dependent cannot take a deduction.
claim an exemption for your dependent	**your dependent** paid all qualified education expenses	**no one** is allowed to take a deduction.
do not claim an exemption for your dependent, but are **eligible** to	**you** paid all qualified education expenses	**no one** is allowed to take a deduction.
do not claim an exemption for your dependent, but are **eligible** to	**your dependent** paid all qualified education expenses	**no one** is allowed to take a deduction.
are **not** eligible to claim an exemption for your dependent	**you** paid all qualified education expenses	only your **dependent** can deduct the amount you paid. The amount you paid is treated as a gift to your dependent.
are **not** eligible to claim an exemption for your dependent	**your dependent** paid all qualified education expenses	only your **dependent** can take a deduction.

return, you may need to include some or all of the refund in your gross income for the year the refund is received. See chapter 6 of Pub. 970 for more information.

Coordination with Coverdell education savings accounts and qualified tuition programs. Reduce your qualified education expenses by any qualified education expenses used to figure the exclusion from gross income of (a) interest received under an education savings bond program, or (b) any distribution from a Coverdell education savings account or qualified tuition program (QTP). For a QTP, this applies only to the amount of tax-free earnings that were distributed, not to the recovery of contributions to the program.

Amounts that do not reduce qualified education expenses. Do not reduce qualified education expenses by amounts paid with funds the student receives as:

- Payment for services, such as wages,
- A loan,
- A gift,
- An inheritance, or
- A withdrawal from the student's personal savings.

Do not reduce the qualified education expenses by any scholarship or fellowship reported as income on the student's tax return in the following situations.

- The use of the money is restricted, by the terms of the scholarship or fellowship, to costs of attendance (such as room and board) other than qualified education expenses.
- The use of the money is not restricted.

Expenses That Do Not Qualify

Qualified education expenses do not include amounts paid for:

- Insurance,
- Medical expenses (including student health fees),
- Room and board,
- Transportation, or
- Similar personal, living, or family expenses.

This is true even if the amount must be paid to the institution as a condition of enrollment or attendance.

Sports, games, hobbies, and noncredit courses. Qualified education expenses generally do not include expenses that relate to any course of instruction or other education that involves sports, games or hobbies, or any noncredit course. However, if the course of instruction or other education is part of the student's degree program, these expenses can qualify.

Comprehensive or bundled fees. Some eligible educational institutions combine all of their fees for an academic period into one amount. If you do not receive, or do not have access to, an allocation showing how much you paid for qualified education expenses and how much you paid for personal expenses, such as those listed above, contact the institution. The institution is required to make this allocation and provide you with the amount you paid (or were billed) for qualified education expenses on Form 1098-T, Tuition Statement. See *How Do You Figure the Deduction*, later, for more information about Form 1098-T.

Who Is an Eligible Student

For purposes of the tuition and fees deduction, an eligible student is a student who is enrolled in one or more courses at an eligible educational institution (defined earlier). The student must have either a high school diploma or a General Educational Development (GED) credential.

Who Can Claim a Dependent's Expenses

Generally, in order to claim the tuition and fees deduction for qualified education expenses for a dependent, you must:

- Have paid the expenses, and
- Claim an exemption for the student as a dependent.

Table 19-3 summarizes who can claim the deduction.

How Much Can You Deduct

The maximum tuition and fees deduction in 2012 is $4,000, $2,000, or $0, depending on the amount of your MAGI. For details on figuring your MAGI, see chapter 6 of Publication 970.

How Do You Figure the Deduction

Figure the deduction using Form 8917.

To help you figure your tuition and fees deduction, you should receive Form 1098-T, Tuition Statement. Generally, an eligible educational institution (such as a college or university) must send Form 1098-T (or acceptable substitute) to each enrolled student by January 31, 2013.

To claim the deduction, enter the allowable amount on Form 1040, line 34, or Form 1040A, line 19, and attach your completed Form 8917.

Educator Expenses

If you were an eligible educator in 2012, you can deduct on Form 1040, line 23, or Form 1040A, line 16, up to $250 of qualified expenses you paid in 2012. If you and your spouse are filing jointly and both of you were eligible educators, the maximum deduction is $500. However, neither spouse can deduct more than $250 of his or her qualified expenses on Form 1040, line 23, or Form 1040A, line 16. You may be able to deduct expenses that are more than the $250 (or $500) limit on Schedule A (Form 1040), line 21.

Eligible educator. An eligible educator is a kindergarten through grade 12 teacher, instructor, counselor, principal, or aide who worked in a school for at least 900 hours during a school year.

Qualified expenses. Qualified expenses include ordinary and necessary expenses paid in connection with books, supplies, equipment (including computer equipment, software, and services), and other materials used in the classroom. An ordinary expense is one that is common and accepted in your educational field. A necessary expense is one that is helpful and appropriate for your profession as an educator.

An expense does not have to be required to be considered necessary.

Qualified expenses do not include expenses for home schooling or for nonathletic supplies for courses in health or physical education.

You must reduce your qualified expenses by the following amounts.

- Excludable U.S. series EE and I savings bond interest from Form 8815. See *Figuring the Tax-Free Amount* in chapter 10 of Publication 970.
- Nontaxable qualified tuition program earnings or distributions. See *Figuring the Taxable Portion of a Distribution* in chapter 8 of Publication 970.
- Nontaxable distribution of earnings from a Coverdell education savings account. See *Figuring the Taxable Portion of a Distribution* in chapter 7 of Publication 970.
- Any reimbursements you received for these expenses that were not reported to you in box 1 of your Form W-2.

Part Five.

Standard Deduction and Itemized Deductions

After you have figured your adjusted gross income, you are ready to subtract the deductions used to figure taxable income. You can subtract either the standard deduction or itemized deductions. Itemized deductions are deductions for certain expenses that are listed on Schedule A (Form 1040). The nine chapters in this part discuss the standard deduction and each itemized deduction. See chapter 20 for the factors to consider when deciding whether to subtract the standard deduction or itemized deductions.

20.

Standard Deduction

What's New

Standard deduction increased. The standard deduction for some taxpayers who do not itemize their deductions on Schedule A (Form 1040) is higher for 2012 than it was for 2011. The amount depends on your filing status. You can use the 2012 Standard Deduction Tables in this chapter to figure your standard deduction.

Introduction

This chapter discusses the following topics.

- How to figure the amount of your standard deduction.
- The standard deduction for dependents.
- Who should itemize deductions.

Most taxpayers have a choice of either taking a standard deduction or itemizing their deductions. If you have a choice, you can use the method that gives you the lower tax.

The standard deduction is a dollar amount that reduces your taxable income. It is a benefit that eliminates the need for many taxpayers to itemize actual deductions, such as medical expenses, charitable contributions, and taxes, on Schedule A (Form 1040). The standard deduction is higher for taxpayers who:

- Are 65 or older, or
- Are blind.

TIP *You benefit from the standard deduction if your standard deduction is more than the total of your allowable itemized deductions.*

Persons not eligible for the standard deduction. Your standard deduction is zero and you should itemize any deductions you have if:

- Your filing status is married filing separately, and your spouse itemizes deductions on his or her return,
- You are filing a tax return for a short tax year because of a change in your annual accounting period, or
- You are a nonresident or dual-status alien during the year. You are considered a dual-status alien if you were both a nonresident and resident alien during the year.

  Note. If you are a nonresident alien who is married to a U.S. citizen or resident alien at the end of the year, you can choose to be treated as a U.S. resident. (See Publication 519, U.S. Tax Guide for Aliens.) If you make this choice, you can take the standard deduction.

CAUTION *If an exemption for you can be claimed on another person's return (such as your parents' return), your standard deduction may be limited. See Standard Deduction for Dependents, later.*

Standard Deduction Amount

The standard deduction amount depends on your filing status, whether you are 65 or older or blind, and whether an exemption can be claimed for you by another taxpayer. Generally, the standard deduction amounts are adjusted each year for inflation. The standard deduction amounts for most people are shown in Table 20-1.

Decedent's final return. The standard deduction for a decedent's final tax return is the same as it would have been had the decedent continued to live. However, if the decedent was not 65 or older at the time of death, the higher standard deduction for age cannot be claimed.

Higher Standard Deduction for Age (65 or Older)

If you are age 65 or older on the last day of the year and do not itemize deductions, you are entitled to a higher standard deduction. You are considered 65 on the day before your 65th birthday. Therefore, you can take a higher standard deduction for 2012 if you were born before January 2, 1948.

Use Table 20-2 to figure the standard deduction amount.

Higher Standard Deduction for Blindness

If you are blind on the last day of the year and you do not itemize deductions, you are entitled to a higher standard deduction.

Not totally blind. If you are not totally blind, you must get a certified statement from an eye doctor (ophthalmologist or optometrist) that:

- You cannot see better than 20/200 in the better eye with glasses or contact lenses, or
- Your field of vision is 20 degrees or less.

If your eye condition is not likely to improve beyond these limits, the statement should include this fact. You must keep the statement in your records.

If your vision can be corrected beyond these limits only by contact lenses that you can wear only briefly because of pain, infection, or ulcers, you can take the higher standard deduction for blindness if you otherwise qualify.

Spouse 65 or Older or Blind

You can take the higher standard deduction if your spouse is age 65 or older or blind and:

- You file a joint return, or
- You file a separate return and can claim an exemption for your spouse because your spouse had no gross income and cannot be claimed as a dependent by another taxpayer.

CAUTION *You cannot claim the higher standard deduction for an individual other than yourself and your spouse.*

Examples

The following examples illustrate how to determine your standard deduction using Tables 20-1 and 20-2.

Example 1. Larry, 46, and Donna, 33, are filing a joint return for 2012. Neither is blind, and neither can be claimed as a dependent. They decide not to itemize their deductions. They use Table 20-1. Their standard deduction is $11,900.

Example 2. The facts are the same as in *Example 1* except that Larry is blind at the end of 2012. Larry and Donna use Table 20-2. Their standard deduction is $13,050.

Example 3. Bill and Lisa are filing a joint return for 2012. Both are over age 65. Neither is blind, and neither can be claimed as a dependent. If they do not itemize deductions, they use Table 20-2. Their standard deduction is $14,200.

Standard Deduction for Dependents

The standard deduction for an individual who can be claimed as a dependent on another person's tax return is generally limited to the greater of:

- $950, or
- The individual's earned income for the year plus $300 (but not more than the regular standard deduction amount, generally $5,950).

However, if the individual is 65 or older or blind, the standard deduction may be higher.

If you (or your spouse, if filing jointly) can be claimed as a dependent on someone else's return, use Table 20-3 to determine your standard deduction.

Earned income defined. Earned income is salaries, wages, tips, professional fees, and other amounts received as pay for work you actually perform.

For purposes of the standard deduction, earned income also includes any part of a scholarship or fellowship grant that you must include in your gross income. See *Scholarships and fellowships* in chapter 12 for more information on what qualifies as a scholarship or fellowship grant.

Example 1. Michael is single. His parents can claim an exemption for him on their 2012 tax return. He has interest income of $780 and wages of $150. He has no itemized deductions. Michael uses Table 20-3 to find his standard deduction. He enters $150 (his earned income) on line 1, $450 ($150 + $300) on line 3, $950 (the larger of $450 and $950) on line 5, and $5,950 on line 6. His standard deduction, on line 7a, is $950 (the smaller of $950 and $5,950).

Example 2. Joe, a 22-year-old full-time college student, can be claimed as a dependent on his parents' 2012 tax return. Joe is married and files a separate return. His wife does not itemize deductions on her separate return. Joe has $1,500 in interest income and wages of $3,800. He has no itemized deductions. Joe finds his standard deduction by using Table 20-3. He enters his earned income, $3,800 on line 1. He adds lines 1 and 2 and enters $4,100 on line 3. On line 5, he enters $4,100, the larger of lines 3 and 4. Because Joe is married filing a separate return, he enters $5,950 on line 6. On line 7a he enters $4,100 as his standard deduction because it is smaller than $5,950, the amount on line 6.

Example 3. Amy, who is single, can be claimed as a dependent on her parents' 2012 tax return. She is 18 years old and blind. She has interest income of $1,300 and wages of $2,900. She has no itemized deductions. Amy uses Table 20-3 to find her standard deduction. She enters her wages of $2,900 on line 1. She adds lines 1 and 2 and enters $3,200 on line 3. On line 5, she enters $3,200, the larger of lines 3 and 4. Because she is single, Amy enters $5,950 on line 6. She enters $3,200 on line 7a. This is the smaller of the amounts on lines 5 and 6. Because she checked one box in the top part of the worksheet, she enters $1,450 on line 7b. She then adds the amounts on lines 7a and 7b and enters her standard deduction of $4,650 on line 7c.

Example 4. Ed is single. His parents can claim an exemption for him on their 2012 tax return. He has wages of $7,000, interest income of $500, and a business loss of $3,000. He has no itemized deductions. Ed uses Table 20-3 to figure his standard deduction. He enters $4,000 ($7,000 - $3,000) on line 1. He adds lines 1 and 2 and enters $4,300 on line 3. On line 5 he enters $4,300, the larger of lines 3 and 4. Because he is single, Ed enters $5,950 on line 6. On line 7a he enters $4,300 as his standard deduction because it is smaller than $5,950, the amount on line 6.

Who Should Itemize

You should itemize deductions if your total deductions are more than the standard deduction amount. Also, you should itemize if you do not qualify for the standard deduction, as discussed earlier under *Persons not eligible for the standard deduction*.

You should first figure your itemized deductions and compare that amount to your standard deduction to make sure you are using the method that gives you the greater benefit.

When to itemize. You may benefit from itemizing your deductions on Schedule A (Form 1040) if you:

- Do not qualify for the standard deduction, or the amount you can claim is limited,
- Had large uninsured medical and dental expenses during the year,
- Paid interest and taxes on your home,
- Had large unreimbursed employee business expenses or other miscellaneous deductions,
- Had large uninsured casualty or theft losses,
- Made large contributions to qualified charities, or
- Have total itemized deductions that are more than the standard deduction to which you otherwise are entitled.

These deductions are explained in chapters 21–28.

If you decide to itemize your deductions, complete Schedule A and attach it to your Form 1040. Enter the amount from Schedule A, line 29, on Form 1040, line 40.

Electing to itemize for state tax or other purposes. Even if your itemized deductions are less than your standard deduction, you can elect to itemize deductions on your federal return rather than take the standard deduction. You may want to do this if, for example, the tax benefit of itemizing your deductions on your state tax return is greater than the tax benefit you lose on your federal return by not taking the standard deduction. To make this election, you must check the box on line 30 of Schedule A.

Changing your mind. If you do not itemize your deductions and later find that you should have itemized — or if you itemize your deductions and later find you should not have — you can change your return by filing Form 1040X, Amended U.S. Individual Income Tax Return. See *Amended Returns and Claims for Refund* in chapter 1 for more information on amended returns.

Married persons who filed separate returns. You can change methods of taking deductions only if you and your spouse both make the same changes. Both of you must file a consent to assessment for any additional tax either one may owe as a result of the change.

You and your spouse can use the method that gives you the lower total tax, even though one of you may pay more tax than you would have paid by using the other method. You both must use the same method of claiming deductions. If one itemizes deductions, the other should itemize because he or she will not qualify for the standard deduction. See *Persons not eligible for the standard deduction*, earlier.

2012 Standard Deduction Tables

If you are married filing a separate return and your spouse itemizes deductions, or if you are a dual-status alien, you cannot take the standard deduction even if you were born before January 2, 1948, or are blind.

Table 20-1. Standard Deduction Chart for Most People*

If your filing status is...	Your standard deduction is:
Single or Married filing separately	$5,950
Married filing jointly or Qualifying widow(er) with dependent child	11,900
Head of household	8,700

*Do not use this chart if you were born before January 2, 1948, are blind, or if someone else can claim you (or your spouse if filing jointly) as a dependent. Use Table 20-2 or 20-3 instead.

Table 20-2. Standard Deduction Chart for People Born Before January 2, 1948, or Who are Blind

Check the correct number of boxes below. Then go to the chart.

You: Born before January 2, 1948 ☐ Blind ☐

Your spouse, if claiming spouse's exemption: Born before January 2, 1948 ☐ Blind ☐

Total number of boxes checked ☐

IF your filing status is...	AND the number in the box above is...	THEN your standard deduction is...
Single	1	$7,400
	2	8,850
Married filing jointly or Qualifying widow(er) with dependent child	1	$13,050
	2	14,200
	3	15,350
	4	16,500
Married filing separately	1	$7,100
	2	8,250
	3	9,400
	4	10,550
Head of household	1	$10,150
	2	11,600

*If someone else can claim you (or your spouse if filing jointly) as a dependent, use Table 20-3 instead.

Table 20-3. Standard Deduction Worksheet for Dependents
Use this worksheet only if someone else can claim you (or your spouse if filing jointly) as a dependent.

Check the correct number of boxes below. Then go to the worksheet.

You: Born before January 2, 1948 ☐ Blind ☐

Your spouse, if claiming spouse's exemption: Born before January 2, 1948 ☐ Blind ☐

Total number of boxes checked ☐

1.	Enter your earned income (defined below). If none, enter -0-.	**1.** ______
2.	Additional amount.	**2.** $300
3.	Add lines 1 and 2.	**3.** ______
4.	Minimum standard deduction.	**4.** $950
5.	Enter the larger of line 3 or line 4.	**5.** ______
6.	Enter the amount shown below for your filing status. • Single or Married filing separately—$5,950 • Married filing jointly—$11,900 • Head of household—$8,700	**6.** ______
7.	**Standard deduction.** **a.** Enter the smaller of line 5 or line 6. If born after January 1, 1948, and not blind, stop here. This is your standard deduction. Otherwise, go on to line 7b. **b.** If born before January 2, 1948, or blind, multiply $1,450 ($1,150 if married) by the number in the box above. **c.** Add lines 7a and 7b. This is your standard deduction for 2012.	**7a.** ______ **7b.** ______ **7c.** ______

Earned income *includes wages, salaries, tips, professional fees, and other compensation received for personal services you performed. It also includes any amount received as a scholarship that you must include in your income.*

21.

Medical and Dental Expenses

What's New

Standard mileage rate. The standard mileage rate allowed for operating expenses for a car when you use it for medical reasons is 23 cents per mile. See *Transportation* under *What Medical Expenses Are Includible*.

Introduction

This chapter will help you determine the following.

- What medical expenses are.
- What expenses you can include this year.
- How much of the expenses you can deduct.
- Whose medical expenses you can include.
- What medical expenses are includible.
- How to treat reimbursements.
- How to report the deduction on your tax return.
- How to report impairment-related work expenses.
- How to report health insurance costs if you are self-employed.

Useful Items

You may want to see:

Publications

- ❑ **502** Medical and Dental Expenses
- ❑ **969** Health Savings Accounts and Other Tax-Favored Health Plans

Form (and Instructions)

- ❑ **Schedule A (Form 1040)** Itemized Deductions

What Are Medical Expenses?

Medical expenses are the costs of diagnosis, cure, mitigation, treatment, or prevention of disease, and the costs for treatments affecting any part or function of the body. These expenses include payments for legal medical services rendered by physicians, surgeons, dentists, and other medical practitioners. They include the costs of equipment, supplies, and diagnostic devices needed for these purposes.

Medical care expenses must be primarily to alleviate or prevent a physical or mental defect or illness. They do not include expenses that are merely beneficial to general health, such as vitamins or a vacation.

Medical expenses include the premiums you pay for insurance that covers the expenses of medical care, and the amounts you pay for transportation to get medical care. Medical expenses also include amounts paid for qualified long-term care services and limited amounts paid for any qualified long-term care insurance contract.

What Expenses Can You Include This Year?

You can include only the medical and dental expenses you paid this year, regardless of when the services were provided. If you pay medical expenses by check, the day you mail or deliver the check generally is the date of payment. If you use a "pay-by-phone" or "online" account to pay your medical expenses, the date reported on the statement of the financial institution showing when payment was made is the date of payment. If you use a credit card, include medical expenses you charge to your credit card in the year the charge is made, not when you actually pay the amount charged.

Separate returns. If you and your spouse live in a noncommunity property state and file separate returns, each of you can include only the medical expenses each actually paid. Any medical expenses paid out of a joint checking account in which you and your spouse have the same interest are considered to have been paid equally by each of you, unless you can show otherwise.

Community property states. If you and your spouse live in a community property state and file separate returns, or are registered domestic partners in Nevada, Washington, or California (or a person in California who is married to a person of the same sex), any medical expenses paid out of community funds are divided equally. Each of you should include half the expenses. If medical expenses are paid out of the separate funds of one individual, only the individual who paid the medical expenses can include them. If you live in a community property state, and are not filing a joint return, see Publication 555, Community Property.

How Much of the Expenses Can You Deduct?

You can deduct on Schedule A (Form 1040) only the amount of your medical and dental expenses that is more than 7.5% of your AGI (Form 1040, line 38).

In this chapter, the term "7.5% limit" is used to refer to 7.5% of your AGI. The phrase "subject to the 7.5% limit" is also used. This phrase means that you must subtract 7.5% (.075) of your AGI from your medical expenses to figure your medical expense deduction.

Example. Your AGI is $40,000, 7.5% of which is $3,000. You paid medical expenses of $2,500. You cannot deduct any of your medical expenses because they are not more than 7.5% of your AGI.

Whose Medical Expenses Can You Include?

You can generally include medical expenses you pay for yourself, as well as those you pay for someone who was your spouse or your dependent either when the services were provided or when you paid for them. There are different rules for decedents and for individuals who are the subject of multiple support agreements. See *Support claimed under a multiple support agreement*, later.

Yourself

You can include medical expenses you paid for yourself.

Spouse

You can include medical expenses you paid for your spouse. To include these expenses, you must have been married either at the time your spouse received the medical services or at the time you paid the medical expenses.

Example 1. Mary received medical treatment before she married Bill. Bill paid for the treatment after they married. Bill can include these expenses in figuring his medical expense deduction even if Bill and Mary file separate returns.

If Mary had paid the expenses, Bill could not include Mary's expenses in his separate return. Mary would include the amounts she paid during the year in her separate return. If they filed a joint return, the medical expenses both paid during the year would be used to figure their medical expense deduction.

Example 2. This year, John paid medical expenses for his wife Louise, who died last year. John married Belle this year and they file a joint return. Because John was married to Louise when she received the medical services, he can include those expenses in figuring his medical expense deduction for this year.

Dependent

You can include medical expenses you paid for your dependent. For you to include these expenses, the person must have been your dependent either at the time the medical services were provided or at the time you paid the expenses. A person generally qualifies as your dependent for purposes of the medical expense deduction if both of the following requirements are met.

1. The person was a qualifying child (defined later) or a qualifying relative (defined later), and
2. The person was a U.S. citizen or national, or a resident of the United States, Canada, or Mexico. If your qualifying child was

adopted, see *Exception for adopted child*, next.

You can include medical expenses you paid for an individual that would have been your dependent except that:

1. He or she received gross income of $3,800 or more in 2012,
2. He or she filed a joint return for 2012, or
3. You, or your spouse if filing jointly, could be claimed as a dependent on someone else's 2012 return.

Exception for adopted child. If you are a U.S. citizen or U.S. national and your adopted child lived with you as a member of your household for 2012, that child does not have to be a U.S. citizen or national or a resident of the United States, Canada, or Mexico.

Qualifying Child

A qualifying child is a child who:

1. Is your son, daughter, stepchild, foster child, brother, sister, stepbrother, stepsister, half brother, half sister, or a descendant of any of them (for example, your grandchild, niece, or nephew),
2. Was:
   a. Under age 19 at the end of 2012 and younger than you (or your spouse, if filing jointly),
   b. Under age 24 at the end of 2012, a full-time student, and younger than you (or your spouse, if filing jointly), or
   c. Any age and permanently and totally disabled,
3. Lived with you for more than half of 2012,
4. Did not provide over half of his or her own support for 2012, and
5. Did not file a joint return, or, if he or she did, it was only to claim a refund.

Adopted child. A legally adopted child is treated as your own child. This includes a child lawfully placed with you for legal adoption.

You can include medical expenses that you paid for a child before adoption if the child qualified as your dependent when the medical services were provided or when the expenses were paid.

If you pay back an adoption agency or other persons for medical expenses they paid under an agreement with you, you are treated as having paid those expenses provided you clearly substantiate that the payment is directly attributable to the medical care of the child.

But if you pay the agency or other person for medical care that was provided and paid for before adoption negotiations began, you cannot include them as medical expenses.

TIP *You may be able to take an adoption credit for other expenses related to an adoption. See the Instructions for Form 8839, Qualified Adoption Expenses, for more information.*

Child of divorced or separated parents. For purposes of the medical and dental expenses deduction, a child of divorced or separated parents can be treated as a dependent of both parents. Each parent can include the medical expenses he or she pays for the child, even if the other parent claims the child's dependency exemption, if:

1. The child is in the custody of one or both parents for more than half the year,
2. The child receives over half of his or her support during the year from his or her parents, and
3. The child's parents:
   a. Are divorced or legally separated under a decree of divorce or separate maintenance,
   b. Are separated under a written separation agreement, or
   c. Live apart at all times during the last 6 months of the year.

This does not apply if the child's exemption is being claimed under a multiple support agreement (discussed later).

Qualifying Relative

A qualifying relative is a person:

1. Who is your:
   a. Son, daughter, stepchild, foster child, or a descendant of any of them (for example, your grandchild),
   b. Brother, sister, half brother, half sister, or a son or daughter of either of them,
   c. Father, mother, or an ancestor or sibling of either of them (for example, your grandmother, grandfather, aunt, or uncle),
   d. Stepbrother, stepsister, stepfather, stepmother, son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law, or
   e. Any other person (other than your spouse) who lived with you all year as a member of your household if your relationship did not violate local law,
2. Who was not a qualifying child (see *Qualifying Child* earlier) of any other person for 2012, and
3. For whom you provided over half of the support in 2012. But see *Child of divorced or separated parents*, earlier, and *Support claimed under a multiple support agreement*, next.

Support claimed under a multiple support agreement. If you are considered to have provided more than half of a qualifying relative's support under a multiple support agreement, you can include medical expenses you pay for that person. A multiple support agreement is used when two or more people provide more than half of a person's support, but no one alone provides more than half.

Any medical expenses paid by others who joined you in the agreement cannot be included as medical expenses by anyone. However, you can include the entire unreimbursed amount you paid for medical expenses.

Example. You and your three brothers each provide one-fourth of your mother's total support. Under a multiple support agreement, you treat your mother as your dependent. You paid all of her medical expenses. Your brothers reimbursed you for three-fourths of these expenses. In figuring your medical expense deduction, you can include only one-fourth of your mother's medical expenses. Your brothers cannot include any part of the expenses. However, if you and your brothers share the nonmedical support items and you separately pay all of your mother's medical expenses, you can include the unreimbursed amount you paid for her medical expenses in your medical expenses.

Decedent

Medical expenses paid before death by the decedent are included in figuring any deduction for medical and dental expenses on the decedent's final income tax return. This includes expenses for the decedent's spouse and dependents as well as for the decedent.

The survivor or personal representative of a decedent can choose to treat certain expenses paid by the decedent's estate for the decedent's medical care as paid by the decedent at the time the medical services were provided. The expenses must be paid within the 1-year period beginning with the day after the date of death. If you are the survivor or personal representative making this choice, you must attach a statement to the decedent's Form 1040 (or the decedent's amended return, Form 1040X) saying that the expenses have not been and will not be claimed on the estate tax return.

CAUTION *Qualified medical expenses paid before death by the decedent are not deductible if paid with a tax-free distribution from any Archer MSA, Medicare Advantage MSA, or health savings account.*

Amended returns and claims for refund are discussed in chapter 1.

What if you pay medical expenses of a deceased spouse or dependent? If you paid medical expenses for your deceased spouse or dependent, include them as medical expenses on your Form 1040 in the year paid, whether they are paid before or after the decedent's death. The expenses can be included if the person was your spouse or dependent either at the time the medical services were provided or at the time you paid the expenses.

What Medical Expenses Are Includible?

Use Table 21-1 later, as a guide to determine which medical and dental expenses you can include on Schedule A (Form 1040).

This table does not include all possible medical expenses. To determine if an expense not listed can be included in figuring your medical expense deduction, see *What Are Medical Expenses*, earlier.

Insurance Premiums

You can include in medical expenses insurance premiums you pay for policies that cover medical care. Medical care policies can provide payment for treatment that includes:

- Hospitalization, surgical services, X-rays,
- Prescription drugs and insulin,
- Dental care,
- Replacement of lost or damaged contact lenses, and
- Long-term care (subject to additional limitations). See *Qualified Long-Term Care Insurance Contracts* in Publication 502.

If you have a policy that provides payments for other than medical care, you can include the premiums for the medical care part of the policy if the charge for the medical part is reasonable. The cost of the medical part must be separately stated in the insurance contract or given to you in a separate statement.

Note. When figuring the amount of insurance premiums you can include in medical expenses on Schedule A, do not include any health coverage tax credit advance payments shown in box 1 of Form 1099-H, Health Coverage Tax Credit (HCTC) Advance Payments. Also, do not include insurance premiums attributable to a nondependent child under age 27 if your premiums increased as a result of adding this child to your policy.

Employer-sponsored health insurance plan. Do not include in your medical and dental expenses any insurance premiums paid by an employer-sponsored health insurance plan unless the premiums are included in box 1 of your Form W-2. Also, do not include any other medical and dental expenses paid by the plan unless the amount paid is included in box 1 of your Form W-2.

Example. You are a federal employee participating in the premium conversion plan of the Federal Employee Health Benefits (FEHB) program. Your share of the FEHB premium is paid by making a pre-tax reduction in your salary. Because you are an employee whose insurance premiums are paid with money that is never included in your gross income, you cannot deduct the premiums paid with that money.

Long-term care services. Contributions made by your employer to provide coverage for qualified long-term care services under a flexible spending or similar arrangement must be included in your income. This amount will be reported as wages in box 1 of your Form W-2.

Health reimbursement arrangement (HRA). If you have medical expenses that are reimbursed by a health reimbursement arrangement, you cannot include those expenses in your medical expenses. This is because an HRA is funded solely by the employer.

Retired public safety officers. If you are a retired public safety officer, do not include as medical expenses any health or long-term care premiums that you elected to have paid with tax-free distributions from your retirement plan. This applies only to distributions that would otherwise be included in income.

Medicare A. If you are covered under social security (or if you are a government employee who paid Medicare tax), you are enrolled in Medicare A. The payroll tax paid for Medicare A is not a medical expense.

If you are not covered under social security (or were not a government employee who paid Medicare tax), you can voluntarily enroll in Medicare A. In this situation you can include the premiums you paid for Medicare A as a medical expense.

Medicare B. Medicare B is supplemental medical insurance. Premiums you pay for Medicare B are a medical expense. Check the information you received from the Social Security Administration to find out your premium.

Medicare D. Medicare D is a voluntary prescription drug insurance program for persons with Medicare A or B. You can include as a medical expense premiums you pay for Medicare D.

Prepaid insurance premiums. Premiums you pay before you are age 65 for insurance for medical care for yourself, your spouse, or your dependents after you reach age 65 are medical care expenses in the year paid if they are:

- Payable in equal yearly installments, or more often, and
- Payable for at least 10 years, or until you reach age 65 (but not for less than 5 years).

Unused sick leave used to pay premiums. You must include in gross income cash payments you receive at the time of retirement for unused sick leave. You also must include in gross income the value of unused sick leave that, at your option, your employer applies to the cost of your continuing participation in your employer's health plan after you retire. You can include this cost of continuing participation in the health plan as a medical expense.

If you participate in a health plan where your employer automatically applies the value of unused sick leave to the cost of your continuing participation in the health plan (and you do not have the option to receive cash), do not include the value of the unused sick leave in gross income. You cannot include this cost of continuing participation in that health plan as a medical expense.

Meals and Lodging

You can include in medical expenses the cost of meals and lodging at a hospital or similar institution if a principal reason for being there is to get medical care. See *Nursing home*, later.

You may be able to include in medical expenses the cost of lodging not provided in a hospital or similar institution. You can include the cost of such lodging while away from home if all of the following requirements are met.

- The lodging is primarily for and essential to medical care.
- The medical care is provided by a doctor in a licensed hospital or in a medical care facility related to, or the equivalent of, a licensed hospital.
- The lodging is not lavish or extravagant under the circumstances.
- There is no significant element of personal pleasure, recreation, or vacation in the travel away from home.

The amount you include in medical expenses for lodging cannot be more than $50 for each night for each person. You can include lodging for a person traveling with the person receiving the medical care. For example, if a parent is traveling with a sick child, up to $100 per night can be included as a medical expense for lodging. Meals are not included.

Nursing home. You can include in medical expenses the cost of medical care in a nursing home, home for the aged, or similar institution, for yourself, your spouse, or your dependents. This includes the cost of meals and lodging in the home if a principal reason for being there is to get medical care.

Do not include the cost of meals and lodging if the reason for being in the home is personal. You can, however, include in medical expenses the part of the cost that is for medical or nursing care.

Transportation

Include in medical expenses amounts paid for transportation primarily for, and essential to, medical care. You can include:

- Bus, taxi, train, or plane fares, or ambulance service,
- Transportation expenses of a parent who must go with a child who needs medical care,
- Transportation expenses of a nurse or other person who can give injections, medications, or other treatment required by a patient who is traveling to get medical care and is unable to travel alone, and
- Transportation expenses for regular visits to see a mentally ill dependent, if these visits are recommended as a part of treatment.

Car expenses. You can include out-of-pocket expenses, such as the cost of gas and oil, when you use your car for medical reasons. You cannot include depreciation, insurance, general repair, or maintenance expenses.

If you do not want to use your actual expenses for 2012, you can use the standard medical mileage rate of 23 cents per mile.

You can also include parking fees and tolls. You can add these fees and tolls to your medical expenses whether you use actual expenses or use the standard mileage rate.

Example. In 2012, Bill Jones drove 2,800 miles for medical reasons. He spent $500 for gas, $30 for oil, and $100 for tolls and parking. He wants to figure the amount he can include in medical expenses both ways to see which gives him the greater deduction.

He figures the actual expenses first. He adds the $500 for gas, the $30 for oil, and the $100 for tolls and parking for a total of $630.

He then figures the standard mileage amount. He multiplies 2,800 miles by 23 cents a mile for a total of $644. He then adds the $100 tolls and parking for a total of $744.

Bill includes the $744 of car expenses with his other medical expenses for the year because the $744 is more than the $630 he figured using actual expenses.

Transportation expenses you cannot include. You cannot include in medical expenses the cost of transportation in the following situations.

- Going to and from work, even if your condition requires an unusual means of transportation.
- Travel for purely personal reasons to another city for an operation or other medical care.
- Travel that is merely for the general improvement of one's health.
- The costs of operating a specially equipped car for other than medical reasons.

Disabled Dependent Care Expenses

Some disabled dependent care expenses may qualify as either:

- Medical expenses, or
- Work-related expenses for purposes of taking a credit for dependent care. (See chapter 31 and Publication 503, Child and Dependent Care Expenses.)

You can choose to apply them either way as long as you do not use the same expenses to claim both a credit and a medical expense deduction.

How Do You Treat Reimbursements?

You can include in medical expenses only those amounts paid during the taxable year for which you received no insurance or other reimbursement.

Insurance Reimbursement

You must reduce your total medical expenses for the year by all reimbursements for medical expenses that you receive from insurance or other sources during the year. This includes payments from Medicare.

Even if a policy provides reimbursement for only certain specific medical expenses, you must use amounts you receive from that policy to reduce your total medical expenses, including those it does not reimburse.

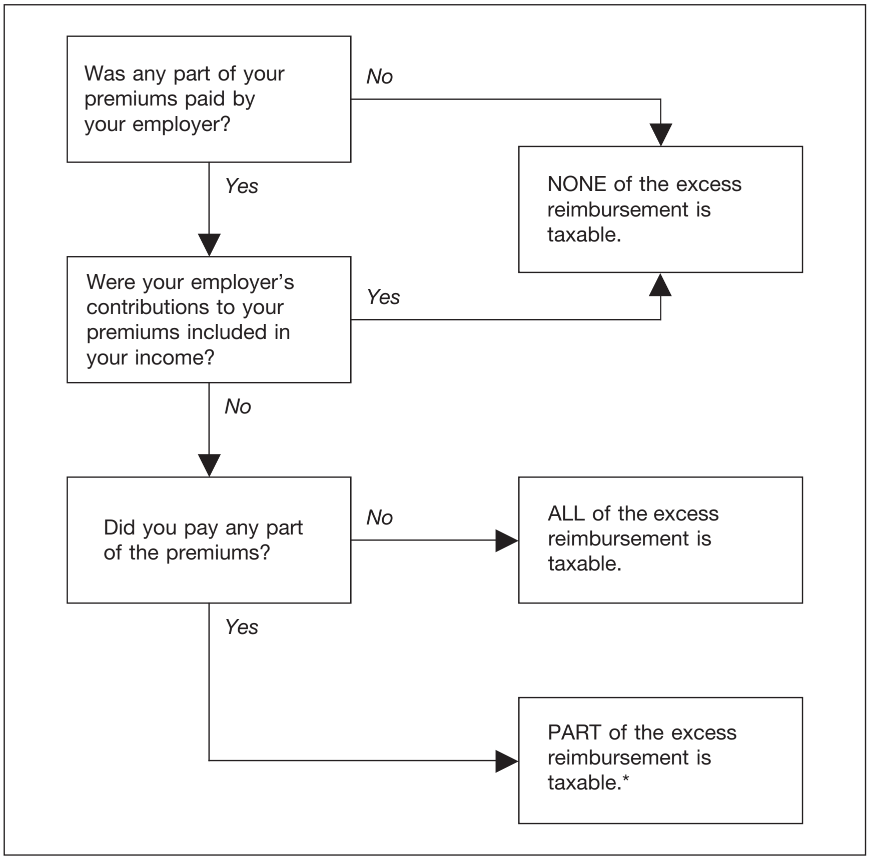
Example. You have insurance policies that cover your hospital and doctors' bills but not your nursing bills. The insurance you receive for the hospital and doctors' bills is more than their charges. In figuring your medical deduction, you must reduce the total amount you spent for medical care by the total amount of insurance you received, even if the policies do not cover some of your medical expenses.

Health reimbursement arrangement (HRA). A health reimbursement arrangement is an employer-funded plan that reimburses employees for medical care expenses and allows unused amounts to be carried forward. An HRA is funded solely by the employer and the reimbursements for medical expenses, up to a maximum dollar amount for a coverage period, are not included in your income.

Table 21-1. **Medical and Dental Expenses Checklist.** See Publication 502 for more information about these and other expenses.

You can include:		You cannot include:	
• Bandages • Birth control pills prescribed by your doctor • Body scan • Braille books • Breast pump and supplies • Capital expenses for equipment or improvements to your 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 • Fertility enhancement, certain 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) • 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 • 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 • 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	• Baby sitting and childcare • Bottled water • Contributions to Archer MSAs (see Publication 969) • Diaper service • Expenses for your general health (even if following your doctor's advice) such as— —Health club dues —Household help (even if recommended by a doctor) —Social activities, such as dancing or swimming lessons —Trip for general health improvement • Flexible spending account reimbursements for medical expenses (if contributions were on a pre-tax basis) • Funeral, burial, or cremation expenses • Health savings account payments for medical expenses • Illegal operation, treatment, or medicine • Life insurance or income protection policies, or policies providing payment for loss of life, limb, sight, etc. • Maternity clothes	• Medical insurance included in a car insurance policy covering all persons injured in or by your car • Medicine you buy without a prescription • Nursing care for a healthy baby • Prescription drugs you brought in (or ordered shipped) from another country, in most cases • Nutritional supplements, vitamins, herbal supplements, "natural medicines," etc., unless recommended by a medical practitioner as a treatment for a specific medical condition diagnosed by a physician • Surgery for purely cosmetic reasons • Toothpaste, toiletries, cosmetics, etc. • Teeth whitening • Weight-loss expenses not for the treatment of obesity or other disease

Figure 21-A. Is Your Excess Medical Reimbursement Taxable?



*See *Premiums paid by you and your employer* in this chapter.

Other reimbursements. Generally, you do not reduce medical expenses by payments you receive for:

- Permanent loss or loss of use of a member or function of the body (loss of limb, sight, hearing, etc.) or disfigurement to the extent the payment is based on the nature of the injury without regard to the amount of time lost from work, or
- Loss of earnings.

You must, however, reduce your medical expenses by any part of these payments that is designated for medical costs. See How Do You Figure and Report the Deduction on Your Tax Return, later.

For how to treat damages received for personal injury or sickness, see Damages for Personal Injuries, later.

You do not have a medical deduction if you are reimbursed for all of your medical expenses for the year.

Excess reimbursement. If you are reimbursed more than your medical expenses, you may have to include the excess in income. You may want to use Figure 21-A to help you decide if any of your reimbursement is taxable.

Premiums paid by you. If you pay either the entire premium for your medical insurance or all of the costs of a plan similar to medical insurance and your insurance payments or other reimbursements are more than your total medical expenses for the year, you have an excess reimbursement. Generally, you do not include the excess reimbursement in your gross income.

Premiums paid by you and your employer. If both you and your employer contribute to your medical insurance plan and your employer's contributions are not included in your gross income, you must include in your gross income the part of your excess reimbursement that is from your employer's contribution.

See Publication 502 to figure the amount of the excess reimbursement you must include in gross income.

Reimbursement in a later year. If you are reimbursed in a later year for medical expenses you deducted in an earlier year, you generally must report the reimbursement as income up to the amount you previously deducted as medical expenses.

However, do not report as income the amount of reimbursement you received up to the amount of your medical deductions that did not reduce your tax for the earlier year. For more information about the recovery of an amount that you claimed as an itemized deduction in an earlier year, see Itemized Deduction Recoveries in chapter 12.

Medical expenses not deducted. If you did not deduct a medical expense in the year you paid it because your medical expenses were not more than 7.5% of your AGI, or because you did not itemize deductions, do not include the reimbursement up to the amount of the expense in income. However, if the reimbursement is more than the expense, see Excess reimbursement, earlier.

Example. Last year, you had medical expenses of $500. You cannot deduct the $500 because it is less than 7.5% of your AGI. If, in a later year, you are reimbursed for any of the $500 in medical expenses, you do not include the amount reimbursed in your gross income.

Damages for Personal Injuries

If you receive an amount in settlement of a personal injury suit, part of that award may be for medical expenses that you deducted in an earlier year. If it is, you must include that part in your income in the year you receive it to the extent it reduced your taxable income in the earlier year. See Reimbursement in a Later Year, discussed under *How Do You Treat Reimbursements*, earlier.

Future medical expenses. If you receive an amount in settlement of a damage suit for personal injuries, part of that award may be for future medical expenses. If it is, you must reduce any future medical expenses for these injuries until the amount you received has been completely used.

How Do You Figure and Report the Deduction on Your Tax Return?

Once you have determined which medical expenses you can include, you figure and report the deduction on your tax return.

What Tax Form Do You Use?

You figure your medical expense deduction on lines 1-4 of Schedule A (Form 1040). You cannot claim medical expenses on Form 1040A or Form 1040EZ. If you need more information on itemized deductions or you are not sure if you can itemize, see chapter 20.

Enter the amount you paid for medical and dental expenses on line 1, Schedule A (Form 1040). This should be your expenses that were not reimbursed by insurance or any other sources.

You can deduct only the amount of your medical and dental expenses that is more than 7.5% of your AGI shown on line 38, Form 1040.

Impairment-Related Work Expenses

If you are a person with a disability, you can take a business deduction for expenses that are necessary for you to be able to work. If you take a business deduction for impairment-related work expenses, do not take a medical deduction for the same expenses.

You have a disability if you have:

- A physical or mental disability (for example, blindness or deafness) that functionally limits your being employed, or
- A physical or mental impairment (for example, a sight or hearing impairment) that substantially limits one or more of your major life activities, such as performing manual tasks, walking, speaking, breathing, learning, or working.

Impairment-related expenses defined. Impairment-related expenses are those ordinary and necessary business expenses that are:

- Necessary for you to do your work satisfactorily,
- For goods and services not required or used, other than incidentally, in your personal activities, and
- Not specifically covered under other income tax laws.

Where to report. If you are self-employed, deduct the business expenses on the appropriate form (Schedule C, C-EZ, E, or F) used to report your business income and expenses.

If you are an employee, complete Form 2106, Employee Business Expenses, or Form 2106-EZ, Unreimbursed Employee Business Expenses. Enter on Schedule A (Form 1040), line 28, that part of the amount on Form 2106, line 10, or Form 2106-EZ, line 6, that is related to your impairment. Enter the amount that is unrelated to your impairment on Schedule A (Form 1040), line 21. Your impairment-related work expenses are not subject to the 2%-of-adjusted-gross-income limit that applies to other employee business expenses.

Example. You are blind. You must use a reader to do your work. You use the reader both during your regular working hours at your place of work and outside your regular working hours away from your place of work. The reader's services are only for your work. You can deduct your expenses for the reader as business expenses.

Health Insurance Costs for Self-Employed Persons

If you were self-employed and had a net profit for the year, you may be able to deduct, as an adjustment to income, amounts paid for medical and qualified long-term care insurance on behalf of yourself, your spouse, your dependents, and, your children who were under age 27 at the end of 2012. For this purpose, you were self-employed if you were a general partner (or a limited partner receiving guaranteed payments) or you received wages from an S corporation in which you were more than a 2% shareholder. The insurance plan must be established under your trade or business and the deduction cannot be more than your earned income from that trade or business.

You cannot deduct payments for medical insurance for any month in which you were eligible to participate in a health plan subsidized by your employer, your spouse's employer, or, an employer of your dependent or your child under age 27 at the end of 2012. You cannot deduct payments for a qualified long-term care insurance contract for any month in which you were eligible to participate in a long-term care insurance plan subsidized by your employer or your spouse's employer.

If you qualify to take the deduction, use the Self-Employed Health Insurance Deduction Worksheet in the Form 1040 instructions to figure the amount you can deduct. But if any of the following applies, do not use that worksheet.

- You had more than one source of income subject to self-employment tax.
- You file Form 2555, Foreign Earned Income, or Form 2555-EZ, Foreign Earned Income Exclusion.
- You are using amounts paid for qualified long-term care insurance to figure the deduction.

If you cannot use the worksheet in the Form 1040 instructions, use the worksheet in Publication 535, Business Expenses, to figure your deduction.

Note. When figuring the amount you can deduct for insurance premiums, do not include any advance payments shown in box 1 of Form 1099-H, Health Coverage Tax Credit (HCTC) Advance Payments. If you are claiming the health coverage tax credit, subtract the amount shown on Form 8885, line 4, from the total insurance premiums you paid.

Do not include amounts paid for health insurance coverage with retirement plan distributions that were tax-free because you are a retired public safety officer.

Where to report. You take this deduction on Form 1040, line 29. If you itemize your deductions and do not claim 100% of your self-employed health insurance on line 29, you can generally include any remaining premiums with all other medical expenses on Schedule A (Form 1040), subject to the 7.5% limit. See *Self-Employed Health Insurance Deduction* in chapter 6 of Publication 535, Business Expenses, and *Medical and Dental Expenses* under Line 1, in the Instructions for Schedule A (Form 1040), for more information.

22. Taxes

Introduction

This chapter discusses which taxes you can deduct if you itemize deductions on Schedule A (Form 1040). It also explains which taxes you can deduct on other schedules or forms and which taxes you cannot deduct.

This chapter covers the following topics.

- Income taxes (federal, state, local, and foreign).
- General sales taxes (state and local).
- Real estate taxes (state, local, and foreign).
- Personal property taxes (state and local).
- Taxes and fees you cannot deduct.

Use Table 22-1 as a guide to determine which taxes you can deduct.

The end of the chapter contains a section that explains which forms you use to deduct different types of taxes.

Business taxes. You can deduct certain taxes only if they are ordinary and necessary expenses of your trade or business or of producing income. For information on these taxes, see Publication 535, Business Expenses.

State or local taxes. These are taxes imposed by the 50 states, U.S. possessions, or any of their political subdivisions (such as a county or city), or by the District of Columbia.

Indian tribal government. An Indian tribal government recognized by the Secretary of the Treasury as performing substantial government functions will be treated as a state for purposes of claiming a deduction for taxes. Income taxes, real estate taxes, and personal property taxes imposed by that Indian tribal government (or by any of its subdivisions that are treated as political subdivisions of a state) are deductible.

General sales taxes. These are taxes imposed at one rate on retail sales of a broad range of classes of items.

Foreign taxes. These are taxes imposed by a foreign country or any of its political subdivisions.

Useful Items

You may want to see:

Publication

- ❏ **514** Foreign Tax Credit for Individuals
- ❏ **530** Tax Information for Homeowners

Form (and Instructions)

- ❏ **Schedule A (Form 1040)** Itemized Deductions
- ❏ **Schedule E (Form 1040)** Supplemental Income and Loss
- ❏ **1116** Foreign Tax Credit

Tests To Deduct Any Tax

The following two tests must be met for you to deduct any tax.

- The tax must be imposed on you.
- You must pay the tax during your tax year.

The tax must be imposed on you. In general, you can deduct only taxes imposed on you.

Generally, you can deduct property taxes only if you are an owner of the property. If your spouse owns the property and pays the real estate taxes, the taxes are deductible on your spouse's separate return or on your joint return.

You must pay the tax during your tax year. If you are a cash basis taxpayer, you can deduct only those taxes you actually paid during your tax year. If you pay your taxes by check, the day you mail or deliver the check is the date of payment, provided the check is honored by the financial institution. If you use a pay-by-phone account (such as a credit card or electronic funds withdrawal), the date reported on the statement of the financial institution showing when payment was made is the date of payment. If you contest a tax liability and are a cash basis taxpayer, you can deduct the tax only in the year you actually pay it (or transfer money or other property to provide for satisfaction of the contested liability). See Publication 538, Accounting Periods and Methods, for details.

If you use an accrual method of accounting, see Publication 538 for more information.

Income Taxes

This section discusses the deductibility of state and local income taxes (including employee contributions to state benefit funds) and foreign income taxes.

State and Local Income Taxes

You can deduct state and local income taxes. However, you can elect to deduct state and local general sales taxes instead of state and local income taxes. See *General Sales Taxes*, later.

Exception. You cannot deduct state and local income taxes you pay on income that is exempt from federal income tax, unless the exempt income is interest income. For example, you cannot deduct the part of a state's income tax that is on a cost-of-living allowance exempt from federal income tax.

What To Deduct

Your deduction may be for withheld taxes, estimated tax payments, or other tax payments as follows.

Withheld taxes. You can deduct state and local income taxes withheld from your salary in the year they are withheld. Your Form(s) W-2 will show these amounts. Forms W-2G, 1099-G, 1099-R, and 1099-MISC may also show state and local income taxes withheld.

Estimated tax payments. You can deduct estimated tax payments you made during the year to a state or local government. However, you must have a reasonable basis for making the estimated tax payments. Any estimated state or local tax payments that are not made in good faith at the time of payment are not deductible. For example, you made an estimated state income tax payment. However, the estimate of your state tax liability shows that you will get a refund of the full amount of your estimated payment. You had no reasonable basis to believe you had any additional liability for state income taxes and you cannot deduct the estimated tax payment.

Refund applied to taxes. You can deduct any part of a refund of prior-year state or local income taxes that you chose to have credited to your 2012 estimated state or local income taxes.

Do not reduce your deduction by either of the following items.

- Any state or local income tax refund (or credit) you expect to receive for 2012.
- Any refund of (or credit for) prior-year state and local income taxes you actually received in 2012.

However, part or all of this refund (or credit) may be taxable. See *Refund (or credit) of state or local income taxes*, later.

Separate federal returns. If you and your spouse file separate state, local, and federal income tax returns, you each can deduct on your federal return only the amount of your own state and local income tax that you paid during the tax year.

Joint state and local returns. If you and your spouse file joint state and local returns and separate federal returns, each of you can deduct on your separate federal return a part of the total state and local income taxes paid during the tax year. You can deduct only the amount of the total taxes that is proportionate to your gross income compared to the combined gross income of you and your spouse. However, you cannot deduct more than the amount you actually paid during the year. You can avoid this calculation if you and your spouse are jointly and individually liable for the full amount of the state and local income taxes. If so, you and your spouse can deduct on your separate federal returns the amount you each actually paid.

Joint federal return. If you file a joint federal return, you can deduct the total of the state and local income taxes both of you paid.

Contributions to state benefit funds. As an employee, you can deduct mandatory contributions to state benefit funds withheld from your wages that provide protection against loss of wages. For example, certain states require employees to make contributions to state funds providing disability or unemployment insurance benefits. Mandatory payments made to the following state benefit funds are deductible as state income taxes on Schedule A (Form 1040), line 5.

- Alaska Unemployment Compensation Fund.
- California Nonoccupational Disability Benefit Fund.
- New Jersey Nonoccupational Disability Benefit Fund.
- New Jersey Unemployment Compensation Fund.
- New York Nonoccupational Disability Benefit Fund.
- Pennsylvania Unemployment Compensation Fund.
- Rhode Island Temporary Disability Benefit Fund.
- Washington State Supplemental Workmen's Compensation Fund.

CAUTION *Employee contributions to private or voluntary disability plans are not deductible.*

Refund (or credit) of state or local income taxes. If you receive a refund of (or credit for) state or local income taxes in a year after the year in which you paid them, you may have to include the refund in income on Form 1040, line 10, in the year you receive it. This includes refunds resulting from taxes that were overwithheld, applied from a prior year return, not figured correctly, or figured again because of an amended return. If you did not itemize your deductions in the previous year, do not include the refund in income. If you deducted the taxes in the previous year, include all or part of the refund on Form 1040, line 10, in the year you receive the refund. For a discussion of how much to include, see *Recoveries* in chapter 12.

Foreign Income Taxes

Generally, you can take either a deduction or a credit for income taxes imposed on you by a foreign country or a U.S. possession. However, you cannot take a deduction or credit for foreign income taxes paid on income that is exempt from U.S. tax under the foreign earned income exclusion or the foreign housing exclusion. For information on these exclusions, see Publication 54, Tax Guide for U.S. Citizens and Resident Aliens Abroad. For information on the foreign tax credit, see Publication 514.

General Sales Taxes

You can elect to deduct state and local general sales taxes, instead of state and local income taxes, as an itemized deduction on Schedule A (Form 1040), line 5b. You can use either your actual expenses or the state and local sales tax tables to figure your sales tax deduction.

Actual expenses. Generally, you can deduct the actual state and local general sales taxes (including compensating use taxes) if the tax rate was the same as the general sales tax rate. However, sales taxes on food, clothing, medical supplies, and motor vehicles are deductible as a general sales tax even if the tax rate was less than the general sales tax rate. If you paid sales tax on a motor vehicle at a rate higher than the general sales tax rate, you can deduct only the amount of tax that you would have paid at the general sales tax rate on that vehicle. If you use the actual expenses method, you must have receipts to show the general sales taxes paid. Do not include sales taxes paid on items used in your trade or business.

Motor vehicles. For purposes of this section, motor vehicles include cars, motorcycles, motor homes, recreational vehicles, sport utility vehicles, trucks, vans, and off-road vehicles. This also includes sales taxes on a leased motor vehicle, but not on vehicles used in your trade or business.

Optional sales tax tables. Instead of using your actual expenses, you can figure your state and local general sales tax deduction using the state and local sales tax tables in the Instructions for Schedule A (Form 1040). You may also be able to add the state and local general sales taxes paid on certain specified items.

Your applicable table amount is based on the state where you live, your income, and the number of exemptions claimed on your tax return. Your income is your adjusted gross income plus any nontaxable items such as the following.

- Tax-exempt interest.
- Veterans' benefits.
- Nontaxable combat pay.
- Workers' compensation.
- Nontaxable part of social security and railroad retirement benefits.
- Nontaxable part of IRA, pension, or annuity distributions, excluding rollovers.
- Public assistance payments.

If you lived in different states during the same tax year, you must prorate your applicable table amount for each state based on the days you lived in each state. See the Instructions for Schedule A (Form 1040), line 5, for details.

Real Estate Taxes

Deductible real estate taxes are any state, local, or foreign taxes on real property levied for the general public welfare. You can deduct these taxes only if they are based on the assessed value of the real property and charged uniformly against all property under the jurisdiction of the taxing authority.

Deductible real estate taxes generally do not include taxes charged for local benefits and improvements that increase the value of the property. They also do not include itemized charges for services (such as trash collection) assessed against specific property or certain people, even if the charge is paid to the taxing authority. For more information about taxes and charges that are not deductible, see *Real Estate-Related Items You Cannot Deduct*, later.

Tenant-shareholders in a cooperative housing corporation. Generally, if you are a tenant-stockholder in a cooperative housing corporation, you can deduct the amount paid to the corporation that represents your share of the real estate taxes the corporation paid or incurred for your dwelling unit. The corporation should provide you with a statement showing your share of the taxes. For more information, see *Special Rules for Cooperatives* in Publication 530.

Division of real estate taxes between buyers and sellers. If you bought or sold real estate during the year, the real estate taxes must be divided between the buyer and the seller.

The buyer and the seller must divide the real estate taxes according to the number of days in the real property tax year (the period to which the tax is imposed relates) that each owned the property. The seller is treated as paying the taxes up to, but not including, the date of sale. The buyer is treated as paying the taxes beginning with the date of sale. This applies regardless of the lien dates under local law. Generally, this information is included on the settlement statement provided at the closing.

If you (the seller) cannot deduct taxes until they are paid because you use the cash method of accounting, and the buyer of your property is personally liable for the tax, you are considered to have paid your part of the tax at the time of the sale. This lets you deduct the part of the tax to the date of sale even though you did not actually pay it. However, you must also include the amount of that tax in the selling price of the property. The buyer must include the same amount in his or her cost of the property.

You figure your deduction for taxes on each property bought or sold during the real property tax year as follows.

Worksheet 22-1. **Figuring Your Real Estate Tax Deduction**
Keep for Your Records

1.	Enter the total real estate taxes for the real property tax year	
2.	Enter the number of days in the real property tax year that you owned the property	
3.	Divide line 2 by 365 (for leap years, divide line 2 by 366)	.
4.	Multiply line 1 by line 3. This is your deduction. Enter it on Schedule A (Form 1040), line 6	

Note. Repeat steps 1 through 4 for each property you bought or sold during the real property tax year. Your total deduction is the sum of the line 4 amounts for all of the properties.

Real estate taxes for prior years. Do not divide delinquent taxes between the buyer and seller if the taxes are for any real property tax year before the one in which the property is sold. Even if the buyer agrees to pay the delinquent taxes, the buyer cannot deduct them. The buyer must add them to the cost of the property. The seller can deduct these taxes paid by the buyer. However, the seller must include them in the selling price.

Examples. The following examples illustrate how real estate taxes are divided between buyer and seller.

Example 1. Dennis and Beth White's real property tax year for both their old home and their new home is the calendar year, with payment due August 1. The tax on their old home, sold on May 7, was $620. The tax on their new home, bought on May 3, was $732. Dennis and Beth are considered to have paid a proportionate share of the real estate taxes on the old home even though they did not actually pay them to the taxing authority. On the other hand, they can claim only a proportionate share of the taxes they paid on their new property even though they paid the entire amount.

Dennis and Beth owned their old home during the real property tax year for 127 days (January 1 to May 6, the day before the sale). They figure their deduction for taxes on their old home as follows.

Worksheet 22-1. **Figuring Your Real Estate Tax Deduction — Taxes on Old Home**

1.	Enter the total real estate taxes for the real property tax year	$620
2.	Enter the number of days in the real property tax year that you owned the property	127
3.	Divide line 2 by 365 (for leap years, divide line 2 by 366)	.3470
4.	Multiply line 1 by line 3. This is your deduction. Enter it on Schedule A (Form 1040), line 6	$215

Since the buyers of their old home paid all of the taxes, Dennis and Beth also include the $215 in the selling price of the old home. (The buyers add the $215 to their cost of the home.)

Dennis and Beth owned their new home during the real property tax year for 243 days (May 3 to December 31, including their date of purchase). They figure their deduction for taxes on their new home as follows.

Worksheet 22-1. **Figuring Your Real Estate Tax Deduction — Taxes on New Home**

1.	Enter the total real estate taxes for the real property tax year	$732
2.	Enter the number of days in the real property tax year that you owned the property	243
3.	Divide line 2 by 365 (for leap years, divide line 2 by 366)	.6639
4.	Multiply line 1 by line 3. This is your deduction. Enter it on Schedule A (Form 1040), line 6	$486

Since Dennis and Beth paid all of the taxes on the new home, they add $246 ($732 paid less $486 deduction) to their cost of the new home. (The sellers add this $246 to their selling price and deduct the $246 as a real estate tax.)

Dennis and Beth's real estate tax deduction for their old and new homes is the sum of $215 and $486, or $701. They will enter this amount on Schedule A (Form 1040), line 6.

Example 2. George and Helen Brown bought a new home on May 3, 2012. Their real property tax year for the new home is the calendar year. Real estate taxes for 2011 were assessed in their state on January 1, 2012. The taxes became due on May 31, 2012, and October 31, 2012.

The Browns agreed to pay all taxes due after the date of purchase. Real estate taxes for 2011 were $680. They paid $340 on May 31, 2012, and $340 on October 31, 2012. These taxes were for the 2011 real property tax year. The Browns cannot deduct them since they did not own the property until 2012. Instead, they must add $680 to the cost of their new home.

In January 2013, the Browns receive their 2012 property tax statement for $752, which they will pay in 2013. The Browns owned their new home during the 2012 real property tax year for 243 days (May 3 to December 31). They will figure their 2013 deduction for taxes as follows.

Worksheet 22-1. **Figuring Your Real Estate Tax Deduction — Taxes on New Home**

1.	Enter the total real estate taxes for the real property tax year	$752
2.	Enter the number of days in the real property tax year that you owned the property	243
3.	Divide line 2 by 365 (for leap years, divide line 2 by 366)	.6639
4.	Multiply line 1 by line 3. This is your deduction. Claim it on Schedule A (Form 1040), line 6	$499

The remaining $253 ($752 paid less $499 deduction) of taxes paid in 2013, along with the $680 paid in 2012, is added to the cost of their new home.

Because the taxes up to the date of sale are considered paid by the seller on the date of sale, the seller is entitled to a 2012 tax deduction of $933. This is the sum of the $680 for 2011 and the $253 for the 123 days the seller owned the home in 2012. The seller must also include the $933 in the selling price when he or she figures the gain or loss on the sale. The seller should contact the Browns in January 2013 to find out how much real estate tax is due for 2012.

Form 1099-S. For certain sales or exchanges of real estate, the person responsible for closing the sale (generally the settlement agent) prepares Form 1099-S, Proceeds From Real Estate Transactions, to report certain information to the IRS and to the seller of the property. Box 2 of Form 1099-S is for the gross proceeds from the sale and should include the portion of the seller's real estate tax liability that the buyer will pay after the date of sale. The buyer includes these taxes in the cost basis of the property, and the seller both deducts this amount as a tax paid and includes it in the sales price of the property.

For a real estate transaction that involves a home, any real estate tax the seller paid in advance but that is the liability of the buyer appears on Form 1099-S, box 5. The buyer deducts this amount as a real estate tax, and the seller reduces his or her real estate tax deduction (or includes it in income) by the same amount. See Refund (or rebate), later.

Taxes placed in escrow. If your monthly mortgage payment includes an amount placed in escrow (put in the care of a third party) for real estate taxes, you may not be able to deduct the total amount placed in escrow. You can deduct only the real estate tax that the third party actually paid to the taxing authority. If the third party does not notify you of the amount of real estate tax that was paid for you, contact the third party or the taxing authority to find the proper amount to show on your return.

Tenants by the entirety. If you and your spouse held property as tenants by the entirety and you file separate federal returns, each of you can deduct only the taxes each of you paid on the property.

Divorced individuals. If your divorce or separation agreement states that you must pay the real estate taxes for a home owned by you and your spouse, part of your payments may be deductible as alimony and part as real estate taxes. See Taxes and insurance in chapter 18 for more information.

Ministers' and military housing allowances. If you are a minister or a member of the uniformed services and receive a housing allowance that you can exclude from income, you still can deduct all of the real estate taxes you pay on your home.

Refund (or rebate). If you received a refund or rebate in 2012 of real estate taxes you paid in 2012, you must reduce your deduction by the amount refunded to you. If you received a refund or rebate in 2012 of real estate taxes you deducted in an earlier year (either as an itemized deduction or an increase to your standard deduction), you generally must include the refund or rebate in income in the year you receive it. However, the amount you include in income is limited to the amount of the deduction that reduced your tax in the earlier year. For more information, see Recoveries in chapter 12.

Real Estate-Related Items You Cannot Deduct

Payments for the following items generally are not deductible as real estate taxes.

- Taxes for local benefits.
- Itemized charges for services (such as trash and garbage pickup fees).
- Transfer taxes (or stamp taxes).
- Rent increases due to higher real estate taxes.
- Homeowners' association charges.

Taxes for local benefits. Deductible real estate taxes generally do not include taxes charged for local benefits and improvements tending to increase the value of your property. These include assessments for streets, sidewalks, water mains, sewer lines, public parking facilities, and similar improvements. You should increase the basis of your property by the amount of the assessment.

Local benefit taxes are deductible only if they are for maintenance, repair, or interest charges related to those benefits. If only a part of the taxes is for maintenance, repair, or interest, you must be able to show the amount of that part to claim the deduction. If you cannot determine what part of the tax is for maintenance, repair, or interest, none of it is deductible.

CAUTION *Taxes for local benefits may be included in your real estate tax bill. If your taxing authority (or mortgage lender) does not furnish you a copy of your real estate tax bill, ask for it. You should use the rules above to determine if the local benefit tax is deductible. Contact the taxing authority if you need additional information about a specific charge on your real estate tax bill.*

Itemized charges for services. An itemized charge for services assessed against specific property or certain people is not a tax, even if the charge is paid to the taxing authority. For example, you cannot deduct the charge as a real estate tax if it is:

- A unit fee for the delivery of a service (such as a $5 fee charged for every 1,000 gallons of water you use),
- A periodic charge for a residential service (such as a $20 per month or $240 annual fee charged to each homeowner for trash collection), or
- A flat fee charged for a single service provided by your government (such as a $30 charge for mowing your lawn because it was allowed to grow higher than permitted under your local ordinance).

CAUTION *You must look at your real estate tax bill to determine if any nondeductible itemized charges, such as those listed above, are included in the bill. If your taxing authority (or mortgage lender) does not furnish you a copy of your real estate tax bill, ask for it.*

Exception. Service charges used to maintain or improve services (such as trash collection or police and fire protection) are deductible as real estate taxes if:

- The fees or charges are imposed at a like rate against all property in the taxing jurisdiction,
- The funds collected are not earmarked; instead, they are commingled with general revenue funds, and
- Funds used to maintain or improve services are not limited to or determined by the amount of these fees or charges collected.

Transfer taxes (or stamp taxes). Transfer taxes and similar taxes and charges on the sale of a personal home are not deductible. If they are paid by the seller, they are expenses of the sale and reduce the amount realized on the sale. If paid by the buyer, they are included in the cost basis of the property.

Rent increase due to higher real estate taxes. If your landlord increases your rent in the form of a tax surcharge because of increased real estate taxes, you cannot deduct the increase as taxes.

Homeowners' association charges. These charges are not deductible because they are imposed by the homeowners' association, rather than the state or local government.

Personal Property Taxes

Personal property tax is deductible if it is a state or local tax that is:

- Charged on personal property,
- Based only on the value of the personal property, and
- Charged on a yearly basis, even if it is collected more or less than once a year.

A tax that meets the above requirements can be considered charged on personal property even if it is for the exercise of a privilege. For example, a yearly tax based on value qualifies as a personal property tax even if it is called

Table 22-1. **Which Taxes Can You Deduct?**

Type of Tax	You Can Deduct	You Cannot Deduct
Fees and Charges	Fees and charges that are expenses of your trade or business or of producing income.	Fees and charges that are not expenses of your trade or business or of producing income, such as fees for driver's licenses, car inspections, parking, or charges for water bills (see Taxes and Fees You Cannot Deduct). Fines and penalties.
Income Taxes	State and local income taxes. Foreign income taxes. Employee contributions to state funds listed under Contributions to state benefit funds.	Federal income taxes. Employee contributions to private or voluntary disability plans. State and local general sales taxes if you choose to deduct state and local income taxes.
General Sales Taxes	State and local general sales taxes, including compensating use taxes.	State and local income taxes if you choose to deduct state and local general sales taxes.
Other Taxes	Taxes that are expenses of your trade or business. Taxes on property producing rent or royalty income. Occupational taxes. See chapter 28. Deductible part of self-employment tax.	Federal excise taxes, such as tax on gasoline, that are not expenses of your trade or business or of producing income. Per capita taxes.
Personal Property Taxes	State and local personal property taxes.	Customs duties that are not expenses of your trade or business or of producing income.
Real Estate Taxes	State and local real estate taxes. Foreign real estate taxes. Tenant's share of real estate taxes paid by cooperative housing corporation.	Real estate taxes that are treated as imposed on someone else (see Division of real estate taxes between buyers and sellers). Taxes for local benefits (with exceptions). See Real Estate-Related Items You Cannot Deduct. Trash and garbage pickup fees (with exceptions). See Real Estate-Related Items You Cannot Deduct. Rent increase due to higher real estate taxes. Homeowners' association charges.

a registration fee and is for the privilege of registering motor vehicles or using them on the highways.

If the tax is partly based on value and partly based on other criteria, it may qualify in part.

Example. Your state charges a yearly motor vehicle registration tax of 1% of value plus 50 cents per hundredweight. You paid $32 based on the value ($1,500) and weight (3,400 lbs.) of your car. You can deduct $15 (1% × $1,500) as a personal property tax because it is based on the value. The remaining $17 ($.50 × 34), based on the weight, is not deductible.

Taxes and Fees You Cannot Deduct

Many federal, state, and local government taxes are not deductible because they do not fall within the categories discussed earlier. Other taxes and fees, such as federal income taxes, are not deductible because the tax law specifically prohibits a deduction for them. See Table 22-1.

Taxes and fees that are generally not deductible include the following items.

- ***Employment taxes.*** This includes social security, Medicare, and railroad retirement taxes withheld from your pay. However, you can take a deduction in 2012 for the deductible part of self-employment tax. See the instructions for Schedule SE (Form 1040) for details. In addition, the social security and other employment taxes you pay on the wages of a household worker may be included in medical expenses that you can deduct or child care expenses that allow you to claim the child and dependent care credit. For more information, see chapters 21 and 31.
- ***Estate, inheritance, legacy, or succession taxes.*** However, you can deduct the estate tax attributable to income in respect of a decedent if you, as a beneficiary, must include that income in your gross income. In that case, deduct the estate tax as a miscellaneous deduction that is not subject to the 2%-of-adjusted-gross-income limit. For more information, see Publication 559, Survivors, Executors, and Administrators.
- ***Federal income taxes.*** This includes income taxes withheld from your pay.
- ***Fines and penalties.*** You cannot deduct fines and penalties paid to a government for violation of any law, including related amounts forfeited as collateral deposits.
- ***Gift taxes.***
- ***License fees.*** You cannot deduct license fees for personal purposes (such as marriage, driver's, and dog license fees).
- ***Per capita taxes.*** You cannot deduct state or local per capita taxes.

Many taxes and fees other than those listed above are also nondeductible, unless they are ordinary and necessary expenses of a business or income producing activity. For other nondeductible items, see Real Estate-Related Items You Cannot Deduct, earlier.

Where To Deduct

You deduct taxes on the following schedules.

State and local income taxes. These taxes are deducted on Schedule A (Form 1040), line 5, even if your only source of income is from business, rents, or royalties. Check **box a** on line 5.

General sales taxes. Sales taxes are deducted on Schedule A (Form 1040), line 5. You **must** check **box b** on line 5. If you elect to deduct sales taxes, you cannot deduct state and local income taxes on Schedule A (Form 1040), line 5, box a.

Foreign income taxes. Generally, income taxes you pay to a foreign country or U.S. possession can be claimed as an itemized deduction on Schedule A (Form 1040), line 8, or as a credit against your U.S. income tax on Form 1040, line 47. To claim the credit, you may have to complete and attach Form 1116. For more information, see chapter 36, the Form 1040 instructions, or Publication 514.

Real estate taxes and personal property taxes. Real estate and personal property taxes are deducted on Schedule A (Form 1040), lines 6 and 7, respectively, unless they are paid on property used in your business, in which case they are deducted on Schedule C, Schedule C-EZ, or Schedule F (Form 1040). Taxes on property that produces rent or royalty income are deducted on Schedule E (Form 1040).

Self-employment tax. The deductible part of your self-employment tax is deducted on Form 1040, line 27.

Other taxes. All other deductible taxes are deducted on Schedule A (Form 1040), line 8.

23. Interest Expense

Introduction

This chapter discusses what interest expenses you can deduct. Interest is the amount you pay for the use of borrowed money.

The following are types of interest you can deduct as itemized deductions on Schedule A (Form 1040).

- Home mortgage interest, including certain points and mortgage insurance premiums.
- Investment interest.

This chapter explains these deductions. It also explains where to deduct other types of interest and lists some types of interest you cannot deduct.

Use Table 23-1 to find out where to get more information on various types of interest, including investment interest.

Useful Items

You may want to see:

Publication

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

Home Mortgage Interest

Generally, home mortgage interest is any interest you pay on a loan secured by your home (main home or a second home). The loan may be a mortgage to buy your home, a second mortgage, a line of credit, or a home equity loan.

You can deduct home mortgage interest if all the following conditions are met.

- You file Form 1040 and itemize deductions on Schedule A (Form 1040).
- The mortgage is a secured debt on a qualified home in which you have an ownership interest. (Generally, your mortgage is a secured debt if you put your home up as collateral to protect the interest of the lender. The term “qualified home” means your main home or second home. For details, see Publication 936.)

Both you and the lender must intend that the loan be repaid.

Amount Deductible

In most cases, you can deduct all of your home mortgage interest. How much you can deduct depends on the date of the mortgage, the amount of the mortgage, and how you use the mortgage proceeds.

Fully deductible interest. If all of your mortgages fit into one or more of the following three categories at all times during the year, you can deduct all of the interest on those mortgages. (If any one mortgage fits into more than one category, add the debt that fits in each category to your other debt in the same category.)

The three categories are as follows:

1. Mortgages you took out on or before October 13, 1987 (called grandfathered debt).
2. Mortgages you took out after October 13, 1987, to buy, build, or improve your home (called home acquisition debt), but only if throughout 2012 these mortgages plus any grandfathered debt totaled $1 million or less ($500,000 or less if married filing separately).
3. Mortgages you took out after October 13, 1987, other than to buy, build, or improve your home (called home equity debt), but only if throughout 2012 these mortgages totaled $100,000 or less ($50,000 or less if married filing separately) and totaled no more than the fair market value of your home reduced by (1) and (2).

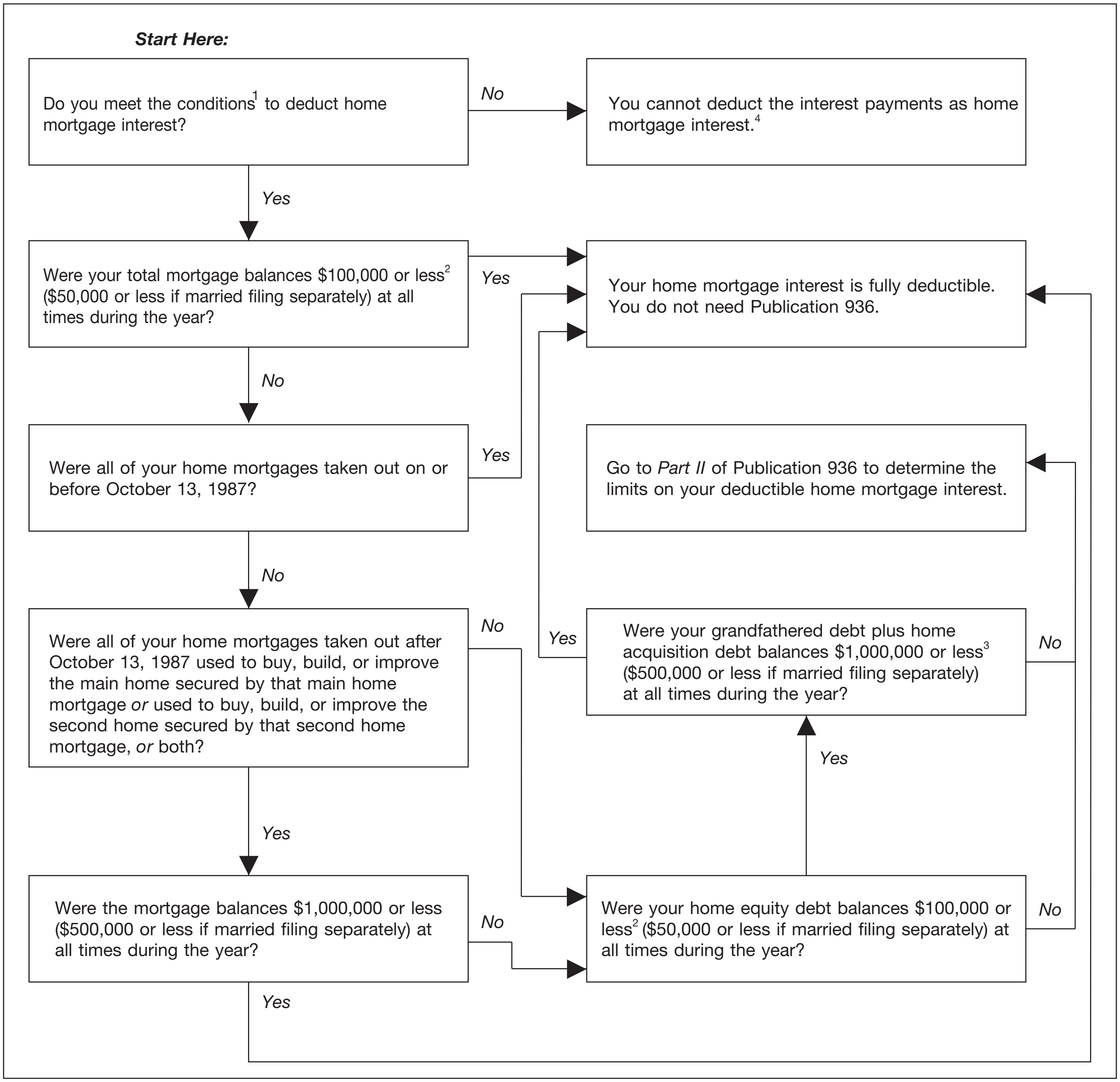
The dollar limits for the second and third categories apply to the combined mortgages on your main home and second home.

See *Part II* of Publication 936 for more detailed definitions of grandfathered, home acquisition, and home equity debt.

You can use Figure 23-A to check whether your home mortgage interest is fully deductible.

Figure 23-A. Is My Home Mortgage Interest Fully Deductible?

(Instructions: Include balances of ALL mortgages secured by your main home and second home.)



[1] You must itemize deductions on Schedule A (Form 1040). The loan must be a secured debt on a qualified home. See *Home Mortgage Interest.*

[2] If all mortgages on your main or second home exceed the home's fair market value, a lower limit may apply. See *Home equity debt limit* under *Home Equity Debt* in *Part II* of Publication 936.

[3] Amounts over the $1,000,000 limit ($500,000 if married filing separately) qualify as home equity debt if they are not more than the total home equity debt limit. See Publication 936 for more information about grandfathered debt, home acquisition debt, and home equity debt.

[4] See Table 23-1 for where to deduct other types of interest payments.

Limits on deduction. You cannot fully deduct interest on a mortgage that does not fit into any of the three categories listed earlier. If this applies to you, see *Part II* of Publication 936 to figure the amount of interest you can deduct.

Special Situations

This section describes certain items that can be included as home mortgage interest and others that cannot. It also describes certain special situations that may affect your deduction.

Late payment charge on mortgage payment. You can deduct as home mortgage interest a late payment charge if it was not for a specific service performed in connection with your mortgage loan.

Mortgage prepayment penalty. If you pay off your home mortgage early, you may have to pay a penalty. You can deduct that penalty as home mortgage interest provided the penalty is not for a specific service performed or cost incurred in connection with your mortgage loan.

Sale of home. If you sell your home, you can deduct your home mortgage interest (subject to any limits that apply) paid up to, but not including, the date of sale.

Example. John and Peggy Harris sold their home on May 7. Through April 30, they made home mortgage interest payments of $1,220. The settlement sheet for the sale of the home showed $50 interest for the 6-day period in May up to, but not including, the date of sale. Their mortgage interest deduction is $1,270 ($1,220 + $50).

Prepaid interest. If you pay interest in advance for a period that goes beyond the end of the tax year, you must spread this interest over the tax years to which it applies. You can deduct in each year only the interest that qualifies as home mortgage interest for that year. However, there is an exception that applies to points, discussed later.

Mortgage interest credit. You may be able to claim a mortgage interest credit if you were issued a mortgage credit certificate (MCC) by a state or local government. Figure the credit on Form 8396, Mortgage Interest Credit. If you take this credit, you must reduce your mortgage interest deduction by the amount of the credit.

For more information on the credit, see chapter 36.

Ministers' and military housing allowance. If you are a minister or a member of the uniformed services and receive a housing allowance that is not taxable, you can still deduct your home mortgage interest.

Hardest Hit Fund and Emergency Homeowners' Loan Programs. You can use a special method to compute your deduction for mortgage interest and real estate taxes on your main home if you meet the following two conditions.

1. You received assistance under:
   a. A State Housing Finance Agency (State HFA) Hardest Hit Fund program in which program payments could be used to pay mortgage interest, or
   b. An Emergency Homeowners' Loan Program administered by the Department of Housing and Urban Development (HUD) or a state.
2. You meet the rules to deduct all of the mortgage interest on your loan and all of the real estate taxes on your main home.

If you meet these tests, then you can deduct all of the payments you actually made during the year to your mortgage servicer, the State HFA, or HUD on the home mortgage (including the amount shown on box 3 of Form 1098-MA, Mortgage Assistance Payments), but not more than the sum of the amounts shown on Form 1098, Mortgage Interest Statement, in box 1 (mortgage interest received from payer(s) / borrower(s)), and box 4 (mortgage insurance premiums and real property taxes). However, you are not required to use this special method to compute your deduction for mortgage interest and real estate taxes on your main home.

Mortgage assistance payments under section 235 of the National Housing Act. If you qualify for mortgage assistance payments for lower-income families under section 235 of the National Housing Act, part or all of the interest on your mortgage may be paid for you. You cannot deduct the interest that is paid for you.

No other effect on taxes. Do not include these mortgage assistance payments in your income. Also, do not use these payments to reduce other deductions, such as real estate taxes.

Divorced or separated individuals. If a divorce or separation agreement requires you or your spouse or former spouse to pay home mortgage interest on a home owned by both of you, the payment of interest may be alimony. See the discussion of *Payments for jointly-owned home* in chapter 18.

Redeemable ground rents. If you make annual or periodic rental payments on a redeemable ground rent, you can deduct them as mortgage interest.

Payments made to end the lease and to buy the lessor's entire interest in the land are not deductible as mortgage interest. For more information, see Publication 936.

Nonredeemable ground rents. Payments on a nonredeemable ground rent are not mortgage interest. You can deduct them as rent if they are a business expense or if they are for rental property.

Reverse mortgages. A reverse mortgage is a loan where the lender pays you (in a lump sum, a monthly advance, a line of credit, or a combination of all three) while you continue to live in your home. With a reverse mortgage, you retain title to your home. Depending on the plan, your reverse mortgage becomes due with interest when you move, sell your home, reach the end of a pre-selected loan period, or die. Because reverse mortgages are considered loan advances and not income, the amount you receive is not taxable. Any interest (including original issue discount) accrued on a reverse mortgage is not deductible until the loan is paid in full. Your deduction may be limited because a reverse mortgage loan generally is subject to the limit on *Home Equity Debt* discussed in Publication 936.

Rental payments. If you live in a house before final settlement on the purchase, any payments you make for that period are rent and not interest. This is true even if the settlement papers call them interest. You cannot deduct these payments as home mortgage interest.

Mortgage proceeds invested in tax-exempt securities. You cannot deduct the home mortgage interest on grandfathered debt or home equity debt if you used the proceeds of the mortgage to buy securities or certificates that produce tax-free income. "Grandfathered debt" and "home equity debt" are defined earlier under *Amount Deductible.*

Refunds of interest. If you receive a refund of interest in the same tax year you paid it, you must reduce your interest expense by the amount refunded to you. If you receive a refund of interest you deducted in an earlier year, you generally must include the refund in income in the year you receive it. However, you need to include it only up to the amount of the deduction that reduced your tax in the earlier year. This is true whether the interest overcharge was refunded to you or was used to reduce the outstanding principal on your mortgage.

If you received a refund of interest you overpaid in an earlier year, you generally will receive a Form 1098, Mortgage Interest Statement, showing the refund in box 3. For information about Form 1098, see *Form 1098, Mortgage Interest Statement*, later.

For more information on how to treat refunds of interest deducted in earlier years, see *Recoveries* in chapter 12.

Points

The term "points" is used to describe certain charges paid, or treated as paid, by a borrower to obtain a home mortgage. Points may also be called loan origination fees, maximum loan charges, loan discount, or discount points.

A borrower is treated as paying any points that a home seller pays for the borrower's mortgage. See *Points paid by the seller*, later.

General Rule

You generally cannot deduct the full amount of points in the year paid. Because they are prepaid interest, you generally deduct them ratably over the life (term) of the mortgage. See *Deduction Allowed Ratably*, next.

For exceptions to the general rule, see *Deduction Allowed in Year Paid*, later.

Deduction Allowed Ratably

If you do not meet the tests listed under *Deduction Allowed in Year Paid*, later, the loan is not a home improvement loan, or you choose not to deduct your points in full in the year paid, you can deduct the points ratably (equally) over the life of the loan if you meet all the following tests.

1. You use the cash method of accounting. This means you report income in the year

you receive it and deduct expenses in the year you pay them. Most individuals use this method.

2. Your loan is secured by a home. (The home does not need to be your main home.)
3. Your loan period is not more than 30 years.
4. If your loan period is more than 10 years, the terms of your loan are the same as other loans offered in your area for the same or longer period.
5. Either your loan amount is $250,000 or less, or the number of points is not more than:
   a. 4, if your loan period is 15 years or less, or
   b. 6, if your loan period is more than 15 years.

Deduction Allowed in Year Paid

You can fully deduct points in the year paid if you meet all the following tests. (You can use Figure 23-B as a quick guide to see whether your points are fully deductible in the year paid.)

1. Your loan is secured by your main home. (Your main home is the one you ordinarily live in most of the time.)
2. Paying points is an established business practice in the area where the loan was made.
3. The points paid were not more than the points generally charged in that area.
4. You use the cash method of accounting. This means you report income in the year you receive it and deduct expenses in the year you pay them. (If you want more information about this method, see *Accounting Methods* in chapter 1.)
5. The points were not paid in place of amounts that ordinarily are stated separately on the settlement statement, such as appraisal fees, inspection fees, title fees, attorney fees, and property taxes.
6. The funds you provided at or before closing, plus any points the seller paid, were at least as much as the points charged. The funds you provided are not required to have been applied to the points. They can include a down payment, an escrow deposit, earnest money, and other funds you paid at or before closing for any purpose. You cannot have borrowed these funds from your lender or mortgage broker.
7. You use your loan to buy or build your main home.
8. The points were computed as a percentage of the principal amount of the mortgage.
9. The amount is clearly shown on the settlement statement (such as the Settlement Statement, Form HUD-1) as points charged for the mortgage. The points may be shown as paid from either your funds or the seller's.

Note. If you meet all of these tests, you can choose to either fully deduct the points in the year paid, or deduct them over the life of the loan.

Home improvement loan. You can also fully deduct in the year paid points paid on a loan to improve your main home, if tests (1) through (6) are met.

CAUTION

Second home. *You cannot fully deduct in the year paid points you pay on loans secured by your second home. You can deduct these points only over the life of the loan.*

Refinancing. Generally, points you pay to refinance a mortgage are not deductible in full in the year you pay them. This is true even if the new mortgage is secured by your main home.

However, if you use part of the refinanced mortgage proceeds to improve your main home and you meet the first 6 tests listed under *Deduction Allowed in Year Paid*, earlier, you can fully deduct the part of the points related to the improvement in the year you paid them with your own funds. You can deduct the rest of the points over the life of the loan.

Example 1. In 1997, Bill Fields got a mortgage to buy a home. In 2012, Bill refinanced that mortgage with a 15-year $100,000 mortgage loan. The mortgage is secured by his home. To get the new loan, he had to pay three points ($3,000). Two points ($2,000) were for prepaid interest, and one point ($1,000) was charged for services, in place of amounts that ordinarily are stated separately on the settlement statement. Bill paid the points out of his private funds, rather than out of the proceeds of the new loan. The payment of points is an established practice in the area, and the points charged are not more than the amount generally charged there. Bill's first payment on the new loan was due July 1. He made six payments on the loan in 2012 and is a cash basis taxpayer.

Bill used the funds from the new mortgage to repay his existing mortgage. Although the new mortgage loan was for Bill's continued ownership of his main home, it was not for the purchase or improvement of that home. He cannot deduct all of the points in 2012. He can deduct two points ($2,000) ratably over the life of the loan. He deducts $67 [($2,000 ÷ 180 months) × 6 payments] of the points in 2012. The other point ($1,000) was a fee for services and is not deductible.

Example 2. The facts are the same as in *Example 1,* except that Bill used $25,000 of the loan proceeds to improve his home and $75,000 to repay his existing mortgage. Bill deducts 25% ($25,000 ÷ $100,000) of the points ($2,000) in 2012. His deduction is $500 ($2,000 × 25%).

Bill also deducts the ratable part of the remaining $1,500 ($2,000 − $500) that must be spread over the life of the loan. This is $50 [($1,500 ÷ 180 months) × 6 payments] in 2012. The total amount Bill deducts in 2012 is $550 ($500 + $50).

Special Situations

This section describes certain special situations that may affect your deduction of points.

Original issue discount. If you do not qualify to either deduct the points in the year paid or deduct them ratably over the life of the loan, or if you choose not to use either of these methods, the points reduce the issue price of the loan. This reduction results in original issue discount, which is discussed in chapter 4 of Publication 535.

Amounts charged for services. Amounts charged by the lender for specific services connected to the loan are not interest. Examples of these charges are:

- Appraisal fees,
- Notary fees, and
- Preparation costs for the mortgage note or deed of trust.

You cannot deduct these amounts as points either in the year paid or over the life of the mortgage.

Points paid by the seller. The term "points" includes loan placement fees that the seller pays to the lender to arrange financing for the buyer.

Treatment by seller. The seller cannot deduct these fees as interest. But they are a selling expense that reduces the amount realized by the seller. See chapter 15 for information on selling your home.

Treatment by buyer. The buyer reduces the basis of the home by the amount of the seller-paid points and treats the points as if he or she had paid them. If all the tests under *Deduction Allowed in Year Paid*, earlier, are met, the buyer can deduct the points in the year paid. If any of those tests are not met, the buyer deducts the points over the life of the loan.

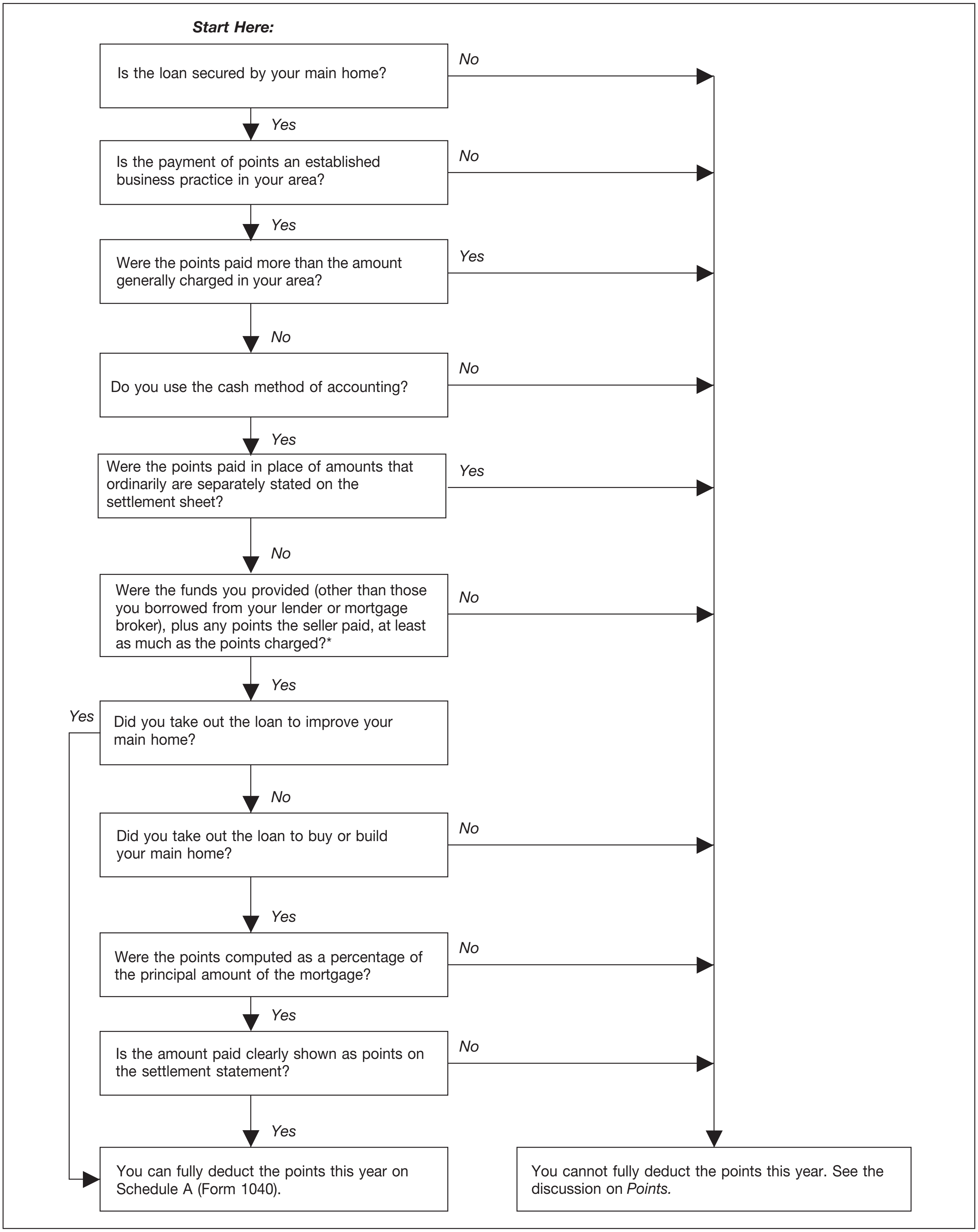
For information about basis, see chapter 13.

Funds provided are less than points. If you meet all the tests in *Deduction Allowed in Year Paid*, earlier, except that the funds you provided were less than the points charged to you (test (6)), you can deduct the points in the year paid, up to the amount of funds you provided. In addition, you can deduct any points paid by the seller.

Example 1. When you took out a $100,000 mortgage loan to buy your home in December, you were charged one point ($1,000). You meet all the tests for deducting points in the year paid, except the only funds you provided were a $750 down payment. Of the $1,000 charged for points, you can deduct $750 in the year paid. You spread the remaining $250 over the life of the mortgage.

Example 2. The facts are the same as in *Example 1,* except that the person who sold you your home also paid one point ($1,000) to help you get your mortgage. In the year paid, you can deduct $1,750 ($750 of the amount you were charged plus the $1,000 paid by the seller). You spread the remaining $250 over the life of the mortgage. You must reduce the basis of your home by the $1,000 paid by the seller.

Figure 23-B. Are My Points Fully Deductible This Year?



*The funds you provided are not required to have been applied to the points. They can include a down payment, an escrow deposit, earnest money, and other funds you paid at or before closing for any purpose.

Excess points. If you meet all the tests in *Deduction Allowed in Year Paid*, earlier, except that the points paid were more than generally paid in your area (test (3)), you deduct in the year paid only the points that are generally charged. You must spread any additional points over the life of the mortgage.

Mortgage ending early. If you spread your deduction for points over the life of the mortgage, you can deduct any remaining balance in the year the mortgage ends. However, if you refinance the mortgage with the same lender, you cannot deduct any remaining balance of spread points. Instead, deduct the remaining balance over the term of the new loan.

A mortgage may end early due to a prepayment, refinancing, foreclosure, or similar event.

Example. Dan paid $3,000 in points in 2001 that he had to spread out over the 15-year life of the mortgage. He deducts $200 points per year. Through 2011, Dan has deducted $2,200 of the points.

Dan prepaid his mortgage in full in 2012. He can deduct the remaining $800 of points in 2012.

Limits on deduction. You cannot fully deduct points paid on a mortgage unless the mortgage fits into one of the categories listed earlier under *Fully deductible interest*. See Publication 936 for details.

Mortgage Insurance Premiums

You can treat amounts you paid during 2012 for qualified mortgage insurance as home mortgage interest. The insurance must be in connection with home acquisition debt and the insurance contract must have been issued after 2006.

Qualified mortgage insurance. Qualified mortgage insurance is mortgage insurance provided by the Department of Veterans Affairs, the Federal Housing Administration, or the Rural Housing Service, and private mortgage insurance (as defined in section 2 of the Homeowners Protection Act of 1998 as in effect on December 20, 2006).

Mortgage insurance provided by the Department of Veterans Affairs is commonly known as a funding fee. If provided by the Rural Housing Service, it is commonly known as a guarantee fee. These fees can be deducted fully in 2012 if the mortgage insurance contract was issued in 2012. Contact the mortgage insurance issuer to determine the deductible amount if it is not reported in box 4 of Form 1098.

Special rules for prepaid mortgage insurance. Generally, if you paid premiums for qualified mortgage insurance that are allocable to periods after the close of the tax year, such premiums are treated as paid in the period to which they are allocated. You must allocate the premiums over the shorter of the stated term of the mortgage or 84 months, beginning with the month the insurance was obtained. No deduction is allowed for the unamortized balance if the mortgage in satisfied before its term. This paragraph does not apply to qualified mortgage insurance provided by the Department of Veterans Affairs or the Rural Housing Service. See the *Example* below.

Example. Ryan purchased a home in May of 2011 and financed the home with a 15-year mortgage. Ryan also prepaid all of the $9,240 in private mortgage insurance required at the time of closing in May. Since the $9,240 in private mortgage insurance is allocable to periods after 2011, Ryan must allocate the $9,240 over the shorter of the life of the mortgage or 84 months. Ryan's adjusted gross income (AGI) for 2011 is $76,000. Ryan can deduct $880 ($9,240 ÷ 84 × 8 months) for qualified mortgage insurance premiums in 2011. For 2012, Ryan can deduct $1,320 ($9,240 ÷ 84 × 12 months) if his AGI is $100,000 or less.

In this example, the mortgage insurance premiums are allocated over 84 months, which is shorter than the life of the mortgage of 15 years (180 months).

Limit on deduction. If your adjusted gross income on Form 1040, line 38, is more than $100,000 ($50,000 if your filing status is married filing separately), the amount of your mortgage insurance premiums that are otherwise deductible is reduced and may be eliminated. See *Line 13* in the instructions for Schedule A (Form 1040) and complete the *Mortgage Insurance Premiums Deduction Worksheet* to figure the amount you can deduct. If your adjusted gross income is more than $109,000 ($54,500 if married filing separately), you cannot deduct your mortgage insurance premiums.

Form 1098, Mortgage Interest Statement

If you paid $600 or more of mortgage interest (including certain points and mortgage insurance premiums) during the year on any one mortgage, you generally will receive a Form 1098 or a similar statement from the mortgage holder. You will receive the statement if you pay interest to a person (including a financial institution or a cooperative housing corporation) in the course of that person's trade or business. A governmental unit is a person for purposes of furnishing the statement.

The statement for each year should be sent to you by January 31 of the following year. A copy of this form will also be sent to the IRS.

The statement will show the total interest you paid during the year, any mortgage insurance premiums you paid, and if you purchased a main home during the year, it also will show the deductible points paid during the year, including seller-paid points. However, it should not show any interest that was paid for you by a government agency.

As a general rule, Form 1098 will include only points that you can fully deduct in the year paid. However, certain points not included on Form 1098 also may be deductible, either in the year paid or over the life of the loan. See *Points*, earlier, to determine whether you can deduct points not shown on Form 1098.

Prepaid interest on Form 1098. If you prepaid interest in 2012 that accrued in full by January 15, 2013, this prepaid interest may be included in box 1 of Form 1098. However, you cannot deduct the prepaid amount for January 2013 in 2012. (See *Prepaid interest*, earlier.) You will have to figure the interest that accrued for 2013 and subtract it from the amount in box 1. You will include the interest for January 2013 with the other interest you pay for 2013. See *How To Report*, later.

Refunded interest. If you received a refund of mortgage interest you overpaid in an earlier year, you generally will receive a Form 1098 showing the refund in box 3. See *Refunds of interest*, earlier.

Mortgage insurance premiums. The amount of mortgage insurance premiums you paid during 2012 may be shown in box 4 of Form 1098. See *Mortgage Insurance Premiums*, earlier.

Investment Interest

This section discusses interest expenses you may be able to deduct as an investor.

If you borrow money to buy property you hold for investment, the interest you pay is investment interest. You can deduct investment interest subject to the limit discussed later. However, you cannot deduct interest you incurred to produce tax-exempt income. Nor can you deduct interest expenses on straddles.

Investment interest does not include any qualified home mortgage interest or any interest taken into account in computing income or loss from a passive activity.

Investment Property

Property held for investment includes property that produces interest, dividends, annuities, or royalties not derived in the ordinary course of a trade or business. It also includes property that produces gain or loss (not derived in the ordinary course of a trade or business) from the sale or trade of property producing these types of income or held for investment (other than an interest in a passive activity). Investment property also includes an interest in a trade or business activity in which you did not materially participate (other than a passive activity).

Partners, shareholders, and beneficiaries. To determine your investment interest, combine your share of investment interest from a partnership, S corporation, estate, or trust with your other investment interest.

Allocation of Interest Expense

If you borrow money for business or personal purposes as well as for investment, you must allocate the debt among those purposes. Only the interest expense on the part of the debt used for investment purposes is treated as investment interest. The allocation is not affected by the use of property that secures the debt.

Limit on Deduction

Generally, your deduction for investment interest expense is limited to the amount of your net investment income.

You can carry over the amount of investment interest that you could not deduct because of this limit to the next tax year. The interest carried over is treated as investment interest paid or accrued in that next year.

You can carry over disallowed investment interest to the next tax year even if it is more than your taxable income in the year the interest was paid or accrued.

Net Investment Income

Determine the amount of your net investment income by subtracting your investment expenses (other than interest expense) from your investment income.

Investment income. This generally includes your gross income from property held for investment (such as interest, dividends, annuities, and royalties). Investment income does not include Alaska Permanent Fund dividends. It also does not include qualified dividends or net capital gain unless you choose to include them.

Choosing to include qualified dividends. Investment income generally does not include qualified dividends, discussed in chapter 8. However, you can choose to include all or part of your qualified dividends in investment income.

You make this choice by completing Form 4952, line 4g, according to its instructions.

If you choose to include any amount of your qualified dividends in investment income, you must reduce your qualified dividends that are eligible for the lower capital gains tax rates by the same amount.

Choosing to include net capital gain. Investment income generally does not include net capital gain from disposing of investment property (including capital gain distributions from mutual funds). However, you can choose to include all or part of your net capital gain in investment income.

You make this choice by completing Form 4952, line 4g, according to its instructions.

If you choose to include any amount of your net capital gain in investment income, you must reduce your net capital gain that is eligible for the lower capital gains tax rates by the same amount.

TIP *Before making either choice, consider the overall effect on your tax liability. Compare your tax if you make one or both of these choices with your tax if you do not.*

Investment income of child reported on parent's return. Investment income includes the part of your child's interest and dividend income that you choose to report on your return. If the child does not have qualified dividends, Alaska Permanent Fund dividends, or capital gain distributions, this is the amount on line 6 of Form 8814, Parents' Election To Report Child's Interest and Dividends.

Child's qualified dividends. If part of the amount you report is your child's qualified dividends, that part (which is reported on Form 1040, line 9b) generally does not count as investment income. However, you can choose to include all or part of it in investment income, as explained under *Choosing to include qualified dividends*, earlier.

Your investment income also includes the amount on Form 8814, line 12, (or, if applicable, the reduced amount figured next under *Child's Alaska Permanent Fund dividends).*

Child's Alaska Permanent Fund dividends. If part of the amount you report is your child's Alaska Permanent Fund dividends, that part does not count as investment income. To figure the amount of your child's income that you can consider your investment income, start with the amount on Form 8814, line 6. Multiply that amount by a percentage that is equal to the Alaska Permanent Fund dividends divided by the total amount on Form 8814, line 4. Subtract the result from the amount on Form 8814, line 12.

Child's capital gain distributions. If part of the amount you report is your child's capital gain distributions, that part (which is reported on Schedule D, line 13, or Form 1040, line 13) generally does not count as investment income. However, you can choose to include all or part of it in investment income, as explained in *Choosing to include net capital gain*, earlier.

Your investment income also includes the amount on Form 8814, line 12 (or, if applicable, the reduced amount figured under *Child's Alaska Permanent Fund dividends*, earlier).

Investment expenses. Investment expenses are your allowed deductions (other than interest expense) directly connected with the production of investment income. Investment expenses that are included as a miscellaneous itemized deduction on Schedule A (Form 1040), are allowable deductions after applying the 2% limit that applies to miscellaneous itemized deductions. Use the smaller of:

- The investment expenses included on Schedule A (Form 1040), line 23, or
- The amount on Schedule A, line 27.

Losses from passive activities. Income or expenses that you used in computing income or loss from a passive activity are not included in determining your investment income or investment expenses (including investment interest expense). See Publication 925, Passive Activity and At-Risk Rules, for information about passive activities.

Form 4952

Use Form 4952, Investment Interest Expense Deduction, to figure your deduction for investment interest.

Exception to use of Form 4952. You do not have to complete Form 4952 or attach it to your return if you meet all of the following tests.

- Your investment interest expense is not more than your investment income from interest and ordinary dividends minus any qualified dividends.
- You do not have any other deductible investment expenses.
- You have no carryover of investment interest expense from 2011.

If you meet all of these tests, you can deduct all of your investment interest.

More Information

For more information on investment interest, see *Interest Expenses* in chapter 3 of Publication 550.

Items You Cannot Deduct

Some interest payments are not deductible. Certain expenses similar to interest also are not deductible. Nondeductible expenses include the following items.

- Personal interest (discussed later).
- Service charges (however, see *Other Expenses (Line 23)* in chapter 28).
- Annual fees for credit cards.
- Loan fees.
- Credit investigation fees.
- Interest to purchase or carry tax-exempt securities.

Penalties. You cannot deduct fines and penalties paid to a government for violations of law, regardless of their nature.

Personal Interest

Personal interest is not deductible. Personal interest is any interest that is not home mortgage interest, investment interest, business interest, or other deductible interest. It includes the following items.

- Interest on car loans (unless you use the car for business).
- Interest on federal, state, or local income tax.
- Finance charges on credit cards, retail installment contracts, and revolving charge accounts incurred for personal expenses.
- Late payment charges by a public utility.

TIP *You may be able to deduct interest you pay on a qualified student loan. For details, see Publication 970, Tax Benefits for Education.*

Allocation of Interest

If you use the proceeds of a loan for more than one purpose (for example, personal and business), you must allocate the interest on the loan to each use. However, you do not have to allocate home mortgage interest if it is fully deductible, regardless of how the funds are used.

You allocate interest (other than fully deductible home mortgage interest) on a loan in the same way as the loan itself is allocated. You do this by tracing disbursements of the debt proceeds to specific uses. For details on how to do this, see chapter 4 of Publication 535.

How To Report

You must file Form 1040 to deduct any home mortgage interest expense on your tax return. Where you deduct your interest expense generally depends on how you use the loan proceeds. See Table 23-1 for a summary of where to deduct your interest expense.

Home mortgage interest and points. Deduct the home mortgage interest and points reported to you on Form 1098 on Schedule A (Form 1040), line 10. If you paid more deductible interest to the financial institution than the amount shown on Form 1098, show the larger deductible amount on line 10. Attach a statement explaining the difference and print "See attached" next to line 10.

Deduct home mortgage interest that was not reported to you on Form 1098 on Schedule A (Form 1040), line 11. If you paid home mortgage interest to the person from whom you bought your home, show that person's name, address, and taxpayer identification number (TIN) on the dotted lines next to line 11. The seller must give you this number and you must give the seller your TIN. A Form W-9, Request for Taxpayer Identification Number and Certification, can be used for this purpose. Failure to meet any of these requirements may result in a $50 penalty for each failure. The TIN can be either a social security number, an individual taxpayer identification number (issued by the Internal Revenue Service), or an employer identification number. See *Social Security Number (SSN)* in chapter 1 for more information about TINs.

If you can take a deduction for points that were not reported to you on Form 1098, deduct those points on Schedule A (Form 1040), line 12.

Deduct mortgage insurance premiums on Schedule A (Form 1040), line 13.

More than one borrower. If you and at least one other person (other than your spouse if you file a joint return) were liable for and paid interest on a mortgage that was for your home, and the other person received a Form 1098 showing the interest that was paid during the year, attach a statement to your return explaining this. Show how much of the interest each of you paid, and give the name and address of the person who received the form. Deduct your share of the interest on Schedule A (Form 1040), line 11, and print "See attached" next to the line. Also, deduct your share of any qualified mortgage insurance premiums on Schedule A (Form 1040), line 13.

Similarly, if you are the payer of record on a mortgage on which there are other borrowers entitled to a deduction for the interest shown on the Form 1098 you received, deduct only your share of the interest on Schedule A (Form 1040), line 10. You should let each of the other borrowers know what his or her share is.

Mortgage proceeds used for business or investment. If your home mortgage interest deduction is limited, but all or part of the mortgage proceeds were used for business, investment, or other deductible activities, see Table 23-1. It shows where to deduct the part of your excess interest that is for those activities.

Table 23-1. **Where To Deduct Your Interest Expense**

IF you have ...	**THEN deduct it on ...**	**AND for more information go to ...**
deductible student loan interest	Form 1040, line 33, or Form 1040A, line 18	Publication 970.
deductible home mortgage interest and points reported on Form 1098	Schedule A (Form 1040), line 10	Publication 936.
deductible home mortgage interest not reported on Form 1098	Schedule A (Form 1040), line 11	Publication 936.
deductible points not reported on Form 1098	Schedule A (Form 1040), line 12	Publication 936.
deductible mortgage insurance premiums	Schedule A (Form 1040), line 13	Publication 936.
deductible investment interest (other than incurred to produce rents or royalties)	Schedule A (Form 1040), line 14	Publication 550.
deductible business interest (non-farm)	Schedule C or C-EZ (Form 1040)	Publication 535.
deductible farm business interest	Schedule F (Form 1040)	Publications 225 and 535.
deductible interest incurred to produce rents or royalties	Schedule E (Form 1040)	Publications 527 and 535.
personal interest	not deductible.	

Investment interest. Deduct investment interest, subject to certain limits discussed in Publication 550, on Schedule A (Form 1040), line 14.

Amortization of bond premium. There are various ways to treat the premium you pay to buy taxable bonds. See *Bond Premium Amortization* in Publication 550.

Income-producing rental or royalty interest. Deduct interest on a loan for income-producing rental or royalty property that is not used in your business in Part I of Schedule E (Form 1040).

Example. You rent out part of your home and borrow money to make repairs. You can deduct only the interest payment for the rented part in Part I of Schedule E (Form 1040). Deduct the rest of the interest payment on Schedule A (Form 1040) if it is deductible home mortgage interest.

24. Contributions

Introduction

This chapter explains how to claim a deduction for your charitable contributions. It discusses the following topics.

- The types of organizations to which you can make deductible charitable contributions.
- The types of contributions you can deduct.
- How much you can deduct.
- What records you must keep.
- How to report your charitable contributions.

A charitable contribution is a donation or gift to, or for the use of, a qualified organization. It is voluntary and is made without getting, or expecting to get, anything of equal value.

Form 1040 required. To deduct a charitable contribution, you must file Form 1040 and itemize deductions on Schedule A. The amount of your deduction may be limited if certain rules and limits explained in this chapter apply to you. The limits are explained in detail in Publication 526.

Useful Items

You may want to see:

Publication

- ❑ **526** Charitable Contributions
- ❑ **561** Determining the Value of Donated Property

Form (and Instructions)

- ❑ **Schedule A (Form 1040)** Itemized Deductions
- ❑ **8283** Noncash Charitable Contributions

Organizations That Qualify To Receive Deductible Contributions

You can deduct your contributions only if you make them to a qualified organization. Most organizations other than churches and governments must apply to the IRS to become a qualified organization.

How to check whether an organization can receive deductible charitable contributions. You can ask any organization whether it is a qualified organization, and most will be able to tell you. Or go to IRS.gov. Click on "Tools" and then on "Exempt Organizations Select Check" (*www.irs.gov/charities*). This online tool will enable you to search for qualified organizations. You can also call the IRS to find out if an organization is qualified. Call 1-877-829-5500. People who are deaf, hard of hearing, or have a speech disability and who have access to TTY/TDD equipment can call 1-800-829-4059. Deaf or hard of hearing individuals can also contact the IRS through relay services such as the Federal Relay Service at *www.gsa.gov/fedrelay*.

Types of Qualified Organizations

Generally, only the following types of organizations can be qualified organizations.

1. A community chest, corporation, trust, fund, or foundation organized or created in or under the laws of the United States, any state, the District of Columbia, or any possession of the United States (including Puerto Rico). It must, however, be organized and operated only for charitable, religious, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals. Certain organizations that foster national or international amateur sports competition also qualify.
2. War veterans' organizations, including posts, auxiliaries, trusts, or foundations, organized in the United States or any of its possessions (including Puerto Rico).
3. Domestic fraternal societies, orders, and associations operating under the lodge system. (Your contribution to this type of organization is deductible only if it is to be used solely for charitable, religious, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals.)
4. Certain nonprofit cemetery companies or corporations. (Your contribution to this type of organization is not deductible if it can be used for the care of a specific lot or mausoleum crypt.)
5. The United States or any state, the District of Columbia, a U.S. possession (including Puerto Rico), a political subdivision of a state or U.S. possession, or an Indian tribal government or any of its subdivisions that perform substantial government functions. (Your contribution to this type of organization is only deductible if it is to be used solely for public purposes.)

Examples. The following list gives some examples of qualified organizations.

- Churches, a convention or association of churches, temples, synagogues, mosques, and other religious organizations.
- Most nonprofit charitable organizations such as the American Red Cross and the United Way.
- Most nonprofit educational organizations, including the Boy (and Girl) Scouts of America, colleges, and museums. This also includes nonprofit daycare centers that provide childcare to the general public if substantially all the childcare is provided to enable parents and guardians to be gainfully employed. However, if your contribution is a substitute for tuition or other enrollment fee, it is not deductible as a charitable contribution, as explained later under *Contributions You Cannot Deduct*.
- Nonprofit hospitals and medical research organizations.
- Utility company emergency energy programs, if the utility company is an agent for a charitable organization that assists individuals with emergency energy needs.
- Nonprofit volunteer fire companies.
- Nonprofit organizations that develop and maintain public parks and recreation facilities.
- Civil defense organizations.

Certain foreign charitable organizations. Under income tax treaties with Canada, Israel, and Mexico, you may be able to deduct contributions to certain Canadian, Israeli, or Mexican charitable organizations. Generally, you must have income from sources in that country. For additional information on the deduction of contributions to Canadian charities, see Publication 597, Information on the United States–Canada Income Tax Treaty. If you need more information on how to figure your contribution to Mexican and Israeli charities, see Publication 526.

Contributions You Can Deduct

Generally, you can deduct contributions of money or property you make to, or for the use of, a qualified organization. A contribution is "for the use of" a qualified organization when it is held in a legally enforceable trust for the qualified organization or in a similar legal arrangement. The contributions must be made to a qualified organization and not set aside for use by a specific person.

If you give property to a qualified organization, you generally can deduct the fair market value of the property at the time of the contribution. See *Contributions of Property*, later in this chapter.

Your deduction for charitable contributions generally cannot be more than 50% of your adjusted gross income (AGI), but in some cases 20% and 30% limits may apply. See *Limits on Deductions*, later.

Table 24-1 gives examples of contributions you can and cannot deduct.

Contributions From Which You Benefit

If you receive a benefit as a result of making a contribution to a qualified organization, you can deduct only the amount of your contribution that is more than the value of the benefit you receive. Also, see *Contributions From Which You Benefit* under *Contributions You Cannot Deduct*, later.

If you pay more than fair market value to a qualified organization for goods or services, the excess may be a charitable contribution. For the excess amount to qualify, you must pay it with the intent to make a charitable contribution.

Example 1. You pay $65 for a ticket to a dinner-dance at a church. Your entire $65 payment goes to the church. The ticket to the dinner-dance has a fair market value of $25. When you buy your ticket, you know that its value is less than your payment. To figure the amount of your charitable contribution, subtract the value of the benefit you receive ($25) from your total payment ($65). You can deduct $40 as a contribution to the church.

Example 2. At a fundraising auction conducted by a charity, you pay $600 for a week's stay at a beach house. The amount you pay is no more than the fair rental value. You have not made a deductible charitable contribution.

Athletic events. If you make a payment to, or for the benefit of, a college or university and, as a result, you receive the right to buy tickets to an athletic event in the athletic stadium of the college or university, you can deduct 80% of the payment as a charitable contribution.

If any part of your payment is for tickets (rather than the right to buy tickets), that part is not deductible. Subtract the price of the tickets from your payment. You can deduct 80% of the remaining amount as a charitable contribution.

Example 1. You pay $300 a year for membership in an athletic scholarship program maintained by a university. The only benefit of membership is that you have the right to buy one season ticket for a seat in a designated area of the stadium at the university's home football games. You can deduct $240 (80% of $300) as a charitable contribution.

Example 2. The facts are the same as in Example 1 except your $300 payment includes the purchase of one season ticket for the stated ticket price of $120. You must subtract the usual price of a ticket ($120) from your $300 payment. The result is $180. Your deductible charitable contribution is $144 (80% of $180).

Charity benefit events. If you pay a qualified organization more than fair market value for the right to attend a charity ball, banquet, show, sporting event, or other benefit event, you can deduct only the amount that is more than the value of the privileges or other benefits you receive.

If there is an established charge for the event, that charge is the value of your benefit. If there is no established charge, the reasonable value of the right to attend the event is the value of your benefit. Whether you use the tickets or other privileges has no effect on the amount you can deduct. However, if you return the ticket to the qualified organization for resale, you can deduct the entire amount you paid for the ticket.

CAUTION

Even if the ticket or other evidence of payment indicates that the payment is a "contribution," this does not mean you can deduct the entire amount. If the ticket shows the price of admission and the amount of the contribution, you can deduct the contribution amount.

Table 24-1. **Examples of Charitable Contributions—A Quick Check**

Use the following lists for a quick check of whether you can deduct a contribution. See the rest of this chapter for more information and additional rules and limits that may apply.

Deductible As Charitable Contributions	Not Deductible As Charitable Contributions
Money or property you give to: • Churches, synagogues, temples, mosques, and other religious organizations • Federal, state, and local governments, if your contribution is solely for public purposes (for example, a gift to reduce the public debt or maintain a public park) • Nonprofit schools and hospitals • The Salvation Army, American Red Cross, CARE, Goodwill Industries, United Way, Boy Scouts of America, Girl Scouts of America, Boys and Girls Clubs of America, etc. • War veterans groups	Money or property you give to: • Civic leagues, social and sports clubs, labor unions, and chambers of commerce • Foreign organizations (except certain Canadian, Israeli, and Mexican charities) • Groups that are run for personal profit • Groups whose purpose is to lobby for law changes • Homeowners' associations • Individuals • Political groups or candidates for public office
Expenses paid for a student living with you, sponsored by a qualified organization	Cost of raffle, bingo, or lottery tickets
Out-of-pocket expenses when you serve a qualified organization as a volunteer	Dues, fees, or bills paid to country clubs, lodges, fraternal orders, or similar groups
	Tuition
	Value of your time or services
	Value of blood given to a blood bank

Example. You pay $40 to see a special showing of a movie for the benefit of a qualified organization. Printed on the ticket is "Contribution—$40." If the regular price for the movie is $8, your contribution is $32 ($40 payment − $8 regular price).

Membership fees or dues. You may be able to deduct membership fees or dues you pay to a qualified organization. However, you can deduct only the amount that is more than the value of the benefits you receive.

You cannot deduct dues, fees, or assessments paid to country clubs and other social organizations. They are not qualified organizations.

Certain membership benefits can be disregarded. Both you and the organization can disregard the following membership benefits if you receive them in return for an annual payment of $75 or less.

1. Any rights or privileges, other than those discussed under *Athletic events*, earlier, that you can use frequently while you are a member, such as:
   a. Free or discounted admission to the organization's facilities or events,
   b. Free or discounted parking,
   c. Preferred access to goods or services, and
   d. Discounts on the purchase of goods and services.
2. Admission, while you are a member, to events open only to members of the organization, if the organization reasonably projects that the cost per person (excluding any allocated overhead) is not more than $9.90.

Token items. You do not have to reduce your contribution by the value of any benefit you receive if both of the following are true.

- You receive only a small item or other benefit of token value.
- The qualified organization correctly determines that the value of the item or benefit you received is not substantial and informs you that you can deduct your payment in full.

Written statement. A qualified organization must give you a written statement if you make a payment of more than $75 that is partly a contribution and partly for goods or services. The statement must say that you can deduct only the amount of your payment that is more than the value of the goods or services you received. It must also give you a good faith estimate of the value of those goods or services.

The organization can give you the statement either when it solicits or when it receives the payment from you.

Exception. An organization will not have to give you this statement if one of the following is true.

1. The organization is:

Table 24-2. **Volunteers' Questions and Answers**

If you volunteer for a qualified organization, the following questions and answers may apply to you. All of the rules explained in this chapter also apply. See, in particular, *Out-of-Pocket Expenses in Giving Services*.

Question	Answer
I volunteer 6 hours a week in the office of a qualified organization. The receptionist is paid $10 an hour for the same work. Can I deduct $60 a week for my time?	No, you cannot deduct the value of your time or services.
The office is 30 miles from my home. Can I deduct any of my car expenses for these trips?	Yes, you can deduct the costs of gas and oil that are directly related to getting to and from the place where you volunteer. If you don't want to figure your actual costs, you can deduct 14 cents for each mile.
I volunteer as a Red Cross nurse's aide at a hospital. Can I deduct the cost of the uniforms I must wear?	Yes, you can deduct the cost of buying and cleaning your uniforms if the hospital is a qualified organization, the uniforms are not suitable for everyday use, and you must wear them when volunteering.
I pay a babysitter to watch my children while I volunteer for a qualified organization. Can I deduct these costs?	No, you cannot deduct payments for childcare expenses as a charitable contribution, even if you would be unable to volunteer without childcare. (If you have childcare expenses so you can work for pay, see chapter 31.)

a. A governmental organization described in (5) under *Types of Qualified Organizations*, earlier, or

b. An organization formed only for religious purposes, and the only benefit you receive is an intangible religious benefit (such as admission to a religious ceremony) that generally is not sold in commercial transactions outside the donative context.

2. You receive only items whose value is not substantial as described under *Token items*, earlier.

3. You receive only membership benefits that can be disregarded, as described earlier.

Expenses Paid for Student Living With You

You may be able to deduct some expenses of having a student live with you. You can deduct qualifying expenses for a foreign or American student who:

1. Lives in your home under a written agreement between you and a qualified organization as part of a program of the organization to provide educational opportunities for the student,
2. Is not your relative or dependent, and
3. Is a full-time student in the twelfth or any lower grade at a school in the United States.

TIP *You can deduct up to $50 a month for each full calendar month the student lives with you. Any month when conditions (1) through (3) are met for 15 days or more counts as a full month.*

For additional information, see *Expenses Paid for Student Living With You* in Publication 526.

Mutual exchange program. You cannot deduct the costs of a foreign student living in your home under a mutual exchange program through which your child will live with a family in a foreign country.

Out-of-Pocket Expenses in Giving Services

Although you cannot deduct the value of your services given to a qualified organization, you may be able to deduct some amounts you pay in giving services to a qualified organization. The amounts must be:

- Unreimbursed,
- Directly connected with the services,
- Expenses you had only because of the services you gave, and
- Not personal, living, or family expenses.

Table 24-2 contains questions and answers that apply to some individuals who volunteer their services.

Conventions. If a qualified organization selects you to attend a convention as its representative, you can deduct unreimbursed expenses for travel, including reasonable amounts for meals and lodging, while away from home overnight in connection with the convention. However, see *Travel*, later.

You cannot deduct personal expenses for sightseeing, fishing parties, theater tickets, or nightclubs. You also cannot deduct transportation, meals and lodging, and other expenses for your spouse or children.

You cannot deduct your travel expenses in attending a church convention if you go only as a member of your church rather than as a chosen representative. You can, however, deduct unreimbursed expenses that are directly connected with giving services for your church during the convention.

Uniforms. You can deduct the cost and upkeep of uniforms that are not suitable for everyday use and that you must wear while performing donated services for a charitable organization.

Foster parents. You may be able to deduct as a charitable contribution some of the costs of being a foster parent (foster care provider) if you have no profit motive in providing the foster care and are not, in fact, making a profit. A qualified organization must select the individuals you take into your home for foster care.

You can deduct expenses that meet both of the following requirements.

1. They are unreimbursed out-of-pocket expenses to feed, clothe, and care for the foster child.
2. They are incurred primarily to benefit the qualified organization.

Unreimbursed expenses that you cannot deduct as charitable contributions may be considered support provided by you in determining whether you can claim the foster child as a dependent. For details, see chapter 3.

Example. You cared for a foster child because you wanted to adopt her, not to benefit the agency that placed her in your home. Your unreimbursed expenses are not deductible as charitable contributions.

Car expenses. You can deduct as a charitable contribution any unreimbursed out-of-pocket expenses, such as the cost of gas and oil, that are directly related to the use of your car in giving services to a charitable organization. You cannot deduct general repair and maintenance expenses, depreciation, registration fees, or the costs of tires or insurance.

If you do not want to deduct your actual expenses, you can use a standard mileage rate of 14 cents a mile to figure your contribution.

You can deduct parking fees and tolls whether you use your actual expenses or the standard mileage rate.

You must keep reliable written records of your car expenses. For more information, see Car expenses under *Records To Keep*, later.

Travel. Generally, you can claim a charitable contribution deduction for travel expenses necessarily incurred while you are away from home performing services for a charitable organization only if there is no significant element of personal pleasure, recreation, or vacation in the travel. This applies whether you pay the expenses directly or indirectly. You are paying the expenses indirectly if you make a payment to the charitable organization and the organization pays for your travel expenses.

The deduction for travel expenses will not be denied simply because you enjoy providing services to the charitable organization. Even if you enjoy the trip, you can take a charitable contribution deduction for your travel expenses if you are on duty in a genuine and substantial sense throughout the trip. However, if you have only nominal duties, or if for significant parts of the trip you do not have any duties, you cannot deduct your travel expenses.

Example 1. You are a troop leader for a tax-exempt youth group and you take the group on a camping trip. You are responsible for overseeing the setup of the camp and for providing adult supervision for other activities during the entire trip. You participate in the activities of the group and enjoy your time with them. You oversee the breaking of camp and you transport the group home. You can deduct your travel expenses.

Example 2. You sail from one island to another and spend 8 hours a day counting whales and other forms of marine life. The project is sponsored by a charitable organization. In most circumstances, you cannot deduct your expenses.

Example 3. You work for several hours each morning on an archaeological dig sponsored by a charitable organization. The rest of the day is free for recreation and sightseeing. You cannot take a charitable contribution deduction even though you work very hard during those few hours.

Example 4. You spend the entire day attending a charitable organization's regional meeting as a chosen representative. In the evening you go to the theater. You can claim your travel expenses as charitable contributions, but you cannot claim the cost of your evening at the theater.

Daily allowance (per diem). If you provide services for a charitable organization and receive a daily allowance to cover reasonable travel expenses, including meals and lodging while away from home overnight, you must include in income any part of the allowance that is more than your deductible travel expenses. You may be able to deduct any necessary travel expenses that are more than the allowance.

Deductible travel expenses. These include:

- Air, rail, and bus transportation,
- Out-of-pocket expenses for your car,
- Taxi fares or other costs of transportation between the airport or station and your hotel,
- Lodging costs, and
- The cost of meals.

Because these travel expenses are not business-related, they are not subject to the same limits as business-related expenses. For information on business travel expenses, see Travel Expenses in chapter 26.

Contributions You Cannot Deduct

There are some contributions you cannot deduct, such as those made to specific individuals and those made to nonqualified organizations. (See Contributions to Individuals and Contributions to Nonqualified Organizations, next.) There are others you can deduct only part of, as discussed later under Contributions From Which You Benefit.

Contributions to Individuals

You cannot deduct contributions to specific individuals, including the following.

- Contributions to fraternal societies made for the purpose of paying medical or burial expenses of deceased members.
- Contributions to individuals who are needy or worthy. You cannot deduct these contributions even if you make them to a qualified organization for the benefit of a specific person. But you can deduct a contribution to a qualified organization that helps needy or worthy individuals if you do not indicate that your contribution is for a specific person.

  Example. You can deduct contributions to a qualified organization for flood relief, hurricane relief, or other disaster relief. However, you cannot deduct contributions earmarked for relief of a particular individual or family.
- Payments to a member of the clergy that can be spent as he or she wishes, such as for personal expenses.
- Expenses you paid for another person who provided services to a qualified organization.

  Example. Your son does missionary work. You pay his expenses. You cannot claim a deduction for your son's unreimbursed expenses related to his contribution of services.
- Payments to a hospital that are for a specific patient's care or for services for a specific patient. You cannot deduct these payments even if the hospital is operated by a city, a state, or other qualified organization.

Contributions to Nonqualified Organizations

You cannot deduct contributions to organizations that are not qualified to receive tax-deductible contributions, including the following.

1. Certain state bar associations if:
   a. The bar is not a political subdivision of a state,
   b. The bar has private, as well as public, purposes, such as promoting the professional interests of members, and
   c. Your contribution is unrestricted and can be used for private purposes.
2. Chambers of commerce and other business leagues or organizations (but see chapter 28).
3. Civic leagues and associations.
4. Communist organizations.
5. Country clubs and other social clubs.
6. Most foreign organizations (other than certain Canadian, Israeli, or Mexican charitable organizations). For details, see Publication 526.
7. Homeowners' associations.
8. Labor unions (but see chapter 28).
9. Political organizations and candidates.

Contributions From Which You Benefit

If you receive or expect to receive a financial or economic benefit as a result of making a contribution to a qualified organization, you cannot deduct the part of the contribution that represents the value of the benefit you receive. See Contributions From Which You Benefit under *Contributions You Can Deduct*, earlier. These contributions include the following.

- Contributions for lobbying. This includes amounts that you earmark for use in, or in connection with, influencing specific legislation.
- Contributions to a retirement home for room, board, maintenance, or admittance. Also, if the amount of your contribution depends on the type or size of apartment you will occupy, it is not a charitable contribution.
- Costs of raffles, bingo, lottery, etc. You cannot deduct as a charitable contribution amounts you pay to buy raffle or lottery tickets or to play bingo or other games of chance. For information on how to report gambling winnings and losses, see Gambling winnings in chapter 12 and Miscellaneous Deductions in chapter 28.
- Dues to fraternal orders and similar groups. However, see Membership fees or dues, earlier, under *Contributions You Can Deduct*.
- Tuition, or amounts you pay instead of tuition. You cannot deduct as a charitable

contribution amounts you pay as tuition even if you pay them for children to attend parochial schools or qualifying nonprofit daycare centers. You also cannot deduct any fixed amount you must pay in addition to, or instead of, tuition to enroll in a private school, even if it is designated as a "donation."

Value of Time or Services

You cannot deduct the value of your time or services, including:

- Blood donations to the American Red Cross or to blood banks, and
- The value of income lost while you work as an unpaid volunteer for a qualified organization.

Personal Expenses

You cannot deduct personal, living, or family expenses, such as the following items.

- The cost of meals you eat while you perform services for a qualified organization unless it is necessary for you to be away from home overnight while performing the services.
- Adoption expenses, including fees paid to an adoption agency and the costs of keeping a child in your home before adoption is final (but see *Adoption Credit* in chapter 36, and the instructions for Form 8839, Qualified Adoption Expenses). You also may be able to claim an exemption for the child. See *Adopted child* in chapter 3.

Appraisal Fees

You cannot deduct as a charitable contribution any fees you pay to find the fair market value of donated property (but see chapter 28).

Contributions of Property

If you contribute property to a qualified organization, the amount of your charitable contribution is generally the fair market value of the property at the time of the contribution. However, if the property has increased in value, you may have to make some adjustments to the amount of your deduction. See *Giving Property That Has Increased in Value*, later.

For information about the records you must keep and the information you must furnish with your return if you donate property, see *Records To Keep* and *How To Report*, later.

Clothing and household items. You cannot take a deduction for clothing or household items you donate unless the clothing or household items are in good used condition or better.

Exception. You can take a deduction for a contribution of an item of clothing or household item that is not in good used condition or better if you deduct more than $500 for it and include a qualified appraisal of it with your return.

Household items. Household items include:

- Furniture and furnishings,
- Electronics,
- Appliances,
- Linens, and
- Other similar items.

Household items do not include:

- Food,
- Paintings, antiques, and other objects of art,
- Jewelry and gems, and
- Collections.

Cars, boats, and airplanes. The following rules apply to any donation of a qualified vehicle.

A qualified vehicle is:

- A car or any motor vehicle manufactured mainly for use on public streets, roads, and highways,
- A boat, or
- An airplane.

Deduction more than $500. If you donate a qualified vehicle with a claimed fair market value of more than $500, you can deduct the smaller of:

- The gross proceeds from the sale of the vehicle by the organization, or
- The vehicle's fair market value on the date of the contribution. If the vehicle's fair market value was more than your cost or other basis, you may have to reduce the fair market value to figure the deductible amount, as described under *Giving Property That Has Increased in Value*, later.

Form 1098-C. You must attach to your return Copy B of the Form 1098-C, Contributions of Motor Vehicles, Boats, and Airplanes, (or other statement containing the same information as Form 1098-C) you received from the organization. The Form 1098-C (or other statement) will show the gross proceeds from the sale of the vehicle.

If you e-file your return, you must:

- Attach Copy B of Form 1098-C to Form 8453 and mail the forms to the IRS, or
- Include Copy B of Form 1098-C as a pdf attachment if your software program allows it.

If you do not attach Form 1098-C (or other statement), you cannot deduct your contribution. You must get Form 1098-C (or other statement) within 30 days of the sale of the vehicle. But if exception 1 or 2 (described later) applies, you must get Form 1098-C (or other statement) within 30 days of your donation.

Filing deadline approaching and still no Form 1098-C. If the filing deadline is approaching and you still do not have a Form 1098-C, you have two choices.

- Request an automatic 6-month extension of time to file your return. You can get this extension by filing Form 4868, Application for Automatic Extension of Time to File U.S. Individual Income Tax Return. For more information, see *Automatic Extension* in chapter 1.
- File the return on time without claiming the deduction for the qualified vehicle. After receiving the Form 1098-C, file an amended return, Form 1040X, claiming the deduction. Attach Copy B of Form 1098-C (or other statement) to the amended return. For more information about amended returns, see *Amended Returns and Claims for Refund* in chapter 1.

Exceptions. There are two exceptions to the rules just described for deductions of more than $500.

Exception 1—vehicle used or improved by organization. If the qualified organization makes a significant intervening use of or material improvement to the vehicle before transferring it, you generally can deduct the vehicle's fair market value at the time of the contribution. But if the vehicle's fair market value was more than your cost or other basis, you may have to reduce the fair market value to get the deductible amount, as described under *Giving Property That Has Increased in Value*, later. The Form 1098-C (or other statement) will show whether this exception applies.

Exception 2—vehicle given or sold to needy individual. If the qualified organization will give the vehicle, or sell it for a price well below fair market value, to a needy individual to further the organization's charitable purpose, you generally can deduct the vehicle's fair market value at the time of the contribution. But if the vehicle's fair market value was more than your cost or other basis, you may have to reduce the fair market value to get the deductible amount, as described under *Giving Property That Has Increased in Value*, later. The Form 1098-C (or other statement) will show whether this exception applies.

This exception does not apply if the organization sells the vehicle at auction. In that case, you cannot deduct the vehicle's fair market value.

Example. Anita donates a used car to a qualified organization. She bought it 3 years ago for $9,000. A used car guide shows the fair market value for this type of car is $6,000. However, Anita gets a Form 1098-C from the organization showing the car was sold for $2,900. Neither exception 1 nor exception 2 applies. If Anita itemizes her deductions, she can deduct $2,900 for her donation. She must attach Form 1098-C and Form 8283 to her return.

Deduction $500 or less. If the qualified organization sells the vehicle for $500 or less and exceptions 1 and 2 do not apply, you can deduct the smaller of:

- $500, or

- The vehicle's fair market value on the date of the contribution. But if the vehicle's fair market value was more than your cost or other basis, you may have to reduce the fair market value to get the deductible amount, as described under *Giving Property That Has Increased in Value*, later.

If the vehicle's fair market value is at least $250 but not more than $500, you must have a written statement from the qualified organization acknowledging your donation. The statement must contain the information and meet the tests for an acknowledgment described under *Deductions of At Least $250 But Not More Than $500* under *Records To Keep*, later.

Partial interest in property. Generally, you cannot deduct a charitable contribution of less than your entire interest in property.

Right to use property. A contribution of the right to use property is a contribution of less than your entire interest in that property and is not deductible. For exceptions and more information, see *Partial Interest in Property Not in Trust* in Publication 561.

Future interests in tangible personal property. You cannot deduct the value of a charitable contribution of a future interest in tangible personal property until all intervening interests in and rights to the actual possession or enjoyment of the property have either expired or been turned over to someone other than yourself, a related person, or a related organization.

Tangible personal property. This is any property, other than land or buildings, that can be seen or touched. It includes furniture, books, jewelry, paintings, and cars.

Future interest. This is any interest that is to begin at some future time, regardless of whether it is designated as a future interest under state law.

Determining Fair Market Value

This section discusses general guidelines for determining the fair market value of various types of donated property. Publication 561 contains a more complete discussion.

Fair market value is the price at which property would change hands between a willing buyer and a willing seller, neither having to buy or sell, and both having reasonable knowledge of all the relevant facts.

Used clothing and household items. The fair market value of used clothing and household goods is usually far less than what you paid for them when they were new.

For used clothing, you should claim as the value the price that buyers of used items actually pay in used clothing stores, such as consignment or thrift shops. See *Household Goods* in Publication 561 for information on the valuation of household goods, such as furniture, appliances, and linens.

Example. Dawn Greene donated a coat to a thrift store operated by her church. She paid $300 for the coat 3 years ago. Similar coats in the thrift store sell for $50. The fair market value of the coat is reasonably determined to be $50. Dawn's donation is limited to $50.

Cars, boats, and airplanes. If you contribute a car, boat, or airplane to a charitable organization, you must determine its fair market value. Certain commercial firms and trade organizations publish used car pricing guides, commonly called "blue books," containing complete dealer sale prices or dealer average prices for recent model years. The guides may be published monthly or seasonally and for different regions of the country. These guides also provide estimates for adjusting for unusual equipment, unusual mileage, and physical condition. The prices are not "official" and these publications are not considered an appraisal of any specific donated property. But they do provide clues for making an appraisal and suggest relative prices for comparison with current sales and offerings in your area.

You can also find used car pricing information on the Internet.

Example. You donate a used car in poor condition to a local high school for use by students studying car repair. A used car guide shows the dealer retail value for this type of car in poor condition is $1,600. However, the guide shows the price for a private party sale of the car is only $750. The fair market value of the car is considered to be $750.

Large quantities. If you contribute a large number of the same item, fair market value is the price at which comparable numbers of the item are being sold.

Giving Property That Has Decreased in Value

If you contribute property with a fair market value that is less than your basis in it, your deduction is limited to its fair market value. You cannot claim a deduction for the difference between the property's basis and its fair market value.

Giving Property That Has Increased in Value

If you contribute property with a fair market value that is more than your basis in it, you may have to reduce the fair market value by the amount of appreciation (increase in value) when you figure your deduction.

Your basis in property is generally what you paid for it. See chapter 13 if you need more information about basis.

Different rules apply to figuring your deduction, depending on whether the property is:

- Ordinary income property, or
- Capital gain property.

Ordinary income property. Property is ordinary income property if you would have recognized ordinary income or short-term capital gain had you sold it at fair market value on the date it was contributed. Examples of ordinary income property are inventory, works of art created by the donor, manuscripts prepared by the donor, and capital assets (defined in chapter 14) held 1 year or less.

Amount of deduction. The amount you can deduct for a contribution of ordinary income property is its fair market value minus the amount that would be ordinary income or short-term capital gain if you sold the property for its fair market value. Generally, this rule limits the deduction to your basis in the property.

Example. You donate stock you held for 5 months to your church. The fair market value of the stock on the day you donate it is $1,000, but you paid only $800 (your basis). Because the $200 of appreciation would be short-term capital gain if you sold the stock, your deduction is limited to $800 (fair market value minus the appreciation).

Capital gain property. Property is capital gain property if you would have recognized long-term capital gain had you sold it at fair market value on the date of the contribution. It includes capital assets held more than 1 year, as well as certain real property and depreciable property used in your trade or business and, generally, held more than 1 year.

Amount of deduction — general rule. When figuring your deduction for a contribution of capital gain property, you generally can use the fair market value of the property.

Exceptions. In certain situations, you must reduce the fair market value by any amount that would have been long-term capital gain if you had sold the property for its fair market value. Generally, this means reducing the fair market value to the property's cost or other basis.

Bargain sales. A bargain sale of property is a sale or exchange for less than the property's fair market value. A bargain sale to a qualified organization is partly a charitable contribution and partly a sale or exchange. A bargain sale may result in a taxable gain.

More information. For more information on donated appreciated property, see *Giving Property That Has Increased in Value* in Publication 526.

When To Deduct

You can deduct your contributions only in the year you actually make them in cash or other property (or in a later carryover year, as explained later under *Carryovers*). This applies whether you use the cash or an accrual method of accounting.

Time of making contribution. Usually, you make a contribution at the time of its unconditional delivery.

Checks. A check you mail to a charity is considered delivered on the date you mail it.

Credit card. Contributions charged on your credit card are deductible in the year you make the charge.

Pay-by-phone account. Contributions made through a pay-by-phone account are considered delivered on the date the financial institution pays the amount.

Stock certificate. A properly endorsed stock certificate is considered delivered on the date of mailing or other delivery to the charity or to the charity's agent. However, if you give a stock certificate to your agent or to the issuing corporation for transfer to the name of the charity, your contribution is not delivered until the date the stock is transferred on the books of the corporation.

Promissory note. If you issue and deliver a promissory note to a charity as a contribution, it is not a contribution until you make the note payments.

Option. If you grant a charity an option to buy real property at a bargain price, it is not a contribution until the organization exercises the option.

Borrowed funds. If you contribute borrowed funds, you can deduct the contribution in the year you deliver the funds to the charity, regardless of when you repay the loan.

Limits on Deductions

The amount you can deduct for charitable contributions cannot be more than 50% of your adjusted gross income (AGI). Your deduction may be further limited to 30% or 20% of your AGI, depending on the type of property you give and the type of organization you give it to. If your total contributions for the year are 20% or less of your AGI, these limits do not apply to you. The limits are discussed in detail under *Limits on Deductions* in Publication 526.

A different limit applies to certain qualified conservation contributions. See Publication 526 for details.

Carryovers

You can carry over any contributions you cannot deduct in the current year because they exceed your adjusted-gross-income limits. You can deduct the excess in each of the next 5 years until it is used up, but not beyond that time. For more information, see *Carryovers* in Publication 526.

Records To Keep

You must keep records to prove the amount of the contributions you make during the year. The kind of records you must keep depends on the amount of your contributions and whether they are:

- Cash contributions,
- Noncash contributions, or
- Out-of-pocket expenses when donating your services.

Note. An organization generally must give you a written statement if it receives a payment from you that is more than $75 and is partly a contribution and partly for goods or services. (See Contributions From Which You Benefit under *Contributions You Can Deduct*, earlier.) Keep the statement for your records. It may satisfy all or part of the recordkeeping requirements explained in the following discussions.

Cash Contributions

Cash contributions include those paid by cash, check, electronic funds transfer, debit card, credit card, or payroll deduction.

You cannot deduct a cash contribution, regardless of the amount, unless you keep one of the following.

1. A bank record that shows the name of the qualified organization, the date of the contribution, and the amount of the contribution. Bank records may include:
   a. A canceled check,
   b. A bank or credit union statement, or
   c. A credit card statement.
2. A receipt (or a letter or other written communication) from the qualified organization showing the name of the organization, the date of the contribution, and the amount of the contribution.
3. The payroll deduction records described next.

Payroll deductions. If you make a contribution by payroll deduction, you must keep:

1. A pay stub, Form W-2, or other document furnished by your employer that shows the date and amount of the contribution, and
2. A pledge card or other document prepared by or for the qualified organization that shows the name of the organization.

If your employer withheld $250 or more from a single paycheck, see Contributions of $250 or More, next.

Contributions of $250 or More

You can claim a deduction for a contribution of $250 or more only if you have an acknowledgment of your contribution from the qualified organization or certain payroll deduction records.

If you made more than one contribution of $250 or more, you must have either a separate acknowledgment for each or one acknowledgment that lists each contribution and the date of each contribution and shows your total contributions.

Amount of contribution. In figuring whether your contribution is $250 or more, do not combine separate contributions. For example, if you gave your church $25 each week, your weekly payments do not have to be combined. Each payment is a separate contribution.

If contributions are made by payroll deduction, the deduction from each paycheck is treated as a separate contribution.

If you made a payment that is partly for goods and services, as described earlier under Contributions From Which You Benefit, your contribution is the amount of the payment that is more than the value of the goods and services.

Acknowledgment. The acknowledgment must meet these tests.

1. It must be written.
2. It must include:
   a. The amount of cash you contributed,
   b. Whether the qualified organization gave you any goods or services as a result of your contribution (other than certain token items and membership benefits),
   c. A description and good faith estimate of the value of any goods or services described in (b) (other than intangible religious benefits), and
   d. A statement that the only benefit you received was an intangible religious benefit, if that was the case. The acknowledgment does not need to describe or estimate the value of an intangible religious benefit. An intangible religious benefit is a benefit that generally is not sold in commercial transactions outside a donative (gift) context. An example is admission to a religious ceremony.
3. You must get it on or before the earlier of:
   a. The date you file your return for the year you make the contribution, or
   b. The due date, including extensions, for filing the return.

If the acknowledgment does not show the date of the contribution, you must also have a bank record or receipt, as described earlier, that does show the date of the contribution. If the acknowledgment shows the date of the contribution and meets the other tests just described, you do not need any other records.

Payroll deductions. If you make a contribution by payroll deduction and your employer withholds $250 or more from a single paycheck, you must keep:

1. A pay stub, Form W-2, or other document furnished by your employer that shows the amount withheld as a contribution, and
2. A pledge card or other document prepared by or for the qualified organization that shows the name of the organization and states the organization does not provide goods or services in return for any contribution made to it by payroll deduction.

A single pledge card may be kept for all contributions made by payroll deduction regardless of amount as long as it contains all the required information.

If the pay stub, Form W-2, pledge card, or other document does not show the date of the contribution, you must have another document that does show the date of the contribution. If the pay stub, Form W-2, pledge card, or other document shows the date of the contribution, you do not need any other records except those just described in (1) and (2).

Noncash Contributions

For a contribution not made in cash, the records you must keep depend on whether your deduction for the contribution is:

1. Less than $250,

2. At least $250 but not more than $500,
3. Over $500 but not more than $5,000, or
4. Over $5,000.

Amount of deduction. In figuring whether your deduction is $500 or more, combine your claimed deductions for all similar items of property donated to any charitable organization during the year.

If you received goods or services in return, as described earlier in Contributions From Which You Benefit, reduce your contribution by the value of those goods or services. If you figure your deduction by reducing the fair market value of the donated property by its appreciation, as described earlier in Giving Property That Has Increased in Value, your contribution is the reduced amount.

Deductions of Less Than $250

If you make any noncash contribution, you must get and keep a receipt from the charitable organization showing:

1. The name of the charitable organization,
2. The date and location of the charitable contribution, and
3. A reasonably detailed description of the property.

A letter or other written communication from the charitable organization acknowledging receipt of the contribution and containing the information in (1), (2), and (3) will serve as a receipt.

You are not required to have a receipt where it is impractical to get one (for example, if you leave property at a charity's unattended drop site).

Additional records. You must also keep reliable written records for each item of contributed property. Your written records must include the following information.

- The name and address of the organization to which you contributed.
- The date and location of the contribution.
- A description of the property in detail reasonable under the circumstances. For a security, keep the name of the issuer, the type of security, and whether it is regularly traded on a stock exchange or in an over-the-counter market.
- The fair market value of the property at the time of the contribution and how you figured the fair market value. If it was determined by appraisal, keep a signed copy of the appraisal.
- The cost or other basis of the property, if you must reduce its fair market value by appreciation. Your records should also include the amount of the reduction and how you figured it.
- The amount you claim as a deduction for the tax year as a result of the contribution, if you contribute less than your entire interest in the property during the tax year. Your records must include the amount you claimed as a deduction in any earlier years for contributions of other interests in this property. They must also include the name and address of each organization to which you contributed the other interests, the place where any such tangible property is located or kept, and the name of any person in possession of the property, other than the organization to which you contributed it.
- The terms of any conditions attached to the contribution of property.

Deductions of At Least $250 But Not More Than $500

If you claim a deduction of at least $250 but not more than $500 for a noncash charitable contribution, you must get and keep an acknowledgment of your contribution from the qualified organization. If you made more than one contribution of $250 or more, you must have either a separate acknowledgment for each or one acknowledgment that shows your total contributions.

The acknowledgment must contain the information in items (1) through (3) under Deductions of Less Than $250, earlier, and your written records must include the information listed in that discussion under Additional records.

The acknowledgment must also meet these tests.

1. It must be written.
2. It must include:
   a. A description (but not necessarily the value) of any property you contributed,
   b. Whether the qualified organization gave you any goods or services as a result of your contribution (other than certain token items and membership benefits), and
   c. A description and good faith estimate of the value of any goods or services described in (b). If the only benefit you received was an intangible religious benefit (such as admission to a religious ceremony) that generally is not sold in a commercial transaction outside the donative context, the acknowledgment must say so and does not need to describe or estimate the value of the benefit.
3. You must get it on or before the earlier of:
   a. The date you file your return for the year you make the contribution, or
   b. The due date, including extensions, for filing the return.

Deductions Over $500

You are required to give additional information if you claim a deduction over $500 for noncash charitable contributions. See *Records To Keep* in Publication 526 for more information.

Out-of-Pocket Expenses

If you give services to a qualified organization and have unreimbursed out-of-pocket expenses related to those services, the following two rules apply.

1. You must have adequate records to prove the amount of the expenses.
2. If any of your unreimbursed out-of-pocket expenses, considered separately, are $250 or more (for example, you pay $250 or more for an airline ticket to attend a convention of a qualified organization as a chosen representative), you must get an acknowledgment from the qualified organization that contains:
   a. A description of the services you provided,
   b. A statement of whether or not the organization provided you any goods or services to reimburse you for the expenses you incurred,
   c. A description and a good faith estimate of the value of any goods or services (other than intangible religious benefits) provided to reimburse you, and
   d. A statement that the only benefit you received was an intangible religious benefit, if that was the case. The acknowledgment does not need to describe or estimate the value of an intangible religious benefit (defined earlier under Acknowledgment).

You must get the acknowledgment on or before the earlier of:

1. The date you file your return for the year you make the contribution, or
2. The due date, including extensions, for filing the return.

Car expenses. If you claim expenses directly related to use of your car in giving services to a qualified organization, you must keep reliable written records of your expenses. Whether your records are considered reliable depends on all the facts and circumstances. Generally, they may be considered reliable if you made them regularly and at or near the time you had the expenses.

For example, your records might show the name of the organization you were serving and the dates you used your car for a charitable purpose. If you use the standard mileage rate of 14 cents a mile, your records must show the miles you drove your car for the charitable purpose. If you deduct your actual expenses, your records must show the costs of operating the car that are directly related to a charitable purpose.

See Car expenses under *Out-of-Pocket Expenses in Giving Services*, earlier, for the expenses you can deduct.

How To Report

Report your charitable contributions on Schedule A (Form 1040).

If your total deduction for all noncash contributions for the year is over $500, you must also file Form 8283. See *How To Report* in Publication 526 for more information.

25. Nonbusiness Casualty and Theft Losses

Introduction

This chapter explains the tax treatment of personal (not business or investment related) casualty losses, theft losses, and losses on deposits.

The chapter also explains the following topics.

- How to figure the amount of your loss.
- How to treat insurance and other reimbursements you receive.
- The deduction limits.
- When and how to report a casualty or theft.

Forms to file. When you have a casualty or theft, you have to file Form 4684. You will also have to file one or more of the following forms.

- Schedule A (Form 1040), Itemized Deductions
- Schedule D (Form 1040), Capital Gains and Losses

Condemnations. For information on condemnations of property, see *Involuntary Conversions* in chapter 1 of Publication 544, Sales and Other Disposition of Assets.

Workbook for casualties and thefts. Publication 584 is available to help you make a list of your stolen or damaged personal-use property and figure your loss. It includes schedules to help you figure the loss on your home, its contents, and your motor vehicles.

Business or investment-related losses. For information on a casualty or theft loss of business or income-producing property, see Publication 547, Casualties, Disasters, and Thefts.

Useful Items

You may want to see:

Publication

- ❑ **544** Sales and Other Dispositions of Assets
- ❑ **547** Casualties, Disasters, and Thefts
- ❑ **584** Casualty, Disaster, and Theft Loss Workbook (Personal-Use Property)

Form (and Instructions)

- ❑ **Schedule A (Form 1040)** Itemized Deductions
- ❑ **Schedule D (Form 1040)** Capital Gains and Losses
- ❑ **4684** Casualties and Thefts

Casualty

A casualty is the damage, destruction, or loss of property resulting from an identifiable event that is sudden, unexpected, or unusual.

- A sudden event is one that is swift, not gradual or progressive.
- An unexpected event is one that is ordinarily unanticipated and unintended.
- An unusual event is one that is not a day-to-day occurrence and that is not typical of the activity in which you were engaged.

Deductible losses. Deductible casualty losses can result from a number of different causes, including the following.

- Car accidents (but see Nondeductible losses, next, for exceptions).
- Earthquakes.
- Fires (but see Nondeductible losses, next, for exceptions).
- Floods.
- Government-ordered demolition or relocation of a home that is unsafe to use because of a disaster as discussed under *Disaster Area Losses* in Publication 547.
- Mine cave-ins.
- Shipwrecks.
- Sonic booms.
- Storms, including hurricanes and tornadoes.
- Terrorist attacks.
- Vandalism.
- Volcanic eruptions.

Nondeductible losses. A casualty loss is not deductible if the damage or destruction is caused by the following.

- Accidentally breaking articles such as glassware or china under normal conditions.
- A family pet (explained below).
- A fire if you willfully set it or pay someone else to set it.
- A car accident if your willful negligence or willful act caused it. The same is true if the willful act or willful negligence of someone acting for you caused the accident.
- Progressive deterioration (explained later).

Family pet. Loss of property due to damage by a family pet is not deductible as a casualty loss unless the requirements discussed earlier under *Casualty* are met.

Example. Your antique oriental rug was damaged by your new puppy before it was housebroken. Because the damage was not unexpected and unusual, the loss is not deductible as a casualty loss.

Progressive deterioration. Loss of property due to progressive deterioration is not deductible as a casualty loss. This is because the damage results from a steadily operating cause or a normal process, rather than from a sudden event. The following are examples of damage due to progressive deterioration.

- The steady weakening of a building due to normal wind and weather conditions.
- The deterioration and damage to a water heater that bursts. However, the rust and water damage to rugs and drapes caused by the bursting of a water heater does qualify as a casualty.
- Most losses of property caused by droughts. To be deductible, a drought-related loss generally must be incurred in a trade or business or in a transaction entered into for profit.
- Termite or moth damage.
- The damage or destruction of trees, shrubs, or other plants by a fungus, disease, insects, worms, or similar pests. However, a sudden destruction due to an unexpected or unusual infestation of beetles or other insects may result in a casualty loss.

Damage from corrosive drywall. Under a special procedure, you may be able to claim a casualty loss deduction for amounts you paid to repair damage to your home and household appliances that resulted from corrosive drywall. For details, see Publication 547.

Theft

A theft is the taking and removing of money or property with the intent to deprive the owner of it. The taking of property must be illegal under the laws of the state where it occurred and it must have been done with criminal intent. You do not need to show a conviction for theft.

Theft includes the taking of money or property by the following means.

- Blackmail.
- Burglary.
- Embezzlement.
- Extortion.
- Kidnapping for ransom.
- Larceny.
- Robbery.

The taking of money or property through fraud or misrepresentation is theft if it is illegal under state or local law.

Decline in market value of stock. You cannot deduct as a theft loss the decline in market value of stock acquired on the open market for investment if the decline is caused by disclosure of accounting fraud or other illegal misconduct by the officers or directors of the corporation that issued the stock. However, you can deduct as a capital loss the loss you sustain when you sell or exchange the stock or the stock becomes completely worthless. You report a capital loss on Schedule D (Form 1040). For more information about stock sales, worthless stock, and capital losses, see chapter 4 of Publication 550.

Mislaid or lost property. The simple disappearance of money or property is not a theft. However, an accidental loss or disappearance of property can qualify as a casualty if it results from an identifiable event that is sudden, unexpected, or unusual. Sudden, unexpected, and unusual events are defined earlier.

Example. A car door is accidentally slammed on your hand, breaking the setting of your diamond ring. The diamond falls from the ring and is never found. The loss of the diamond is a casualty.

Losses from Ponzi-type investment schemes. If you had a loss from a Ponzi-type investment scheme, see:

- Revenue Ruling 2009-9, 2009-14 I.R.B. 735 (available at *www.irs.gov/irb/2009-14_IRB/ar07.html*).
- Revenue Procedure 2009-20, 2009-14 I.R.B. 749 (available at *www.irs.gov/irb/2009-14_IRB/ar11.html*).
- Revenue Procedure 2011-58, 2011-50 I.R.B. 849 (available at *www.irs.gov/irb/2011-50_IRB/ar11.html*).

These losses are deductible as theft losses of income-producing property on your tax return for the year the loss was discovered. You figure the deductible loss in Section B of Form 4684. If you qualify to use Revenue Procedure 2009-20 and you choose to follow the procedures in Revenue Procedure 2009-20, you also must complete Appendix A of that procedure and write "Revenue Procedure 2009-20" across the top of Form 4684. For more information, see the above revenue ruling and revenue procedures.

Loss on Deposits

A loss on deposits can occur when a bank, credit union, or other financial institution becomes insolvent or bankrupt. If you incurred this type of loss, you can choose one of the following ways to deduct the loss.

- As a casualty loss.
- As an ordinary loss.
- As a nonbusiness bad debt.

Casualty loss or ordinary loss. You can choose to deduct a loss on deposits as a casualty loss or as an ordinary loss for any year in which you can reasonably estimate how much of your deposits you have lost in an insolvent or bankrupt financial institution. The choice is generally made on the return you file for that year and applies to all your losses on deposits for the year in that particular financial institution. If you treat the loss as a casualty or ordinary loss, you cannot treat the same amount of the loss as a nonbusiness bad debt when it actually becomes worthless. However, you can take a nonbusiness bad debt deduction for any amount of loss that is more than the estimated amount you deducted as a casualty or ordinary loss. Once you make this choice, you cannot change it without permission from the Internal Revenue Service.

If you claim an ordinary loss, report it as a miscellaneous itemized deduction on Schedule A (Form 1040), line 23. The maximum amount you can claim is $20,000 ($10,000 if you are married filing separately) reduced by any expected state insurance proceeds. Your loss is subject to the 2%-of-adjusted-gross-income limit. You cannot choose to claim an ordinary loss if any part of the deposit is federally insured.

Nonbusiness bad debt. If you do not choose to deduct the loss as a casualty loss or as an ordinary loss, you must wait until the year the actual loss is determined and deduct the loss as a nonbusiness bad debt in that year.

How to report. The kind of deduction you choose for your loss on deposits determines how you report your loss. If you choose:

- Casualty loss — report it on Form 4684 first and then on Schedule A (Form 1040).
- Ordinary loss — report it on Schedule A (Form 1040) as a miscellaneous itemized deduction.
- Nonbusiness bad debt — report it on Form 8949 first and then on Schedule D (Form 1040).

More information. For more information, see *Special Treatment for Losses on Deposits in Insolvent or Bankrupt Financial Institutions* in the Instructions for Form 4684 or *Deposit in Insolvent or Bankrupt Financial Institution* in Publication 550.

Proof of Loss

To deduct a casualty or theft loss, you must be able to prove that you had a casualty or theft. You also must be able to support the amount you take as a deduction.

Casualty loss proof. For a casualty loss, your records should show all the following.

- The type of casualty (car accident, fire, storm, etc.) and when it occurred.
- That the loss was a direct result of the casualty.
- That you were the owner of the property or, if you leased the property from someone else, that you were contractually liable to the owner for the damage.
- Whether a claim for reimbursement exists for which there is a reasonable expectation of recovery.

Theft loss proof. For a theft loss, your records should show all the following.

- When you discovered that your property was missing.
- That your property was stolen.
- That you were the owner of the property.
- Whether a claim for reimbursement exists for which there is a reasonable expectation of recovery.

It is important that you have records that will prove your deduction. If you do not have the actual records to support your deduction, you can use other satisfactory evidence to support it.

Figuring a Loss

Figure the amount of your loss using the following steps.

1. Determine your adjusted basis in the property before the casualty or theft.
2. Determine the decrease in fair market value of the property as a result of the casualty or theft.
3. From the smaller of the amounts you determined in (1) and (2), subtract any insurance or other reimbursement you received or expect to receive.

For personal-use property and property used in performing services as an employee, apply the deduction limits, discussed later, to determine the amount of your deductible loss.

Gain from reimbursement. If your reimbursement is more than your adjusted basis in the property, you have a gain. This is true even if the decrease in the FMV of the property is smaller than your adjusted basis. If you have a gain, you may have to pay tax on it, or you may be able to postpone reporting the gain. See Publication 547 for more information on how to treat a gain from a reimbursement for a casualty or theft.

Leased property. If you are liable for casualty damage to property you lease, your loss is the amount you must pay to repair the property minus any insurance or other reimbursement you receive or expect to receive.

Decrease in Fair Market Value

Fair market value (FMV) is the price for which you could sell your property to a willing buyer when neither of you has to sell or buy and both of you know all the relevant facts.

The decrease in FMV used to figure the amount of a casualty or theft loss is the difference between the property's fair market value immediately before and immediately after the casualty or theft.

FMV of stolen property. The FMV of property immediately after a theft is considered to be zero, since you no longer have the property.

Example. Several years ago, you purchased silver dollars at face value for $150. This is your adjusted basis in the property. Your silver dollars were stolen this year. The FMV of the coins was $1,000 just before they were stolen, and insurance did not cover them. Your theft loss is $150.

Recovered stolen property. Recovered stolen property is your property that was stolen and later returned to you. If you recovered property after you had already taken a theft loss deduction, you must refigure your loss using the smaller of the property's adjusted basis (explained later) or the decrease in FMV from the time just before it was stolen until the time it was recovered. Use this amount to refigure your total loss for the year in which the loss was deducted.

If your refigured loss is less than the loss you deducted, you generally have to report the difference as income in the recovery year. But report the difference only up to the amount of the loss that reduced your tax. For more information on the amount to report, see Recoveries in chapter 12.

Figuring Decrease in FMV— Items To Consider

To figure the decrease in FMV because of a casualty or theft, you generally need a competent appraisal. However, other measures can also be used to establish certain decreases.

Appraisal. An appraisal to determine the difference between the FMV of the property immediately before a casualty or theft and immediately afterward should be made by a competent appraiser. The appraiser must recognize the effects of any general market decline that may occur along with the casualty. This information is needed to limit any deduction to the actual loss resulting from damage to the property.

Several factors are important in evaluating the accuracy of an appraisal, including the following.

- The appraiser's familiarity with your property before and after the casualty or theft.
- The appraiser's knowledge of sales of comparable property in the area.
- The appraiser's knowledge of conditions in the area of the casualty.
- The appraiser's method of appraisal.

TIP *You may be able to use an appraisal that you used to get a federal loan (or a federal loan guarantee) as the result of a federally declared disaster to establish the amount of your disaster loss. For more information on disasters, see* Disaster Area Losses, *in Pub. 547.*

Cost of cleaning up or making repairs. The cost of repairing damaged property is not part of a casualty loss. Neither is the cost of cleaning up after a casualty. But you can use the cost of cleaning up or making repairs after a casualty as a measure of the decrease in FMV if you meet all the following conditions.

- The repairs are actually made.
- The repairs are necessary to bring the property back to its condition before the casualty.
- The amount spent for repairs is not excessive.
- The repairs take care of the damage only.
- The value of the property after the repairs is not, due to the repairs, more than the value of the property before the casualty.

Landscaping. The cost of restoring landscaping to its original condition after a casualty may indicate the decrease in FMV. You may be able to measure your loss by what you spend on the following.

- Removing destroyed or damaged trees and shrubs minus any salvage you receive.
- Pruning and other measures taken to preserve damaged trees and shrubs.
- Replanting necessary to restore the property to its approximate value before the casualty.

Car value. Books issued by various automobile organizations that list your car may be useful in figuring the value of your car. You can use the book's retail values and modify them by such factors as mileage and the condition of your car to figure its value. The prices are not official, but they may be useful in determining value and suggesting relative prices for comparison with current sales and offerings in your area. If your car is not listed in the books, determine its value from other sources. A dealer's offer for your car as a trade-in on a new car is not usually a measure of its true value.

Figuring Decrease in FMV— Items Not To Consider

You generally should not consider the following items when attempting to establish the decrease in FMV of your property.

Cost of protection. The cost of protecting your property against a casualty or theft is not part of a casualty or theft loss. The amount you spend on insurance or to board up your house against a storm is not part of your loss.

If you make permanent improvements to your property to protect it against a casualty or theft, add the cost of these improvements to your basis in the property. An example would be the cost of a dike to prevent flooding.

Exception. You cannot increase your basis in the property by, or deduct as a business expense, any expenditures you made with respect to qualified disaster mitigation payments. See *Disaster Area Losses* in Publication 547.

Incidental expenses. Any incidental expenses you have due to a casualty or theft, such as expenses for the treatment of personal injuries, for temporary housing, or for a rental car, are not part of your casualty or theft loss.

Replacement cost. The cost of replacing stolen or destroyed property is not part of a casualty or theft loss.

Sentimental value. Do not consider sentimental value when determining your loss. If a family portrait, heirloom, or keepsake is damaged, destroyed, or stolen, you must base your loss on its FMV.

Decline in market value of property in or near casualty area. A decrease in the value of your property because it is in or near an area that suffered a casualty, or that might again suffer a casualty, is not to be taken into consideration. You have a loss only for actual casualty damage to your property. However, if your home is in a federally declared disaster area, see *Disaster Area Losses* in Publication 547.

Costs of photographs and appraisals. Photographs taken after a casualty will be helpful in establishing the condition and value of the property after it was damaged. Photographs showing the condition of the property after it was repaired, restored, or replaced may also be helpful.

Appraisals are used to figure the decrease in FMV because of a casualty or theft. See *Appraisal*, earlier, under *Figuring Decrease in FMV — Items To Consider*, for information about appraisals.

The costs of photographs and appraisals used as evidence of the value and condition of property damaged as a result of a casualty are not a part of the loss. You can claim these costs as a miscellaneous itemized deduction subject to the 2%-of-adjusted-gross-income limit on Schedule A (Form 1040). For information about miscellaneous deductions, see chapter 28.

Adjusted Basis

Adjusted basis is your basis in the property (usually cost) increased or decreased by various events, such as improvements and casualty losses. For more information, see chapter 13.

Insurance and Other Reimbursements

If you receive an insurance payment or other type of reimbursement, you must subtract the reimbursement when you figure your loss. You do not have a casualty or theft loss to the extent you are reimbursed.

If you expect to be reimbursed for part or all of your loss, you must subtract the expected reimbursement when you figure your loss. You must reduce your loss even if you do not receive payment until a later tax year. See *Reimbursement Received After Deducting Loss*, later.

Failure to file a claim for reimbursement. If your property is covered by insurance, you must file a timely insurance claim for reimbursement of your loss. Otherwise, you cannot deduct this loss as a casualty or theft loss. However, this rule does not apply to the portion of the loss not covered by insurance (for example, a deductible).

Example. You have a car insurance policy with a $1000 deductible. Because your insurance did not cover the first $1000 of an auto collision, the $1000 would be deductible (subject to the deduction limits discussed later). This is true even if you do not file an insurance claim, because your insurance policy would never have reimbursed you for the deductible.

Types of Reimbursements

The most common type of reimbursement is an insurance payment for your stolen or damaged property. Other types of reimbursements are discussed next. Also see the Instructions for Form 4684.

Employer's emergency disaster fund. If you receive money from your employer's emergency disaster fund and you must use that money to rehabilitate or replace property on which you are claiming a casualty loss deduction, you must take that money into consideration in computing the casualty loss deduction. Take into consideration only the amount you used to replace your destroyed or damaged property.

Example. Your home was extensively damaged by a tornado. Your loss after reimbursement from your insurance company was $10,000. Your employer set up a disaster relief fund for its employees. Employees receiving money from the fund had to use it to rehabilitate or replace their damaged or destroyed property. You received $4,000 from the fund and spent the entire amount on repairs to your home. In figuring your casualty loss, you must reduce your unreimbursed loss ($10,000) by the $4,000 you received from your employer's fund. Your casualty loss before applying the deduction limits discussed later is $6,000.

Cash gifts. If you receive excludable cash gifts as a disaster victim and there are no limits on how you can use the money, you do not reduce your casualty loss by these excludable cash gifts. This applies even if you use the money to pay for repairs to property damaged in the disaster.

Example. Your home was damaged by a hurricane. Relatives and neighbors made cash gifts to you that were excludable from your income. You used part of the cash gifts to pay for repairs to your home. There were no limits or restrictions on how you could use the cash gifts. Because it was an excludable gift, the money you received and used to pay for repairs to your home does not reduce your casualty loss on the damaged home.

Insurance payments for living expenses. You do not reduce your casualty loss by insurance payments you receive to cover living expenses in either of the following situations.

- You lose the use of your main home because of a casualty.
- Government authorities do not allow you access to your main home because of a casualty or threat of one.

Inclusion in income. If these insurance payments are more than the temporary increase in your living expenses, you must include the excess in your income. Report this amount on Form 1040, line 21. However, if the casualty occurs in a federally declared disaster area, none of the insurance payments are taxable. See *Qualified disaster relief payments*, under *Disaster Area Losses* in Publication 547.

A temporary increase in your living expenses is the difference between the actual living expenses you and your family incurred during the period you could not use your home and your normal living expenses for that period. Actual living expenses are the reasonable and necessary expenses incurred because of the loss of your main home. Generally, these expenses include the amounts you pay for the following.

- Rent for suitable housing.
- Transportation.
- Food.
- Utilities.
- Miscellaneous services.

Normal living expenses consist of these same expenses that you would have incurred but did not because of the casualty or the threat of one.

Example. As a result of a fire, you vacated your apartment for a month and moved to a motel. You normally pay $525 a month for rent. None was charged for the month the apartment was vacated. Your motel rent for this month was $1,200. You normally pay $200 a month for food. Your food expenses for the month you lived in the motel were $400. You received $1,100 from your insurance company to cover your living expenses. You determine the payment you must include in income as follows.

1) Insurance payment for living expenses		$1,100
2) Actual expenses during the month you are unable to use your home because of fire	1,600	
3) Normal living expenses	725	
4) Temporary increase in living expenses: Subtract line 3 from line 2		875
5) Amount of payment includible in income: Subtract line 4 from line 1		$ 225

Tax year of inclusion. You include the taxable part of the insurance payment in income for the year you regain the use of your main home or, if later, for the year you receive the taxable part of the insurance payment.

Example. Your main home was destroyed by a tornado in August 2010. You regained use of your home in November 2011. The insurance payments you received in 2010 and 2011 were $1,500 more than the temporary increase in your living expenses during those years. You include this amount in income on your 2011 Form 1040. If, in 2012, you receive further payments to cover the living expenses you had in 2010 and 2011, you must include those payments in income on your 2012 Form 1040.

Disaster relief. Food, medical supplies, and other forms of assistance you receive do not reduce your casualty loss unless they are replacements for lost or destroyed property.

Qualified disaster relief payments you receive for expenses you incurred as a result of a federally declared disaster are not taxable income to you. For more information, see Disaster Area Losses *in Publication 547.*

Disaster unemployment assistance payments are unemployment benefits that are taxable.

Generally, disaster relief grants and qualified disaster mitigation payments made under the Robert T. Stafford Disaster Relief and Emergency Assistance Act or the National Flood Insurance Act (as in effect on April 15, 2005) are not includible in your income. See *Disaster Area Losses* in Publication 547.

Reimbursement Received After Deducting Loss

If you figured your casualty or theft loss using your expected reimbursement, you may have to adjust your tax return for the tax year in which you receive your actual reimbursement. This section explains the adjustment you may have to make.

Actual reimbursement less than expected. If you later receive less reimbursement than you expected, include that difference as a loss with your other losses (if any) on your return for the year in which you can reasonably expect no more reimbursement.

Example. Your personal car had an FMV of $2,000 when it was destroyed in a collision with another car in 2011. The accident was due to the negligence of the other driver. At the end of 2011, there was a reasonable prospect that the owner of the other car would reimburse you in full. You did not have a deductible loss in 2011.

In January 2012, the court awarded you a judgment of $2,000. However, in July it became apparent that you will be unable to collect any amount from the other driver. You can deduct the loss in 2012 subject to the limits discussed later.

Actual reimbursement more than expected. If you later receive more reimbursement than you expected after you claimed a deduction for the loss, you may have to include the extra reimbursement in your income for the year you receive it. However, if any part of the original deduction did not reduce your tax for the earlier year, do not include that part of the reimbursement in your income. You do not refigure your tax for the year you claimed the deduction. For more information, see *Recoveries* in chapter 12.

If the total of all the reimbursements you receive is more than your adjusted basis in the destroyed or stolen property, you will have a gain on the casualty or theft. If you have already taken a deduction for a loss and you receive the reimbursement in a later year, you may have to include the gain in your income for the later year. Include the gain as ordinary income up to the amount of your deduction that reduced your tax for the earlier year. See Publication 547 for more information on how to treat a gain from the reimbursement of a casualty or theft.

Actual reimbursement same as expected. If you receive exactly the reimbursement you expected to receive, you do not have to include any of the reimbursement in your income and you cannot deduct any additional loss.

Example. In December 2012, you had a collision while driving your personal car. Repairs to the car cost $950. You had $100

Table 25-1. **How To Apply the Deduction Limits for Personal-Use Property**

<table>
<tr><th colspan="2"></th><th>$100 Rule</th><th>10% Rule</th></tr>
<tr><td colspan="2">General Application</td><td>You must reduce each casualty or theft loss by $100 when figuring your deduction. Apply this rule after you have figured the amount of your loss.</td><td>You must reduce your total casualty or theft loss by 10% of your adjusted gross income. Apply this rule after you reduce each loss by $100 (the $100 rule).</td></tr>
<tr><td colspan="2">Single Event</td><td>Apply this rule only once, even if many pieces of property are affected.</td><td>Apply this rule only once, even if many pieces of property are affected.</td></tr>
<tr><td colspan="2">More Than One Event</td><td>Apply to the loss from each event.</td><td>Apply to the total of all your losses from all events.</td></tr>
<tr><td colspan="2">More Than One Person—
With Loss From the Same Event
(other than a married couple filing jointly)</td><td>Apply separately to each person.</td><td>Apply separately to each person.</td></tr>
<tr><td rowspan="2">Married Couple—
With Loss From the Same Event</td><td>Filing Jointly</td><td>Apply as if you were one person.</td><td>Apply as if you were one person.</td></tr>
<tr><td>Filing Separately</td><td>Apply separately to each spouse.</td><td>Apply separately to each spouse.</td></tr>
<tr><td colspan="2">More Than One Owner
(other than a married couple filing jointly)</td><td>Apply separately to each owner of jointly owned property.</td><td>Apply separately to each owner of jointly owned property.</td></tr>
</table>

deductible collision insurance. Your insurance company agreed to reimburse you for the rest of the damage. Because you expected a reimbursement from the insurance company, you did not have a casualty loss deduction in 2012.

Due to the $100 rule (discussed later under *Deduction Limits*), you cannot deduct the $100 you paid as the deductible. When you receive the $850 from the insurance company in 2013, do not report it as income.

Single Casualty on Multiple Properties

Personal property. Personal property is any property that is not real property. If your personal property is stolen or is damaged or destroyed by a casualty, you must figure your loss separately for each item of property. Then combine these separate losses to figure the total loss from that casualty or theft.

Example. A fire in your home destroyed an upholstered chair, an oriental rug, and an antique table. You did not have fire insurance to cover your loss. (This was the only casualty or theft you had during the year.) You paid $750 for the chair and you established that it had an FMV of $500 just before the fire. The rug cost $3,000 and had an FMV of $2,500 just before the fire. You bought the table at an auction for $100 before discovering it was an antique. It had been appraised at $900 before the fire. You figure your loss on each of these items as follows:

	Chair	Rug	Table
1) Basis (cost)	$750	$3,000	$100
2) FMV before fire	$500	$2,500	$900
3) FMV after fire	–0–	–0–	–0–
4) Decrease in FMV	$500	$2,500	$900
5) Loss (smaller of (1) or (4))	$500	$2,500	$100
6) Total loss			**$3,100**

Real property. In figuring a casualty loss on personal-use real property, treat the entire property (including any improvements, such as buildings, trees, and shrubs) as one item. Figure the loss using the smaller of the adjusted basis or the decrease in FMV of the entire property.

Example. You bought your home a few years ago. You paid $160,000 ($20,000 for the land and $140,000 for the house). You also spent $2,000 for landscaping. This year a fire destroyed your home. The fire also damaged the shrubbery and trees in your yard. The fire was your only casualty or theft loss this year. Competent appraisers valued the property as a whole at $200,000 before the fire, but only $30,000 after the fire. (The loss to your household furnishings is not shown in this example. It would be figured separately on each item, as explained earlier under *Personal property*.) Shortly after the fire, the insurance company paid you $155,000 for the loss. You figure your casualty loss as follows:

1)	Adjusted basis of the entire property (land, building, and landscaping)	$162,000
2)	FMV of entire property before fire	$200,000
3)	FMV of entire property after fire	30,000
4)	Decrease in FMV of entire property	$170,000
5)	Loss (smaller of (1) or (4))	$162,000
6)	Subtract insurance	155,000
7)	**Amount of loss after reimbursement**	**$7,000**

Deduction Limits

After you have figured your casualty or theft loss, you must figure how much of the loss you can deduct. If the loss was to property for your personal use or your family's use, there are two limits on the amount you can deduct for your casualty or theft loss.

1. You must reduce each casualty or theft loss by $100 ($100 rule).
2. You must further reduce the total of all your casualty or theft losses by 10% of your adjusted gross income (10% rule).

You make these reductions on Form 4684.

These rules are explained next and *Table 25-1* summarizes how to apply the $100 rule and the 10% rule in various situations. For more detailed explanations and examples, see Publication 547.

Property used partly for business and partly for personal purposes. When property is used partly for personal purposes and partly for business or income-producing purposes, the casualty or theft loss deduction must be figured separately for the personal-use part and for the business or income-producing part. You must figure each loss separately because the $100 rule and the 10% rule apply only to the loss on the personal-use part of the property.

$100 Rule

After you have figured your casualty or theft loss on personal-use property, you must reduce that loss by $100. This reduction applies to each total casualty or theft loss. It does not matter how many pieces of property are involved in an event. Only a single $100 reduction applies.

Example. A hailstorm damages your home and your car. Determine the amount of loss, as discussed earlier, for each of these items. Since the losses are due to a single event, you combine the losses and reduce the combined amount by $100.

Single event. Generally, events closely related in origin cause a single casualty. It is a single casualty when the damage is from two or more closely related causes, such as wind and flood damage caused by the same storm.

10% Rule

You must reduce the total of all your casualty or theft losses on personal-use property by 10% of your adjusted gross income. Apply this rule after you reduce each loss by $100. For more information, see the Form 4684 instructions. If you have both gains and losses from casualties or thefts, see *Gains and losses*, later in this discussion.

Example 1. In June, you discovered that your house had been burglarized. Your loss after insurance reimbursement was $2,000. Your adjusted gross income for the year you discovered the theft is $29,500. You first apply the $100 rule and then the 10% rule. Figure your theft loss deduction as follows.

1) Loss after insurance	$2,000
2) Subtract $100	100
3) Loss after $100 rule	$1,900
4) Subtract 10% × $29,500 AGI	2,950
5) Theft loss deduction	**–0–**

You do not have a theft loss deduction because your loss after you apply the $100 rule ($1,900) is less than 10% of your adjusted gross income ($2,950).

Example 2. In March, you had a car accident that totally destroyed your car. You did not have collision insurance on your car, so you did not receive any insurance reimbursement. Your loss on the car was $1,800. In November, a fire damaged your basement and totally destroyed the furniture, washer, dryer, and other items stored there. Your loss on the basement items after reimbursement was $2,100. Your adjusted gross income for the year that the accident and fire occurred is $25,000. You figure your casualty loss deduction as follows.

	Car	Basement
1) Loss	$1,800	$2,100
2) Subtract $100 per incident	100	100
3) Loss after $100 rule	$1,700	$2,000
4) Total loss		$3,700
5) Subtract 10% × $25,000 AGI		2,500
6) Casualty loss deduction		**$1,200**

Gains and losses. If you had both gains and losses from casualties or thefts to personal-use property, you must compare your total gains to your total losses. Do this after you have reduced each loss by any reimbursements and by $100, but before you have reduced the losses by 10% of your adjusted gross income.

CAUTION *Casualty or theft gains do not include gains you choose to postpone. See Publication 547 for information on the postponement of gain.*

Losses more than gains. If your losses are more than your recognized gains, subtract your gains from your losses and reduce the result by 10% of your adjusted gross income. The rest, if any, is your deductible loss from personal-use property.

Gains more than losses. If your recognized gains are more than your losses, subtract your losses from your gains. The difference is treated as capital gain and must be reported on Schedule D (Form 1040). The 10% rule does not apply to your gains.

Table 25-2. **When To Deduct a Loss**

IF you have a loss...	**THEN deduct it in the year...**
from a casualty,	the loss occurred.
in a federally declared disaster area,	the disaster occurred or the year immediately before the disaster.
from a theft,	the theft was discovered.
on a deposit treated as a:	
• casualty or any ordinary loss,	a reasonable estimate can be made.
• bad debt,	deposits are totally worthless.

When To Report Gains and Losses

Gains. If you receive an insurance or other reimbursement that is more than your adjusted basis in the destroyed or stolen property, you have a gain from the casualty or theft. You must include this gain in your income in the year you receive the reimbursement, unless you choose to postpone reporting the gain as explained in Publication 547.

If you have a loss, see *Table 25-2*.

Losses. Generally, you can deduct a casualty loss that is not reimbursable only in the tax year in which the casualty occurred. This is true even if you do not repair or replace the damaged property until a later year.

You can deduct theft losses that are not reimbursable only in the year you discover your property was stolen.

If you are not sure whether part of your casualty or theft loss will be reimbursed, do not deduct that part until the tax year when you become reasonably certain that it will not be reimbursed.

Loss on deposits. If your loss is a loss on deposits in an insolvent or bankrupt financial institution, see *Loss on Deposits*, earlier.

Disaster Area Loss

You generally must deduct a casualty loss in the year it occurred. However, if you have a casualty loss from a federally declared disaster that occurred in an area warranting public or individual assistance (or both), you can choose to deduct the loss on your tax return or amended return for either of the following years.

- The year the disaster occurred.
- The year immediately preceding the year the disaster occurred.

Gains. Special rules apply if you choose to postpone reporting gain on property damaged or destroyed in a federally declared disaster area. For those special rules, see Publication 547.

Postponed tax deadlines. The IRS may postpone for up to 1 year certain tax deadlines of taxpayers who are affected by a federally declared disaster. The tax deadlines the IRS may postpone include those for filing income and employment tax returns, paying income and employment taxes, and making contributions to a traditional IRA or Roth IRA.

If any tax deadline is postponed, the IRS will publicize the postponement in your area by publishing a news release, revenue ruling, revenue procedure, notice, announcement, or other guidance in the Internal Revenue Bulletin (IRB).

Who is eligible. If the IRS postpones a tax deadline, the following taxpayers are eligible for the postponement.

- Any individual whose main home is located in a covered disaster area (defined next).
- Any business entity or sole proprietor whose principal place of business is located in a covered disaster area.
- Any individual who is a relief worker affiliated with a recognized government or philanthropic organization who is assisting in a covered disaster area.
- Any individual, business entity, or sole proprietorship whose records are needed to meet a postponed tax deadline, provided those records are maintained in a covered disaster area. The main home or principal place of business does not have to be located in the covered disaster area.
- Any estate or trust that has tax records necessary to meet a postponed tax deadline, provided those records are maintained in a covered disaster area.
- The spouse on a joint return with a taxpayer who is eligible for postponements.
- Any individual, business entity, or sole proprietorship not located in a covered disaster area, but whose records necessary to meet a postponed tax deadline are located in the covered disaster area.
- Any individual visiting the covered disaster area who was killed or injured as a result of the disaster.
- Any other person determined by the IRS to be affected by a federally declared disaster.

Covered disaster area. This is an area of a federally declared disaster in which the IRS has decided to postpone tax deadlines for up to 1 year.

Abatement of interest and penalties. The IRS may abate the interest and penalties on underpaid income tax for the length of any postponement of tax deadlines.

More information. For more information, see *Disaster Area Losses* in Publication 547.

How To Report Gains and Losses

Use Form 4684 to report a gain or a deductible loss from a casualty or theft. If you have more than one casualty or theft, use a separate Form 4684 to determine your gain or loss for each event. Combine the gains and losses on one Form 4684. Follow the form instructions as to which lines to fill out. In addition, you must use the appropriate schedule to report a gain or loss. The schedule you use depends on whether you have a gain or loss.

If you have a:	Report it on:
Gain	Schedule D (Form 1040)
Loss	Schedule A (Form 1040)

Adjustments to basis. If you have a casualty or theft loss, you must decrease your basis in the property by any insurance or other reimbursement you receive, and by any deductible loss. Amounts you spend to restore your property after a casualty increase your adjusted basis. See *Adjusted Basis* in chapter 13 for more information.

Net operating loss (NOL). If your casualty or theft loss deduction causes your deductions for the year to be more than your income for the year, you may have an NOL. You can use an NOL to lower your tax in an earlier year, allowing you to get a refund for tax you have already paid. Or, you can use it to lower your tax in a later year. You do not have to be in business to have an NOL from a casualty or theft loss. For more information, see Publication 536, Net Operating Losses (NOLs) for Individuals, Estates, and Trusts.

26.

Car Expenses and Other Employee Business Expenses

What's New

Standard mileage rate. For 2012, the standard mileage rate for the cost of operating your car for business use is 55½ cents per mile.

Car expenses and use of the standard mileage rate are explained under *Transportation Expenses*, later.

Depreciation limits on cars, trucks, and vans. For 2012, the first-year limit on the total section 179 deduction, special depreciation allowance, and depreciation deduction for cars increases to $11,160 ($3,160 if you elect not to claim the special depreciation allowance). For trucks and vans the first-year limit has increased to $11,360 ($3,360 if you elect not to claim the special depreciation allowance). For more information see *Depreciation limits* in Publication 463.

Introduction

You may be able to deduct the ordinary and necessary business-related expenses you have for:

- Travel,
- Entertainment,
- Gifts, or
- Transportation.

An ordinary expense is one that is common and accepted in your trade or business. A necessary expense is one that is helpful and appropriate for your business. An expense does not have to be required to be considered necessary.

This chapter explains the following.

- What expenses are deductible.
- How to report your expenses on your return.
- What records you need to prove your expenses.
- How to treat any expense reimbursements you may receive.

Who does not need to use this chapter. If you are an employee, you will not need to read this chapter if all of the following are true.

- You fully accounted to your employer for your work-related expenses.
- You received full reimbursement for your expenses.
- Your employer required you to return any excess reimbursement and you did so.
- There is no amount shown with a code "L" in box 12 of your Form W-2, Wage and Tax Statement.

If you meet all of these conditions, there is no need to show the expenses or the reimbursements on your return. See *Reimbursements*, later, if you would like more information on reimbursements and accounting to your employer.

TIP *If you meet these conditions and your employer included reimbursements on your Form W-2 in error, ask your employer for a corrected Form W-2.*

Useful Items

You may want to see:

Publication

- ❑ **463** Travel, Entertainment, Gift, and Car Expenses
- ❑ **535** Business Expenses

Form (and Instructions)

- ❑ **Schedule A (Form 1040)** Itemized Deductions
- ❑ **Schedule C (Form 1040)** Profit or Loss From Business
- ❑ **Schedule C-EZ (Form 1040)** Net Profit From Business
- ❑ **Schedule F (Form 1040)** Profit or Loss From Farming
- ❑ **Form 2106** Employee Business Expenses
- ❑ **Form 2106-EZ** Unreimbursed Employee Business Expenses

Travel Expenses

If you temporarily travel away from your tax home, you can use this section to determine if you have deductible travel expenses. This section discusses:

- Traveling away from home,
- Tax home,
- Temporary assignment or job, and
- What travel expenses are deductible.

It also discusses the standard meal allowance, rules for travel inside and outside the United States, and deductible convention expenses.

Travel expenses defined. For tax purposes, travel expenses are the ordinary and necessary expenses (defined earlier) of traveling away from home for your business, profession, or job.

You will find examples of deductible travel expenses in Table 26-1.

Traveling Away From Home

You are traveling away from home if:

- Your duties require you to be away from the general area of your tax home (defined later) substantially longer than an ordinary day's work, and
- You need to sleep or rest to meet the demands of your work while away from home.

This rest requirement is not satisfied by merely napping in your car. You do not have to be away from your tax home for a whole day or from dusk to dawn as long as your relief from duty is long enough to get necessary sleep or rest.

Example 1. You are a railroad conductor. You leave your home terminal on a regularly scheduled round-trip run between two cities and return home 16 hours later. During the run, you have 6 hours off at your turnaround point where you eat two meals and rent a hotel room to get necessary sleep before starting the return trip. You are considered to be away from home.

Example 2. You are a truck driver. You leave your terminal and return to it later the same day. You get an hour off at your turnaround point to eat. Because you are not off to get necessary sleep and the brief time off is not an adequate rest period, you are not traveling away from home.

Members of the Armed Forces. If you are a member of the U.S. Armed Forces on a permanent duty assignment overseas, you are not traveling away from home. You cannot deduct your expenses for meals and lodging. You cannot deduct these expenses even if you have to maintain a home in the United States for your family members who are not allowed to accompany you overseas. If you are transferred from one permanent duty station to another, you may have deductible moving expenses, which are explained in Publication 521, Moving Expenses.

A naval officer assigned to permanent duty aboard a ship that has regular eating and living facilities has a tax home aboard ship for travel expense purposes.

Tax Home

To determine whether you are traveling away from home, you must first determine the location of your tax home.

Generally, your tax home is your regular place of business or post of duty, regardless of where you maintain your family home. It includes the entire city or general area in which your business or work is located.

If you have more than one regular place of business, your tax home is your main place of business. See *Main place of business or work*, later.

If you do not have a regular or a main place of business because of the nature of your work, then your tax home may be the place where you regularly live. See *No main place of business or work*, later.

If you do not have a regular or a main place of business or post of duty and there is no place where you regularly live, you are considered an itinerant (a transient) and your tax home is wherever you work. As an itinerant, you cannot claim a travel expense deduction because you are never considered to be traveling away from home.

Main place of business or work. If you have more than one place of business or work, consider the following when determining which one is your main place of business or work.

- The total time you ordinarily spend in each place.
- The level of your business activity in each place.
- Whether your income from each place is significant or insignificant.

Example. You live in Cincinnati where you have a seasonal job for 8 months each year and earn $40,000. You work the other 4 months in Miami, also at a seasonal job, and earn $15,000. Cincinnati is your main place of work because you spend most of your time there and earn most of your income there.

No main place of business or work. You may have a tax home even if you do not have a regular or main place of business or work. Your tax home may be the home where you regularly live.

Factors used to determine tax home. If you do not have a regular or main place of business or work, use the following three factors to determine where your tax home is.

1. You perform part of your business in the area of your main home and use that home for lodging while doing business in the area.
2. You have living expenses at your main home that you duplicate because your business requires you to be away from that home.
3. You have not abandoned the area in which both your historical place of lodging and your claimed main home are located; you have a member or members of your family living at your main home; or you often use that home for lodging.

If you satisfy all three factors, your tax home is the home where you regularly live. If you satisfy only two factors, you may have a tax home depending on all the facts and circumstances. If you satisfy only one factor, you are an itinerant; your tax home is wherever you work and you cannot deduct travel expenses.

Example. You are single and live in Boston in an apartment you rent. You have worked for your employer in Boston for a number of years. Your employer enrolls you in a 12-month executive training program. You do not expect to return to work in Boston after you complete your training.

During your training, you do not do any work in Boston. Instead, you receive classroom and on-the-job training throughout the United States. You keep your apartment in Boston and return to it frequently. You use your apartment to conduct your personal business. You also keep up your community contacts in Boston. When you complete your training, you are transferred to Los Angeles.

You do not satisfy factor (1) because you did not work in Boston. You satisfy factor (2) because you had duplicate living expenses. You also satisfy factor (3) because you did not abandon your apartment in Boston as your main home, you kept your community contacts, and you frequently returned to live in your apartment. Therefore, you have a tax home in Boston.

Tax home different from family home. If you (and your family) do not live at your tax home (defined earlier), you cannot deduct the cost of traveling between your tax home and your family home. You also cannot deduct the cost of meals and lodging while at your tax home. See *Example 1*, later.

If you are working temporarily in the same city where you and your family live, you may be considered as traveling away from home. See *Example 2*, later.

Example 1. You are a truck driver and you and your family live in Tucson. You are employed by a trucking firm that has its terminal in Phoenix. At the end of your long runs, you return to your home terminal in Phoenix and spend one night there before returning home. You cannot deduct any expenses you have for meals and lodging in Phoenix or the cost of traveling from Phoenix to Tucson. This is because Phoenix is your tax home.

Example 2. Your family home is in Pittsburgh, where you work 12 weeks a year. The rest of the year you work for the same employer in Baltimore. In Baltimore, you eat in restaurants and sleep in a rooming house. Your salary is the same whether you are in Pittsburgh or Baltimore.

Because you spend most of your working time and earn most of your salary in Baltimore, that city is your tax home. You cannot deduct any expenses you have for meals and lodging there. However, when you return to work in Pittsburgh, you are away from your tax home even though you stay at your family home. You can deduct the cost of your round trip between Baltimore and Pittsburgh. You can also deduct your part of your family's living expenses for meals and lodging while you are living and working in Pittsburgh.

Temporary Assignment or Job

You may regularly work at your tax home and also work at another location. It may not be practical to return to your tax home from this other location at the end of each work day.

Temporary assignment vs. indefinite assignment. If your assignment or job away from your main place of work is temporary, your tax home does not change. You are considered to be away from home for the whole period you are away from your main place of work. You can deduct your travel expenses if they otherwise qualify for deduction. Generally, a temporary assignment in a single location is one that is realistically expected to last (and does in fact last) for 1 year or less.

However, if your assignment or job is indefinite, the location of the assignment or job becomes your new tax home and you cannot deduct your travel expenses while there. An assignment or job in a single location is considered indefinite if it is realistically expected to last for more than 1 year, whether or not it actually lasts for more than 1 year.

If your assignment is indefinite, you must include in your income any amounts you receive from your employer for living expenses, even if they are called travel allowances and you account to your employer for them. You may be able to deduct the cost of relocating to your new tax home as a moving expense. See Publication 521 for more information.

Exception for federal crime investigations or prosecutions. If you are a federal employee participating in a federal crime investigation or prosecution, you are not subject to the

1-year rule. This means you may be able to deduct travel expenses even if you are away from your tax home for more than 1 year, provided you meet the other requirements for deductibility.

For you to qualify, the Attorney General (or his or her designee) must certify that you are traveling:

- For the federal government,
- In a temporary duty status, and
- To investigate or prosecute, or provide support services for the investigation or prosecution of a federal crime.

Determining temporary or indefinite. You must determine whether your assignment is temporary or indefinite when you start work. If you expect an assignment or job to last for 1 year or less, it is temporary unless there are facts and circumstances that indicate otherwise. An assignment or job that is initially temporary may become indefinite due to changed circumstances. A series of assignments to the same location, all for short periods but that together cover a long period, may be considered an indefinite assignment.

Going home on days off. If you go back to your tax home from a temporary assignment on your days off, you are not considered away from home while you are in your hometown. You cannot deduct the cost of your meals and lodging there. However, you can deduct your travel expenses, including meals and lodging, while traveling between your temporary place of work and your tax home. You can claim these expenses up to the amount it would have cost you to stay at your temporary place of work.

If you keep your hotel room during your visit home, you can deduct the cost of your hotel room. In addition, you can deduct your expenses of returning home up to the amount you would have spent for meals had you stayed at your temporary place of work.

Probationary work period. If you take a job that requires you to move, with the understanding that you will keep the job if your work is satisfactory during a probationary period, the job is indefinite. You cannot deduct any of your expenses for meals and lodging during the probationary period.

What Travel Expenses Are Deductible?

Once you have determined that you are traveling away from your tax home, you can determine what travel expenses are deductible.

You can deduct ordinary and necessary expenses you have when you travel away from home on business. The type of expense you can deduct depends on the facts and your circumstances.

Table 26-1, later, summarizes travel expenses you may be able to deduct. You may have other deductible travel expenses that are not covered there, depending on the facts and your circumstances.

RECORDS When you travel away from home on business, you should keep records of all the expenses you have and any advances you receive from your employer. You can use a log, diary, notebook, or any other written record to keep track of your expenses. The types of expenses you need to record, along with supporting documentation, are described in Table 26-2, later.

Separating costs. If you have one expense that includes the costs of meals, entertainment, and other services (such as lodging or transportation), you must allocate that expense between the cost of meals and entertainment and the cost of other services. You must have a reasonable basis for making this allocation. For example, you must allocate your expenses if a hotel includes one or more meals in its room charge.

Travel expenses for another individual. If a spouse, dependent, or other individual goes with you (or your employee) on a business trip or to a business convention, you generally cannot deduct his or her travel expenses.

Employee. You can deduct the travel expenses of someone who goes with you if that person:

1. Is your employee,
2. Has a *bona fide* business purpose for the travel, and
3. Would otherwise be allowed to deduct the travel expenses.

Business associate. If a business associate travels with you and meets the conditions in (2) and (3) above, you can deduct the travel expenses you have for that person. A business associate is someone with whom you could reasonably expect to engage or deal in the active conduct of your business. A business associate can be a current or prospective (likely to become) customer, client, supplier, employee, agent, partner, or professional advisor.

Bona fide business purpose. A *bona fide* business purpose exists if you can prove a real business purpose for the individual's presence. Incidental services, such as typing notes or assisting in entertaining customers, are not enough to make the expenses deductible.

Example. Jerry drives to Chicago on business and takes his wife, Linda, with him. Linda is not Jerry's employee. Linda occasionally types notes, performs similar services, and accompanies Jerry to luncheons and dinners. The performance of these services does not establish that her presence on the trip is necessary to the conduct of Jerry's business. Her expenses are not deductible.

Jerry pays $199 a day for a double room. A single room costs $149 a day. He can deduct the total cost of driving his car to and from Chicago, but only $149 a day for his hotel room. If he uses public transportation, he can deduct only his fare.

Meals and Incidental Expenses

You can deduct the cost of meals in either of the following situations.

- It is necessary for you to stop for substantial sleep or rest to properly perform your duties while traveling away from home on business.
- The meal is business-related entertainment.

Business-related entertainment is discussed under Entertainment Expenses, later. The following discussion deals only with meals (and incidental expenses) that are not business-related entertainment.

Lavish or extravagant. You cannot deduct expenses for meals that are lavish or extravagant. An expense is not considered lavish or extravagant if it is reasonable based on the facts and circumstances. Expenses will not be disallowed merely because they are more than a fixed dollar amount or take place at deluxe restaurants, hotels, nightclubs, or resorts.

50% limit on meals. You can figure your meal expenses using either of the following methods.

- Actual cost.
- The standard meal allowance.

Both of these methods are explained below. But, regardless of the method you use, you generally can deduct only 50% of the unreimbursed cost of your meals.

If you are reimbursed for the cost of your meals, how you apply the 50% limit depends on whether your employer's reimbursement plan was accountable or nonaccountable. If you are not reimbursed, the 50% limit applies whether the unreimbursed meal expense is for business travel or business entertainment. The 50% limit is explained later under Entertainment Expenses. Accountable and nonaccountable plans are discussed later under Reimbursements.

Actual cost. You can use the actual cost of your meals to figure the amount of your expense before reimbursement and application of the 50% deduction limit. If you use this method, you must keep records of your actual cost.

Standard meal allowance. Generally, you can use the “standard meal allowance” method as an alternative to the actual cost method. It allows you to use a set amount for your daily meals and incidental expenses (M&IE), instead of keeping records of your actual costs. The set amount varies depending on where and when you travel. In this chapter, “standard meal allowance” refers to the federal rate for M&IE, discussed later under Amount of standard meal allowance. If you use the standard meal allowance, you still must keep records to prove the time, place, and business purpose of your travel. See Recordkeeping, later.

Incidental expenses. The term “incidental expenses” means fees and tips given to porters, baggage carriers, hotel staff, and staff on ships. Incidental expenses do not include expenses for laundry, cleaning and pressing of clothing, lodging taxes, costs of telegrams or telephone calls, transportation between places of lodging or business and places where meals

Table 26-1. **Travel Expenses You Can Deduct**

This chart summarizes expenses you can deduct when you travel away from home for business purposes.

IF you have expenses for...	THEN you can deduct the cost of...
transportation	travel by airplane, train, bus, or car between your home and your business destination. If you were provided with a ticket or you are riding free as a result of a frequent traveler or similar program, your cost is zero. If you travel by ship, see *Luxury Water Travel* and *Cruise ships* (under *Conventions*) in Publication 463 for additional rules and limits.
taxi, commuter bus, and airport limousine	fares for these and other types of transportation that take you between: • The airport or station and your hotel, and • The hotel and the work location of your customers or clients, your business meeting place, or your temporary work location.
baggage and shipping	sending baggage and sample or display material between your regular and temporary work locations.
car	operating and maintaining your car when traveling away from home on business. You can deduct actual expenses or the standard mileage rate as well as business-related tolls and parking. If you rent a car while away from home on business, you can deduct only the business-use portion of the expenses.
lodging and meals	your lodging and meals if your business trip is overnight or long enough that you need to stop for sleep or rest to properly perform your duties. Meals include amounts spent for food, beverages, taxes, and related tips. See *Meals and Incidental Expenses* for additional rules and limits.
cleaning	dry cleaning and laundry.
telephone	business calls while on your business trip. This includes business communication by fax machine or other communication devices.
tips	tips you pay for any expenses in this chart.
other	other similar ordinary and necessary expenses related to your business travel. These expenses might include transportation to or from a business meal, public stenographer's fees, computer rental fees, and operating and maintaining a house trailer.

are taken, or the mailing cost of filing travel vouchers and paying employer-sponsored charge card billings.

Incidental expenses only method. You can use an optional method (instead of actual cost) for deducting incidental expenses only. The amount of the deduction is $5 a day. You can use this method only if you did not pay or incur any meal expenses. You cannot use this method on any day that you use the standard meal allowance.

CAUTION *Federal employees should refer to the Federal Travel Regulations at www.gsa.gov. Find "What GSA Offers" and click on "Regulations: FMR, FTR, & FAR" for Federal Travel Regulation (FTR) for changes affecting claims for reimbursement.*

50% limit may apply. If you use the standard meal allowance method for meal expenses and you are not reimbursed or you are reimbursed under a nonaccountable plan, you can generally deduct only 50% of the standard meal allowance. If you are reimbursed under an accountable plan and you are deducting amounts that are more than your reimbursements, you can deduct only 50% of the excess amount. The 50% limit is explained later under *Entertainment Expenses*. Accountable and nonaccountable plans are discussed later under *Reimbursements*.

CAUTION *There is no optional standard lodging amount similar to the standard meal allowance. Your allowable lodging expense deduction is your actual cost.*

Who can use the standard meal allowance. You can use the standard meal allowance whether you are an employee or self-employed, and whether or not you are reimbursed for your traveling expenses.

Use of the standard meal allowance for other travel. You can use the standard meal allowance to figure your meal expenses when you travel in connection with investment and other income-producing property. You can also use it to figure your meal expenses when you travel for qualifying educational purposes. You cannot use the standard meal allowance to figure the cost of your meals when you travel for medical or charitable purposes.

Amount of standard meal allowance. The standard meal allowance is the federal M&IE rate. For travel in 2012, the rate for most small localities in the United States is $46 a day.

Most major cities and many other localities in the United States are designated as high-cost areas, qualifying for higher standard meal allowances. You can find this information (organized by state) on the Internet at www.gsa.gov. Click on "Per Diem Rates," then select "2012" for the period January 1, 2012 –

September 30, 2012, and select “2013” for the period October 1, 2012 – December 31, 2012. However, you can apply the rates in effect before October 1, 2012, for expenses of all travel within the United States for 2012 instead of the updated rates. You must consistently use either the rates for the first 9 months for all of 2012 or the updated rates for the period of October 1, 2012, through December 31, 2012.

If you travel to more than one location in one day, use the rate in effect for the area where you stop for sleep or rest. If you work in the transportation industry, however, see *Special rate for transportation workers*, later.

Standard meal allowance for areas outside the continental United States. The standard meal allowance rates above do not apply to travel in Alaska, Hawaii, or any other location outside the continental United States. The Department of Defense establishes per diem rates for Alaska, Hawaii, Puerto Rico, American Samoa, Guam, Midway, the Northern Mariana Islands, the U.S. Virgin Islands, Wake Island, and other non-foreign areas outside the continental United States. The Department of State establishes per diem rates for all other foreign areas.

You can access per diem rates for non-foreign areas outside the continental United States at: *www.defensetravel.dod.mil/site/perdiemCalc.cfm*. You can access all other foreign per diem rates at *www.state.gov/travel/*. Click on “Travel Per Diem Allowances for Foreign Areas” under “Foreign Per Diem Rates,” to obtain the latest foreign per diem rates.

Special rate for transportation workers. You can use a special standard meal allowance if you work in the transportation industry. You are in the transportation industry if your work:

- Directly involves moving people or goods by airplane, barge, bus, ship, train, or truck, and
- Regularly requires you to travel away from home and, during any single trip, usually involves travel to areas eligible for different standard meal allowance rates.

If this applies to you, you can claim a standard meal allowance of $59 a day ($65 for travel outside the continental United States).

Using the special rate for transportation workers eliminates the need for you to determine the standard meal allowance for every area where you stop for sleep or rest. If you choose to use the special rate for any trip, you must use the special rate (and not use the regular standard meal allowance rates) for all trips you take that year.

Travel for days you depart and return. For both the day you depart for and the day you return from a business trip, you must prorate the standard meal allowance (figure a reduced amount for each day). You can do so by one of two methods.

- Method 1: You can claim $\frac{3}{4}$ of the standard meal allowance.
- Method 2: You can prorate using any method that you consistently apply and that is in accordance with reasonable business practice.

Example. Jen is employed in New Orleans as a convention planner. In March, her employer sent her on a 3-day trip to Washington, DC, to attend a planning seminar. She left her home in New Orleans at 10 a.m. on Wednesday and arrived in Washington, DC, at 5:30 p.m. After spending two nights there, she flew back to New Orleans on Friday and arrived back home at 8:00 p.m. Jen's employer gave her a flat amount to cover her expenses and included it with her wages.

Under Method 1, Jen can claim $2\frac{1}{2}$ days of the standard meal allowance for Washington, DC: $\frac{3}{4}$ of the daily rate for Wednesday and Friday (the days she departed and returned), and the full daily rate for Thursday.

Under Method 2, Jen could also use any method that she applies consistently and that is in accordance with reasonable business practice. For example, she could claim 3 days of the standard meal allowance even though a federal employee would have to use Method 1 and be limited to only $2\frac{1}{2}$ days.

Travel in the United States

The following discussion applies to travel in the United States. For this purpose, the United States includes only the 50 states and the District of Columbia. The treatment of your travel expenses depends on how much of your trip was business related and on how much of your trip occurred within the United States. See *Part of Trip Outside the United States*, later.

Trip Primarily for Business

You can deduct all your travel expenses if your trip was entirely business related. If your trip was primarily for business and, while at your business destination, you extended your stay for a vacation, made a personal side trip, or had other personal activities, you can deduct your business-related travel expenses. These expenses include the travel costs of getting to and from your business destination and any business-related expenses at your business destination.

Example. You work in Atlanta and take a business trip to New Orleans in May. On your way home, you stop in Mobile to visit your parents. You spend $1,996 for the 9 days you are away from home for travel, meals, lodging, and other travel expenses. If you had not stopped in Mobile, you would have been gone only 6 days, and your total cost would have been $1,696. You can deduct $1,696 for your trip, including the cost of round-trip transportation to and from New Orleans. The deduction for your meals is subject to the 50% limit on meals mentioned earlier.

Trip Primarily for Personal Reasons

If your trip was primarily for personal reasons, such as a vacation, the entire cost of the trip is a nondeductible personal expense. However, you can deduct any expenses you have while at your destination that are directly related to your business.

A trip to a resort or on a cruise ship may be a vacation even if the promoter advertises that it is primarily for business. The scheduling of incidental business activities during a trip, such as viewing videotapes or attending lectures dealing with general subjects, will not change what is really a vacation into a business trip.

Part of Trip Outside the United States

If part of your trip is outside the United States, use the rules described later under *Travel Outside the United States* for that part of the trip. For the part of your trip that is inside the United States, use the rules for travel in the United States. Travel outside the United States does not include travel from one point in the United States to another point in the United States. The following discussion can help you determine whether your trip was entirely within the United States.

Public transportation. If you travel by public transportation, any place in the United States where that vehicle makes a scheduled stop is a point in the United States. Once the vehicle leaves the last scheduled stop in the United States on its way to a point outside the United States, you apply the rules under *Travel Outside the United States*.

Example. You fly from New York to Puerto Rico with a scheduled stop in Miami. You return to New York nonstop. The flight from New York to Miami is in the United States, so only the flight from Miami to Puerto Rico is outside the United States. Because there are no scheduled stops between Puerto Rico and New York, all of the return trip is outside the United States.

Private car. Travel by private car in the United States is travel between points in the United States, even when you are on your way to a destination outside the United States.

Example. You travel by car from Denver to Mexico City and return. Your travel from Denver to the border and from the border back to Denver is travel in the United States, and the rules in this section apply. The rules under *Travel Outside the United States* apply to your trip from the border to Mexico City and back to the border.

Travel Outside the United States

If any part of your business travel is outside the United States, some of your deductions for the cost of getting to and from your destination may be limited. For this purpose, the United States includes only the 50 states and the District of Columbia.

How much of your travel expenses you can deduct depends in part upon how much of your trip outside the United States was business related.

See chapter 1 of Publication 463 for information on luxury water travel.

Travel Entirely for Business or Considered Entirely for Business

You can deduct all your travel expenses of getting to and from your business destination if your trip is entirely for business or considered entirely for business.

Travel entirely for business. If you travel outside the United States and you spend the entire time on business activities, you can deduct all of your travel expenses.

Travel considered entirely for business. Even if you did not spend your entire time on business activities, your trip is considered entirely for business if you meet at least one of the following four exceptions.

Exception 1 - No substantial control. Your trip is considered entirely for business if you did not have substantial control over arranging the trip. The fact that you control the timing of your trip does not, by itself, mean that you have substantial control over arranging your trip.

You do not have substantial control over your trip if you:

- Are an employee who was reimbursed or paid a travel expense allowance,
- Are not related to your employer, and
- Are not a managing executive.

"Related to your employer" is defined later in this chapter under *Per Diem and Car Allowances*.

A "managing executive" is an employee who has the authority and responsibility, without being subject to the veto of another, to decide on the need for the business travel.

A self-employed person generally has substantial control over arranging business trips.

Exception 2 - Outside United States no more than a week. Your trip is considered entirely for business if you were outside the United States for a week or less, combining business and nonbusiness activities. One week means 7 consecutive days. In counting the days, do not count the day you leave the United States, but do count the day you return to the United States.

Exception 3 - Less than 25% of time on personal activities. Your trip is considered entirely for business if:

- You were outside the United States for more than a week, and
- You spent less than 25% of the total time you were outside the United States on nonbusiness activities.

For this purpose, count both the day your trip began and the day it ended.

Exception 4 - Vacation not a major consideration. Your trip is considered entirely for business if you can establish that a personal vacation was not a major consideration, even if you have substantial control over arranging the trip.

Travel Primarily for Business

If you travel outside the United States primarily for business but spend some of your time on nonbusiness activities, you generally cannot deduct all of your travel expenses. You can only deduct the business portion of your cost of getting to and from your destination. You must allocate the costs between your business and nonbusiness activities to determine your deductible amount. These travel allocation rules are discussed in chapter 1 of Publication 463.

TIP *You do not have to allocate your travel expense deduction if you meet one of the four exceptions listed earlier under* Travel considered entirely for business*. In those cases, you can deduct the total cost of getting to and from your destination.*

Travel Primarily for Personal Reasons

If you travel outside the United States primarily for vacation or for investment purposes, the entire cost of the trip is a nondeductible personal expense. If you spend some time attending brief professional seminars or a continuing education program, you can deduct your registration fees and other expenses you have that are directly related to your business.

Conventions

You can deduct your travel expenses when you attend a convention if you can show that your attendance benefits your trade or business. You cannot deduct the travel expenses for your family.

If the convention is for investment, political, social, or other purposes unrelated to your trade or business, you cannot deduct the expenses.

CAUTION *Your appointment or election as a delegate does not, in itself, determine whether you can deduct travel expenses. You can deduct your travel expenses only if your attendance is connected to your own trade or business.*

Convention agenda. The convention agenda or program generally shows the purpose of the convention. You can show your attendance at the convention benefits your trade or business by comparing the agenda with the official duties and responsibilities of your position. The agenda does not have to deal specifically with your official duties and responsibilities; it will be enough if the agenda is so related to your position that it shows your attendance was for business purposes.

Conventions held outside the North American area. See chapter 1 of Publication 463 for information on conventions held outside the North American area.

Entertainment Expenses

You may be able to deduct business-related entertainment expenses you have for entertaining a client, customer, or employee.

You can deduct entertainment expenses only if they are both ordinary and necessary (defined earlier in the *Introduction*) and meet one of the following tests.

- Directly-related test.
- Associated test.

Both of these tests are explained in chapter 2 of Publication 463.

CAUTION *The amount you can deduct for entertainment expenses may be limited. Generally, you can deduct only 50% of your unreimbursed entertainment expenses. This limit is discussed next.*

50% Limit

In general, you can deduct only 50% of your business-related meal and entertainment expenses. (If you are subject to the Department of Transportation's "hours of service" limits, you can deduct 80% of your business-related meal and entertainment expenses. See *Individuals subject to "hours of service" limits*, later.)

The 50% limit applies to employees or their employers, and to self-employed persons (including independent contractors) or their clients, depending on whether the expenses are reimbursed.

Figure 26-A summarizes the general rules explained in this section.

The 50% limit applies to business meals or entertainment expenses you have while:

- Traveling away from home (whether eating alone or with others) on business,
- Entertaining customers at your place of business, a restaurant, or other location, or
- Attending a business convention or reception, business meeting, or business luncheon at a club.

Included expenses. Expenses subject to the 50% limit include:

- Taxes and tips relating to a business meal or entertainment activity,
- Cover charges for admission to a nightclub,
- Rent paid for a room in which you hold a dinner or cocktail party, and
- Amounts paid for parking at a sports arena.

However, the cost of transportation to and from a business meal or a business-related entertainment activity is not subject to the 50% limit.

Application of 50% limit. The 50% limit on meal and entertainment expenses applies if the expense is otherwise deductible and is not covered by one of the exceptions discussed later in this section.

The 50% limit also applies to certain meal and entertainment expenses that are not business related. It applies to meal and entertainment expenses incurred for the production of income, including rental or royalty income. It also applies to the cost of meals included in deductible educational expenses.

When to apply the 50% limit. You apply the 50% limit after determining the amount that would otherwise qualify for a deduction. You first have to determine the amount of meal and entertainment expenses that would be deductible under the other rules discussed in this chapter.

Example 1. You spend $200 for a business-related meal. If $110 of that amount is not allowable because it is lavish and extravagant, the remaining $90 is subject to the 50% limit. Your deduction cannot be more than $45 (.50 × $90).

Example 2. You purchase two tickets to a concert and give them to a client. You purchased the tickets through a ticket agent. You paid $200 for the two tickets, which had a face value of $80 each ($160 total). Your deduction cannot be more than $80 (.50 × $160).

Exceptions to the 50% Limit

Generally, business-related meal and entertainment expenses are subject to the 50% limit. Figure 26-A can help you determine if the 50% limit applies to you.

Your meal or entertainment expense is not subject to the 50% limit if the expense meets one of the following exceptions.

Employee's reimbursed expenses. If you are an employee, you are not subject to the 50% limit on expenses for which your employer reimburses you under an accountable plan. Accountable plans are discussed later under *Reimbursements*.

Individuals subject to "hours of service" limits. You can deduct a higher percentage of your meal expenses while traveling away from your tax home if the meals take place during or incident to any period subject to the Department of Transportation's "hours of service" limits. The percentage is 80%.

Individuals subject to the Department of Transportation's "hours of service" limits include the following persons.

- Certain air transportation workers (such as pilots, crew, dispatchers, mechanics, and control tower operators) who are under Federal Aviation Administration regulations.
- Interstate truck operators and bus drivers who are under Department of Transportation regulations.
- Certain railroad employees (such as engineers, conductors, train crews, dispatchers, and control operations personnel) who are under Federal Railroad Administration regulations.
- Certain merchant mariners who are under Coast Guard regulations.

Other exceptions. There are also exceptions for the self-employed, advertising expenses, selling meals or entertainment, and charitable sports events. These are discussed in Publication 463.

What Entertainment Expenses Are Deductible?

This section explains different types of entertainment expenses you may be able to deduct.

Entertainment. Entertainment includes any activity generally considered to provide entertainment, amusement, or recreation. Examples include entertaining guests at nightclubs; at social, athletic, and sporting clubs; at theaters; at sporting events; or on hunting, fishing, vacation, and similar trips.

A meal as a form of entertainment. Entertainment includes the cost of a meal you provide to a customer or client, whether the meal is a part of other entertainment or by itself. A meal expense includes the cost of food, beverages, taxes, and tips for the meal. To deduct an entertainment-related meal, you or your employee must be present when the food or beverages are provided.

CAUTION *You cannot claim the cost of your meal both as an entertainment expense and as a travel expense.*

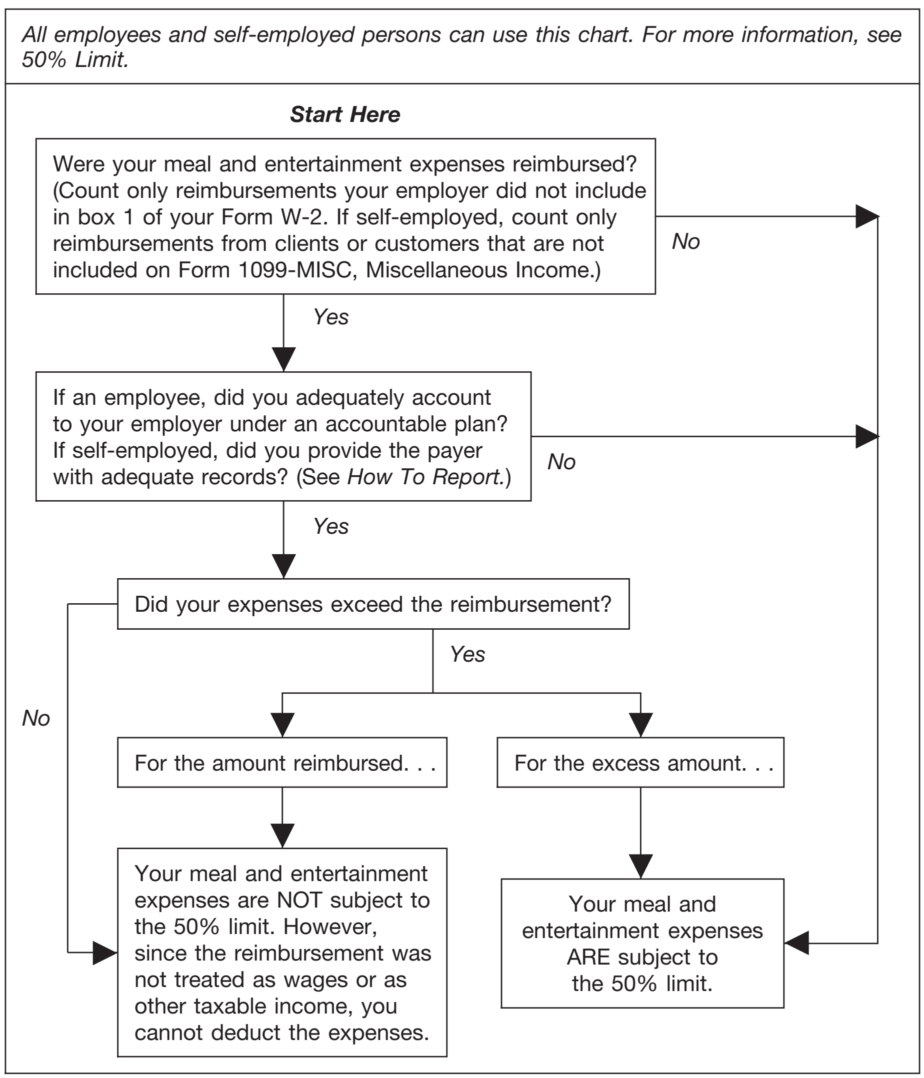
Separating costs. If you have one expense that includes the costs of entertainment and other services (such as lodging or transportation), you must allocate that expense between the cost of entertainment and the cost of other services. You must have a reasonable basis for making this allocation. For example, you must allocate your expenses if a hotel includes entertainment in its lounge on the same bill with your room charge.

Taking turns paying for meals or entertainment. If a group of business acquaintances take turns picking up each others' meal or entertainment checks without regard to whether any business purposes are served, no member of the group can deduct any part of the expense.

Lavish or extravagant expenses. You cannot deduct expenses for entertainment that are lavish or extravagant. An expense is not

Figure 26-A. Does the 50% Limit Apply to Your Expenses?

There are exceptions to these rules. See Exceptions to the 50% Limit.



considered lavish or extravagant if it is reasonable considering the facts and circumstances. Expenses will not be disallowed just because they are more than a fixed dollar amount or take place at deluxe restaurants, hotels, nightclubs, or resorts.

Trade association meetings. You can deduct entertainment expenses that are directly related to, and necessary for, attending business meetings or conventions of certain exempt organizations if the expenses of your attendance are related to your active trade or business. These organizations include business leagues, chambers of commerce, real estate boards, trade associations, and professional associations.

Entertainment tickets. Generally, you cannot deduct more than the face value of an entertainment ticket, even if you paid a higher price. For example, you cannot deduct service fees you pay to ticket agencies or brokers or any amount over the face value of the tickets you pay to scalpers.

What Entertainment Expenses Are Not Deductible?

This section explains different types of entertainment expenses you generally may not be able to deduct.

Club dues and membership fees. You cannot deduct dues (including initiation fees) for membership in any club organized for:

- Business,
- Pleasure,
- Recreation, or
- Other social purpose.

This rule applies to any membership organization if one of its principal purposes is either:

- To conduct entertainment activities for members or their guests, or
- To provide members or their guests with access to entertainment facilities.

The purposes and activities of a club, not its name, will determine whether or not you can deduct the dues. You cannot deduct dues paid to:

- Country clubs,
- Golf and athletic clubs,
- Airline clubs,
- Hotel clubs, and
- Clubs operated to provide meals under circumstances generally considered to be conducive to business discussions.

Entertainment facilities. Generally, you cannot deduct any expense for the use of an entertainment facility. This includes expenses for depreciation and operating costs such as rent, utilities, maintenance, and protection.

An entertainment facility is any property you own, rent, or use for entertainment. Examples include a yacht, hunting lodge, fishing camp, swimming pool, tennis court, bowling alley, car, airplane, apartment, hotel suite, or home in a vacation resort.

Out-of-pocket expenses. You can deduct out-of-pocket expenses, such as for food and beverages, catering, gas, and fishing bait, that you provided during entertainment at a facility. These are not expenses for the use of an entertainment facility. However, these expenses are subject to the directly-related and associated tests and to the *50% Limit* discussed earlier.

Additional information. For more information on entertainment expenses, including discussions of the directly-related and associated tests, see chapter 2 of Publication 463.

Gift Expenses

If you give gifts in the course of your trade or business, you can deduct all or part of the cost. This section explains the limits and rules for deducting the costs of gifts.

$25 limit. You can deduct no more than $25 for business gifts you give directly or indirectly to each person during your tax year. A gift to a company that is intended for the eventual personal use or benefit of a particular person or a limited class of people will be considered an indirect gift to that particular person or to the individuals within that class of people who receive the gift.

If you give a gift to a member of a customer's family, the gift is generally considered to be an indirect gift to the customer. This rule does not apply if you have a *bona fide*, independent business connection with that family member and the gift is not intended for the customer's eventual use or benefit.

If you and your spouse both give gifts, both of you are treated as one taxpayer. It does not matter whether you have separate businesses, are separately employed, or whether each of you has an independent connection with the recipient. If a partnership gives gifts, the partnership and the partners are treated as one taxpayer.

Incidental costs. Incidental costs, such as engraving on jewelry, or packaging, insuring, and mailing, are generally not included in determining the cost of a gift for purposes of the $25 limit.

A cost is incidental only if it does not add substantial value to the gift. For example, the cost of customary gift wrapping is an incidental cost. However, the purchase of an ornamental basket for packaging fruit is not an incidental cost if the value of the basket is substantial compared to the value of the fruit.

Exceptions. The following items are not considered gifts for purposes of the $25 limit.

1. An item that costs $4 or less and:
   a. Has your name clearly and permanently imprinted on the gift, and
   b. Is one of a number of identical items you widely distribute. Examples include pens, desk sets, and plastic bags and cases.
2. Signs, display racks, or other promotional material to be used on the business premises of the recipient.

Gift or entertainment. Any item that might be considered either a gift or entertainment generally will be considered entertainment. However, if you give a customer packaged food or beverages you intend the customer to use at a later date, treat it as a gift.

If you give a customer tickets to a theater performance or sporting event and you do not go with the customer to the performance or event, you have a choice. You can treat the cost of the tickets as either a gift expense or an entertainment expense, whichever is to your advantage.

If you go with the customer to the event, you must treat the cost of the tickets as an entertainment expense. You cannot choose, in this case, to treat the cost of the tickets as a gift expense.

Transportation Expenses

This section discusses expenses you can deduct for business transportation when you are not traveling away from home as defined earlier under *Travel Expenses*. These expenses include the cost of transportation by air, rail, bus, taxi, etc., and the cost of driving and maintaining your car.

Transportation expenses include the ordinary and necessary costs of all of the following.

- Getting from one workplace to another in the course of your business or profession when you are traveling within the area of your tax home. (Tax home is defined earlier under *Travel Expenses*.)
- Visiting clients or customers.
- Going to a business meeting away from your regular workplace.
- Getting from your home to a temporary workplace when you have one or more regular places of work. These temporary workplaces can be either within the area of your tax home or outside that area.

Transportation expenses do not include expenses you have while traveling away from home overnight. Those expenses are travel expenses, discussed earlier. However, if you use your car while traveling away from home overnight, use the rules in this section to figure your car expense deduction. See *Car Expenses*, later.

Illustration of transportation expenses. *Figure 26-B* illustrates the rules for when you can deduct transportation expenses when you have a regular or main job away from your home. You may want to refer to it when deciding whether you can deduct your transportation expenses. Daily transportation expenses you incur while traveling from home to one or more regular places of business are generally nondeductible commuting expenses. However, there are many exceptions for deducting transportation expenses, like whether your work location is temporary (inside or outside the metropolitan area), traveling for same trade or business, or if you have a home office.

Temporary work location. If you have one or more regular work locations away from your home and you commute to a temporary work location in the same trade or business, you can deduct the expenses of the daily round-trip transportation between your home and the temporary location, regardless of distance.

If your employment at a work location is realistically expected to last (and does in fact last) for 1 year or less, the employment is temporary unless there are facts and circumstances that would indicate otherwise.

If your employment at a work location is realistically expected to last for more than 1 year or if there is no realistic expectation that the employment will last for 1 year or less, the employment is not temporary, regardless of whether it actually lasts for more than 1 year.

If employment at a work location initially is realistically expected to last for 1 year or less, but at some later date the employment is realistically expected to last more than 1 year, that employment will be treated as temporary (unless there are facts and circumstances that would indicate otherwise) until your expectation changes. It will not be treated as temporary after the date you determine it will last more than 1 year.

If the temporary work location is beyond the general area of your regular place of work and you stay overnight, you are traveling away from home. You may have deductible travel expenses as discussed earlier in this chapter.

No regular place of work. If you have no regular place of work but ordinarily work in the metropolitan area where you live, you can deduct daily transportation costs between home and a temporary work site outside that metropolitan area.

Generally, a metropolitan area includes the area within the city limits and the suburbs that are considered part of that metropolitan area.

You cannot deduct daily transportation costs between your home and temporary work sites within your metropolitan area. These are nondeductible commuting expenses.

Two places of work. If you work at two places in one day, whether or not for the same employer, you can deduct the expense of getting from one workplace to the other. However, if for some personal reason you do not go directly from one location to the other, you cannot deduct more than the amount it would have cost you to go directly from the first location to the second.

Transportation expenses you have in going between home and a part-time job on a day off from your main job are commuting expenses. You cannot deduct them.

Armed Forces reservists. A meeting of an Armed Forces reserve unit is a second place of business if the meeting is held on a day on which you work at your regular job. You can deduct the expense of getting from one workplace to the other as just discussed under Two places of work, earlier.

You usually cannot deduct the expense if the reserve meeting is held on a day on which you do not work at your regular job. In this case, your transportation generally is a nondeductible commuting expense. However, you can deduct your transportation expenses if the location of the meeting is temporary and you have one or more regular places of work.

If you ordinarily work in a particular metropolitan area but not at any specific location and the reserve meeting is held at a temporary location outside that metropolitan area, you can deduct your transportation expenses.

If you travel away from home overnight to attend a guard or reserve meeting, you can deduct your travel expenses. These expenses are discussed earlier under Travel Expenses.

If you travel more than 100 miles away from home in connection with your performance of services as a member of the reserves, you may be able to deduct some of your reserve-related travel costs as an adjustment to income rather than as an itemized deduction. See Armed Forces reservists traveling more than 100 miles from home under *Special Rules*, later.

Commuting expenses. You cannot deduct the costs of taking a bus, trolley, subway, or taxi, or of driving a car between your home and your main or regular place of work. These costs are personal commuting expenses. You cannot deduct commuting expenses no matter how far your home is from your regular place of work. You cannot deduct commuting expenses even if you work during the commuting trip.

Example. You sometimes use your cell phone to make business calls while commuting to and from work. Sometimes business associates ride with you to and from work, and you have a business discussion in the car. These activities do not change the trip from personal to business. You cannot deduct your commuting expenses.

Parking fees. Fees you pay to park your car at your place of business are nondeductible commuting expenses. You can, however, deduct business-related parking fees when visiting a customer or client.

Advertising display on car. Putting display material that advertises your business on your car does not change the use of your car from personal use to business use. If you use this car for commuting or other personal uses, you still cannot deduct your expenses for those uses.

Car pools. You cannot deduct the cost of using your car in a nonprofit car pool. Do not include payments you receive from the passengers in your income. These payments are considered reimbursements of your expenses. However, if you operate a car pool for a profit, you must include payments from passengers in your income. You can then deduct your car expenses (using the rules in this chapter).

Hauling tools or instruments. Hauling tools or instruments in your car while commuting to and from work does not make your car expenses deductible. However, you can deduct any additional costs you have for hauling tools or instruments (such as for renting a trailer you tow with your car).

Union members' trips from a union hall. If you get your work assignments at a union hall and then go to your place of work, the costs of getting from the union hall to your place of work are nondeductible commuting expenses. Although you need the union to get your work assignments, you are employed where you work, not where the union hall is located.

Office in the home. If you have an office in your home that qualifies as a principal place of business, you can deduct your daily transportation costs between your home and another work location in the same trade or business. (See chapter 28 for information on determining if your home office qualifies as a principal place of business.)

Examples of deductible transportation. The following examples show when you can deduct transportation expenses based on the location of your work and your home.

Example 1. You regularly work in an office in the city where you live. Your employer sends you to a 1-week training session at a different office in the same city. You travel directly from your home to the training location and return each day. You can deduct the cost of your daily round-trip transportation between your home and the training location.

Example 2. Your principal place of business is in your home. You can deduct the cost of round-trip transportation between your qualifying home office and your client's or customer's place of business.

Example 3. You have no regular office, and you do not have an office in your home. In this case, the location of your first business contact inside the metropolitan area is considered your office. Transportation expenses between your home and this first contact are nondeductible commuting expenses. Transportation expenses between your last business contact and your home are also nondeductible commuting expenses. While you cannot deduct the costs of these first and last trips, you can deduct the costs of going from one client or customer to another. With no regular or home office, the costs of travel between two or more business contacts in a metropolitan area are deductible while the costs of travel between the home to (and from) business contacts are not deductible.

Car Expenses

If you use your car for business purposes, you may be able to deduct car expenses. You generally can use one of the two following methods to figure your deductible expenses.

- Standard mileage rate.
- Actual car expenses.

If you use actual car expenses to figure your deduction for a car you lease, there are rules that affect the amount of your lease payments you can deduct. See Leasing a car under *Actual Car Expenses,* later.

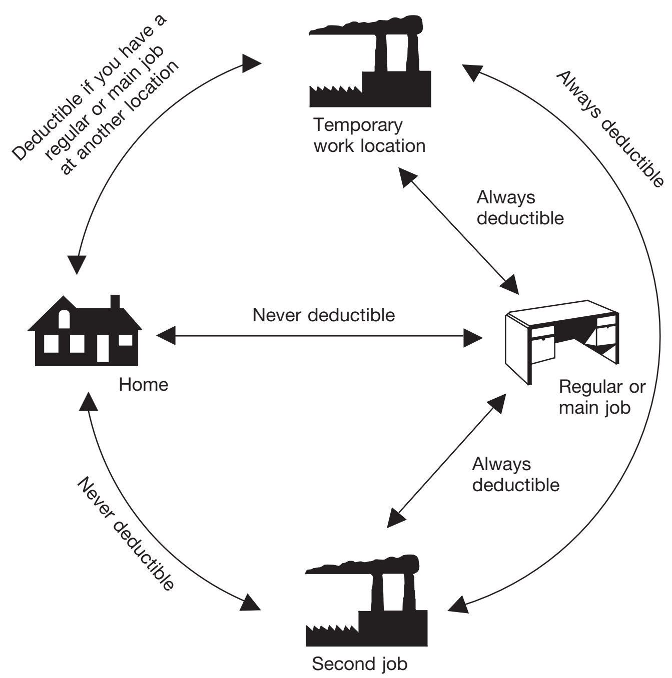
In this chapter, “car” includes a van, pickup, or panel truck.

Rural mail carriers. If you are a rural mail carrier, you may be able to treat the amount of qualified reimbursement you received as the amount of your allowable expense. Because the qualified reimbursement is treated as paid under an accountable plan, your employer should not include the amount of reimbursement in your income.

If your vehicle expenses are more than the amount of your reimbursement, you can deduct

Figure 26-B. When Are Transportation Expenses Deductible?

Most employees and self-employed persons can use this chart. (Do not use this chart if your home is your principal place of business. See Office in the home.)



Home: The place where you reside. Transportation expenses between your home and your main or regular place of work are personal commuting expenses.

Regular or main job: Your principal place of business. If you have more than one job, you must determine which one is your regular or main job. Consider the time you spend at each, the activity you have at each, and the income you earn at each.

Temporary work location: A place where your work assignment is realistically expected to last (and does in fact last) one year or less. Unless you have a regular place of business, you can only deduct your transportation expenses to a temporary work location outside your metropolitan area.

Second job: If you regularly work at two or more places in one day, whether or not for the same employer, you can deduct your transportation expenses of getting from one workplace to another. If you do not go directly from your first job to your second job, you can only deduct the transportation expenses of going directly from your first job to your second job. You cannot deduct your transportation expenses between your home and a second job on a day off from your main job.

the unreimbursed expenses as an itemized deduction on Schedule A (Form 1040). You must complete Form 2106 and attach it to your Form 1040.

A "qualified reimbursement" is the reimbursement you receive that meets both of the following conditions.

- It is given as an equipment maintenance allowance (EMA) to employees of the U.S. Postal Service.
- It is at the rate contained in the 1991 collective bargaining agreement. Any later agreement cannot increase the qualified reimbursement amount by more than the rate of inflation.

See your employer for information on your reimbursement.

If you are a rural mail carrier and received a qualified reimbursement, you cannot use the standard mileage rate.

Standard Mileage Rate

You may be able to use the standard mileage rate to figure the deductible costs of operating your car for business purposes. For 2012, the standard mileage rate for business use is $55^1/_2$ cents per mile.

If you use the standard mileage rate for a year, you cannot deduct your actual car expenses for that year, but see Parking fees and tolls*, later.*

You generally can use the standard mileage rate whether or not you are reimbursed and whether or not any reimbursement is more or less than the amount figured using the standard mileage rate. See Reimbursements under *How To Report*, later.

Choosing the standard mileage rate. If you want to use the standard mileage rate for a car you own, you must choose to use it in the first year the car is available for use in your business. Then in later years, you can choose to use either the standard mileage rate or actual expenses.

If you want to use the standard mileage rate for a car you lease, you must use it for the entire lease period.

You must make the choice to use the standard mileage rate by the due date (including extensions) of your return. You cannot revoke the choice. However, in a later year, you can switch from the standard mileage rate to the actual expenses method. If you change to the actual expenses method in a later year, but before your car is fully depreciated, you have to estimate the remaining useful life of the car and use straight line depreciation.

Example. Larry is an employee who occasionally uses his own car for business purposes. He purchased the car in 2010, but he did not claim any unreimbursed employee expenses on his 2010 tax return. Because Larry did not use the standard mileage rate the first year the car was available for business use, he cannot use the standard mileage rate in 2012 to claim unreimbursed employee business expenses.

For more information about depreciation included in the standard mileage rate, see the exception in *Methods of depreciation* under *Depreciation Deduction* in chapter 4 of Publication 463.

Standard mileage rate not allowed. You cannot use the standard mileage rate if you:

- Use five or more cars at the same time (as in fleet operations),
- Claimed a depreciation deduction for the car using any method other than straight line depreciation,
- Claimed a section 179 deduction on the car,
- Claimed the special depreciation allowance on the car,
- Claimed actual car expenses after 1997 for a car you leased, or
- Are a rural mail carrier who received a qualified reimbursement. (See Rural mail carriers, earlier.)

Five or more cars. If you own or lease five or more cars that are used for business at the same time, you cannot use the standard mileage rate for the business use of any car. However, you may be able to deduct your actual expenses for operating each of the cars in your business. See *Actual Car Expenses* in chapter 4 of Publication 463 for information on how to figure your deduction.

You are not using five or more cars for business at the same time if you alternate using (use at different times) the cars for business.

Note. You can elect to use the standard mileage rate if you used a car for hire (such as a taxi).

Parking fees and tolls. In addition to using the standard mileage rate, you can deduct any business-related parking fees and tolls. (Parking fees you pay to park your car at your place of work are nondeductible commuting expenses.)

Actual Car Expenses

If you do not use the standard mileage rate, you may be able to deduct your actual car expenses.

TIP *If you qualify to use both methods, you may want to figure your deduction both ways to see which gives you a larger deduction.*

Actual car expenses include:

Depreciation	Lease payments	Registration fees
Licenses	Insurance	Repairs
Gas	Garage rent	Tires
Oil	Parking fees	
Tolls		

Business and personal use. If you use your car for both business and personal purposes, you must divide your expenses between business and personal use. You can divide your expense based on the miles driven for each purpose.

Example. You are a contractor and drive your car 20,000 miles during the year: 12,000 miles for business use and 8,000 miles for personal use. You can claim only 60% (12,000 ÷ 20,000) of the cost of operating your car as a business expense.

Interest on car loans. If you are an employee, you cannot deduct any interest paid on a car loan. This interest is treated as personal interest and is not deductible. However, if you are self-employed and use your car in that business, see chapter 4 of Publication 535.

TIP *If you use a home equity loan to purchase your car, you may be able to deduct the interest. See* chapter 23 *for more information.*

Taxes paid on your car. If you are an employee, you can deduct personal property taxes paid on your car if you itemize deductions. Enter the amount paid on line 7 of Schedule A (Form 1040). (See *chapter 22* for more information on taxes.) If you are not an employee, see your form instructions for information on how to deduct personal property taxes paid on your car.

Sales taxes. Generally, sales taxes on your car are part of your car's basis and are recovered through depreciation, discussed later.

CAUTION *The deduction for state and local general sales taxes in lieu of state and local income taxes expired at the end of 2011. At the time this publication went to print, Congress had not enacted legislation on expiring provisions. For additional information, go to www.irs.gov/pub17.*

Fines and collateral. You cannot deduct fines you pay and collateral you forfeited for traffic violations.

Depreciation and section 179 deductions. Generally, the cost of a car, plus sales tax and improvements, is a capital expense. Because the benefits last longer than 1 year, you generally cannot deduct a capital expense. However, you can recover this cost through the section 179 deduction (the deduction allowed by section 179), special depreciation allowance, and depreciation deductions. Depreciation allows you to recover the cost over more than 1 year by deducting part of it each year. The section 179 deduction, special depreciation allowance, and the depreciation deduction are discussed in more detail in chapter 4 of Publication 463.

Generally, there are limits on these deductions. Special rules apply if you use your car 50% or less in your work or business.

Leasing a car. If you lease a car, truck, or van that you use in your business, you can use the standard mileage rate or actual expenses to figure your deductible car expense.

Deductible payments. If you choose to use actual expenses, you can deduct the part of each lease payment that is for the use of the vehicle in your business. You cannot deduct any part of a lease payment that is for personal use of the vehicle, such as commuting.

You must spread any advance payments over the entire lease period. You cannot deduct any payments you make to buy a vehicle, even if the payments are called lease payments.

If you lease a car, truck, or van for 30 days or more, you may have to reduce your lease payment deduction by an "inclusion amount." For information on reporting lease inclusion amounts, see *Leasing a Car* in chapter 4 of Publication 463.

Sale, Trade-In, or Other Disposition

If you sell, trade in, or otherwise dispose of your car, you may have a taxable gain or a deductible loss. This is true whether you used the standard mileage rate or actual car expenses to deduct the business use of your car. Publication 544 has information on sales of property used in a trade or business, and details on how to report the disposition.

Recordkeeping

If you deduct travel, entertainment, gift, or transportation expenses, you must be able to prove (substantiate) certain elements of the expense. This section discusses the records you need to keep to prove these expenses.

RECORDS If you keep timely and accurate records, you will have support to show the IRS if your tax return is ever examined. You will also have proof of expenses that your employer may require if you are reimbursed under an accountable plan. These plans are discussed later under *Reimbursements*.

How To Prove Expenses

Table 26-2 is a summary of records you need to prove each expense discussed in this chapter. You must be able to prove the elements listed across the top portion of the chart. You prove them by having the information and receipts (where needed) for the expenses listed in the first column.

CAUTION *You cannot deduct amounts that you approximate or estimate.*

You should keep adequate records to prove your expenses or have sufficient evidence that will support your own statement. You must generally prepare a written record for it to be considered adequate. This is because written evidence is more reliable than oral evidence alone.

TIP *However, if you contemporaneously prepare a record on a computer it is considered an adequate record.*

What Are Adequate Records?

You should keep the proof you need in an account book, diary, statement of expense, or similar record. You should also keep documentary evidence that, together with your records, will support each element of an expense.

Documentary evidence. You generally must have documentary evidence, such as receipts, canceled checks, or bills, to support your expenses.

Exception. Documentary evidence is not needed if any of the following conditions apply.

- You have meals or lodging expenses while traveling away from home for which you account to your employer under an accountable plan and you use a per diem allowance method that includes meals and/or lodging. (Accountable plans and per diem allowances are discussed later under *Reimbursements*.)
- Your expense, other than lodging, is less than $75.
- You have a transportation expense for which a receipt is not readily available.

Adequate evidence. Documentary evidence ordinarily will be considered adequate if it shows the amount, date, place, and essential character of the expense.

For example, a hotel receipt is enough to support expenses for business travel if it has all of the following information.

- The name and location of the hotel.
- The dates you stayed there.
- Separate amounts for charges such as lodging, meals, and telephone calls.

A restaurant receipt is enough to prove an expense for a business meal if it has all of the following information.

- The name and location of the restaurant.
- The number of people served.
- The date and amount of the expense.

If a charge is made for items other than food and beverages, the receipt must show that this is the case.

Canceled check. A canceled check, together with a bill from the payee, ordinarily establishes the cost. However, a canceled check by itself does not prove a business expense without other evidence to show that it was for a business purpose.

Duplicate information. You do not have to record information in your account book or other record that duplicates information shown on a receipt as long as your records and receipts complement each other in an orderly manner.

You do not have to record amounts your employer pays directly for any ticket or other travel item. However, if you charge these items to your employer, through a credit card or otherwise, you must keep a record of the amounts you spend.

Timely-kept records. You should record the elements of an expense or of a business use at or near the time of the expense or use and support it with sufficient documentary evidence. A timely-kept record has more value than a statement prepared later when generally there is a lack of accurate recall.

You do not need to write down the elements of every expense on the day of the expense. If you maintain a log on a weekly basis which accounts for use during the week, the log is considered a timely-kept record.

If you give your employer, client, or customer an expense account statement, it can also be considered a timely-kept record. This is true if you copy it from your account book, diary, statement of expense, or similar record.

Proving business purpose. You must generally provide a written statement of the business purpose of an expense. However, the degree of proof varies according to the circumstances in each case. If the business purpose of an expense is clear from the surrounding circumstances, then you do not need to give a written explanation.

Confidential information. You do not need to put confidential information relating to an element of a deductible expense (such as the place, business purpose, or business relationship) in your account book, diary, or other record. However, you do have to record the information elsewhere at or near the time of the expense and have it available to fully prove that element of the expense.

What if I Have Incomplete Records?

If you do not have complete records to prove an element of an expense, then you must prove the element with:

- Your own written or oral statement, containing specific information about the element, and
- Other supporting evidence that is sufficient to establish the element.

Destroyed records. If you cannot produce a receipt because of reasons beyond your control, you can prove a deduction by reconstructing your records or expenses. Reasons beyond your control include fire, flood, and other casualty.

Separating and Combining Expenses

This section explains when expenses must be kept separate and when expenses can be combined.

Separating expenses. Each separate payment is generally considered a separate expense. For example, if you entertain a customer or client at dinner and then go to the theater, the dinner expense and the cost of the theater tickets are two separate expenses. You must record them separately in your records.

Combining items. You can make one daily entry in your record for reasonable categories of expenses. Examples are taxi fares, telephone calls, or other incidental travel costs. Meals should be in a separate category. You can include tips for meal-related services with the costs of the meals.

Expenses of a similar nature occurring during the course of a single event are considered a single expense. For example, if during entertainment at a cocktail lounge, you pay separately for each serving of refreshments, the total expense for the refreshments is treated as a single expense.

Allocating total cost. If you can prove the total cost of travel or entertainment but you cannot prove how much it cost for each person who participated in the event, you may have to allocate the total cost among you and your guests on a pro rata basis. An allocation would be needed, for example, if you did not have a business relationship with all of your guests.

If your return is examined. If your return is examined, you may have to provide additional information to the IRS. This information could be needed to clarify or to establish the accuracy or reliability of information contained in your records, statements, testimony, or documentary evidence before a deduction is allowed.

How Long To Keep Records and Receipts

You must keep records as long as they may be needed for the administration of any provision of the Internal Revenue Code. Generally, this means you must keep your records that support your deduction (or an item of income) for 3 years from the date you file the income tax return on which the deduction is claimed. A return filed early is considered filed on the due date. For a more complete explanation, see Publication 583, Starting a Business and Keeping Records.

Reimbursed for expenses. Employees who give their records and documentation to their employers and are reimbursed for their expenses generally do not have to keep copies of this information. However, you may have to prove your expenses if any of the following conditions apply.

- You claim deductions for expenses that are more than reimbursements.
- Your expenses are reimbursed under a nonaccountable plan.
- Your employer does not use adequate accounting procedures to verify expense accounts.
- You are related to your employer, as defined later under *Related to employer*.

See the next section, *How To Report*, for a discussion of reimbursements, adequate accounting, and nonaccountable plans.

Additional information. Chapter 5 of Publication 463 has more information on recordkeeping, including examples.

How To Report

This section explains where and how to report the expenses discussed in this chapter. It discusses reimbursements and how to treat them under accountable and nonaccountable plans. It also explains rules for independent contractors and clients, fee-basis officials, certain performing artists, Armed Forces reservists, and certain disabled employees. This section ends with an illustration of how to report travel, entertainment, gift, and car expenses on Form 2106-EZ.

Self-employed. You must report your income and expenses on Schedule C or C-EZ (Form 1040) if you are a sole proprietor, or on Schedule F (Form 1040) if you are a farmer. You do not use Form 2106 or 2106-EZ. See your form instructions for information on how to complete your tax return. You can also find information in Publication 535 if you are a sole proprietor, or in Publication 225, Farmer's Tax Guide, if you are a farmer.

Both self-employed and an employee. If you are both self-employed and an employee, you must keep separate records for each business activity. Report your business expenses for self-employment on Schedule C, C-EZ, or F (Form 1040), as discussed earlier. Report your business expenses for your work as an employee on Form 2106 or 2106-EZ, as discussed next.

Employees. If you are an employee, you generally must complete Form 2106 to deduct your travel, transportation, and entertainment expenses. However, you can use the shorter Form 2106-EZ instead of Form 2106 if you meet all of the following conditions.

- You are an employee deducting expenses attributable to your job.
- You were not reimbursed by your employer for your expenses (amounts included in box 1 of your Form W-2 are not considered reimbursements).
- If you claim car expenses, you use the standard mileage rate.

For more information on how to report your expenses on Forms 2106 and 2106-EZ, see *Completing Forms 2106 and 2106-EZ*, later.

Gifts. If you did not receive any reimbursements (or the reimbursements were all included in box 1 of your Form W-2), the only business expense you are claiming is for gifts, and the rules for certain individuals (such as performing artists) discussed later under *Special Rules* do not apply to you, do not complete Form 2106 or

Table 26-2. **How To Prove Certain Business Expenses**

IF you have expenses for...	THEN you must keep records that show details of the following elements...			
	Amount	**Time**	**Place or Description**	**Business Purpose and Business Relationship**
Travel	Cost of each separate expense for travel, lodging, and meals. Incidental expenses may be totaled in reasonable categories such as taxis, fees and tips, etc.	Dates you left and returned for each trip and number of days spent on business.	Destination or area of your travel (name of city, town, or other designation).	Purpose: Business purpose for the expense or the business benefit gained or expected to be gained. Relationship: N/A
Entertainment	Cost of each separate expense. Incidental expenses such as taxis, telephones, etc., may be totaled on a daily basis.	Date of entertainment. (Also see *Business Purpose*.)	Name and address or location of place of entertainment. Type of entertainment if not otherwise apparent. (Also see *Business Purpose*.)	Purpose: Business purpose for the expense or the business benefit gained or expected to be gained. For entertainment, the nature of the business discussion or activity. If the entertainment was directly before or after a business discussion: the date, place, nature, and duration of the business discussion, and the identities of the persons who took part in both the business discussion and the entertainment activity. Relationship: Occupations or other information (such as names, titles, or other designations) about the recipients that shows their business relationship to you. For entertainment, you must also prove that you or your employee was present if the entertainment was a business meal.
Gifts	Cost of the gift.	Date of the gift.	Description of the gift.	
Transportation	Cost of each separate expense. For car expenses, the cost of the car and any improvements, the date you started using it for business, the mileage for each business use, and the total miles for the year.	Date of the expense. For car expenses, the date of the use of the car.	Your business destination.	Purpose: Business purpose for the expense. Relationship: N/A

2106-EZ. Instead, claim the amount of your deductible gifts directly on line 21 of Schedule A (Form 1040).

Statutory employees. If you received a Form W-2 and the "Statutory employee" box in box 13 was checked, report your income and expenses related to that income on Schedule C or C-EZ (Form 1040). Do not complete Form 2106 or 2106-EZ.

Statutory employees include full-time life insurance salespersons, certain agent or commission drivers, traveling salespersons, and certain homeworkers.

CAUTION *If you are entitled to a reimbursement from your employer but you do not claim it, you cannot claim a deduction for the expenses to which that unclaimed reimbursement applies.*

Reimbursement for personal expenses. If your employer reimburses you for nondeductible personal expenses, such as for vacation trips, your employer must report the reimbursement as wage income in box 1 of your Form W-2. You cannot deduct personal expenses.

Reimbursements

This section explains what to do when you receive an advance or are reimbursed for any of the employee business expenses discussed in this chapter.

If you received an advance, allowance, or reimbursement for your expenses, how you report this amount and your expenses depends on whether the reimbursement was paid to you under an accountable plan or a nonaccountable plan.

This section explains the two types of plans, how per diem and car allowances simplify proving the amount of your expenses, and the tax treatment of your reimbursements and expenses.

No reimbursement. You are not reimbursed or given an allowance for your expenses if you are paid a salary or commission with the understanding that you will pay your own expenses. In this situation, you have no reimbursement or allowance arrangement, and you do not have to read this section on reimbursements. Instead, see *Completing Forms 2106 and 2106-EZ*, later, for information on completing your tax return.

Reimbursement, allowance, or advance. A reimbursement or other expense allowance arrangement is a system or plan that an employer uses to pay, substantiate, and recover the expenses, advances, reimbursements, and amounts charged to the employer for employee business expenses. Arrangements include per diem and car allowances.

A per diem allowance is a fixed amount of daily reimbursement your employer gives you for your lodging, meal, and incidental expenses when you are away from home on business. (The term "incidental expenses" is defined earlier under *Meals and Incidental Expenses*.) A car allowance is an amount your employer gives you for the business use of your car.

Your employer should tell you what method of reimbursement is used and what records you must provide.

Accountable Plans

To be an accountable plan, your employer's reimbursement or allowance arrangement must include all of the following rules.

1. Your expenses must have a business connection — that is, you must have paid or incurred deductible expenses while performing services as an employee of your employer.
2. You must adequately account to your employer for these expenses within a reasonable period of time.
3. You must return any excess reimbursement or allowance within a reasonable period of time.

See *Adequate Accounting* and *Returning Excess Reimbursements*, later.

An excess reimbursement or allowance is any amount you are paid that is more than the business-related expenses that you adequately accounted for to your employer.

The definition of a reasonable period of time depends on the facts and circumstances of your situation. However, regardless of the facts and circumstances of your situation, actions that take place within the times specified in the following list will be treated as taking place within a reasonable period of time.

- You receive an advance within 30 days of the time you have an expense.
- You adequately account for your expenses within 60 days after they were paid or incurred.
- You return any excess reimbursement within 120 days after the expense was paid or incurred.
- You are given a periodic statement (at least quarterly) that asks you to either return or adequately account for outstanding advances and you comply within 120 days of the statement.

Employee meets accountable plan rules. If you meet the three rules for accountable plans, your employer should not include any reimbursements in your income in box 1 of your Form W-2. If your expenses equal your reimbursement, you do not complete Form 2106. You have no deduction since your expenses and reimbursement are equal.

TIP *If your employer included reimbursements in box 1 of your Form W-2 and you meet all the rules for accountable plans, ask your employer for a corrected Form W-2.*

Accountable plan rules not met. Even though you are reimbursed under an accountable plan, some of your expenses may not meet all the rules. Those expenses that fail to meet all three rules for accountable plans are treated as having been reimbursed under a *nonaccountable plan* (discussed later).

Reimbursement of nondeductible expenses. You may be reimbursed under your employer's accountable plan for expenses related to that employer's business, some of which are deductible as employee business expenses and some of which are not deductible. The reimbursements you receive for the nondeductible expenses do not meet rule (1) for accountable plans, and they are treated as paid under a nonaccountable plan.

Example. Your employer's plan reimburses you for travel expenses while away from home on business and also for meals when you work late at the office, even though you are not away from home. The part of the arrangement that reimburses you for the nondeductible meals when you work late at the office is treated as paid under a nonaccountable plan.

TIP *The employer makes the decision whether to reimburse employees under an accountable plan or a nonaccountable plan. If you are an employee who receives payments under a nonaccountable plan, you cannot convert these amounts to payments under an accountable plan by voluntarily accounting to your employer for the expenses and voluntarily returning excess reimbursements to the employer.*

Adequate Accounting

One of the rules for an accountable plan is that you must adequately account to your employer for your expenses. You adequately account by giving your employer a statement of expense, an account book, a diary, or a similar record in which you entered each expense at or near the time you had it, along with documentary evidence (such as receipts) of your travel, mileage, and other employee business expenses. (See *Table 26-2*, earlier, for details you need to enter in your record and documents you need to prove certain expenses.) A per diem or car allowance satisfies the adequate accounting requirement under certain conditions. See *Per Diem and Car Allowances*, later.

You must account for all amounts you received from your employer during the year as advances, reimbursements, or allowances. This includes amounts you charged to your employer by credit card or other method. You must give your employer the same type of records and supporting information that you would have to give to the IRS if the IRS questioned a deduction on your return. You must pay back the amount of any reimbursement or other expense allowance for which you do not adequately account or that is more than the amount for which you accounted.

Per Diem and Car Allowances

If your employer reimburses you for your expenses using a per diem or car allowance, you can generally use the allowance as proof of the amount of your expenses. A per diem or car allowance satisfies the adequate accounting requirements for the amount of your expenses only if all the following conditions apply.

- Your employer reasonably limits payments of your expenses to those that are ordinary and necessary in the conduct of the trade or business.
- The allowance is similar in form to and not more than the federal rate (discussed later).
- You prove the time (dates), place, and business purpose of your expenses to your employer (as explained in *Table 26-2*) within a reasonable period of time.
- You are not related to your employer (as defined next). If you are related to your employer, you must be able to prove your expenses to the IRS even if you have already adequately accounted to your employer and returned any excess reimbursement.

If the IRS finds that an employer's travel allowance practices are not based on reasonably accurate estimates of travel costs (including recognition of cost differences in different areas for per diem amounts), you will not be considered to have accounted to your employer. In this case, you must be able to prove your expenses to the IRS.

Related to employer. You are related to your employer if:

1. Your employer is your brother or sister, half brother or half sister, spouse, ancestor, or lineal descendant,
2. Your employer is a corporation in which you own, directly or indirectly, more than 10% in value of the outstanding stock, or
3. Certain relationships (such as grantor, fiduciary, or beneficiary) exist between you, a trust, and your employer.

You may be considered to indirectly own stock, for purposes of (2), if you have an interest in a corporation, partnership, estate, or trust that owns the stock or if a member of your family or your partner owns the stock.

The federal rate. The federal rate can be figured using any one of the following methods.

1. For per diem amounts:
   a. The regular federal per diem rate.
   b. The standard meal allowance.
   c. The high-low rate.
2. For car expenses:
   a. The standard mileage rate.
   b. A fixed and variable rate (FAVR).

TIP *For per diem amounts, use the rate in effect for the area where you stop for sleep or rest.*

Regular federal per diem rate. The regular federal per diem rate is the highest amount that the federal government will pay to its employees for lodging, meal, and incidental expenses (or meal and incidental expenses only) while they are traveling away from home in a particular area. The rates are different for different locations. Your employer should have these rates available. (They are also available at *www.gsa.gov*.)

The standard meal allowance. The standard meal allowance (discussed earlier) is the federal rate for meals and incidental expenses (M&IE). The rate for most small localities in the United States is $46 a day. Most major cities and many other localities qualify for higher rates. You can find the rates for all localities within the continental United States on the Internet at www.gsa.gov.

You receive an allowance only for meals and incidental expenses when your employer does one of the following.

- Provides you with lodging (furnishes it in kind).
- Reimburses you, based on your receipts, for the actual cost of your lodging.
- Pays the hotel, motel, etc., directly for your lodging.
- Does not have a reasonable belief that you had (or will have) lodging expenses, such as when you stay with friends or relatives or sleep in the cab of your truck.
- Figures the allowance on a basis similar to that used in computing your compensation, such as number of hours worked or miles traveled.

High-low rate. This is a simplified method of computing the federal per diem rate for travel within the continental United States. It eliminates the need to keep a current list of the per diem rate for each city.

Under the high-low method, the per diem amount for travel during January through September 2012 is $242 (including $65 for M&IE) for certain high-cost locations. All other areas have a per diem amount of $163 (including $52 for M&IE). (You can find the areas eligible for the $242 per diem amount under the high-low method for all or part of this period at www.gsa.gov).

CAUTION *Effective October 1, 2012, the per diem rate for certain high-cost locations remained at $242 (including $65 for M&IE). The rate for all other locations remained at $163 (including $52 for M&IE). Employers who did not use the high-low method during the first 9 months of 2012 cannot begin to use it before 2013. For more information see Notice 2012-63, which can be found on the Internet at www.irs.gov/pub/irs-drop/N-12-63.pdf and Revenue Procedure 2011-47 at www.irs.gov/irb/2011-42_IRB/ar12.html.*

Prorating the standard meal allowance on partial days of travel. The standard meal allowance is for a full 24-hour day of travel. If you travel for part of a day, such as on the days you depart and return, you must prorate the full-day M&IE rate. This rule also applies if your employer uses the regular federal per diem rate or the high-low rate.

You can use either of the following methods to figure the federal M&IE for that day.

1. *Method 1:*
   a. For the day you depart, add $\frac{3}{4}$ of the standard meal allowance amount for that day.
   b. For the day you return, add $\frac{3}{4}$ of the standard meal allowance amount for the preceding day.
2. *Method 2:* Prorate the standard meal allowance using any method you consistently apply in accordance with reasonable business practice.

The standard mileage rate. This is a set rate per mile that you can use to compute your deductible car expenses. For 2012, the standard mileage rate for the cost of operating your car is $55\frac{1}{2}$ cents per mile.

Fixed and variable rate (FAVR). This is an allowance your employer may use to reimburse your car expenses. Under this method, your employer pays an allowance that includes a combination of payments covering fixed and variable costs, such as a cents-per-mile rate to cover your variable operating costs (such as gas, oil, etc.) plus a flat amount to cover your fixed costs (such as depreciation (or lease payments), insurance, etc.). If your employer chooses to use this method, your employer will request the necessary records from you.

Reporting your expenses with a per diem or car allowance. If your reimbursement is in the form of an allowance received under an accountable plan, the following facts affect your reporting.

- The federal rate.
- Whether the allowance or your actual expenses were more than the federal rate.

The following discussions explain where to report your expenses depending upon how the amount of your allowance compares to the federal rate.

Allowance less than or equal to the federal rate. If your allowance is less than or equal to the federal rate, the allowance will not be included in box 1 of your Form W-2. You do not need to report the related expenses or the allowance on your return if your expenses are equal to or less than the allowance.

However, if your actual expenses are more than your allowance, you can complete Form 2106 and deduct the excess amount on Schedule A (Form 1040). If you are using actual expenses, you must be able to prove to the IRS the total amount of your expenses and reimbursements for the entire year. If you are using the standard meal allowance or the standard mileage rate, you do not have to prove that amount.

Example. Nicole drives 10,000 miles in 2012 for business. Under her employer's accountable plan, she accounts for the time (dates), place, and business purpose of each trip. Her employer pays her a mileage allowance of 40 cents a mile.

Since Nicole's $5,550 expense computed under the standard mileage rate (10,000 miles x $55\frac{1}{2}$ cents) is more than her $4,000 reimbursement (10,000 miles × 40 cents), she itemizes her deductions to claim the excess expense. Nicole completes Form 2106 (showing all her expenses and reimbursements) and enters $1,550 ($5,550 − $4,000) as an itemized deduction.

Allowance more than the federal rate. If your allowance is more than the federal rate, your employer must include the allowance amount up to the federal rate in box 12 of your Form W-2. This amount is not taxable. However, the excess allowance will be included in box 1 of your Form W-2. You must report this part of your allowance as if it were wage income.

If your actual expenses are less than or equal to the federal rate, you do not complete Form 2106 or claim any of your expenses on your return.

However, if your actual expenses are more than the federal rate, you can complete Form 2106 and deduct those excess expenses. You must report on Form 2106 your reimbursements up to the federal rate (as shown in box 12 of your Form W-2) and all your expenses. You should be able to prove these amounts to the IRS.

Example. Joe lives and works in Austin. In May his employer sent him to San Diego for 4 days and paid the hotel directly for Joe's hotel bill. The employer reimbursed Joe $75 a day for his meals and incidental expenses. The federal rate for San Diego is $71 a day.

Joe can prove that his actual meal expenses totaled $380. His employer's accountable plan will not pay more than $75 a day for travel to San Diego, so Joe does not give his employer the records that prove that he actually spent $380. However, he does account for the time, place, and business purpose of the trip. This is Joe's only business trip this year.

Joe was reimbursed $300 ($75 × 4 days), which is $16 more than the federal rate of $284 ($71 × 4 days). His employer includes the $16 as income on Joe's Form W-2 in box 1. His employer also enters $284 in box 12 of Joe's Form W-2.

Joe completes Form 2106 to figure his deductible expenses. He enters the total of his actual expenses for the year ($380) on Form 2106. He also enters the reimbursements that were not included in his income ($284). His total deductible expense, before the 50% limit, is $96. After he figures the 50% limit on his unreimbursed meals and entertainment, he will include the balance, $48, as an itemized deduction on Schedule A (Form 1040).

Returning Excess Reimbursements

Under an accountable plan, you are required to return any excess reimbursement or other expense allowances for your business expenses to the person paying the reimbursement or allowance. Excess reimbursement means any amount for which you did not adequately account within a reasonable period of time. For example, if you received a travel advance and you did not spend all the money on business-related expenses or you do not have proof of all your expenses, you have an excess reimbursement.

"Adequate accounting" and "reasonable period of time" were discussed earlier in this chapter.

Travel advance. You receive a travel advance if your employer provides you with an expense allowance before you actually have the expense, and the allowance is reasonably expected to be no more than your expense. Under an accountable plan, you are required to adequately account to your employer for this advance and to return any excess within a reasonable period of time.

If you do not adequately account for or do not return any excess advance within a reasonable period of time, the amount you do not account for or return will be treated as having been paid under a nonaccountable plan (discussed later).

Unproven amounts. If you do not prove that you actually traveled on each day for which you received a per diem or car allowance (proving the elements described in *Table 26-2*), you must return this unproved amount of the travel advance within a reasonable period of time. If you do not do this, the unproved amount will be considered paid under a nonaccountable plan (discussed later).

Per diem allowance more than federal rate. If your employer's accountable plan pays you an allowance that is higher than the federal rate, you do not have to return the difference between the two rates for the period you can prove business-related travel expenses. However, the difference will be reported as wages on your Form W-2. This excess amount is considered paid under a nonaccountable plan (discussed later).

Example. Your employer sends you on a 5-day business trip to Phoenix in March 2012 and gives you a $400 ($80 × 5 days) advance to cover your meals and incidental expenses. The federal per diem for meals and incidental expenses for Phoenix is $71. Your trip lasts only 3 days. Under your employer's accountable plan, you must return the $160 ($80 × 2 days) advance for the 2 days you did not travel. For the 3 days you did travel you do not have to return the $27 difference between the allowance you received and the federal rate for Phoenix (($80 − $71) × 3 days). However, the $27 will be reported on your Form W-2 as wages.

Nonaccountable Plans

A nonaccountable plan is a reimbursement or expense allowance arrangement that does not meet one or more of the three rules listed earlier under *Accountable Plans*.

In addition, even if your employer has an accountable plan, the following payments will be treated as being paid under a nonaccountable plan.

- Excess reimbursements you fail to return to your employer.
- Reimbursement of nondeductible expenses related to your employer's business. See *Reimbursement of nondeductible expenses* earlier under *Accountable Plans*.

If you are not sure if the reimbursement or expense allowance arrangement is an accountable or nonaccountable plan, ask your employer.

Reporting your expenses under a nonaccountable plan. Your employer will combine the amount of any reimbursement or other expense allowance paid to you under a nonaccountable plan with your wages, salary, or other pay. Your employer will report the total in box 1 of your Form W-2.

You must complete Form 2106 or 2106-EZ and itemize your deductions to deduct your expenses for travel, transportation, meals, or entertainment. Your meal and entertainment expenses will be subject to the 50% limit discussed earlier under *Entertainment Expenses*. Also, your total expenses will be subject to the 2%-of-adjusted-gross-income limit that applies to most miscellaneous itemized deductions on Schedule A (Form 1040).

Example. Kim's employer gives her $1,000 a month ($12,000 for the year) for her business expenses. Kim does not have to provide any proof of her expenses to her employer, and Kim can keep any funds that she does not spend.

Kim is being reimbursed under a nonaccountable plan. Her employer will include the $12,000 on Kim's Form W-2 as if it were wages. If Kim wants to deduct her business expenses, she must complete Form 2106 or 2106-EZ and itemize her deductions.

Completing Forms 2106 and 2106-EZ

This section briefly describes how employees complete Forms 2106 and 2106-EZ. *Table 26-3* explains what the employer reports on Form W-2 and what the employee reports on Form 2106. The instructions for the forms have more information on completing them.

CAUTION *If you are self-employed, do not file Form 2106 or 2106-EZ. Report your expenses on Schedule C, C-EZ, or F (Form 1040). See the instructions for the form that you must file.*

Form 2106-EZ. You may be able to use the shorter Form 2106-EZ to claim your employee business expenses. You can use this form if you meet all the following conditions.

- You are an employee deducting expenses attributable to your job.
- You were not reimbursed by your employer for your expenses (amounts included in box 1 of your Form W-2 are not considered reimbursements).
- If you are claiming car expenses, you use the standard mileage rate.

Car expenses. If you used a car to perform your job as an employee, you may be able to deduct certain car expenses. These are generally figured on Form 2106, Part II, and then claimed on Form 2106, Part I, line 1, Column A. Car expenses using the standard mileage rate can also be figured on Form 2106-EZ by completing Part II and Part I, line 1.

Transportation expenses. Show your transportation expenses that did not involve overnight travel on Form 2106, line 2, Column A, or on Form 2106-EZ, Part I, line 2. Also include on this line business expenses you have for parking fees and tolls. Do not include expenses of operating your car or expenses of commuting between your home and work.

Employee business expenses other than meals and entertainment. Show your other employee business expenses on Form 2106, lines 3 and 4, Column A, or Form 2106-EZ, lines 3 and 4. Do not include expenses for meals and entertainment on those lines. Line 4 is for expenses such as gifts, educational expenses (tuition and books), office-in-the-home expenses, and trade and professional publications.

TIP *If line 4 expenses are the only ones you are claiming, you received no reimbursements (or the reimbursements were all included in box 1 of your Form W-2), and the Special Rules discussed later do not apply to you, do not complete Form 2106 or 2106-EZ. Claim these amounts directly on Schedule A (Form 1040), line 21. List the type and amount of each expense on the dotted lines and include the total on line 21.*

Meal and entertainment expenses. Show the full amount of your expenses for business-related meals and entertainment on Form 2106, line 5, Column B. Include meals while away from your tax home overnight and other business meals and entertainment. Enter 50% of the line 8, Column B, meal and entertainment expenses on line 9, Column B.

If you file Form 2106-EZ, enter the full amount of your meals and entertainment on the line to the left of line 5 and multiply the total by 50%. Enter the result on line 5.

Hours of service limits. If you are subject to the Department of Transportation's "hours of service" limits, use 80% instead of 50% for meals while away from your tax home.

Reimbursements. Enter on Form 2106, line 7, the amounts your employer (or third party) reimbursed you that were not included in box 1 of your Form W-2. (You cannot use Form 2106-EZ.) This includes any reimbursement reported under code L in box 12 of Form W-2.

Allocating your reimbursement. If you were reimbursed under an accountable plan and want to deduct excess expenses that were not reimbursed, you may have to allocate your reimbursement. This is necessary if your employer pays your reimbursement in the following manner:

- Pays you a single amount that covers meals and/or entertainment, as well as other business expenses, and
- Does not clearly identify how much is for deductible meals and/or entertainment.

You must allocate that single payment so that you know how much to enter on Form 2106, line 7, Column A and Column B.

Example. Rob's employer paid him an expense allowance of $12,000 this year under an accountable plan. The $12,000 payment consisted of $5,000 for airfare and $7,000 for entertainment and car expenses. Rob's employer did not clearly show how much of the $7,000 was for the cost of deductible entertainment. Rob actually spent $14,000 during the year ($5,500 for airfare, $4,500 for entertainment, and $4,000 for car expenses).

Since the airfare allowance was clearly identified, Rob knows that $5,000 of the payment goes in Column A, line 7 of Form 2106. To allocate the remaining $7,000, Rob uses the worksheet from the instructions for Form 2106. His completed worksheet follows.

Table 26-3. **Reporting Travel, Entertainment, Gift, and Car Expenses and Reimbursements**

IF the type of reimbursement (or other expense allowance) arrangement is under:	THEN the employer reports on Form W-2:	AND the employee reports on Form 2106: *
An accountable plan with:		
Actual expense reimbursement: Adequate accounting made and excess returned.	No amount.	No amount.
Actual expense reimbursement: Adequate accounting and return of excess both required but excess not returned.	The excess amount as wages in box 1.	No amount.
Per diem or mileage allowance up to the federal rate: Adequate accounting made and excess returned.	No amount.	All expenses and reimbursements only if excess expenses are claimed. Otherwise, form is not filed.
Per diem or mileage allowance up to the federal rate: Adequate accounting and return of excess both required but excess not returned.	The excess amount as wages in box 1. The amount up to the federal rate is reported only in box 12—it is not reported in box 1.	No amount.
Per diem or mileage allowance exceeds the federal rate: Adequate accounting up to the federal rate only and excess not returned.	The excess amount as wages in box 1. The amount up to the federal rate is reported only in box 12—it is not reported in box 1.	All expenses (and reimbursement reported on Form W-2, box 12) only if expenses in excess of the federal rate are claimed. Otherwise, form is not required.
A nonaccountable plan with:		
Either adequate accounting or return of excess, or both, not required by plan	The entire amount as wages in box 1.	All expenses.
No reimbursement plan:	The entire amount as wages in box 1.	All expenses.

* You may be able to use Form 2106-EZ. See Completing Forms 2106 and 2106-EZ.

Reimbursement Allocation Worksheet
(keep for your records)

1.	Enter the total amount of reimbursements your employer gave you that were not reported to you in box 1 of Form W-2	$7,000
2.	Enter the total amount of your expenses for the periods covered by this reimbursement	8,500
3.	Of the amount on line 2, enter your total expense for meals and entertainment	4,500
4.	Divide line 3 by line 2. Enter the result as a decimal (rounded to at least three places)	.529
5.	Multiply line 1 by line 4. Enter the result here and in Column B, line 7	3,703
6.	Subtract line 5 from line 1. Enter the result here and in Column A, line 7	$3,297

On line 7 of Form 2106, Rob enters $8,297 ($5,000 airfare and $3,297 of the $7,000) in Column A and $3,703 (of the $7,000) in Column B.

After you complete the form. After you have completed your Form 2106 or 2106-EZ, follow the directions on that form to deduct your expenses on the appropriate line of your tax return. For most taxpayers, this is line 21 of Schedule A (Form 1040). However, if you are a government official paid on a fee basis, a performing artist, an Armed Forces reservist, or a disabled employee with impairment-related work expenses, see Special Rules, later.

Limits on employee business expenses. Your employee business expenses may be subject to either of the limits described next. These limits are figured in the following order on the specified form.

1. Limit on meals and entertainment. Certain meal and entertainment expenses are subject to a 50% limit. If you are an employee, you figure this limit on line 9 of Form 2106 or line 5 of Form 2106-EZ. See 50% Limit under *Entertainment Expenses*, earlier.

2. Limit on miscellaneous itemized deductions. If you are an employee, deduct employee business expenses (as figured on Form 2106 or 2106-EZ) on line 21 of Schedule A (Form 1040). Most miscellaneous itemized deductions, including employee business expenses, are subject to a 2% limit. This limit is figured on line 26 of Schedule A (Form 1040).

Special Rules

This section discusses special rules that apply to Armed Forces reservists, government officials who are paid on a fee basis, performing artists, and disabled employees with impairment-related work expenses.

Armed Forces reservists traveling more than 100 miles from home. If you are a member of a reserve component of the Armed Forces of the United States and you travel more than 100 miles away from home in connection with your performance of services as a member of the reserves, you can deduct your travel expenses as an adjustment to gross income rather than as a miscellaneous itemized deduction. The amount of expenses you can deduct as an adjustment to gross income is limited to the regular federal per diem rate (for lodging, meals, and incidental expenses) and the standard mileage rate (for car expenses) plus any parking fees, ferry fees, and tolls. The federal rate is explained earlier under Per Diem and Car Allowances. Any expenses in excess of these amounts can be claimed only as a miscellaneous itemized deduction subject to the 2% limit.

Member of a reserve component. You are a member of a reserve component of the Armed Forces of the United States if you are in the Army, Navy, Marine Corps, Air Force, or Coast Guard Reserve, the Army National Guard of the United States, the Air National Guard of the United States, or the Reserve Corps of the Public Health Service.

How to report. If you have reserve-related travel that takes you more than 100 miles from home, you should first complete Form 2106 or Form 2106-EZ. Then include your expenses for reserve travel over 100 miles from home, up to the federal rate, from Form 2106, line 10, or Form 2106-EZ, line 6, in the total on Form 1040, line 24. Subtract this amount from the total on Form 2106, line 10, or Form 2106-EZ, line 6, and deduct the balance as an itemized deduction on Schedule A (Form 1040), line 21.

You cannot deduct expenses of travel that does not take you more than 100 miles from home as an adjustment to gross income. Instead, you must complete Form 2106 or 2106-EZ and deduct those expenses as an itemized deduction on Schedule A (Form 1040), line 21.

Officials paid on a fee basis. Certain fee-basis officials can claim their employee business expenses whether or not they itemize their other deductions on Schedule A (Form 1040).

Fee-basis officials are persons who are employed by a state or local government and who are paid in whole or in part on a fee basis. They can deduct their business expenses in performing services in that job as an adjustment to gross income rather than as a miscellaneous itemized deduction.

If you are a fee-basis official, include your employee business expenses from Form 2106, line 10, or Form 2106-EZ, line 6, on Form 1040, line 24.

Expenses of certain performing artists. If you are a performing artist, you may qualify to deduct your employee business expenses as an adjustment to gross income rather than as a miscellaneous itemized deduction. To qualify, you must meet all of the following requirements.

1. During the tax year, you perform services in the performing arts as an employee for at least two employers.
2. You receive at least $200 each from any two of these employers.
3. Your related performing-arts business expenses are more than 10% of your gross income from the performance of those services.
4. Your adjusted gross income is not more than $16,000 before deducting these business expenses.

Special rules for married persons. If you are married, you must file a joint return unless you lived apart from your spouse at all times during the tax year.

If you file a joint return, you must figure requirements (1), (2), and (3) separately for both you and your spouse. However, requirement (4) applies to your and your spouse's combined adjusted gross income.

Where to report. If you meet all of the above requirements, you should first complete Form 2106 or 2106-EZ. Then you include your performing-arts-related expenses from line 10 of Form 2106 or line 6 of Form 2106-EZ in the total on line 24 of Form 1040.

If you do not meet all of the above requirements, you do not qualify to deduct your expenses as an adjustment to gross income. Instead, you must complete Form 2106 or 2106-EZ and deduct your employee business expenses as an itemized deduction on Schedule A (Form 1040), line 21.

Impairment-related work expenses of disabled employees. If you are an employee with a physical or mental disability, your impairment-related work expenses are not subject to the 2%-of-adjusted-gross-income limit that applies to most other employee business expenses. After you complete Form 2106 or 2106-EZ, enter your impairment-related work expenses from Form 2106, line 10, or Form 2106-EZ, line 6, on Schedule A (Form 1040), line 28, and identify the type and amount of this expense on the dotted line next to line 28. Enter your employee business expenses that are unrelated to your disability from Form 2106, line 10, or Form 2106-EZ, line 6, on Schedule A, line 21.

Impairment-related work expenses are your allowable expenses for attendant care at your workplace and other expenses you have in connection with your workplace that are necessary for you to be able to work. For more information, see *chapter 21*.

27. Tax Benefits for Work-Related Education

What's New

Standard mileage rate. Generally, if you claim a business deduction for work-related education and you drive your car to and from school, the amount you can deduct for miles driven from January 1, 2012, through December 31, 2012, is 55½ cents per mile. For more information, see *Transportation Expenses* under *What Expenses Can Be Deducted*.

Introduction

This chapter discusses work-related education expenses that you may be able to deduct as business expenses.

To claim such a deduction, you must:

- Itemize your deductions on Schedule A (Form 1040) if you are an employee,
- File Schedule C (Form 1040), Schedule C-EZ (Form 1040), or Schedule F (Form 1040) if you are self-employed, and
- Have expenses for education that meet the requirements discussed under *Qualifying Work-Related Education*.

If you are an employee and can itemize your deductions, you may be able to claim a deduction for the expenses you pay for your work-related education. Your deduction will be the amount by which your qualifying work-related education expenses plus other job and certain miscellaneous expenses (except for impairment-related work expenses of disabled individuals) is greater than 2% of your adjusted gross income. See chapter 28.

If you are self-employed, you deduct your expenses for qualifying work-related education directly from your self-employment income.

Your work-related education expenses may also qualify you for other tax benefits, such as the American opportunity and lifetime learning credits (see chapter 34). You may qualify for these other benefits even if you do not meet the requirements listed earlier.

Also, keep in mind that your work-related education expenses may qualify you to claim more than one tax benefit. Generally, you may claim any number of benefits as long as you use different expenses to figure each one.

TIP *When you figure your taxes, you may want to compare these tax benefits so you can choose the method(s) that give you the lowest tax liability.*

Useful Items

You may want to see:

Publication

- ❑ **463** Travel, Entertainment, Gift, and Car Expenses
- ❑ **970** Tax Benefits for Education

Form (and Instructions)

- ❑ **2106** Employee Business Expenses
- ❑ **2106-EZ** Unreimbursed Employee Business Expenses
- ❑ **Schedule A (Form 1040)** Itemized Deductions

Qualifying Work-Related Education

You can deduct the costs of qualifying work-related education as business expenses. This is education that meets at least one of the following two tests.

- The education is required by your employer or the law to keep your present salary, status, or job. The required education must serve a bona fide business purpose of your employer.
- The education maintains or improves skills needed in your present work.

However, even if the education meets one or both of the above tests, it is not qualifying work-related education if it:

- Is needed to meet the minimum educational requirements of your present trade or business, or
- Is part of a program of study that will qualify you for a new trade or business.

You can deduct the costs of qualifying work-related education as a business expense even if the education could lead to a degree.

Use Figure 27-A, later, as a quick check to see if your education qualifies.

Education Required by Employer or by Law

Once you have met the minimum educational requirements for your job, your employer or the law may require you to get more education. This additional education is qualifying work-related education if all three of the following requirements are met.

- It is required for you to keep your present salary, status, or job,

- The requirement serves a bona fide business purpose of your employer, and
- The education is not part of a program that will qualify you for a new trade or business.

When you get more education than your employer or the law requires, the additional education can be qualifying work-related education only if it maintains or improves skills required in your present work. See Education To Maintain or Improve Skills, later.

Example. You are a teacher who has satisfied the minimum requirements for teaching. Your employer requires you to take an additional college course each year to keep your teaching job. If the courses will not qualify you for a new trade or business, they are qualifying work-related education even if you eventually receive a master's degree and an increase in salary because of this extra education.

Education To Maintain or Improve Skills

If your education is not required by your employer or the law, it can be qualifying work-related education only if it maintains or improves skills needed in your present work. This could include refresher courses, courses on current developments, and academic or vocational courses.

Example. You repair televisions, radios, and stereo systems for XYZ Store. To keep up with the latest changes, you take special courses in radio and stereo service. These courses maintain and improve skills required in your work.

Maintaining skills vs. qualifying for new job. Education to maintain or improve skills needed in your present work is not qualifying education if it will also qualify you for a new trade or business.

Education during temporary absence. If you stop working for a year or less in order to get education to maintain or improve skills needed in your present work and then return to the same general type of work, your absence is considered temporary. Education that you get during a temporary absence is qualifying work-related education if it maintains or improves skills needed in your present work.

Example. You quit your biology research job to become a full-time biology graduate student for one year. If you return to work in biology research after completing the courses, the education is related to your present work even if you do not go back to work with the same employer.

Education during indefinite absence. If you stop work for more than a year, your absence from your job is considered indefinite. Education during an indefinite absence, even if it maintains or improves skills needed in the work from which you are absent, is considered to qualify you for a new trade or business. Therefore, it is not qualifying work-related education.

Education To Meet Minimum Requirements

Education you need to meet the minimum educational requirements for your present trade or business is not qualifying work-related education. The minimum educational requirements are determined by:

- Laws and regulations,
- Standards of your profession, trade, or business, and
- Your employer.

Once you have met the minimum educational requirements that were in effect when you were hired, you do not have to meet any new minimum educational requirements. This means that if the minimum requirements change after you were hired, any education you need to meet the new requirements can be qualifying education.

CAUTION

You have not necessarily met the minimum educational requirements of your trade or business simply because you are already doing the work.

Example 1. You are a full-time engineering student. Although you have not received your degree or certification, you work part-time as an engineer for a firm that will employ you as a full-time engineer after you finish college. Although your college engineering courses improve your skills in your present job, they are also needed to meet the minimum job requirements for a full-time engineer. The education is not qualifying work-related education.

Example 2. You are an accountant and you have met the minimum educational requirements of your employer. Your employer later changes the minimum educational requirements and requires you to take college courses to keep your job. These additional courses can be qualifying work-related education because you have already satisfied the minimum requirements that were in effect when you were hired.

Requirements for Teachers

States or school districts usually set the minimum educational requirements for teachers. The requirement is the college degree or the minimum number of college hours usually required of a person hired for that position.

If there are no requirements, you will have met the minimum educational requirements when you become a faculty member. You generally will be considered a faculty member when one or more of the following occurs.

- You have tenure.
- Your years of service count toward obtaining tenure.
- You have a vote in faculty decisions.
- Your school makes contributions for you to a retirement plan other than social security or a similar program.

Example 1. The law in your state requires beginning secondary school teachers to have a bachelor's degree, including 10 professional education courses. In addition, to keep the job a teacher must complete a fifth year of training within 10 years from the date of hire. If the employing school certifies to the state Department of Education that qualified teachers cannot be found, the school can hire persons with only 3 years of college. However, to keep their jobs, these teachers must get a bachelor's degree and the required professional education courses within 3 years.

Under these facts, the bachelor's degree, whether or not it includes the 10 professional education courses, is considered the minimum educational requirement for qualification as a teacher in your state.

If you have all the required education except the fifth year, you have met the minimum educational requirements. The fifth year of training is qualifying work-related education unless it is part of a program of study that will qualify you for a new trade or business.

Example 2. Assume the same facts as in *Example 1* except that you have a bachelor's degree and only six professional education courses. The additional four education courses can be qualifying work-related education. Although you do not have all the required courses, you have already met the minimum educational requirements.

Example 3. Assume the same facts as in *Example 1* except that you are hired with only 3 years of college. The courses you take that lead to a bachelor's degree (including those in education) are not qualifying work-related education. They are needed to meet the minimum educational requirements for employment as a teacher.

Example 4. You have a bachelor's degree and you work as a temporary instructor at a university. At the same time, you take graduate courses toward an advanced degree. The rules of the university state that you can become a faculty member only if you get a graduate degree. Also, you can keep your job as an instructor only as long as you show satisfactory progress toward getting this degree. You have not met the minimum educational requirements to qualify you as a faculty member. The graduate courses are not qualifying work-related education.

Certification in a new state. Once you have met the minimum educational requirements for teachers for your state, you are considered to have met the minimum educational requirements in all states. This is true even if you must get additional education to be certified in another state. Any additional education you need is qualifying work-related education. You have already met the minimum requirements for teaching. Teaching in another state is not a new trade or business.

Example. You hold a permanent teaching certificate in State A and are employed as a teacher in that state for several years. You move to State B and are promptly hired as a teacher. You are required, however, to complete certain prescribed courses to get a permanent teaching certificate in State B. These additional courses are qualifying work-related education because the teaching position in State B involves the same general kind of work for which you were qualified in State A.

Education That Qualifies You for a New Trade or Business

Education that is part of a program of study that will qualify you for a new trade or business is not qualifying work-related education. This is true even if you do not plan to enter that trade or business.

If you are an employee, a change of duties that involves the same general kind of work is not a new trade or business.

Example 1. You are an accountant. Your employer requires you to get a law degree at your own expense. You register at a law school for the regular curriculum that leads to a law degree. Even if you do not intend to become a lawyer, the education is not qualifying because the law degree will qualify you for a new trade or business.

Example 2. You are a general practitioner of medicine. You take a 2-week course to review developments in several specialized fields of medicine. The course does not qualify you for a new profession. It is qualifying work-related education because it maintains or improves skills required in your present profession.

Example 3. While working in the private practice of psychiatry, you enter a program to study and train at an accredited psychoanalytic institute. The program will lead to qualifying you to practice psychoanalysis. The psychoanalytic training does not qualify you for a new profession. It is qualifying work-related education because it maintains or improves skills required in your present profession.

Bar or CPA Review Course

Review courses to prepare for the bar examination or the certified public accountant (CPA) examination are not qualifying work-related education. They are part of a program of study that can qualify you for a new profession.

Teaching and Related Duties

All teaching and related duties are considered the same general kind of work. A change in duties in any of the following ways is not considered a change to a new business.

- Elementary school teacher to secondary school teacher.
- Teacher of one subject, such as biology, to teacher of another subject, such as art.
- Classroom teacher to guidance counselor.
- Classroom teacher to school administrator.

What Expenses Can Be Deducted

If your education meets the requirements described earlier under *Qualifying Work-Related Education*, you can generally deduct your education expenses as business expenses. If you are not self-employed, you can deduct business expenses only if you itemize your deductions.

You cannot deduct expenses related to tax-exempt and excluded income.

Deductible expenses. The following education expenses can be deducted.

- Tuition, books, supplies, lab fees, and similar items.
- Certain transportation and travel costs.
- Other education expenses, such as costs of research and typing when writing a paper as part of an educational program.

Nondeductible expenses. You cannot deduct personal or capital expenses. For example, you cannot deduct the dollar value of vacation time or annual leave you take to attend classes. This amount is a personal expense.

Unclaimed reimbursement. If you do not claim reimbursement that you are entitled to receive from your employer, you cannot deduct the expenses that apply to that unclaimed reimbursement.

Example. Your employer agrees to pay your education expenses if you file a voucher showing your expenses. You do not file a voucher, and you do not get reimbursed. Because you did not file a voucher, you cannot deduct the expenses on your tax return.

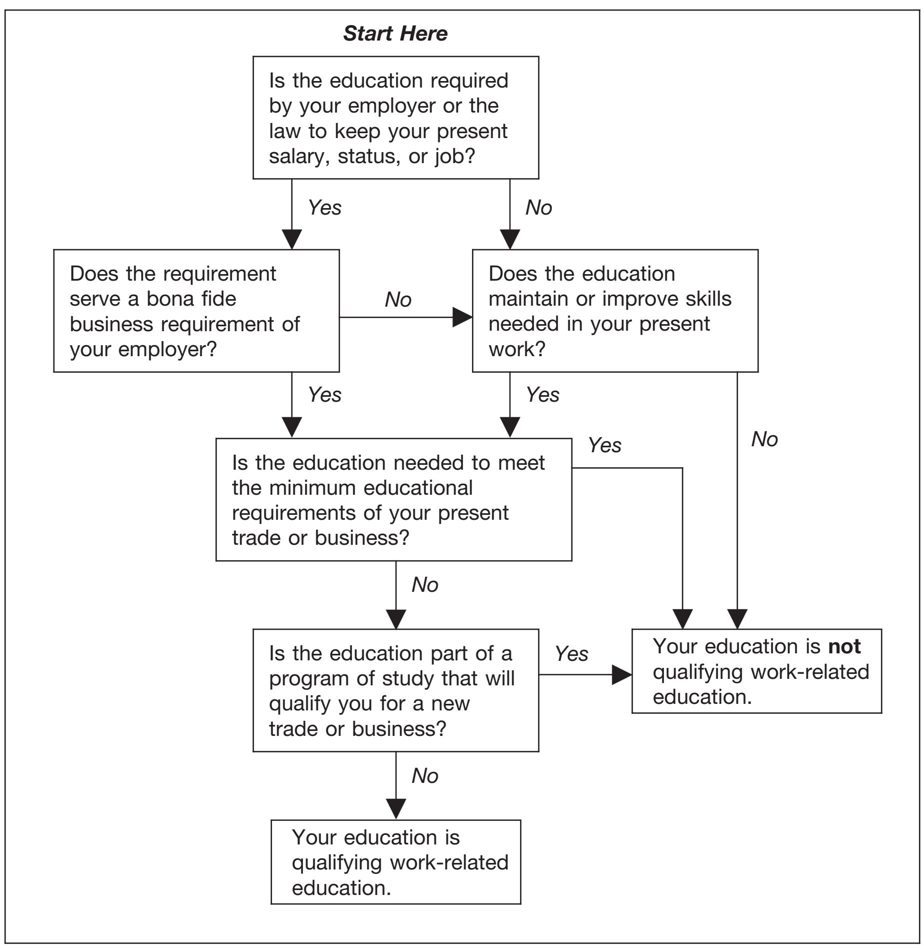
Transportation Expenses

If your education qualifies, you can deduct local transportation costs of going directly from work to school. If you are regularly employed and go to school on a temporary basis, you can also deduct the costs of returning from school to home.

Temporary basis. You go to school on a temporary basis if either of the following situations applies to you.

1. Your attendance at school is realistically expected to last 1 year or less and does indeed last for 1 year or less.
2. Initially, your attendance at school is realistically expected to last 1 year or less, but at a later date your attendance is reasonably expected to last more than 1 year. Your attendance is temporary up to the date you determine it will last more than 1 year.

Figure 27-A Does Your Work-Related Education Qualify?



Note. If you are in either situation (1) or (2), your attendance is not temporary if facts and circumstances indicate otherwise.

Attendance not on a temporary basis. You do not go to school on a temporary basis if either of the following situations apply to you.

1. Your attendance at school is realistically expected to last more than 1 year. It does not matter how long you actually attend.
2. Initially, your attendance at school is realistically expected to last 1 year or less, but at a later date your attendance is reasonably expected to last more than 1 year. Your attendance is not temporary after the date you determine it will last more than 1 year.

Deductible Transportation Expenses

If you are regularly employed and go directly from home to school on a temporary basis, you can deduct the round-trip costs of transportation between your home and school. This is true regardless of the location of the school, the distance traveled, or whether you attend school on nonwork days.

Transportation expenses include the actual costs of bus, subway, cab, or other fares, as well as the costs of using your car. Transportation expenses do not include amounts spent for travel, meals, or lodging while you are away from home overnight.

Example 1. You regularly work in a nearby town, and go directly from work to home. You also attend school every work night for 3 months to take a course that improves your job skills. Since you are attending school on a temporary basis, you can deduct your daily round-trip transportation expenses in going between home and school. This is true regardless of the distance traveled.

Example 2. Assume the same facts as in *Example 1* except that on certain nights you go directly from work to school and then home. You can deduct your transportation expenses from your regular work site to school and then home.

Example 3. Assume the same facts as in *Example 1* except that you attend the school for 9 months on Saturdays, nonwork days. Since you are attending school on a temporary basis, you can deduct your round-trip transportation expenses in going between home and school.

Example 4. Assume the same facts as in *Example 1* except that you attend classes twice a week for 15 months. Since your attendance in school is not considered temporary, you cannot deduct your transportation expenses in going between home and school. If you go directly from work to school, you can deduct the one-way transportation expenses of going from work to school. If you go from work to home to school and return home, your transportation expenses cannot be more than if you had gone directly from work to school.

Using your car. If you use your car (whether you own or lease it) for transportation to school, you can deduct your actual expenses or use the standard mileage rate to figure the amount you can deduct. The standard mileage rate for miles driven from January 1, 2012, through December 31, 2012 is $55\frac{1}{2}$ cents per mile. Whichever method you use, you can also deduct parking fees and tolls. See chapter 26 for information on deducting your actual expenses of using a car.

Travel Expenses

You can deduct expenses for travel, meals (see *50% limit on meals*, later), and lodging if you travel overnight mainly to obtain qualifying work-related education.

Travel expenses for qualifying work-related education are treated the same as travel expenses for other employee business purposes. For more information, see chapter 26.

CAUTION *You cannot deduct expenses for personal activities, such as sightseeing, visiting, or entertaining.*

Mainly personal travel. If your travel away from home is mainly personal, you cannot deduct all of your expenses for travel, meals, and lodging. You can deduct only your expenses for lodging and 50% of your expenses for meals during the time you attend the qualified educational activities.

Whether a trip's purpose is mainly personal or educational depends upon the facts and circumstances. An important factor is the comparison of time spent on personal activities with time spent on educational activities. If you spend more time on personal activities, the trip is considered mainly educational only if you can show a substantial nonpersonal reason for traveling to a particular location.

Example 1. John works in Newark, New Jersey. He traveled to Chicago to take a deductible 1-week course at the request of his employer. His main reason for going to Chicago was to take the course.

While there, he took a sight-seeing trip, entertained some friends, and took a side trip to Pleasantville for a day.

Since the trip was mainly for business, John can deduct his round-trip airfare to Chicago. He cannot deduct his transportation expenses of going to Pleasantville. He can deduct only the meals (subject to the 50% limit) and lodging connected with his educational activities.

Example 2. Sue works in Boston. She went to a university in Michigan to take a course for work. The course is qualifying work-related education.

She took one course, which is one-fourth of a full course load of study. She spent the rest of the time on personal activities. Her reasons for taking the course in Michigan were all personal.

Sue's trip is mainly personal because three-fourths of her time is considered personal time. She cannot deduct the cost of her round-trip train ticket to Michigan. She can deduct one-fourth of the meals (subject to the 50% limit) and lodging costs for the time she attended the university.

Example 3. Dave works in Nashville and recently traveled to California to take a 2-week seminar. The seminar is qualifying work-related education.

While there, he spent an extra 8 weeks on personal activities. The facts, including the extra 8-week stay, show that his main purpose was to take a vacation.

Dave cannot deduct his round-trip airfare or his meals and lodging for the 8 weeks. He can deduct only his expenses for meals (subject to the 50% limit) and lodging for the 2 weeks he attended the seminar.

Cruises and conventions. Certain cruises and conventions offer seminars or courses as part of their itinerary. Even if the seminars or courses are work-related, your deduction for travel may be limited. This applies to:

- Travel by ocean liner, cruise ship, or other form of luxury water transportation, and
- Conventions outside the North American area.

For a discussion of the limits on travel expense deductions that apply to cruises and conventions, see *Luxury Water Travel* and *Conventions* in chapter 1 of Publication 463.

50% limit on meals. You can deduct only 50% of the cost of your meals while traveling away from home to obtain qualifying work-related education. You cannot have been reimbursed for the meals.

Employees must use Form 2106 or Form 2106-EZ to apply the 50% limit.

Travel as Education

You cannot deduct the cost of travel as a form of education even if it is directly related to your duties in your work or business.

Example. You are a French language teacher. While on sabbatical leave granted for travel, you traveled through France to improve your knowledge of the French language. You chose your itinerary and most of your activities to improve your French language skills. You cannot deduct your travel expenses as education expenses. This is true even if you spent most of your time learning French by visiting French schools and families, attending movies or plays, and engaging in similar activities.

No Double Benefit Allowed

You cannot do either of the following.

- Deduct work-related education expenses as business expenses if you benefit from these expenses under any other provision of the law, for example, the tuition and fees deduction (see chapter 34).
- Deduct work-related education expenses paid with tax-free scholarship, grant, or employer-provided educational assistance. See *Adjustments to Qualifying Work-Related Education Expenses*, next.

Adjustments to Qualifying Work-Related Education Expenses

If you pay qualifying work-related education expenses with certain tax-free funds, you cannot claim a deduction for those amounts. You must reduce the qualifying expenses by the amount of such expenses allocable to the tax-free educational assistance. For more information, see chapter 12 of Publication 970.

Tax-free educational assistance includes:

- The tax-free part of scholarships and fellowships (see chapter 1 of Publication 970),
- The tax-free part of Pell grants (see chapter 1 of Publication 970),
- The tax-free part of employer-provided educational assistance (see chapter 11 of Publication 970),
- Veterans' educational assistance (see chapter 1 of Publication 970), and
- Any other nontaxable (tax-free) payments (other than gifts or inheritances) received for education assistance.

Amounts that do not reduce qualifying work-related education expenses. Do not reduce the qualifying work-related education expenses by amounts paid with funds the student receives as:

- Payment for services, such as wages,
- A loan,
- A gift,
- An inheritance, or
- A withdrawal from the student's personal savings.

Also, do not reduce the qualifying work-related education expenses by any scholarship or fellowship reported as income on the student's return or any scholarship which, by its terms, cannot be applied to qualifying work-related education expenses.

Reimbursements

How you treat reimbursements depends on the arrangement you have with your employer.

There are two basic types of reimbursement arrangements—accountable plans and nonaccountable plans. You can tell the type of plan you are reimbursed under by the way the reimbursement is reported on your Form W-2.

For information on how to treat reimbursements under both accountable and nonaccountable plans, see *Reimbursements* in chapter 26.

Deducting Business Expenses

Self-employed persons and employees report business expenses differently.

The following information explains what forms you must use to deduct the cost of your qualifying work-related education as a business expense.

Self-Employed Persons

If you are self-employed, report the cost of your qualifying work-related education on the appropriate form used to report your business income and expenses (generally Schedule C, C-EZ, or F). If your educational expenses include expenses for a car or truck, travel, or meals, report those expenses the same way you report other business expenses for those items. See the instructions for the form you file for information on how to complete it.

Employees

If you are an employee, you can deduct the cost of qualifying work-related education only if you:

1. Did not receive (and were not entitled to receive) any reimbursement from your employer,
2. Were reimbursed under a nonaccountable plan (amount is included in box 1 of Form W-2), or
3. Received reimbursement under an accountable plan, but the amount received was less than your expenses for which you claimed reimbursement.

If either (1) or (2) applies, you can deduct the total qualifying cost. If (3) applies, you can deduct only the qualifying costs that were more than your reimbursement.

In order to deduct the cost of your qualifying work-related education as a business expense, include the amount with your deduction for any other employee business expenses on Schedule A (Form 1040), line 21. (Special rules for expenses of certain performing artists and fee-basis officials and for impairment-related work expenses are explained later.)

This deduction (except for impairment-related work expenses of disabled individuals) is subject to the 2%-of-adjusted-gross-income limit that applies to most miscellaneous itemized deductions. See chapter 28.

Form 2106 or 2106-EZ. To figure your deduction for employee business expenses, including qualifying work-related education, you generally must complete Form 2106 or Form 2106-EZ.

Form not required. Do not complete either Form 2106 or Form 2106-EZ if:

- If amounts included in box 1 of your Form W-2, are not considered reimbursements, and
- You are not claiming travel, transportation, meal, or entertainment expenses.

If you meet both of these requirements, enter the expenses directly on Schedule A (Form 1040), line 21. (Special rules for expenses of certain performing artists and fee-basis officials and for impairment-related work expenses are explained later.)

Using Form 2106-EZ. This form is shorter and easier to use than Form 2106. Generally, you can use this form if:

- All reimbursements, if any, are included in box 1 of your Form W-2, and
- You are using the standard mileage rate if you are claiming vehicle expenses.

If you do not meet both of these requirements, use Form 2106.

Performing Artists and Fee-Basis Officials

If you are a qualified performing artist, or a state (or local) government official who is paid in whole or in part on a fee basis, you can deduct the cost of your qualifying work-related education as an adjustment to gross income rather than as an itemized deduction.

Include the cost of your qualifying work-related education with any other employee business expenses on Form 1040, line 24. You do not have to itemize your deductions on Schedule A (Form 1040), and, therefore, the deduction is not subject to the 2%-of-adjusted-gross-income limit. You must complete Form 2106 or 2106-EZ to figure your deduction, even if you meet the requirements described earlier under *Form not required*.

For more information on qualified performing artists, see chapter 6 of Publication 463.

Impairment-Related Work Expenses

If you are disabled and have impairment-related work expenses that are necessary for you to be able to get qualifying work-related education, you can deduct these expenses on Schedule A (Form 1040), line 28. They are not subject to the 2%-of-adjusted-gross-income limit. To deduct these expenses, you must complete Form 2106 or 2106-EZ even if you meet the requirements described earlier under *Form not required*.

For more information on impairment-related work expenses, see chapter 6 of Publication 463.

Recordkeeping

RECORDS

You must keep records as proof of any deduction claimed on your tax return. Generally, you should keep records for 3 years from the date of filing the tax return and claiming the deduction.

For specific information about keeping records of business expenses, see *Recordkeeping* in chapter 26.

28.

Miscellaneous Deductions

What's New

Standard mileage rate. The 2012 rate for business use of a vehicle is 55$\frac{1}{2}$ cents per mile.

Introduction

This chapter explains which expenses you can claim as miscellaneous itemized deductions on Schedule A (Form 1040). You must reduce the total of most miscellaneous itemized deductions by 2% of your adjusted gross income. This chapter covers the following topics.

- Deductions subject to the 2% limit.
- Deductions not subject to the 2% limit.
- Expenses you cannot deduct.

RECORDS

You must keep records to verify your deductions. You should keep receipts, canceled checks, substitute checks, financial account statements, and other documentary evidence. For more information on recordkeeping, get Publication 552, Recordkeeping for Individuals.

Useful Items

You may want to see:

Publication

- ❑ **463** Travel, Entertainment, Gift, and Car Expenses
- ❑ **525** Taxable and Nontaxable Income
- ❑ **529** Miscellaneous Deductions
- ❑ **535** Business Expenses
- ❑ **587** Business Use of Your Home (Including Use by Daycare Providers)
- ❑ **946** How To Depreciate Property

Form (and Instructions)

- ❑ **Schedule A (Form 1040)** Itemized Deductions
- ❑ **2106** Employee Business Expenses
- ❑ **2106-EZ** Unreimbursed Employee Business Expenses

Deductions Subject to the 2% Limit

You can deduct certain expenses as miscellaneous itemized deductions on Schedule A (Form 1040). You can claim the amount of expenses that is more than 2% of your adjusted gross income. You figure your deduction on Schedule A by subtracting 2% of your adjusted gross income from the total amount of these expenses. Your adjusted gross income is the amount on Form 1040, line 38.

Generally, you apply the 2% limit after you apply any other deduction limit. For example, you apply the 50% (or 80%) limit on business-related meals and entertainment (discussed in chapter 26) before you apply the 2% limit.

Deductions subject to the 2% limit are discussed in the three categories in which you report them on Schedule A (Form 1040).

- Unreimbursed employee expenses (line 21).
- Tax preparation fees (line 22).
- Other expenses (line 23).

Unreimbursed Employee Expenses (Line 21)

Generally, you can deduct on Schedule A (Form 1040), line 21, unreimbursed employee expenses that are:

- Paid or incurred during your tax year,
- For carrying on your trade or business of being an employee, and
- Ordinary and necessary.

An expense is ordinary if it is common and accepted in your trade, business, or profession. An expense is necessary if it is appropriate and helpful to your business. An expense does not have to be required to be considered necessary.

Examples of unreimbursed employee expenses are listed next. The list is followed by discussions of additional unreimbursed employee expenses.

- Business bad debt of an employee.
- Education that is work related. (See chapter 27.)
- Legal fees related to your job.
- Licenses and regulatory fees.
- Malpractice insurance premiums.
- Medical examinations required by an employer.
- Occupational taxes.
- Passport for a business trip.
- Subscriptions to professional journals and trade magazines related to your work.
- Travel, transportation, entertainment, and gifts related to your work. (See chapter 26.)

Business Liability Insurance

You can deduct insurance premiums you paid for protection against personal liability for wrongful acts on the job.

Damages for Breach of Employment Contract

If you break an employment contract, you can deduct damages you pay your former employer that are attributable to the pay you received from that employer.

Depreciation on Computers

You can claim a depreciation deduction for a computer that you use in your work as an employee if its use is:

- For the convenience of your employer, and
- Required as a condition of your employment.

For more information about the rules and exceptions to the rules affecting the allowable deductions for a home computer, see Publication 529.

Dues to Chambers of Commerce and Professional Societies

You may be able to deduct dues paid to professional organizations (such as bar associations and medical associations) and to chambers of commerce and similar organizations, if membership helps you carry out the duties of your job. Similar organizations include:

- Boards of trade,
- Business leagues,
- Civic or public service organizations,
- Real estate boards, and
- Trade associations.

Lobbying and political activities. You may not be able to deduct that part of your dues that is for certain lobbying and political activities. See *Dues used for lobbying* under *Nondeductible Expenses,* later.

Educator Expenses

If you were an eligible educator in 2012, you can deduct up to $250 of qualified expenses you paid in 2012 as an adjustment to gross income on Form 1040, line 23, rather than as a miscellaneous itemized deduction. If you file Form 1040A, you can deduct these expenses on line 16. If you and your spouse are filing jointly and both of you were eligible educators, the maximum deduction is $500. However, neither spouse can deduct more than $250 of his or her qualified expenses.

Home Office

If you use a part of your home regularly and exclusively for business purposes, you may be able to deduct a part of the operating expenses and depreciation of your home.

You can claim this deduction for the business use of a part of your home only if you use that part of your home regularly and exclusively:

- As your principal place of business for any trade or business,

- As a place to meet or deal with your patients, clients, or customers in the normal course of your trade or business, or
- In the case of a separate structure not attached to your home, in connection with your trade or business.

The regular and exclusive business use must be for the convenience of your employer and not just appropriate and helpful in your job. See Publication 587 for more detailed information and a worksheet.

Job Search Expenses

You can deduct certain expenses you have in looking for a new job in your present occupation, even if you do not get a new job. You cannot deduct these expenses if:

- You are looking for a job in a new occupation,
- There was a substantial break between the ending of your last job and your looking for a new one, or
- You are looking for a job for the first time.

Employment and outplacement agency fees. You can deduct employment and outplacement agency fees you pay in looking for a new job in your present occupation.

Employer pays you back. If, in a later year, your employer pays you back for employment agency fees, you must include the amount you receive in your gross income up to the amount of your tax benefit in the earlier year. (See Recoveries in chapter 12.)

Employer pays the employment agency. If your employer pays the fees directly to the employment agency and you are not responsible for them, you do not include them in your gross income.

Résumé. You can deduct amounts you spend for preparing and mailing copies of a résumé to prospective employers if you are looking for a new job in your present occupation.

Travel and transportation expenses. If you travel to an area and, while there, you look for a new job in your present occupation, you may be able to deduct travel expenses to and from the area. You can deduct the travel expenses if the trip is primarily to look for a new job. The amount of time you spend on personal activity compared to the amount of time you spend in looking for work is important in determining whether the trip is primarily personal or is primarily to look for a new job.

Even if you cannot deduct the travel expenses to and from an area, you can deduct the expenses of looking for a new job in your present occupation while in the area.

You can choose to use the standard mileage rate to figure your car expenses. The 2012 rate for business use of a vehicle is $55\frac{1}{2}$ cents per mile. See chapter 26 for more information.

Licenses and Regulatory Fees

You can deduct the amount you pay each year to state or local governments for licenses and regulatory fees for your trade, business, or profession.

Occupational Taxes

You can deduct an occupational tax charged at a flat rate by a locality for the privilege of working or conducting a business in the locality. If you are an employee, you can claim occupational taxes only as a miscellaneous deduction subject to the 2% limit; you cannot claim them as a deduction for taxes elsewhere on your return.

Repayment of Income Aid Payment

An “income aid payment” is one that is received under an employer's plan to aid employees who lose their jobs because of lack of work. If you repay a lump-sum income aid payment that you received and included in income in an earlier year, you can deduct the repayment.

Research Expenses of a College Professor

If you are a college professor, you can deduct research expenses, including travel expenses, for teaching, lecturing, or writing and publishing on subjects that relate directly to your teaching duties. You must have undertaken the research as a means of carrying out the duties expected of a professor and without expectation of profit apart from salary. However, you cannot deduct the cost of travel as a form of education.

Tools Used in Your Work

Generally, you can deduct amounts you spend for tools used in your work if the tools wear out and are thrown away within 1 year from the date of purchase. You can depreciate the cost of tools that have a useful life substantially beyond the tax year. For more information about depreciation, see Publication 946.

Union Dues and Expenses

You can deduct dues and initiation fees you pay for union membership.

You can also deduct assessments for benefit payments to unemployed union members. However, you cannot deduct the part of the assessments or contributions that provides funds for the payment of sick, accident, or death benefits. Also, you cannot deduct contributions to a pension fund, even if the union requires you to make the contributions.

You may not be able to deduct amounts you pay to the union that are related to certain lobbying and political activities. See *Lobbying Expenses* under *Nondeductible Expenses,* later.

Work Clothes and Uniforms

You can deduct the cost and upkeep of work clothes if the following two requirements are met.

- You must wear them as a condition of your employment.
- The clothes are not suitable for everyday wear.

CAUTION *It is not enough that you wear distinctive clothing. The clothing must be specifically required by your employer. Nor is it enough that you do not, in fact, wear your work clothes away from work. The clothing must not be suitable for taking the place of your regular clothing.*

Examples of workers who may be able to deduct the cost and upkeep of work clothes are: delivery workers, firefighters, health care workers, law enforcement officers, letter carriers, professional athletes, and transportation workers (air, rail, bus, etc.).

Musicians and entertainers can deduct the cost of theatrical clothing and accessories that are not suitable for everyday wear.

However, work clothing consisting of white cap, white shirt or white jacket, white bib overalls, and standard work shoes, which a painter is required by his union to wear on the job, is not distinctive in character or in the nature of a uniform. Similarly, the costs of buying and maintaining blue work clothes worn by a welder at the request of a foreman are not deductible.

Protective clothing. You can deduct the cost of protective clothing required in your work, such as safety shoes or boots, safety glasses, hard hats, and work gloves.

Examples of workers who may be required to wear safety items are: carpenters, cement workers, chemical workers, electricians, fishing boat crew members, machinists, oil field workers, pipe fitters, steamfitters, and truck drivers.

Military uniforms. You generally cannot deduct the cost of your uniforms if you are on full-time active duty in the armed forces. However, if you are an armed forces reservist, you can deduct the unreimbursed cost of your uniform if military regulations restrict you from wearing it except while on duty as a reservist. In figuring the deduction, you must reduce the cost by any nontaxable allowance you receive for these expenses.

If local military rules do not allow you to wear fatigue uniforms when you are off duty, you can deduct the amount by which the cost of buying and keeping up these uniforms is more than the uniform allowance you receive.

You can deduct the cost of your uniforms if you are a civilian faculty or staff member of a military school.

Tax Preparation Fees (Line 22)

You can usually deduct tax preparation fees in the year you pay them. Thus, on your 2012 return, you can deduct fees paid in 2012 for preparing your 2011 return. These fees include the cost of tax preparation software programs and tax publications. They also include any fee you paid for electronic filing of your return.

Other Expenses (Line 23)

You can deduct certain other expenses as miscellaneous itemized deductions subject to the

2% limit. On Schedule A (Form 1040), line 23, you can deduct expenses that you pay:

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

You can deduct expenses you pay for the purposes in (1) and (2) above only if they are reasonably and closely related to these purposes. Some of these other expenses are explained in the following discussions.

If the expenses you pay produce income that is only partially taxable, see *Tax-Exempt Income Expenses*, later, under *Nondeductible Expenses.*

Appraisal Fees

You can deduct appraisal fees if you pay them to figure a casualty loss or the fair market value of donated property.

Casualty and Theft Losses

You can deduct a casualty or theft loss as a miscellaneous itemized deduction subject to the 2% limit if you used the damaged or stolen property in performing services as an employee. First report the loss in Section B of Form 4684, Casualties and Thefts. You may also have to include the loss on Form 4797, Sales of Business Property, if you are otherwise required to file that form. To figure your deduction, add all casualty or theft losses from this type of property included on Form 4684, lines 32 and 38b, or Form 4797, line 18a. For other casualty and theft losses, see chapter 25.

Clerical Help and Office Rent

You can deduct office expenses, such as rent and clerical help, that you have in connection with your investments and collecting the taxable income on them.

Credit or Debit Card Convenience Fees

You can deduct the convenience fee charged by the card processor for paying your income tax (including estimated tax payments) by credit or debit card. The fees are deductible in the year paid.

Depreciation on Home Computer

You can deduct depreciation on your home computer if you use it to produce income (for example, to manage your investments that produce taxable income). You generally must depreciate the computer using the straight line method over the Alternative Depreciation System (ADS) recovery period. But if you work as an employee and also use the computer in that work, see Publication 946.

Excess Deductions of an Estate

If an estate's total deductions in its last tax year are more than its gross income for that year, the beneficiaries succeeding to the estate's property can deduct the excess. Do not include deductions for the estate's personal exemption and charitable contributions when figuring the estate's total deductions. The beneficiaries can claim the deduction only for the tax year in which, or with which, the estate terminates, whether the year of termination is a normal year or a short tax year. For more information, see *Termination of Estate* in Publication 559, Survivors, Executors, and Administrators.

Fees to Collect Interest and Dividends

You can deduct fees you pay to a broker, bank, trustee, or similar agent to collect your taxable bond interest or dividends on shares of stock. But you cannot deduct a fee you pay to a broker to buy investment property, such as stocks or bonds. You must add the fee to the cost of the property.

You cannot deduct the fee you pay to a broker to sell securities. You can use the fee only to figure gain or loss from the sale. See the instructions for Form 8949 for information on how to report the fee.

Hobby Expenses

You can generally deduct hobby expenses, but only up to the amount of hobby income. A hobby is not a business because it is not carried on to make a profit. See *Activity not for profit* in chapter 12 under *Other Income.*

Indirect Deductions of Pass-Through Entities

Pass-through entities include partnerships, S corporations, and mutual funds that are not publicly offered. Deductions of pass-through entities are passed through to the partners or shareholders. The partners or shareholders can deduct their share of passed-through deductions for investment expenses as miscellaneous itemized deductions subject to the 2% limit.

Example. You are a member of an investment club that is formed solely to invest in securities. The club is treated as a partnership. The partnership's income is solely from taxable dividends, interest, and gains from sales of securities. In this case, you can deduct your share of the partnership's operating expenses as miscellaneous itemized deductions subject to the 2% limit. However, if the investment club partnership has investments that also produce nontaxable income, you cannot deduct your share of the partnership's expenses that produce the nontaxable income.

Publicly offered mutual funds. Publicly offered mutual funds do not pass deductions for investment expenses through to shareholders. A mutual fund is "publicly offered" if it is:

- Continuously offered pursuant to a public offering,
- Regularly traded on an established securities market, or
- Held by or for at least 500 persons at all times during the tax year.

A publicly offered mutual fund will send you a Form 1099-DIV, Dividends and Distributions, or a substitute form, showing the net amount of dividend income (gross dividends minus investment expenses). This net figure is the amount you report on your return as income. You cannot further deduct investment expenses related to publicly offered mutual funds because they are already included as part of the net income amount.

Information returns. You should receive information returns from pass-through entities.

Partnerships and S corporations. These entities issue Schedule K-1, which lists the items and amounts you must report and identifies the tax return schedules and lines to use.

Nonpublicly offered mutual funds. These funds will send you a Form 1099-DIV, Dividends and Distributions, or a substitute form, showing your share of gross income and investment expenses. You can claim the expenses only as a miscellaneous itemized deduction subject to the 2% limit.

Investment Fees and Expenses

You can deduct investment fees, custodial fees, trust administration fees, and other expenses you paid for managing your investments that produce taxable income.

Legal Expenses

You can usually deduct legal expenses that you incur in attempting to produce or collect taxable income or that you pay in connection with the determination, collection, or refund of any tax.

You can also deduct legal expenses that are:

- Related to either doing or keeping your job, such as those you paid to defend yourself against criminal charges arising out of your trade or business,
- For tax advice related to a divorce, if the bill specifies how much is for tax advice and it is determined in a reasonable way, or
- To collect taxable alimony.

You can deduct expenses of resolving tax issues relating to profit or loss from business (Schedule C or C-EZ), rentals or royalties (Schedule E), or farm income and expenses (Schedule F), on the appropriate schedule. You deduct expenses of resolving nonbusiness tax issues on Schedule A (Form 1040). See *Tax Preparation Fees*, earlier.

Loss on Deposits

For information on whether, and if so, how, you may deduct a loss on your deposit in a qualified financial institution, see *Loss on Deposits* in chapter 25.

Repayments of Income

If you had to repay an amount that you included in income in an earlier year, you may be able to deduct the amount you repaid. If the amount you had to repay was ordinary income of $3,000 or less, the deduction is subject to the 2% limit. If it was more than $3,000, see *Repayments Under Claim of Right* under *Deductions Not Subject to the 2% Limit,* later.

Repayments of Social Security Benefits

For information on how to deduct your repayments of certain social security benefits, see *Repayments More Than Gross Benefits* in chapter 11.

Safe Deposit Box Rent

You can deduct safe deposit box rent if you use the box to store taxable income-producing stocks, bonds, or investment-related papers and documents. You cannot deduct the rent if you use the box only for jewelry, other personal items, or tax-exempt securities.

Service Charges on Dividend Reinvestment Plans

You can deduct service charges you pay as a subscriber in a dividend reinvestment plan. These service charges include payments for:

- Holding shares acquired through a plan,
- Collecting and reinvesting cash dividends, and
- Keeping individual records and providing detailed statements of accounts.

Trustee's Administrative Fees for IRA

Trustee's administrative fees that are billed separately and paid by you in connection with your individual retirement arrangement (IRA) are deductible (if they are ordinary and necessary) as a miscellaneous itemized deduction subject to the 2% limit. For more information about IRAs, see chapter 17.

Deductions Not Subject to the 2% Limit

You can deduct the items listed below as miscellaneous itemized deductions. They are not subject to the 2% limit. Report these items on Schedule A (Form 1040), line 28.

List of Deductions

Each of the following items is discussed in detail after the list (except where indicated).

- Amortizable premium on taxable bonds.
- Casualty and theft losses from income-producing property.
- Federal estate tax on income in respect of a decedent.
- Gambling losses up to the amount of gambling winnings.
- Impairment-related work expenses of persons with disabilities.
- Loss from other activities from Schedule K-1 (Form 1065-B), box 2.
- Losses from Ponzi-type investment schemes. See *Losses from Ponzi-type investment schemes* under *Theft* in chapter 25.
- Repayments of more than $3,000 under a claim of right.
- Unrecovered investment in an annuity.

Amortizable Premium on Taxable Bonds

In general, if the amount you pay for a bond is greater than its stated principal amount, the excess is bond premium. You can elect to amortize the premium on taxable bonds. The amortization of the premium is generally an offset to interest income on the bond rather than a separate deduction item.

Part of the premium on some bonds may be a miscellaneous deduction not subject to the 2% limit. For more information, see *Amortizable Premium on Taxable Bonds* in Publication 529, and *Bond Premium Amortization* in chapter 3 of Publication 550, Investment Income and Expenses.

Casualty and Theft Losses of Income-Producing Property

You can deduct a casualty or theft loss as a miscellaneous itemized deduction not subject to the 2% limit if the damaged or stolen property was income-producing property (property held for investment, such as stocks, notes, bonds, gold, silver, vacant lots, and works of art). First, report the loss in Form 4684, Section B. You may also have to include the loss on Form 4797, Sales of Business Property if you are otherwise required to file that form. To figure your deduction, add all casualty or theft losses from this type of property included on Form 4684, lines 32 and 38b, or Form 4797, line 18a. For more information on casualty and theft losses, see chapter 25.

Federal Estate Tax on Income in Respect of a Decedent

You can deduct the federal estate tax attributable to income in respect of a decedent that you as a beneficiary include in your gross income. Income in respect of the decedent is gross income that the decedent would have received had death not occurred and that was not properly includible in the decedent's final income tax return. See Publication 559 for more information.

Gambling Losses Up to the Amount of Gambling Winnings

You must report the full amount of your gambling winnings for the year on Form 1040, line 21. You deduct your gambling losses for the year on Schedule A (Form 1040), line 28. You cannot deduct gambling losses that are more than your winnings.

CAUTION *You cannot reduce your gambling winnings by your gambling losses and report the difference. You must report the full amount of your winnings as income and claim your losses (up to the amount of winnings) as an itemized deduction. Therefore, your records should show your winnings separately from your losses.*

RECORDS **Diary of winnings and losses.** You must keep an accurate diary or similar record of your losses and winnings.

Your diary should contain at least the following information.

- The date and type of your specific wager or wagering activity.
- The name and address or location of the gambling establishment.
- The names of other persons present with you at the gambling establishment.
- The amount(s) you won or lost.

See Publication 529 for more information.

Impairment-Related Work Expenses

If you have a physical or mental disability that limits your being employed, or substantially limits one or more of your major life activities, such as performing manual tasks, walking, speaking, breathing, learning, and working, you can deduct your impairment-related work expenses.

Impairment-related work expenses are ordinary and necessary business expenses for attendant care services at your place of work and for other expenses in connection with your place of work that are necessary for you to be able to work.

Self-employed. If you are self-employed, enter your impairment-related work expenses on the appropriate form (Schedule C, C-EZ, E, or F) used to report your business income and expenses.

Loss From Other Activities From Schedule K-1 (Form 1065-B), Box 2

If the amount reported in Schedule K-1 (Form 1065-B), box 2, is a loss, report it on Schedule A (Form 1040), line 28. It is not subject to the passive activity limitations.

Repayments Under Claim of Right

If you had to repay more than $3,000 that you included in your income in an earlier year because at the time you thought you had an unrestricted right to it, you may be able to deduct the amount you repaid or take a credit against your tax. See *Repayments* in chapter 12 for more information.

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. See chapter 10 for more information about the tax treatment of pensions and annuities.

Nondeductible Expenses

Examples of nondeductible expenses are listed next. The list is followed by discussions of additional nondeductible expenses.

List of Nondeductible Expenses

- Broker's commissions that you paid in connection with your IRA or other investment property.
- Burial or funeral expenses, including the cost of a cemetery lot.
- Capital expenses.
- Fees and licenses, such as car licenses, marriage licenses, and dog tags.
- Hobby losses, but see *Hobby Expenses*, earlier.
- Home repairs, insurance, and rent.
- Illegal bribes and kickbacks. See *Bribes and kickbacks* in chapter 11 of Publication 535.
- Losses from the sale of your home, furniture, personal car, etc.
- Personal disability insurance premiums.
- Personal, living, or family expenses.
- The value of wages never received or lost vacation time.

Adoption Expenses

You cannot deduct the expenses of adopting a child, but you may be able to take a credit for those expenses. See chapter 36.

Campaign Expenses

You cannot deduct campaign expenses of a candidate for any office, even if the candidate is running for reelection to the office. These include qualification and registration fees for primary elections.

Legal fees. You cannot deduct legal fees paid to defend charges that arise from participation in a political campaign.

Check-Writing Fees on Personal Account

If you have a personal checking account, you cannot deduct fees charged by the bank for the privilege of writing checks, even if the account pays interest.

Club Dues

Generally, you cannot deduct the cost of membership in any club organized for business, pleasure, recreation, or other social purpose. This includes business, social, athletic, luncheon, sporting, airline, hotel, golf, and country clubs.

You cannot deduct dues paid to an organization if one of its main purposes is to:

- Conduct entertainment activities for members or their guests, or
- Provide members or their guests with access to entertainment facilities.

Dues paid to airline, hotel, and luncheon clubs are not deductible.

Commuting Expenses

You cannot deduct commuting expenses (the cost of transportation between your home and your main or regular place of work). If you haul tools, instruments, or other items, in your car to and from work, you can deduct only the additional cost of hauling the items such as the rent on a trailer to carry the items.

Fines or Penalties

You cannot deduct fines or penalties you pay to a governmental unit for violating a law. This includes an amount paid in settlement of your actual or potential liability for a fine or penalty (civil or criminal). Fines or penalties include parking tickets, tax penalties, and penalties deducted from teachers' paychecks after an illegal strike.

Health Spa Expenses

You cannot deduct health spa expenses, even if there is a job requirement to stay in excellent physical condition, such as might be required of a law enforcement officer.

Home Security System

You cannot deduct the cost of a home security system as a miscellaneous deduction. However, you may be able to claim a deduction for a home security system as a business expense if you have a home office. See *Home Office* under *Unreimbursed Employee Expenses,* earlier, and *Security System* under *Deducting Expenses* in Publication 587.

Investment-Related Seminars

You cannot deduct any expenses for attending a convention, seminar, or similar meeting for investment purposes.

Life Insurance Premiums

You cannot deduct premiums you pay on your life insurance. You may be able to deduct, as alimony, premiums you pay on life insurance policies assigned to your former spouse. See chapter 18 for information on alimony.

Lobbying Expenses

You generally cannot deduct amounts paid or incurred for lobbying expenses. These include expenses to:

- Influence legislation,
- Participate or intervene in any political campaign for, or against, any candidate for public office,
- Attempt to influence the general public, or segments of the public, about elections, legislative matters, or referendums, or
- Communicate directly with covered executive branch officials in any attempt to influence the official actions or positions of those officials.

Lobbying expenses also include any amounts paid or incurred for research, preparation, planning, or coordination of any of these activities.

Dues used for lobbying. If a tax-exempt organization notifies you that part of the dues or other amounts you pay to the organization are used to pay nondeductible lobbying expenses, you cannot deduct that part. See *Lobbying Expenses* in Publication 529 for information on exceptions.

Lost or Mislaid Cash or Property

You cannot deduct a loss based on the mere disappearance of money or property. However, an accidental loss or disappearance of property can qualify as a casualty if it results from an identifiable event that is sudden, unexpected, or unusual. See chapter 25.

Example. A car door is accidentally slammed on your hand, breaking the setting of your diamond ring. The diamond falls from the ring and is never found. The loss of the diamond is a casualty.

Lunches with Co-workers

You cannot deduct the expenses of lunches with co-workers, except while traveling away from home on business. See chapter 26 for information on deductible expenses while traveling away from home.

Meals While Working Late

You cannot deduct the cost of meals while working late. However, you may be able to claim a deduction if the cost of meals is a deductible entertainment expense, or if you are traveling away from home. See chapter 26 for information on deductible entertainment expenses and expenses while traveling away from home.

Personal Legal Expenses

You cannot deduct personal legal expenses such as those for the following.

- Custody of children.
- Breach of promise to marry suit.
- Civil or criminal charges resulting from a personal relationship.

- Damages for personal injury, except for certain unlawful discrimination and whistle-blower claims.
- Preparation of a title (or defense or perfection of a title).
- Preparation of a will.
- Property claims or property settlement in a divorce.

You cannot deduct these expenses even if a result of the legal proceeding is the loss of income-producing property.

Political Contributions

You cannot deduct contributions made to a political candidate, a campaign committee, or a newsletter fund. Advertisements in convention bulletins and admissions to dinners or programs that benefit a political party or political candidate are not deductible.

Professional Accreditation Fees

You cannot deduct professional accreditation fees such as the following.

- Accounting certificate fees paid for the initial right to practice accounting.
- Bar exam fees and incidental expenses in securing initial admission to the bar.
- Medical and dental license fees paid to get initial licensing.

Professional Reputation

You cannot deduct expenses of radio and TV appearances to increase your personal prestige or establish your professional reputation.

Relief Fund Contributions

You cannot deduct contributions paid to a private plan that pays benefits to any covered employee who cannot work because of any injury or illness not related to the job.

Residential Telephone Service

You cannot deduct any charge (including taxes) for basic local telephone service for the first telephone line to your residence, even if it is used in a trade or business.

Stockholders' Meetings

You cannot deduct transportation and other expenses you pay to attend stockholders' meetings of companies in which you own stock but have no other interest. You cannot deduct these expenses even if you are attending the meeting to get information that would be useful in making further investments.

Tax-Exempt Income Expenses

You cannot deduct expenses to produce tax-exempt income. You cannot deduct interest on a debt incurred or continued to buy or carry tax-exempt securities.

If you have expenses to produce both taxable and tax-exempt income, but you cannot identify the expenses that produce each type of income, you must divide the expenses based on the amount of each type of income to determine the amount that you can deduct.

Example. During the year, you received taxable interest of $4,800 and tax-exempt interest of $1,200. In earning this income, you had total expenses of $500 during the year. You cannot identify the amount of each expense item that is for each income item. Therefore, 80% ($4,800/$6,000) of the expense is for the taxable interest and 20% ($1,200/$6,000) is for the tax-exempt interest. You can deduct, subject to the 2% limit, expenses of $400 (80% of $500).

Travel Expenses for Another Individual

You generally cannot deduct travel expenses you pay or incur for a spouse, dependent, or other individual who accompanies you (or your employee) on business or personal travel unless the spouse, dependent, or other individual is an employee of the taxpayer, the travel is for a bona fide business purpose, and such expenses would otherwise be deductible by the spouse, dependent, or other individual. See chapter 26 for more information on deductible travel expenses.

Voluntary Unemployment Benefit Fund Contributions

You cannot deduct voluntary unemployment benefit fund contributions you make to a union fund or a private fund. However, you can deduct contributions as taxes if state law requires you to make them to a state unemployment fund that covers you for the loss of wages from unemployment caused by business conditions.

Wristwatches

You cannot deduct the cost of a wristwatch, even if there is a job requirement that you know the correct time to properly perform your duties.

Part Six.

Figuring Your Taxes and Credits

The eight chapters in this part explain how to figure your tax and how to figure the tax of certain children who have more than $1,900 of investment income. They also discuss tax credits that, unlike deductions, are subtracted directly from your tax and reduce your tax, dollar for dollar. Chapter 35 discusses the earned income credit. Chapter 36 discusses a wide variety of other credits, such as the adoption credit.

29. How To Figure Your Tax

Introduction

After you have figured your income and deductions as explained in *Parts One* through *Five*, your next step is to figure your tax. This chapter discusses:

- The general steps you take to figure your tax,
- An additional tax you may have to pay called the alternative minimum tax (AMT), and
- The conditions you must meet if you want the IRS to figure your tax.

Figuring Your Tax

Your income tax is based on your taxable income. After you figure your income tax and AMT, if any, subtract your tax credits and add any other taxes you may owe. The result is your total tax. Compare your total tax with your total payments to determine whether you are entitled to a refund or if you must make a payment.

This section provides a general outline of how to figure your tax. You can find step-by-step directions in the Instructions for Forms 1040EZ, 1040A, and 1040. If you are unsure of which tax form you should file, see *Which Form Should I Use?* in chapter 1.

Tax. Most taxpayers use either the Tax Table or the Tax Computation Worksheet to figure their income tax. However, there are special methods if your income includes any of the following items.

- A net capital gain. (See chapter 16.)
- Qualified dividends taxed at the same rates as a net capital gain. (See chapters 8 and 16.)
- Lump-sum distributions. (See chapter 10.)
- Farming or fishing income. (See Schedule J (Form 1040), Income Averaging for Farmers and Fishermen.)
- Investment income over $1,900 for certain children. (See chapter 30.)
- Parents' election to report child's interest and dividends. (See chapter 30.)
- Foreign earned income exclusion or the housing exclusion. (See Form 2555, Foreign Earned Income, or Form 2555-EZ, Foreign Earned Income Exclusion, and the Foreign Earned Income Tax Worksheet in the Form 1040 instructions.)

Credits. After you figure your income tax and any AMT (discussed later), determine if you are eligible for any tax credits. Eligibility information for these tax credits is discussed in chapters 31 through 36 and your form instructions. The following table lists the credits you may be able to subtract from your tax and shows where you can find more information on each credit.

CREDITS

For information on:	See chapter:
Adoption	36
Alternative motor vehicle	36
Alternative fuel vehicle refueling property	36
Child and dependent care	31
Child tax	33
Credit to holders of tax credit bonds	36
Education	34
Elderly or disabled	32
Electric vehicle	36
Foreign tax	36
Mortgage interest	36
Prior year minimum tax	36
Residential energy	36
Retirement savings contributions	36

Some credits (such as the earned income credit) are not listed above because they are treated as payments. See *Payments*, later.

There are other credits that are not discussed in this publication. These include the following credits.

- General business credit, which is made up of several separate business-related credits. These generally are reported on Form 3800, General Business Credit, and are discussed in chapter 4 of Publication 334, Tax Guide for Small Business.
- Renewable electricity, refined coal, and Indian coal production credit for electricity and refined coal produced at facilities placed in service after October 22, 2004 (after October 2, 2008, for electricity produced from marine and hydrokinetic renewables), and Indian coal produced at facilities placed in service after August 8, 2005. See Form 8835, Part II.
- Work opportunity credit. See Form 5884.
- Credit for employer social security and Medicare taxes paid on certain employee tips. See Form 8846.

Other taxes. After you subtract your tax credits, determine whether there are any other taxes you must pay. This chapter does not explain these other taxes. You can find that information in other chapters of this publication and your form instructions. See the following table for other taxes you may need to add to your income tax.

OTHER TAXES

For information on:	See chapter:
Additional taxes on qualified retirement plans and IRAs	10, 17
Household employment taxes	31
Recapture of an education credit	34
Social security and Medicare tax on wages	5
Social security and Medicare tax on tips	6
Uncollected social security and Medicare tax on tips	6

You also may have to pay AMT (discussed later in this chapter).

There are other taxes that are not discussed in this publication. These include the following items.

1. *Self-employment tax.* You must figure this tax if either of the following applies to you (or your spouse if you file a joint return).
   a. Your net earnings from self-employment from other than church employee income were $400 or more. The term “net earnings from self-employment” may include certain nonemployee compensation and other amounts reported to you on Form 1099-MISC, Miscellaneous Income. If you received a Form 1099-MISC, see the *Instructions for Recipient* on the back. Also see the Instructions for Schedule SE (Form 1040), Self-Employment Tax; and Publication 334, Tax Guide for Small Business.
   b. You had church employee income of $108.28 or more.

2. *Recapture taxes.* You may have to pay these taxes if you previously claimed an investment credit, a low-income housing credit, a new markets credit, a qualified plug-in electric vehicle credit, an alternative motor vehicle credit, a credit for employer-provided child care facilities, an Indian employment credit, or other credits listed in the instructions for Form 1040, line 60. For more information, see the instructions for Form 1040, line 60.
3. *Section 72(m)(5) excess benefits tax.* If you are (or were) a 5% owner of a business and you received a distribution that exceeds the benefits provided for you under the qualified pension or annuity plan formula, you may have to pay this additional tax. See *Tax on Excess Benefits* in chapter 4 of Publication 560, Retirement Plans for Small Business.
4. *Uncollected social security and Medicare tax on group-term life insurance.* If your former employer provides you with more than $50,000 of group-term life insurance coverage, you must pay the employee part of social security and Medicare taxes on those premiums. The amount should be shown in box 12 of your Form W-2 with codes M and N.
5. *Tax on golden parachute payments.* This tax applies if you received an "excess parachute payment" (EPP) due to a change in a corporation's ownership or control. The amount should be shown in box 12 of your Form W-2 with code K. See the instructions for Form 1040, line 60.
6. *Tax on accumulation distribution of trusts.* This applies if you are the beneficiary of a trust that accumulated its income instead of distributing it currently. See Form 4970 and its instructions.
7. *Additional tax on HSAs or MSAs.* If amounts contributed to, or distributed from, your health savings account or medical savings account do not meet the rules for these accounts, you may have to pay additional taxes. See Publication 969, Health Savings Accounts and Other Tax-Favored Health Plans; Form 8853, Archer MSAs and Long-Term Care Insurance Contracts; Form 8889, Health Savings Accounts (HSAs); and Form 5329, Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts.
8. *Additional tax on Coverdell ESAs.* This applies if amounts contributed to, or distributed from, your Coverdell ESA do not meet the rules for these accounts. See Publication 970, Tax Benefits for Education, and Form 5329.
9. *Additional tax on qualified tuition programs.* This applies to amounts distributed from qualified tuition programs that do not meet the rules for these accounts. See Publication 970 and Form 5329.
10. *Excise tax on insider stock compensation from an expatriated corporation.* You may owe a 15% excise tax on the value of nonstatutory stock options and certain other stock-based compensation held by you or a member of your family from an expatriated corporation or its expanded affiliated group in which you were an officer, director, or more-than-10% owner. For more information, see the instructions for Form 1040, line 60.
11. *Additional tax on income you received from a nonqualified deferred compensation plan that fails to meet certain requirements.* This income should be shown in Form W-2, box 12, with code Z, or in Form 1099-MISC, box 15b. For more information, see the instructions for Form 1040, line 60.
12. *Interest on the tax due on installment income from the sale of certain residential lots and timeshares.* For more information, see the instructions for Form 1040, line 60.
13. *Interest on the deferred tax on gain from certain installment sales with a sales price over $150,000.* For more information, see the instructions for Form 1040, line 60.
14. *Repayment of first-time homebuyer credit.* For more information, see Form 5405, Repayment of the First-Time Homebuyer Credit, and its instructions. Also see the instructions for Form 1040, line 59b.

Payments. After you determine your total tax, figure the total payments you have already made for the year. Include credits that are treated as payments. This chapter does not explain these payments and credits. You can find that information in other chapters of this publication and your form instructions. See the following table for amounts you can include in your total payments.

PAYMENTS

For information on:	See chapter:
Child tax credit (additional)	33
Earned income credit	35
Estimated tax paid	4
Excess social security and RRTA tax withheld	36
Federal income tax withheld	4
Health coverage tax credit	36
Regulated investment company credit	36
Refundable credit for prior year minimum tax	36
Tax paid with extension	1

Another credit that is treated as a payment is the credit for federal excise tax paid on fuels. This credit is for persons who have a nontaxable use of certain fuels, such as diesel fuel and kerosene. It is claimed on Form 1040, line 70. See Form 4136, Credit for Federal Tax Paid on Fuels.

Refund or balance due. To determine whether you are entitled to a refund or whether you must make a payment, compare your total payments with your total tax. If you are entitled to a refund, see your form instructions for information on having it directly deposited into one or more of your accounts, or to purchase U.S. savings bonds instead of receiving a paper check.

Alternative Minimum Tax (AMT)

This section briefly discusses an additional tax you may have to pay.

The tax law gives special treatment to some kinds of income and allows special deductions and credits for some kinds of expenses. Taxpayers who benefit from this special treatment may have to pay at least a minimum amount of tax through an additional tax called AMT.

You may have to pay the AMT if your taxable income for regular tax purposes, combined with certain adjustments and tax preference items, is more than a certain amount. See Form 6251, Alternative Minimum Tax — Individuals.

Adjustments and tax preference items. The more common adjustments and tax preference items include:

- Addition of personal exemptions,
- Addition of the standard deduction (if claimed),
- Addition of itemized deductions claimed for state and local taxes, certain interest, most miscellaneous deductions, and part of medical expenses,
- Subtraction of any refund of state and local taxes included in gross income,
- Changes to accelerated depreciation of certain property,
- Difference between gain or loss on the sale of property reported for regular tax purposes and AMT purposes,
- Addition of certain income from incentive stock options,
- Change in certain passive activity loss deductions,
- Addition of certain depletion that is more than the adjusted basis of the property,
- Addition of part of the deduction for certain intangible drilling costs, and
- Addition of tax-exempt interest on certain private activity bonds.

More information. For more information about the AMT, see the instructions for Form 1040, line 45, and Form 6251.

Tax Figured by IRS

If you file by April 15, 2013, you can have the IRS figure your tax for you on Form 1040EZ, Form 1040A, or Form 1040.

If the IRS figures your tax and you paid too much, you will receive a refund. If you did not pay enough, you will receive a bill for the balance. To avoid interest or the penalty for late payment, you must pay the bill within 30 days of the date of the bill or by the due date for your return, whichever is later.

The IRS will also figure the credit for the elderly or the disabled and the earned income credit for you.

When the IRS cannot figure your tax. The IRS cannot figure your tax for you if any of the following apply.

1. You want your refund directly deposited into your accounts.
2. You want any part of your refund applied to your 2013 estimated tax.
3. You had income for the year from sources other than wages, salaries, tips, interest, dividends, taxable social security benefits, unemployment compensation, IRA distributions, pensions, and annuities.
4. Your taxable income is $100,000 or more.
5. You itemize deductions.
6. You file any of the following forms.
   a. Form 2555, Foreign Earned Income.
   b. Form 2555-EZ, Foreign Earned Income Exclusion.
   c. Form 4137, Social Security and Medicare Tax on Unreported Tip Income.
   d. Form 4970, Tax on Accumulation Distribution of Trusts.
   e. Form 4972, Tax on Lump-Sum Distributions.
   f. Form 6198, At-Risk Limitations.
   g. Form 6251, Alternative Minimum Tax—Individuals.
   h. Form 8606, Nondeductible IRAs.
   i. Form 8615, Tax for Certain Children Who Have Investment Income of More Than $1,900.
   j. Form 8814, Parents' Election To Report Child's Interest and Dividends.
   k. Form 8839, Qualified Adoption Expenses.
   l. Form 8853, Archer MSAs and Long-Term Care Insurance Contracts.
   m. Form 8889, Health Savings Accounts (HSAs).
   n. Form 8919, Uncollected Social Security and Medicare Tax on Wages.
   o. Form 8930, Qualified Disaster Recovery Assistance Retirement Plan Distributions and Repayments.

Filing the Return

After you complete the line entries for the tax form you are filing, fill in your name and address. Enter your social security number in the space provided. If you are married, enter the social security numbers of you and your spouse even if you file separately. Sign and date your return and enter your occupation(s). If you are filing a joint return, both you and your spouse must sign it. Enter your daytime phone number in the space provided. This may help speed the processing of your return if we have a question that can be answered over the phone. If you are filing a joint return, you may enter either your or your spouse's daytime phone number.

If you want to allow a friend, family member, or any other person you choose to discuss your 2012 tax return with the IRS, check the "Yes" box in the "Third party designee" area on your return. Also enter the designee's name, phone number, and any five digits the designee chooses as his or her personal identification number (PIN). If you check the "Yes" box, you, and your spouse if filing a joint return, are authorizing the IRS to call the designee to answer any questions that may arise during the processing of your return.

Fill in and attach any schedules and forms asked for on the lines you completed. Attach a copy of each of your Forms W-2 to your return. Also attach any Form 1099-R you received that has withholding tax in box 4.

Mail your return to the Internal Revenue Service Center for the area where you live. A list of Service Center addresses is shown near the end of this publication.

Form 1040EZ Line Entries

Read lines 1 through 8b and fill in the lines that apply to you. Do not complete lines 9 through 12. If you are filing a joint return, use the space to the left of line 6 to separately show your taxable income and your spouse's taxable income.

Payments. Enter any federal income tax withheld on line 7. Federal income tax withheld is shown on Form W-2, box 2, or Form 1099, box 4.

Earned income credit. If you can take this credit, as discussed in chapter 35, the IRS can figure it for you. Enter "EIC" in the space to the left of line 8a. Enter the nontaxable combat pay you elect to include in earned income on line 8b.

If your credit for any year after 1996 was reduced or disallowed by the IRS, you may also have to file Form 8862, Information To Claim Earned Income Credit After Disallowance, with your return. For details, see the Form 1040EZ Instructions.

Form 1040A Line Entries

Read lines 1 through 27 and fill in the lines that apply to you. If you are filing a joint return, use the space to the left of the entry space for line 27 to separately show your taxable income and your spouse's taxable income. Do not complete line 28. Complete lines 29 through 33 and 36 through 40 if they apply to you. However, do not fill in lines 30 and 38a if you want the IRS to figure the credits shown on those lines. Also, enter any write-in information that applies to you in the space to the left of line 41. Do not complete lines 34, 35, and 42 through 46.

Payments. Enter any federal income tax withheld that is shown on Form W-2, box 2, or Form 1099, box 4, on line 36. Enter any estimated tax payments you made on line 37.

Credit for child and dependent care expenses. If you can take this credit, as discussed in chapter 31, complete Form 2441, Child and Dependent Care Expenses, and attach it to your return. Enter the amount of the credit on line 29. The IRS will not figure this credit.

Credit for the elderly or the disabled. If you can take this credit, as discussed in chapter 32, the IRS will figure it for you. Enter "CFE" in the space to the left of line 30 and attach Schedule R (Form 1040A or 1040), Credit for the Elderly or the Disabled, to your return. On Schedule R (Form 1040A or 1040), check the box in Part I for your filing status and age. Complete Part II and Part III, lines 11 and 13, if they apply.

Earned income credit. If you can take this credit, as discussed in chapter 35, the IRS will figure it for you. Enter "EIC" to the left of the entry space for line 38a. Enter the nontaxable combat pay you elect to include in earned income on line 38b.

If you have a qualifying child, you must fill in Schedule EIC, Earned Income Credit, and attach it to your return. If you do not provide the child's social security number on Schedule EIC, line 2, the credit will be reduced or disallowed unless the child was born and died in 2012.

If your credit for any year after 1996 was reduced or disallowed by the IRS, you may also have to file Form 8862 with your return. For details, see the Form 1040A Instructions.

Form 1040 Line Entries

Read lines 1 through 43 and fill in the lines that apply to you. Do not complete line 44.

If you are filing a joint return, use the space under the words "Adjusted Gross Income" on the front of your return to separately show your taxable income and your spouse's taxable income.

Read lines 45 through 71. Fill in the lines that apply to you, but do not fill in lines 54, 61, and 72. Also, do not complete line 55 and lines 73 through 77. Do not fill in line 53, box "c," if you are completing Schedule R (Form 1040A or 1040), or line 64a if you want the IRS to figure the credits shown on those lines.

Payments. Enter any federal income tax withheld that is shown on Form W-2, box 2, or Form 1099, box 4, on line 62. Enter any estimated tax payments you made on line 63.

Credit for child and dependent care expenses. If you can take this credit, as discussed in chapter 31, complete Form 2441 and attach it to your return. Enter the amount of the credit on line 48. The IRS will not figure this credit.

Credit for the elderly or the disabled. If you can take this credit, as discussed in chapter 32, the IRS will figure it for you. Enter "CFE" on the line next to line 53, check box "c," and attach Schedule R (Form 1040A or 1040) to your return. On Schedule R (Form 1040A or 1040) check the box in Part I for your filing status and age. Complete Part II and Part III, lines 11 and 13, if they apply.

Earned income credit. If you can take this credit, as discussed in chapter 35, the IRS will figure it for you. Enter "EIC" on the dotted line next to Form 1040, line 64a. Enter the nontaxable combat pay you elect to include in earned income on line 64b.

If you have a qualifying child, you must fill in Schedule EIC and attach it to your return. If you do not provide the child's social security number on Schedule EIC, line 2, the credit will be reduced or disallowed unless the child was born and died in 2012.

If your credit for any year after 1996 was reduced or disallowed by the IRS, you may also have to file Form 8862 with your return. For details, see the Form 1040 Instructions.

30. Tax on Investment Income of Certain Children

Introduction

This chapter discusses the following two rules that may affect the tax on investment income of certain children.

1. If the child's interest and dividend income (including capital gain distributions) total less than $9,500, the child's parent may be able to choose to include that income on the parent's return rather than file a return for the child. (See Parent's Election To Report Child's Interest and Dividends, later.)
2. If the child's interest, dividends, and other investment income total more than $1,900, part of that income may be taxed at the parent's tax rate instead of the child's tax rate. (See Tax for Certain Children Who Have Investment Income of More Than $1,900, later.)

For these rules, the term “child” includes a legally adopted child and a stepchild. These rules apply whether or not the child is a dependent.

Useful Items

You may want to see:

Publication

- ❑ **929** Tax Rules for Children and Dependents

Form (and Instructions)

- ❑ **8615** Tax for Certain Children Who Have Investment Income of More Than $1,900
- ❑ **8814** Parents' Election To Report Child's Interest and Dividends

Which Parent's Return To Use

If a child's parents are married to each other and file a joint return, use the joint return to figure the tax on the child's investment income. The tax rate and other return information from that return are used to figure the child's tax as explained later under Tax for Certain Children Who Have Investment Income of More Than $1,900.

Parents Who Do Not File a Joint Return

For parents who do not file a joint return, the following discussions explain which parent's tax return must be used to figure the tax.

Only the parent whose tax return is used can make the election described under Parent's Election To Report Child's Interest and Dividends.

Parents are married. If the child's parents file separate returns, use the return of the parent with the greater taxable income.

Parents not living together. If the child's parents are married to each other but not living together, and the parent with whom the child lives (the custodial parent) is considered unmarried, use the return of the custodial parent. If the custodial parent is not considered unmarried, use the return of the parent with the greater taxable income.

For an explanation of when a married person living apart from his or her spouse is considered unmarried, see Head of Household in chapter 2.

Parents are divorced. If the child's parents are divorced or legally separated, and the parent who had custody of the child for the greater part of the year (the custodial parent) has not remarried, use the return of the custodial parent.

Custodial parent remarried. If the custodial parent has remarried, the stepparent (rather than the noncustodial parent) is treated as the child's other parent. Therefore, if the custodial parent and the stepparent file a joint return, use that joint return. Do not use the return of the noncustodial parent.

If the custodial parent and the stepparent are married, but file separate returns, use the return of the one with the greater taxable income. If the custodial parent and the stepparent are married but not living together, the earlier discussion under Parents not living together applies.

Parents never married. If a child's parents have never been married to each other, but lived together all year, use the return of the parent with the greater taxable income. If the parents did not live together all year, the rules explained earlier under Parents are divorced apply.

Widowed parent remarried. If a widow or widower remarries, the new spouse is treated as the child's other parent. The rules explained earlier under Custodial parent remarried apply.

Parent's Election To Report Child's Interest and Dividends

You may be able to elect to include your child's interest and dividend income (including capital gain distributions) on your tax return. If you do, your child will not have to file a return.

You can make this election only if all the following conditions are met.

- Your child was under age 19 (or under age 24 if a full-time student) at the end of the year.
- Your child had income only from interest and dividends (including capital gain distributions and Alaska Permanent Fund dividends).
- The child's gross income was less than $9,500.
- The child is required to file a return unless you make this election.
- The child does not file a joint return for the year.
- No estimated tax payment was made for the year, and no overpayment from the previous year (or from any amended return) was applied to this year under your child's name and social security number.
- No federal income tax was taken out of your child's income under the backup withholding rules.
- You are the parent whose return must be used when applying the special tax rules for children. (See Which Parent's Return To Use, earlier.)

These conditions are also shown in Figure 30-A.

Certain January 1 birthdays. A child born on January 1, 1994, is considered to be age 19 at the end of 2012. You cannot make this election for such a child unless the child was a full-time student.

A child born on January 1, 1989, is considered to be age 24 at the end of 2012. You cannot make this election for such a child.

Full-time student. A full-time student is a child who during some part of each of any 5 calendar months of the year was enrolled as a full-time student at a school, or took a full-time on-farm training course given by a school or a state, county, or local government agency. A school includes a technical, trade, or mechanical school. It does not include an on-the-job training course, correspondence school, or school offering courses only through the Internet.

How to make the election. Make the election by attaching Form 8814 to your Form 1040. (If you make this election, you cannot file Form 1040A or Form 1040EZ.) Attach a separate Form 8814 for each child for whom you make the election. You can make the election for one or more children and not for others.

Effect of Making the Election

The federal income tax on your child's income may be more if you make the Form 8814 election.

Rate may be higher. If your child received qualified dividends or capital gain distributions, you may pay up to $95 more tax if you make this election instead of filing a separate tax return for the child. This is because the tax rate on the child's income between $950 and $1,900 is 10% if you make this election. However, if you file a separate return for the child, the tax rate may be as low as 0% (zero percent) because of the preferential tax rates for qualified dividends and capital gain distributions.

Deductions you cannot take. By making the Form 8814 election, you cannot take any of the following deductions that the child would be entitled to on his or her return.

- The additional standard deduction if the child is blind.
- The deduction for a penalty on an early withdrawal of your child's savings.
- Itemized deductions (such as your child's investment expenses or charitable contributions).

Reduced deductions or credits. If you use Form 8814, your increased adjusted gross income may reduce certain deductions or credits on your return including the following.

- Deduction for contributions to a traditional individual retirement arrangement (IRA).
- Deduction for student loan interest.
- Itemized deductions for medical expenses, casualty and theft losses, and certain miscellaneous expenses.
- Credit for child and dependent care expenses.
- Child tax credit.
- Education tax credits.
- Earned income credit.

Penalty for underpayment of estimated tax. If you make this election for 2012 and did not have enough tax withheld or pay enough estimated tax to cover the tax you owe, you may be subject to a penalty. If you plan to make this election for 2013, you may need to increase your federal income tax withholding or your estimated tax payments to avoid the penalty. See chapter 4 for more information.

Figuring Child's Income

Use Form 8814, Part I, to figure your child's interest and dividend income to report on your return. Only the amount over $1,900 is added to your income. The amount over $1,900 is shown on Form 8814, line 6. Unless the child's income includes qualified dividends or capital gain distributions (discussed next), the same amount is shown on Form 8814, line 12. Include the amount from Form 8814, line 12, on Form 1040, line 21. Enter "Form 8814" on the dotted line next to line 21. If you file more than one Form 8814, include the total amounts from line 12 of all your Forms 8814 on Form 1040, line 21.

Capital gain distributions and qualified dividends. If your child's dividend income included any capital gain distributions, see *Capital gain distributions* under *Figuring Child's Income* in Publication 929, Part 2. If your child's dividend income included any qualified dividends, see *Qualified dividends* under *Figuring Child's Income* in Publication 929, Part 2.

Figuring Additional Tax

Use Form 8814, Part II, to figure the tax on the $1,900 of your child's interest and dividends that you do not include in your income. This tax is added to the tax figured on your income.

This additional tax is the smaller of:

1. 10% × (your child's gross income – $950), or
2. $95.

Include the amount from line 15 of all your Forms 8814 in the total on Form 1040, line 44. Check box a on Form 1040, line 44.

Illustrated Example

David and Linda Parks are married and will file separate tax returns for 2012. Their only child, Philip, is 8. Philip received a Form 1099-INT showing $1,650 taxable interest income and a Form 1099-DIV showing $1,150 ordinary dividends. All the dividends were qualified dividends. His parents decide to include that income on one of their returns so they will not have to file a return for Philip.

First, David and Linda each figure their taxable income (Form 1040, line 43) without regard to Philip's income. David's taxable income is $56,700 and Linda's is $74,300. Because her taxable income is greater, Linda can elect to include Philip's income on her return. See *Which Parent's Return To Use*, earlier.

On Form 8814 (see illustrated form), Linda enters her name and social security number, then Philip's name and social security number. She enters Philip's taxable interest income, $1,650, on line 1a. Philip had no tax-exempt interest income, so she leaves line 1b blank. She enters Philip's ordinary dividends, $1,150, on line 2a. All of Philip's ordinary dividends were qualified dividends, so Linda also enters $1,150 on line 2b. Philip did not have any capital gain distributions, so she leaves line 3 blank.

Linda adds lines 1a and 2a and enters the result, $2,800, on line 4. Because Philip had qualified dividends, Linda must complete lines 7 through 11 of Form 8814. She includes the amount from line 9 of Form 8814 ($370) on lines 9a and 9b of her Form 1040. On the dotted lines next to lines 9a and 9b, she enters "Form 8814–$370."

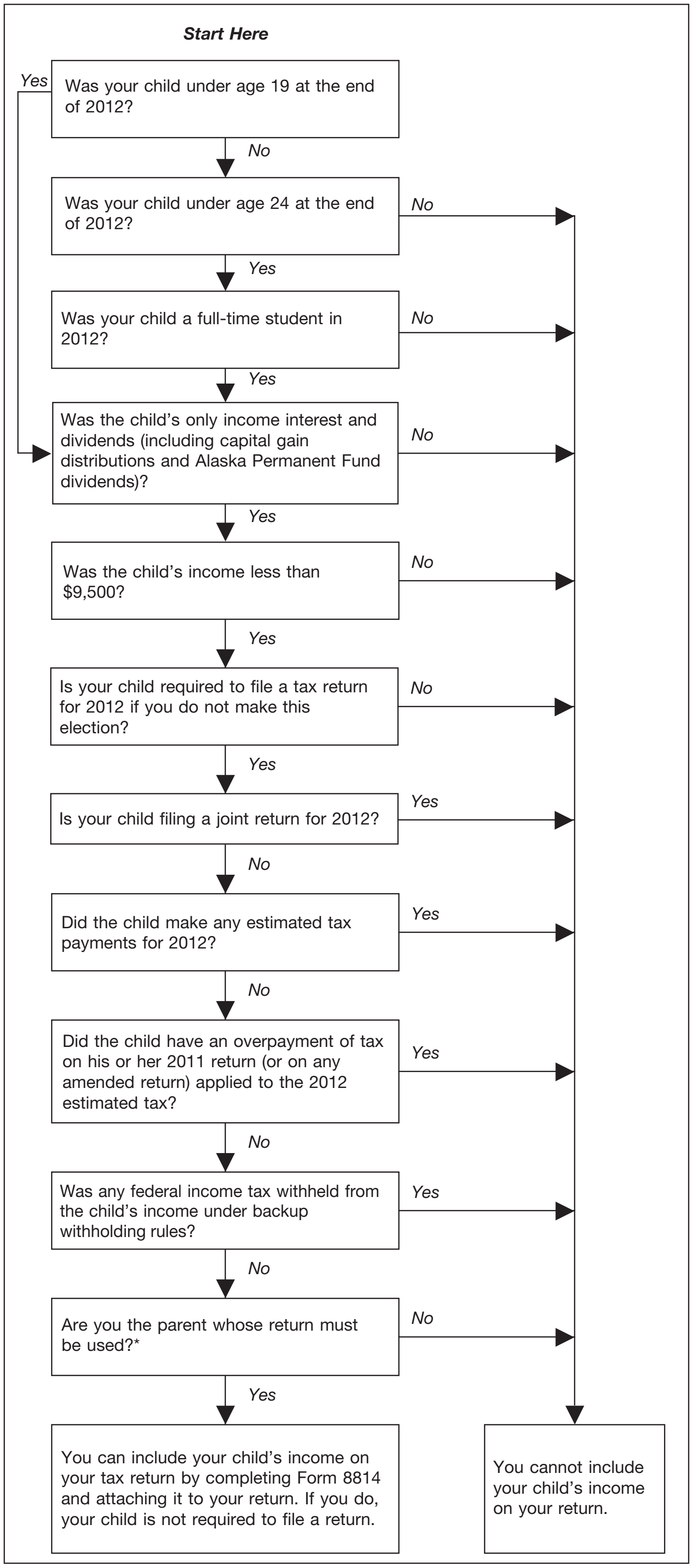
Linda includes $530 in the total on line 21 of her Form 1040 (not illustrated) and in the space next to that line writes "Form 8814–$530." Adding that amount, plus the $370 of qualified dividends, to her income increases each of the amounts on lines 22, 37, 38, 41, and 43 of her Form 1040 by $900. Linda is not claiming any deductions that are affected by the increase to her income. Therefore, her revised taxable income on line 43 is $75,200 ($74,300 + $370 + $530).

On Form 8814, Linda subtracts the $950 shown on line 13 from the $2,800 on line 4 and enters the result, $1,850, on line 14. Because that amount is not less than $950, she enters $95 on line 15. This is the tax on the first $1,900 of Philip's income, which Linda did not have to add to her income. She must add this additional tax to the tax figured on her revised taxable income.

The tax on her $75,200 revised taxable income, figured using the Qualified Dividends and Capital Gain Tax Worksheet in the Form 1040 instructions, is $14,897. She adds $95, and enters $14,992 on Form 1040, line 44, and checks box a.

Linda attaches Form 8814 to her Form 1040.

Figure 30-A. Can You Include Your Child's Income On Your Tax Return?



*See *Which Parent's Return To Use*

Form **8814**

Department of the Treasury
Internal Revenue Service (99)

Parents' Election To Report Child's Interest and Dividends

▶ **Information about Form 8814 and its instructions is at *www.irs.gov/form8814.***
▶ **Attach to parents' Form 1040 or Form 1040NR.**

OMB No. 1545-0074

2012

Attachment Sequence No. **40**

Name(s) shown on your return	**Your social security number**
Linda Parks	111-00-1111

Caution. The federal income tax on your child's income, including qualified dividends and capital gain distributions, may be less if you file a separate tax return for the child instead of making this election. This is because you cannot take certain tax benefits that your child could take on his or her own return. For details, see **Tax benefits you cannot take** in the instructions.

A Child's name (first, initial, and last)	**B Child's social security number**
Philip Parks	000-00-0000

C If more than one Form 8814 is attached, check here . . . . ▶ ☐

Part I Child's Interest and Dividends To Report on Your Return

1a	Enter your child's **taxable** interest. If this amount is different from the amounts shown on the child's Forms 1099-INT and 1099-OID, see the instructions			**1a**	1,650
b	Enter your child's **tax-exempt** interest. **Do not** include this amount on line 1a	**1b**			
2a	Enter your child's ordinary dividends, including any Alaska Permanent Fund dividends. If your child received any ordinary dividends as a nominee, see the instructions			**2a**	1,150
b	Enter your child's qualified dividends included on line 2a. See the instructions	**2b**	1,150		
3	Enter your child's capital gain distributions. If your child received any capital gain distributions as a nominee, see the instructions			**3**	
4	Add lines 1a, 2a, and 3. If the total is $1,900 or less, skip lines 5 through 12 and go to line 13. If the total is $9,500 or more, **do not** file this form. Your child **must** file his or her own return to report the income			**4**	2,800
5	Base amount			**5**	1,900 00
6	Subtract line 5 from line 4 . . . . **If both lines 2b and 3 are zero or blank, skip lines 7 through 10, enter -0- on line 11, and go to line 12. Otherwise, go to line 7.**			**6**	900
7	Divide line 2b by line 4. Enter the result as a decimal (rounded to at least three places)	**7**	.411		
8	Divide line 3 by line 4. Enter the result as a decimal (rounded to at least three places)	**8**	.		
9	Multiply line 6 by line 7. Enter the result here. See the instructions for where to report this amount on your return	**9**	370		
10	Multiply line 6 by line 8. Enter the result here. See the instructions for where to report this amount on your return	**10**			
11	Add lines 9 and 10			**11**	370
12	Subtract line 11 from line 6. Include this amount in the total on Form 1040, line 21, or Form 1040NR, line 21. In the space next to line 21, enter "Form 8814" and show the amount. If you checked the box on line C above, see the instructions. Go to line 13 below			**12**	530

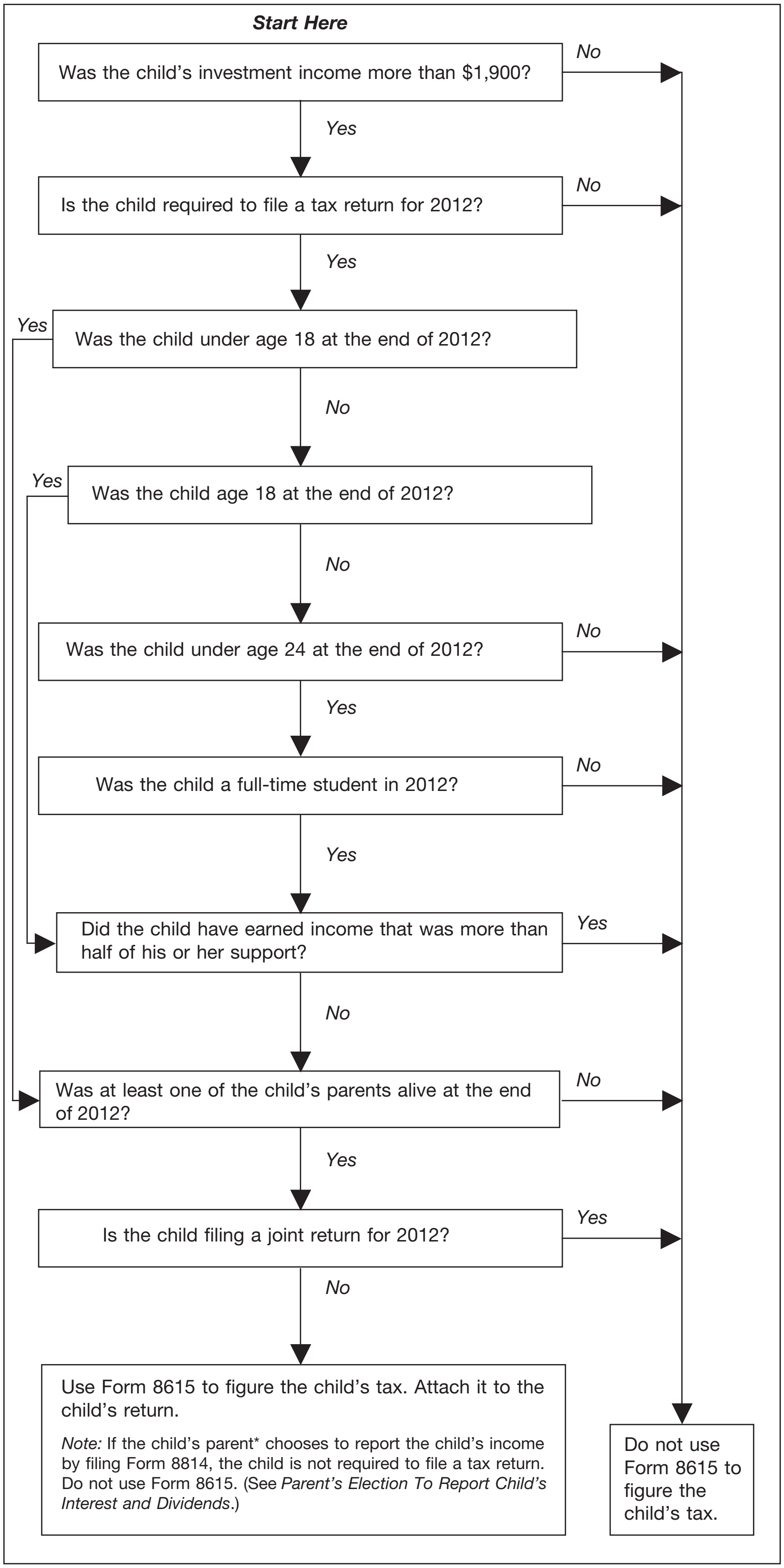
Part II Tax on the First $1,900 of Child's Interest and Dividends

13	Amount not taxed	**13**	950 00
14	Subtract line 13 from line 4. If the result is zero or less, enter -0-	**14**	1,850
15	**Tax.** Is the amount on line 14 less than $950? ☑ **No.** Enter $95 here and see the **Note** below. ☐ **Yes.** Multiply line 14 by 10% (.10). Enter the result here and see the **Note** below. . . .	**15**	95

Note. If you checked the box on line C above, see the instructions. Otherwise, include the amount from line 15 in the tax you enter on Form 1040, line 44, or Form 1040NR, line 42. Be sure to check box **a** on Form 1040, line 44, or Form 1040NR, line 42.

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 10750J Form **8814** (2012)

Figure 30-B. Do You Have To Use Form 8615 To Figure Your Child's Tax?



*See *Which Parent's Return To Use*

Tax for Certain Children Who Have Investment Income of More Than $1,900

If a child's interest, dividends, and other investment income total more than $1,900, part of that income may be taxed at the parent's tax rate instead of the child's tax rate. If the parent does not or cannot choose to include the child's income on the parent's return, use Form 8615 to figure the child's tax. Attach the completed form to the child's Form 1040 or Form 1040A.

When Form 8615 must be filed. Form 8615 must be filed for a child if all of the following statements are true.

1. The child's investment income was more than $1,900.
2. The child is required to file a return for 2012.
3. The child either:
   a. Was under age 18 at the end of the year,
   b. Was age 18 at the end of the year and did not have earned income that was more than half of his or her support, or
   c. Was over age 18 and under age 24 at the end of the year, was a full-time student, and did not have earned income that was more than half of his or her support.
4. At least one of the child's parents was alive at the end of 2012.
5. The child does not file a joint return for 2012.

These conditions are also shown in Figure 30-B.

Earned income. Earned income includes salaries, wages, tips, and other payments received for personal services performed. It does not include investment income as defined later in this chapter.

Support. Your child's support includes all amounts spent to provide the child with food, lodging, clothing, education, medical and dental care, recreation, transportation, and similar necessities. To figure your child's support, count support provided by you, your child, and others. However, a scholarship received by your child is not considered support if your child is a full-time student. See chapter 3 for details about support.

Certain January 1 birthdays. Use the following chart to determine whether certain children with January 1 birthdays meet condition 3 under *When Form 8615 must be filed.*

IF a child was born on...	THEN, at the end of 2012, the child is considered to be...
January 1, 1995	18*
January 1, 1994	19**
January 1, 1989	24***

*This child is not **under** age 18. The child meets condition 3 only if the child did not have earned income that was more than half of the child's support.
**This child meets condition 3 only if the child was a full-time student who did not have earned income that was more than half of the child's support.
***Do not use Form 8615 for this child.

Providing Parental Information (Form 8615, lines A–C)

On Form 8615, lines A and B, enter the parent's name and social security number. (If the parents filed a joint return, enter the name and social security number listed first on the joint return.) On line C, check the box for the parent's filing status.

See Which Parent's Return To Use at the beginning of this chapter for information on which parent's return information must be used on Form 8615.

Parent with different tax year. If the parent and the child do not have the same tax year, complete Form 8615 using the information on the parent's return for the tax year that ends in the child's tax year.

Parent's return information not known timely. If the information needed from the parent's return is not known by the time the child's return is due (usually April 15), you can file the return using estimates.

You can use any reasonable estimate. This includes using information from last year's return. If you use an estimated amount on Form 8615, enter "Estimated" on the line next to the amount.

When you get the correct information, file an amended return on Form 1040X, Amended U.S. Individual Income Tax Return.

Instead of using estimates, you can get an automatic 6-month extension of time to file if, by the date your return is due, you file Form 4868, Application for Automatic Extension of Time To File U.S. Individual Income Tax Return. Extensions are discussed in chapter 1.

Step 1. Figuring the Child's Net Investment Income (Form 8615, Part I)

The first step in figuring a child's tax using Form 8615 is to figure the child's net investment income. To do that, use Form 8615, Part I.

Line 1 (investment income). If the child had no earned income, enter on this line the adjusted gross income shown on the child's return. Adjusted gross income is shown on Form 1040, line 38, or Form 1040A, line 22. Form 1040EZ cannot be used if Form 8615 must be filed.

If the child had earned income, figure the amount to enter on Form 8615, line 1, by using the worksheet in the instructions for the form.

However, if the child has:

- excluded any foreign earned income,
- deducted either a loss from self-employment, or
- deducted a net operating loss from another year,

then use the Alternate Worksheet for Form 8615, Line 1, in Publication 929 to figure the amount to enter on Form 8615, line 1.

Investment income defined. Investment income is generally all income other than salaries, wages, and other amounts received as pay for work actually done. It includes taxable interest, dividends (including capital gain distributions), capital gains, unemployment compensation, the taxable part of social security and pension payments, and certain distributions from trusts. Investment income includes amounts produced by assets the child obtained with earned income (such as interest on a savings account into which the child deposited wages).

Nontaxable income. For this purpose, investment income includes only amounts the child must include in total income. Nontaxable investment income, such as tax-exempt interest and the nontaxable part of social security and pension payments, is not included.

Income from property received as a gift. A child's investment income includes all income produced by property belonging to the child. This is true even if the property was transferred to the child, regardless of when the property was transferred or purchased or who transferred it.

A child's investment income includes income produced by property given as a gift to the child. This includes gifts to the child from grandparents or any other person and gifts made under the Uniform Gift to Minors Act.

Example. Amanda Black, age 13, received the following income.

- Dividends — $600
- Wages — $2,100
- Taxable interest — $1,200
- Tax-exempt interest — $100
- Net capital gains — $100

The dividends were qualified dividends on stock given to her by her grandparents.

Amanda's investment income is $1,900. This is the total of the dividends ($600), taxable interest ($1,200), and net capital gains ($100). Her wages are earned (not investment) income because they are received for work actually done. Her tax-exempt interest is not included because it is nontaxable.

Trust income. If a child is the beneficiary of a trust, distributions of taxable interest, dividends, capital gains, and other investment income from the trust are investment income to the child.

However, for purposes of completing Form 8615, a taxable distribution from a qualified disability trust is considered earned income, not investment income.

Line 2 (deductions). If the child does not itemize deductions on Schedule A (Form 1040), enter $1,900 on line 2.

If the child does itemize deductions, enter on line 2 the larger of:

1. $950 plus the portion of the child's itemized deductions on Schedule A (Form 1040), line 29, that are directly connected with the production of investment income entered on line 1, or
2. $1,900.

Directly connected. Itemized deductions are directly connected with the production of investment income if they are for expenses paid to produce or collect taxable income or to manage, conserve, or maintain property held for producing income. These expenses include custodian fees and service charges, service fees to collect taxable interest and dividends, and certain investment counsel fees.

These expenses are added to certain other miscellaneous itemized deductions on Schedule A (Form 1040). Only the amount greater than 2% of the child's adjusted gross income can be deducted. See chapter 28 for more information.

Example 1. Roger, age 12, has investment income of $8,000, no other income, no adjustments to income, and itemized deductions of $300 (net of the 2% limit) that are directly connected with his investment income. His adjusted gross income is $8,000, which is entered on Form 1040, line 38, and on Form 8615, line 1. Roger enters $1,900 on line 2 because that is more than the total of $950 plus his directly connected itemized deductions of $300.

Example 2. Eleanor, age 8, has investment income of $16,000 and an early withdrawal penalty of $100. She has no other income. She has itemized deductions of $1,050 (net of the 2% limit) that are directly connected with the production of her investment income. Her adjusted gross income, entered on line 1, is $15,900 ($16,000 − $100). The amount on line 2 is $2,000. This is the larger of:

1. $950 plus the $1,050 of directly connected itemized deductions, or
2. $1,900.

Line 3. Subtract line 2 from line 1 and enter the result on this line. If zero or less, do not complete the rest of the form. However, you must still attach Form 8615 to the child's tax return. Figure the tax on the child's taxable income in the normal manner.

Line 4 (child's taxable income). Enter on line 4 the child's taxable income from Form 1040, line 43, or Form 1040A, line 27.

However, if the child files Form 2555 or 2555-EZ to claim the foreign earned income exclusion, housing exclusion, or housing deduction, see the Form 8615 instructions or Pub. 929.

Line 5 (net investment income). A child's net investment income cannot be more than his or her taxable income. Enter on Form 8615, line 5, the smaller of line 3 or line 4. This is the child's net investment income.

If zero or less, do not complete the rest of the form. However, you must still attach Form 8615 to the child's tax return. Figure the tax on the child's taxable income in the normal manner.

Step 2. Figuring Tentative Tax at the Parent's Tax Rate (Form 8615, Part II)

The next step in completing Form 8615 is to figure a tentative tax on the child's net investment income at the parent's tax rate. The tentative tax at the parent's tax rate is the difference between the tax on the parent's taxable income figured with the child's net investment income (plus the net investment income of any other child whose Form 8615 includes the tax return information of that parent) and the tax figured without it.

When figuring the tentative tax at the parent's tax rate on Form 8615, do not refigure any of the exclusions, deductions, or credits on the parent's return because of the child's net investment income. For example, do not refigure the medical expense deduction.

Figure the tentative tax on Form 8615, lines 6 through 13.

Note. If the child or parent has any capital gains or losses, get Publication 929 for help in completing Form 8615, Part II.

Line 6 (parent's taxable income). Enter on line 6 the parent's taxable income from Form 1040, line 43, or Form 1040A, line 27.

If the Foreign Earned Income Tax Worksheet (in the Form 1040 instructions) was used to figure the parent's tax, enter the amount from line 3 of that worksheet instead of the parent's taxable income.

Line 7 (net investment income of other children). If the tax return information of the parent is also used on any other child's Form 8615, enter on line 7 the total of the amounts from line 5 of all the other children's Forms 8615. Do not include the amount from line 5 of the Form 8615 being completed.

Example. Paul and Jane Persimmon have three children, Sharon, Jerry, and Mike, who must attach Form 8615 to their tax returns. The children's net investment income amounts on line 5 of their Forms 8615 are:

- Sharon — $800
- Jerry — $600
- Mike — $1,000

Line 7 of Sharon's Form 8615 will show $1,600, the total of the amounts on line 5 of Jerry's and Mike's Forms 8615.

Line 7 of Jerry's Form 8615 will show $1,800 ($800 + $1,000).

Line 7 of Mike's Form 8615 will show $1,400 ($800 + $600).

Other children's information not available. If the net investment income of the other children is not available when the return is due, either file the return using estimates or get an extension of time to file. See *Parent's return information not known timely*, earlier.

Line 11 (tentative tax). Subtract line 10 from line 9 and enter the result on this line. This is the tentative tax.

If line 7 is blank, skip lines 12a and 12b and enter the amount from line 11 on line 13. Also skip the discussion for lines 12a and 12b that follows.

Lines 12a and 12b (dividing the tentative tax). If an amount is entered on line 7, divide the tentative tax shown on line 11 among the children according to each child's share of the total net investment income. This is done on lines 12a, 12b, and 13. Add the amount on line 7 to the amount on line 5 and enter the total on line 12a. Divide the amount on line 5 by the amount on line 12a and enter the result, as a decimal, on line 12b.

Example. In the earlier example under *Line 7 (net investment income of other children),* Sharon's Form 8615 shows $1,600 on line 7. The amount entered on line 12a is $2,400, the total of the amounts on lines 5 and 7 ($800 + $1,600). The decimal on line 12b is .333, figured as follows and rounded to three places.

$$\frac{\$800}{\$2,400} = .333$$

Step 3. Figuring the Child's Tax (Form 8615, Part III)

The final step in figuring a child's tax using Form 8615 is to determine the larger of:

1. The total of:
   a. The child's share of the tentative tax based on the parent's tax rate, plus
   b. The tax on the child's taxable income in excess of net investment income, figured at the child's tax rate, or
2. The tax on the child's taxable income, figured at the child's tax rate.

This is the child's tax. It is figured on Form 8615, lines 14 through 18.

Alternative minimum tax. A child may be subject to alternative minimum tax (AMT) if he or she has certain items given preferential treatment under the tax law. See *Alternative Minimum Tax (AMT)* in chapter 29.

For more information on who is liable for AMT and how to figure it, see Form 6251, Alternative Minimum Tax—Individuals. For information on special limits that apply to a child who files Form 6251, see *Certain Children Under Age 24* in the Instructions for Form 6251.

Illustrated Example

The following example includes a completed Form 8615. Form 1040A is not shown.

John and Laura Brown have one child, Sara. She is 13 and has $2,800 taxable interest income and $1,500 earned income. She does not itemize deductions. John and Laura file a joint return with John's name and social security number listed first. They claim three exemptions, including an exemption for Sara, on their return.

Because Sara is under age 18 and has more than $1,900 investment income, part of her income may be subject to tax at her parents' rate. A completed Form 8615 must be attached to her return.

Sara's father, John, fills out Sara's return for her. He completes her Form 1040A through line 27, then begins completing her Form 8615.

John enters his name and social security number on Sara's Form 8615 because his name and number are listed first on the joint return he and Laura are filing. He checks the box for married filing jointly.

He enters Sara's investment income, $2,800, on line 1. Sara does not itemize deductions, so John enters $1,900 on line 2. He enters $900 ($2,800 – $1,900) on line 3.

Sara's taxable income on her Form 1040A, line 27, is $2,500. This is her total income ($4,300) minus her standard deduction ($1,800). Her standard deduction is limited to the amount of her earned income plus $300. John enters $2,500 on line 4.

John compares lines 3 and 4 and enters the smaller amount, $900, on line 5.

John enters $48,000 on line 6. This is the taxable income from line 43 of John and Laura's joint Form 1040 return. Sara is an only child, so line 7 is blank. He adds line 5 ($900), line 6 ($48,000), and line 7 (blank), and enters $48,900 on line 8.

Using the column for married filing jointly in the Tax Table, John finds the tax on $48,900. He enters the tax, $6,469, on line 9. He enters $6,334 on line 10. This is the tax from line 44 of John and Laura's Form 1040. He enters $135 on line 11 ($6,469 – $6,334).

Because line 7 is blank, John skips lines 12a and 12b and enters $135 on line 13.

John subtracts line 5 ($900) from line 4 ($2,500) and enters the result, $1,600, on line 14. Using the column for single filing status in the Tax Table, John finds the tax on $1,600 and enters this tax, $161, on line 15. He adds lines 13 ($135) and 15 ($161) and enters $296 on line 16.

Using the column for single filing status in the Tax Table, John finds the tax on $2,500 (line 4) and enters this tax, $251, on line 17.

John compares lines 16 and 17 and enters the larger amount, $296, on line 18 of Sara's Form 8615. He also enters that amount on line 28 of Sara's Form 1040A.

John also completes Schedule B (Form 1040A or 1040) for Sara.

Form **8615**

Department of the Treasury
Internal Revenue Service (99)

Tax for Certain Children Who Have Investment Income of More Than $1,900

▶ **Attach only to the child's Form 1040, Form 1040A, or Form 1040NR.**
▶ **Information about Form 8615 and its separate instructions is at *www.irs.gov/form8615*.**

OMB No. 1545-0074
2012
Attachment Sequence No. **33**

Child's name shown on return	**Child's social security number**
Sara L. Brown	117-00-1111

Before you begin: If the child, the parent, or any of the parent's other children for whom Form 8615 must be filed must use the Schedule D Tax Worksheet or has income from farming or fishing, see **Pub. 929,** Tax Rules for Children and Dependents. It explains how to figure the child's tax using the **Schedule D Tax Worksheet** or **Schedule J** (Form 1040).

A Parent's name (first, initial, and last). **Caution:** *See instructions before completing.*	**B Parent's social security number**
John J. Brown	007-00-0001

C Parent's filing status (check one):
☐ Single ☑ Married filing jointly ☐ Married filing separately ☐ Head of household ☐ Qualifying widow(er)

Part I Child's Net Investment Income

1	Enter the child's investment income (see instructions)	**1**	2,800
2	If the child **did not** itemize deductions on **Schedule A** (Form 1040 or Form 1040NR), enter $1,900. Otherwise, see instructions	**2**	1,900
3	Subtract line 2 from line 1. If zero or less, **stop;** do not complete the rest of this form but **do** attach it to the child's return	**3**	900
4	Enter the child's **taxable income** from Form 1040, line 43; Form 1040A, line 27; or Form 1040NR, line 41. If the child files Form 2555 or 2555-EZ, see the instructions	**4**	2,500
5	Enter the **smaller** of line 3 or line 4. If zero, **stop;** do not complete the rest of this form but **do** attach it to the child's return	**5**	900

Part II Tentative Tax Based on the Tax Rate of the Parent

6	Enter the parent's **taxable income** from Form 1040, line 43; Form 1040A, line 27; Form 1040EZ, line 6; Form 1040NR, line 41; or Form 1040NR-EZ, line 14. If zero or less, enter -0-. If the parent files Form 2555 or 2555-EZ, see the instructions	**6**	48,000
7	Enter the total, if any, from Forms 8615, line 5, of **all other** children of the parent named above. **Do not** include the amount from line 5 above	**7**	
8	Add lines 5, 6, and 7 (see instructions)	**8**	48,900
9	Enter the tax on the amount on line 8 based on the **parent's** filing status above (see instructions). If the Qualified Dividends and Capital Gain Tax Worksheet, Schedule D Tax Worksheet, or Schedule J (Form 1040) is used to figure the tax, check here ▶ ☐	**9**	6,469
10	Enter the parent's tax from Form 1040, line 44; Form 1040A, line 28, minus any alternative minimum tax; Form 1040EZ, line 10; Form 1040NR, line 42; or Form 1040NR-EZ, line 15. **Do not** include any tax from **Form 4972** or **8814** or any tax from recapture of an education credit. If the parent files Form 2555 or 2555-EZ, see the instructions. If the Qualified Dividends and Capital Gain Tax Worksheet, Schedule D Tax Worksheet, or Schedule J (Form 1040) was used to figure the tax, check here ▶ ☐	**10**	6,334
11	Subtract line 10 from line 9 and enter the result. If line 7 is blank, also enter this amount on line 13 and go to **Part III**	**11**	135
12a	Add lines 5 and 7 — **12a**		
b	Divide line 5 by line 12a. Enter the result as a decimal (rounded to at least three places)	**12b**	× .
13	Multiply line 11 by line 12b	**13**	135

Part III Child's Tax—If lines 4 and 5 above are the same, enter -0- on line 15 and go to line 16.

14	Subtract line 5 from line 4 — **14** 1,600		
15	Enter the tax on the amount on line 14 based on the **child's** filing status (see instructions). If the Qualified Dividends and Capital Gain Tax Worksheet, Schedule D Tax Worksheet, or Schedule J (Form 1040) is used to figure the tax, check here ▶ ☐	**15**	161
16	Add lines 13 and 15	**16**	296
17	Enter the tax on the amount on line 4 based on the **child's** filing status (see instructions). If the Qualified Dividends and Capital Gain Tax Worksheet, Schedule D Tax Worksheet, or Schedule J (Form 1040) is used to figure the tax, check here ▶ ☐	**17**	251
18	Enter the **larger** of line 16 or line 17 here and on the **child's** Form 1040, line 44; Form 1040A, line 28; or Form 1040NR, line 42. If the child files Form 2555 or 2555-EZ, see the instructions	**18**	296

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 64113U Form **8615** (2012)

31.

Child and Dependent Care Credit

Reminders

Taxpayer identification number needed for each qualifying person. You must include on line 2 of Form 2441 the name and taxpayer identification number (generally the social security number) of each qualifying person. See *Taxpayer identification number* under *Qualifying Person Test*, later.

You may have to pay employment taxes. If you pay someone to come to your home and care for your dependent or spouse, you may be a household employer who has to pay employment taxes. Usually, you are not a household employer if the person who cares for your dependent or spouse does so at his or her home or place of business. See *Employment Taxes for Household Employers*, later.

Introduction

This chapter discusses the credit for child and dependent care expenses and covers the following topics.

- Tests you must meet to claim the credit.
- How to figure the credit.
- How to claim the credit.
- Employment taxes you may have to pay as a household employer.

You may be able to claim the credit if you pay someone to care for your dependent who is under age 13 or for your spouse or dependent who is not able to care for himself or herself. The credit can be up to 35% of your expenses. To qualify, you must pay these expenses so you can work or look for work.

CAUTION *This credit should not be confused with the child tax credit discussed in chapter 33.*

Dependent care benefits. If you received any dependent care benefits from your employer during the year, you may be able to exclude from your income all or part of them. You must complete Form 2441, Part III before you can figure the amount of your credit. See *Dependent Care Benefits* under *How To Figure the Credit*, later.

Useful Items

You may want to see:

Publication

- ❑ **501** Exemptions, Standard Deduction, and Filing Information
- ❑ **503** Child and Dependent Care Expenses
- ❑ **926** Household Employer's Tax Guide

Form (and Instructions)

- ❑ **2441** Child and Dependent Care Expenses
- ❑ **Schedule H (Form 1040)** Household Employment Taxes
- ❑ **W-7** Application for IRS Individual Taxpayer Identification Number
- ❑ **W-10** Dependent Care Provider's Identification and Certification

Tests To Claim the Credit

To be able to claim the credit for child and dependent care expenses, you must file Form 1040 or Form 1040A, not Form 1040EZ, and meet all the following tests.

1. The care must be for one or more qualifying persons who are identified on the form you use to claim the credit. (See *Qualifying Person Test*.)
2. You (and your spouse if filing jointly) must have earned income during the year. (However, see *Rule for student-spouse or spouse not able to care for self* under *Earned Income Test*, later.)
3. You must pay child and dependent care expenses so you (and your spouse if filing jointly) can work or look for work. (See *Work-Related Expense Test*, later.)
4. You must make payments for child and dependent care to someone you (and your spouse) cannot claim as a dependent. If you make payments to your child, he or she cannot be your dependent and must be age 19 or older by the end of the year. You cannot make payments to:
   a. Your spouse, or
   b. The parent of your qualifying person if your qualifying person is your child and under age 13.

   (See *Payments to Relatives or Dependents* under *Work-Related Expense Test*, later.)
5. Your filing status may be single, head of household, or qualifying widow(er) with dependent child. If you are married, you must file a joint return, unless an exception applies to you. (See *Joint Return Test*, later.)
6. You must identify the care provider on your tax return. (See *Provider Identification Test*, later.)
7. If you exclude or deduct dependent care benefits provided by a dependent care benefits plan, the total amount you exclude or deduct must be less than the dollar limit for qualifying expenses (generally, $3,000 if one qualifying person was cared for or $6,000 if two or more qualifying persons were cared for). (If two or more qualifying persons were cared for, the amount you exclude or deduct will always be less than the dollar limit, since the total amount you can exclude or deduct is limited to $5,000. See *Reduced Dollar Limit* under *How To Figure the Credit*, later.)

These tests are presented in Figure 31-A and are also explained in detail in this chapter.

Qualifying Person Test

Your child and dependent care expenses must be for the care of one or more qualifying persons.

A qualifying person is:

1. Your qualifying child who is your dependent and who was under age 13 when the care was provided (but see *Note* later),
2. Your spouse who was not physically or mentally able to care for himself or herself and lived with you for more than half the year, or
3. A person who was not physically or mentally able to care for himself or herself, lived with you for more than half the year, and either:
   a. Was your dependent, or
   b. Would have been your dependent except that:
      i. He or she received gross income of $3,800 or more,
      ii. He or she filed a joint return, or
      iii. You, or your spouse if filing jointly, could be claimed as a dependent on someone else's 2012 return.

Note. If you are divorced or separated, see *Child of divorced or separated parents or parents living apart*, later, to determine which parent may treat the child as a qualifying person.

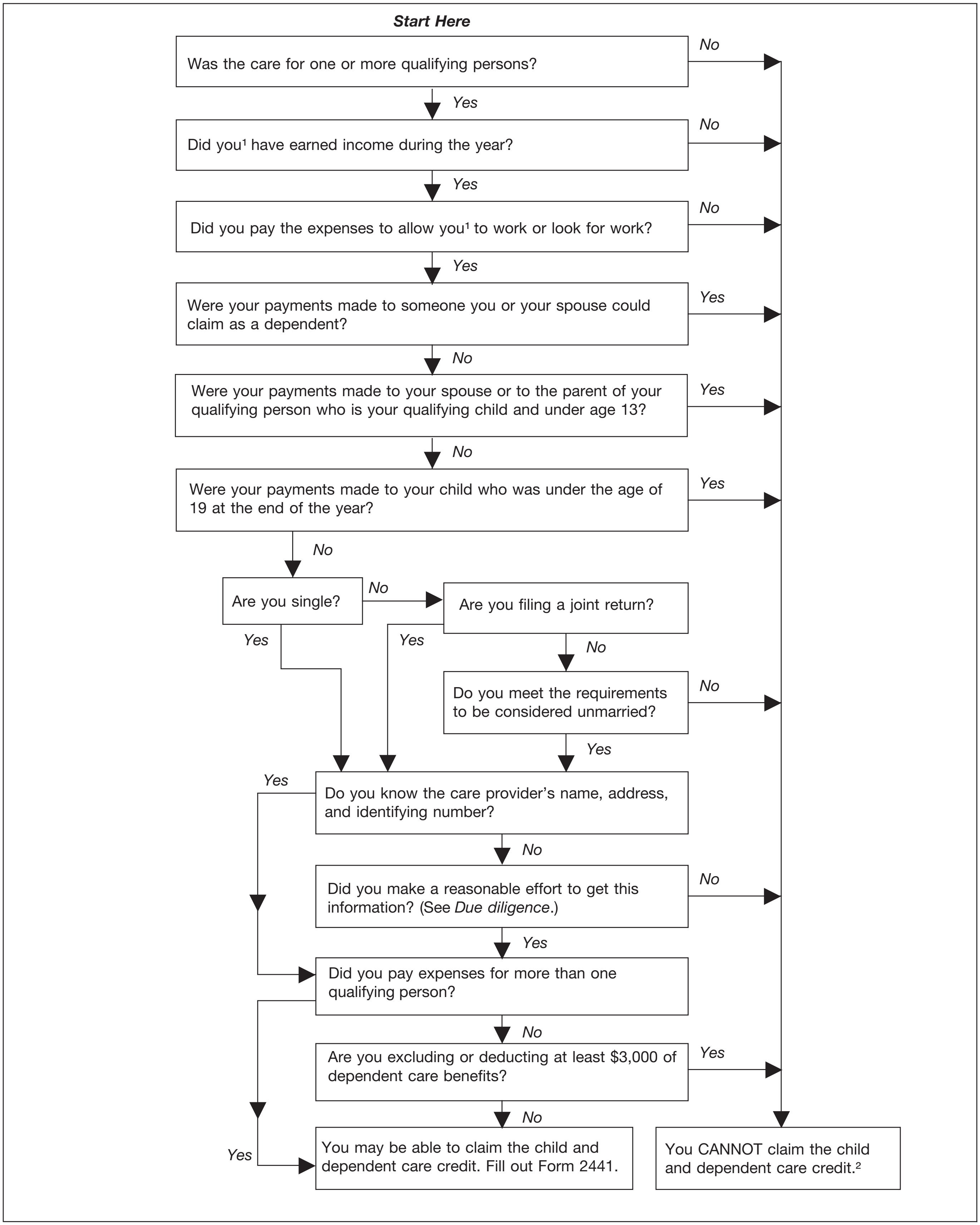
Dependent defined. A dependent is a person, other than you or your spouse, for whom you can claim an exemption. To be your dependent, a person must be your qualifying child (or your qualifying relative).

Qualifying child. To be your qualifying child, a child must live with you for more than half the year and meet other requirements.

More information. For more information about who is a dependent or a qualifying child, see chapter 3.

Physically or mentally not able to care for oneself. Persons who cannot dress, clean, or feed themselves because of physical or mental problems are considered not able to care for themselves. Also, persons who must have constant attention to prevent them from injuring themselves or others are considered not able to care for themselves.

Figure 31-A. Can You Claim the Credit?



[1] This also applies to your spouse, unless your spouse was disabled or a full-time student

[2] If you had expenses that met the requirements for 2011, except that you did not pay them until 2012, you may be able to claim those expenses in 2012. See *Expenses not paid until the following year* under *How To Figure the Credit.*

Person qualifying for part of year. You determine a person's qualifying status each day. For example, if the person for whom you pay child and dependent care expenses no longer qualifies on September 16, count only those expenses through September 15. Also see *Yearly Limit* under *Dollar Limit*, later.

Birth or death of otherwise qualifying person. In determining whether a person is a qualifying person, a person who was born or died in 2012 is treated as having lived with you for more than half of 2012 if your home was the person's home for more than half the time he or she was alive in 2012.

Taxpayer identification number. You must include on your return the name and taxpayer identification number (generally the social security number) of the qualifying person(s). If the correct information is not shown, the credit may be reduced or disallowed.

Individual taxpayer identification number (ITIN) for aliens. If your qualifying person is a nonresident or resident alien who does not have and cannot get a social security number (SSN), use that person's ITIN. The ITIN is entered wherever an SSN is requested on a tax return. To apply for an ITIN, see Form W-7.

An ITIN is for tax use only. It does not entitle the holder to social security benefits or change the holder's employment or immigration status under U.S. law.

Adoption taxpayer identification number (ATIN). If your qualifying person is a child who was placed in your home for adoption and for whom you do not have an SSN, you must get an ATIN for the child. File Form W-7A, Application for Taxpayer Identification Number for Pending U.S. Adoptions.

Child of divorced or separated parents or parents living apart. Even if you cannot claim your child as a dependent, he or she is treated as your qualifying person if:

- The child was under age 13 or was not physically or mentally able to care for himself or herself,
- The child received over half of his or her support during the calendar year from one or both parents who are divorced or legally separated under a decree of divorce or separate maintenance, are separated under a written separation agreement, or lived apart at all times during the last 6 months of the calendar year,
- The child was in the custody of one or both parents for more than half the year, and
- You were the child's custodial parent.

The custodial parent is the parent with whom the child lived for the greater number of nights in 2012. If the child was with each parent for an equal number of nights, the custodial parent is the parent with the higher adjusted gross income. For details and an exception for a parent who works at night, see Pub. 501.

The noncustodial parent cannot treat the child as a qualifying person even if that parent is entitled to claim the child as a dependent under the special rules for a child of divorced or separated parents.

Earned Income Test

To claim the credit, you (and your spouse if filing jointly) must have earned income during the year.

Earned income. Earned income includes wages, salaries, tips, other taxable employee compensation, and net earnings from self-employment. A net loss from self-employment reduces earned income. Earned income also includes strike benefits and any disability pay you report as wages.

Generally, only taxable compensation is included. However, you can elect to include nontaxable combat pay in earned income. If you are filing a joint return and both you and your spouse received nontaxable combat pay, you can each make your own election. You should figure your credit both ways and make the election if it gives you a greater tax benefit.

Members of certain religious faiths opposed to social security. Certain income earned by persons who are members of certain religious faiths that are opposed to participation in Social Security Act programs and have an IRS-approved form that exempts certain income from social security and Medicare taxes may not be considered earned income for this purpose. See *Earned Income Test* in Publication 503.

Not earned income. Earned income does not include:

- Pensions and annuities,
- Social security and railroad retirement benefits,
- Workers' compensation,
- Interest and dividends,
- Unemployment compensation,
- Scholarship or fellowship grants, except for those reported on a Form W-2 and paid to you for teaching or other services,
- Nontaxable workfare payments,
- Child support payments received by you,
- Income of nonresident aliens that is not effectively connected with a U.S. trade or business, or
- Any amount received for work while an inmate in a penal institution.

Rule for student-spouse or spouse not able to care for self. Your spouse is treated as having earned income for any month that he or she is:

1. A full-time student, or
2. Physically or mentally not able to care for himself or herself. (Your spouse also must live with you for more than half the year.)

Figure the earned income of the nonworking spouse described under (1) or (2) above as explained under *Earned Income Limit*, later.

This rule applies to only one spouse for any one month. If, in the same month, both you and your spouse do not work and are either full-time students or not physically or mentally able to care for yourselves, only one of you can be treated as having earned income in that month.

Full-time student. You are a full-time student if you are enrolled at a school for the number of hours or classes that the school considers full time. You must have been a full-time student for some part of each of 5 calendar months during the year. (The months need not be consecutive.)

School. The term “school” includes high schools, colleges, universities, and technical, trade, and mechanical schools. A school does not include an on-the-job training course, correspondence school, or school offering courses only through the Internet.

Work-Related Expense Test

Child and dependent care expenses must be work-related to qualify for the credit. Expenses are considered work-related only if both of the following are true.

- They allow you (and your spouse if filing jointly) to work or look for work.
- They are for a qualifying person's care.

Working or Looking for Work

To be work-related, your expenses must allow you to work or look for work. If you are married, generally both you and your spouse must work or look for work. Your spouse is treated as working during any month he or she is a full-time student or is not physically or mentally able to care for himself or herself.

Your work can be for others or in your own business or partnership. It can be either full time or part time.

Work also includes actively looking for work. However, if you do not find a job and have no earned income for the year, you cannot take this credit. See *Earned Income Test*, earlier.

An expense is not considered work-related merely because you had it while you were working. The purpose of the expense must be to allow you to work. Whether your expenses allow you to work or look for work depends on the facts.

Example 1. The cost of a babysitter while you and your spouse go out to eat is not normally a work-related expense.

Example 2. You work during the day. Your spouse works at night and sleeps during the day. You pay for care of your 5-year-old child during the hours when you are working and your spouse is sleeping. Your expenses are considered work-related.

Volunteer work. For this purpose, you are not considered to be working if you do unpaid volunteer work or volunteer work for a nominal salary.

Work for part of year. If you work or actively look for work during only part of the period covered by the expenses, then you must figure your expenses for each day. For example, if you work all year and pay care expenses of

$250 a month ($3,000 for the year), all the expenses are work-related. However, if you work or look for work for only 2 months and 15 days during the year and pay expenses of $250 a month, your work-related expenses are limited to $625 (2½ months × $250).

Temporary absence from work. You do not have to figure your expenses for each day during a short, temporary absence from work, such as for vacation or a minor illness, if you have to pay for care anyway. Instead, you can figure your credit including the expenses you paid for the period of absence.

An absence of 2 weeks or less is a short, temporary absence. An absence of more than 2 weeks may be considered a short, temporary absence, depending on the circumstances.

Example. You pay a nanny to care for your 2-year-old son and 4-year-old daughter so you can work. You become ill and miss 4 months of work but receive sick pay. You continue to pay the nanny to care for the children while you are ill. Your absence is not a short, temporary absence, and your expenses are not considered work-related.

Part-time work. If you work part-time, you generally must figure your expenses for each day. However, if you have to pay for care weekly, monthly, or in another way that includes both days worked and days not worked, you can figure your credit including the expenses you paid for days you did not work. Any day when you work at least 1 hour is a day of work.

Example 1. You work 3 days a week. While you work, your 6-year-old child attends a dependent care center, which complies with all state and local regulations. You can pay the center $150 for any 3 days a week or $250 for 5 days a week. Your child attends the center 5 days a week. Your work-related expenses are limited to $150 a week.

Example 2. The facts are the same as in *Example 1* except the center does not offer a 3-day option. The entire $250 weekly fee may be a work-related expense.

Care of a Qualifying Person

To be work-related, your expenses must be to provide care for a qualifying person.

You do not have to choose the least expensive way of providing care. The cost of a paid care provider may be an expense for the care of a qualifying person even if another care provider is available at no cost.

Expenses are for the care of a qualifying person only if their main purpose is the person's well-being and protection.

Expenses for household services qualify if part of the services is for the care of qualifying persons. See *Household services*, later.

Expenses not for care. Expenses for care do not include amounts you pay for food, lodging, clothing, education, and entertainment. However, you can include small amounts paid for these items if they are incidental to and cannot be separated from the cost of caring for the qualifying person.

Education. Expenses for a child in nursery school, preschool, or similar programs for children below the level of kindergarten are expenses for care. Expenses to attend kindergarten or a higher grade are not expenses for care. Do not use these expenses to figure your credit.

However, expenses for before- or after-school care of a child in kindergarten or a higher grade may be expenses for care.

Summer school and tutoring programs are not for care.

Example 1. You take your 3-year-old child to a nursery school that provides lunch and educational activities as a part of its preschool childcare service. The lunch and educational activities are incidental to the childcare, and their cost cannot be separated from the cost of care. You can count the total cost when you figure the credit.

Example 2. You place your 10-year-old child in a boarding school so you can work full time. Only the part of the boarding school expense that is for the care of your child is a work-related expense. You can count that part of the expense in figuring your credit if it can be separated from the cost of education. You cannot count any part of the amount you pay the school for your child's education.

Care outside your home. You can count the cost of care provided outside your home if the care is for your dependent under age 13 or any other qualifying person who regularly spends at least 8 hours each day in your home.

Dependent care center. You can count care provided outside your home by a dependent care center only if the center complies with all state and local regulations that apply to these centers.

A dependent care center is a place that provides care for more than six persons (other than persons who live there) and receives a fee, payment, or grant for providing services for any of those persons, even if the center is not run for profit.

Camp. The cost of sending your child to an overnight camp is not considered a work-related expense. The cost of sending your child to a day camp may be a work-related expense, even if the camp specializes in a particular activity, such as computers or soccer.

Transportation. If a care provider takes a qualifying person to or from a place where care is provided, that transportation is for the care of the qualifying person. This includes transportation by bus, subway, taxi, or private car. However, transportation not provided by a care provider is not for the care of a qualifying person. Also, if you pay the transportation cost for the care provider to come to your home, that expense is not for care of a qualifying person.

Fees and deposits. Fees you paid to an agency to get the services of a care provider, deposits you paid to an agency or preschool, application fees, and other indirect expenses are work-related expenses if you have to pay them to get care, even though they are not directly for care. However, a forfeited deposit is not for the care of a qualifying person if care is not provided.

Example 1. You paid a fee to an agency to get the services of the nanny who cares for your 2-year-old daughter while you work. The fee you paid is a work-related expense.

Example 2. You placed a deposit with a preschool to reserve a place for your 3-year-old child. You later sent your child to a different preschool and forfeited the deposit. The forfeited deposit is not for care and so is not a work-related expense.

Household services. Expenses you pay for household services meet the work-related expense test if they are at least partly for the well-being and protection of a qualifying person.

Household services are ordinary and usual services done in and around your home that are necessary to run your home. They include the services of a housekeeper, maid, or cook. However, they do not include the services of a chauffeur, bartender, or gardener. See *Household Services* in Publication 503 for more information.

In this chapter, the term housekeeper refers to any household employee whose services include the care of a qualifying person.

Taxes paid on wages. The taxes you pay on wages for qualifying child and dependent care services are work-related expenses. See *Employment Taxes for Household Employers*, later.

Payments to Relatives or Dependents

You can count work-related payments you make to relatives who are not your dependents, even if they live in your home. However, do not count any amounts you pay to:

1. A dependent for whom you (or your spouse if filing jointly) can claim an exemption,
2. Your child who was under age 19 at the end of the year, even if he or she is not your dependent,
3. A person who was your spouse any time during the year, or
4. The parent of your qualifying person if your qualifying person is your child and under age 13.

Joint Return Test

Generally, married couples must file a joint return to take the credit. However, if you are legally separated or living apart from your spouse, you may be able to file a separate return and still take the credit.

Legally separated. You are not considered married if you are legally separated from your spouse under a decree of divorce or separate maintenance. You may be eligible to take the credit on your return using head of household filing status.

Married and living apart. You are not considered married and are eligible to take the credit if all the following apply.

1. You file a return apart from your spouse.

2. Your home is the home of a qualifying person for more than half the year.
3. You pay more than half the cost of keeping up your home for the year.
4. Your spouse does not live in your home for the last 6 months of the year.

Costs of keeping up a home. The costs of keeping up a home normally include property taxes, mortgage interest, rent, utility charges, home repairs, insurance on the home, and food eaten at home.

The costs of keeping up a home do not include payments for clothing, education, medical treatment, vacations, life insurance, transportation, or mortgage principal.

They also do not include the purchase, permanent improvement, or replacement of property. For example, you cannot include the cost of replacing a water heater. However, you can include the cost of repairing a water heater.

Death of spouse. If your spouse died during the year and you do not remarry before the end of the year, you generally must file a joint return to take the credit. If you do remarry before the end of the year, the credit can be claimed on your deceased spouse's return.

Provider Identification Test

You must identify all persons or organizations that provide care for your child or dependent. Use Form 2441, Part I to show the information.

Note. If you do not have any care providers and you are filing Form 2441 only to report taxable income in Part III, enter "none" in line 1, column (a).

Information needed. To identify the care provider, you must give the provider's:

1. Name,
2. Address, and
3. Taxpayer identification number.

If the care provider is an individual, the taxpayer identification number is his or her social security number or individual taxpayer identification number. If the care provider is an organization, then it is the employer identification number (EIN).

You do not have to show the taxpayer identification number if the care provider is a tax-exempt organization (such as a church or school). In this case, enter "Tax-Exempt" in the space where the tax form calls for the number.

If you cannot provide all of the information or if the information is incorrect, you must be able to show that you used due diligence (discussed later) in trying to furnish the necessary information.

Getting the information. You can use Form W-10 to request the required information from the care provider. If you do not use Form W-10, you can get the information from one of the other sources listed in the instructions for Form W-10 including:

1. A copy of the provider's social security card,
2. A copy of the provider's completed Form W-4 if he or she is your household employee,
3. A copy of the statement furnished by your employer if the provider is your employer's dependent care plan, or
4. A letter or invoice from the provider if it shows the information.

RECORDS You should keep this information with your tax records. Do not send Form W-10 (or other document containing this information) to the Internal Revenue Service.

Due diligence. If the care provider information you give is incorrect or incomplete, your credit may not be allowed. However, if you can show that you used due diligence in trying to supply the information, you can still claim the credit.

You can show due diligence by getting and keeping the provider's completed Form W-10 or one of the other sources of information listed earlier. Care providers can be penalized if they do not provide this information to you or if they provide incorrect information.

Provider refusal. If the provider refuses to give you their identifying information, you should report whatever information you have (such as the name and address) on the form you use to claim the credit. Enter "See Attached Statement" in the columns calling for the information you do not have. Then attach a statement explaining that you requested the information from the care provider, but the provider did not give you the information. Be sure to write your name and social security number on this statement. The statement will show that you used due diligence in trying to furnish the necessary information.

U.S. citizens and resident aliens living abroad. If you are living abroad, your care provider may not have, and may not be required to get, a U.S. taxpayer identification number (for example, an SSN or EIN). If so, enter "LAFCP" (Living Abroad Foreign Care Provider) in the space for the care provider's taxpayer identification number.

How To Figure the Credit

Your credit is a percentage of your work-related expenses. Your expenses are subject to the earned income limit and the dollar limit. The percentage is based on your adjusted gross income.

Figuring Total Work-Related Expenses

To figure the credit for 2012 work-related expenses, count only those you paid by December 31, 2012.

Expenses prepaid in an earlier year. If you pay for services before they are provided, you can count the prepaid expenses only in the year the care is received. Claim the expenses for the later year as if they were actually paid in that later year.

Expenses not paid until the following year. Do not count 2011 expenses that you paid in 2012 as work-related expenses for 2012. You may be able to claim an additional credit for them on your 2012 return, but you must figure it separately. See *Payments for prior year's expenses* under *Amount of Credit* in Publication 503.

TIP *If you had expenses in 2012 that you did not pay until 2013, you cannot count them when figuring your 2012 credit. You may be able to claim a credit for them on your 2013 return.*

Expenses reimbursed. If a state social services agency pays you a nontaxable amount to reimburse you for some of your child and dependent care expenses, you cannot count the expenses that are reimbursed as work-related expenses.

Example. You paid work-related expenses of $3,000. You are reimbursed $2,000 by a state social services agency. You can use only $1,000 to figure your credit.

Medical expenses. Some expenses for the care of qualifying persons who are not able to care for themselves may qualify as work-related expenses and also as medical expenses. You can use them either way, but you cannot use the same expenses to claim both a credit and a medical expense deduction.

If you use these expenses to figure the credit and they are more than the earned income limit or the dollar limit, discussed later, you can add the excess to your medical expenses. However, if you use your total expenses to figure your medical expense deduction, you cannot use any part of them to figure your credit.

CAUTION *Amounts excluded from your income under your employer's dependent care benefits plan cannot be used to claim a medical expense deduction.*

Dependent Care Benefits

If you receive dependent care benefits, your dollar limit for purposes of the credit may be reduced. See Reduced Dollar Limit, later. But, even if you cannot take the credit, you may be able to take an exclusion or deduction for the dependent care benefits.

Dependent care benefits. Dependent care benefits include:

1. Amounts your employer paid directly to either you or your care provider for the care of your qualifying person while you work,
2. The fair market value of care in a daycare facility provided or sponsored by your employer, and
3. Pre-tax contributions you made under a dependent care flexible spending arrangement.

Your salary may have been reduced to pay for these benefits. If you received benefits as an employee, they should be shown in box 10 of your Form W-2. See *Statement for employee*, later. Benefits you received as a partner should be shown in box 13 of your Schedule K-1 (Form 1065) with code O. Enter the amount of these benefits on Form 2441, Part III, line 12.

Exclusion or deduction. If your employer provides dependent care benefits under a qualified plan, you may be able to exclude these benefits from your income. Your employer can tell you whether your benefit plan qualifies. To claim the exclusion, you must complete Part III of Form 2441. You cannot use Form 1040EZ.

If you are self-employed and receive benefits from a qualified dependent care benefit plan, you are treated as both employer and employee. Therefore, you would not get an exclusion from wages. Instead, you would get a deduction on Form 1040, Schedule C, line 14; Schedule E, line 19 or 28; or Schedule F, line 15. To claim the deduction, you must use Form 2441.

The amount you can exclude or deduct is limited to the smallest of:

1. The total amount of dependent care benefits you received during the year,
2. The total amount of qualified expenses you incurred during the year,
3. Your earned income,
4. Your spouse's earned income, or
5. $5,000 ($2,500 if married filing separately).

The definition of earned income for the exclusion or deduction is the same as the definition used when figuring the credit except that earned income for the exclusion or deduction does not include any dependent care benefits you receive. See *Earned Income Limit,* later.

TIP *You can choose to include your nontaxable combat pay in earned income when figuring your exclusion or deduction, even if you choose not to include it in earned income for the earned income credit or the credit for child and dependent care expenses.*

Statement for employee. Your employer must give you a Form W-2 (or similar statement) showing in box 10 the total amount of dependent care benefits provided to you during the year under a qualified plan. Your employer will also include any dependent care benefits over $5,000 in your wages shown on your Form W-2 in box 1.

Effect of exclusion on credit. If you exclude dependent care benefits from your income, the amount of the excluded benefits:

1. Is not included in your work-related expenses, and
2. Reduces the dollar limit, discussed later.

Earned Income Limit

The amount of work-related expenses you use to figure your credit cannot be more than:

1. Your earned income for the year if you are single at the end of the year, or
2. The smaller of your or your spouse's earned income for the year if you are married at the end of the year.

Earned income is defined under *Earned Income Test*, earlier.

TIP *For purposes of item (2), use your spouse's earned income for the entire year, even if you were married for only part of the year.*

Separated spouse. If you are legally separated or married and living apart from your spouse (as described under *Joint Return Test*, earlier), you are not considered married for purposes of the earned income limit. Use only your income in figuring the earned income limit.

Surviving spouse. If your spouse died during the year and you file a joint return as a surviving spouse, you may, but are not required to, take into account the earned income of your spouse who died during the year.

Community property laws. You should disregard community property laws when you figure earned income for this credit.

Student-spouse or spouse not able to care for self. Your spouse who is either a full-time student or not able to care for himself or herself is treated as having earned income. His or her earned income for each month is considered to be at least $250 if there is one qualifying person in your home, or at least $500 if there are two or more.

Spouse works. If your spouse works during that month, use the higher of $250 (or $500) or his or her actual earned income for that month.

Spouse qualifies for part of month. If your spouse is a full-time student or not able to care for himself or herself for only part of a month, the full $250 (or $500) still applies for that month.

Both spouses qualify. If, in the same month, both you and your spouse are either full-time students or not able to care for yourselves, only one spouse can be considered to have this earned income of $250 (or $500) for that month.

Dollar Limit

There is a dollar limit on the amount of your work-related expenses you can use to figure the credit. This limit is $3,000 for one qualifying person, or $6,000 for two or more qualifying persons.

TIP *If you paid work-related expenses for the care of two or more qualifying persons, the applicable dollar limit is $6,000. This $6,000 limit does not need to be divided equally among them. For example, if your work-related expenses for the care of one qualifying person are $3,200 and your work-related expenses for another qualifying person are $2,800, you can use the total, $6,000, when figuring the credit.*

Yearly limit. The dollar limit is a yearly limit. The amount of the dollar limit remains the same no matter how long, during the year, you have a qualifying person in your household. Use the $3,000 limit if you paid work-related expenses for the care of one qualifying person at any time during the year. Use $6,000 if you paid work-related expenses for the care of more than one qualifying person at any time during the year.

Reduced Dollar Limit

If you received dependent care benefits that you exclude or deduct from your income, you must subtract that amount from the dollar limit that applies to you. Your reduced dollar limit is figured on Form 2441, Part III. See *Dependent Care Benefits*, earlier, for information on excluding or deducting these benefits.

Example 1. George is a widower with one child and earns $24,000 a year. He pays work-related expenses of $2,900 for the care of his 4-year-old child and qualifies to claim the credit for child and dependent care expenses. His employer pays an additional $1,000 under a dependent care benefit plan. This $1,000 is excluded from George's income.

Although the dollar limit for his work-related expenses is $3,000 (one qualifying person), George figures his credit on only $2,000 of the $2,900 work-related expenses he paid. This is because his dollar limit is reduced as shown next.

George's Reduced Dollar Limit

1)	Maximum allowable expenses for one qualifying person	$3,000
2)	Minus: Dependent care benefits George excludes from income	−1,000
3)	Reduced dollar limit on expenses George can use for the credit	$2,000

Example 2. Randall is married and both he and his wife are employed and each has earned income in excess of $6,000. They have two children, Anne and Andy, ages 2 and 4 who attend a daycare facility licensed and regulated by the state. Randall's work-related expenses are $6,000 for the year.

Randall's employer has a dependent care assistance program as part of its cafeteria plan, which allows employees to make pre-tax contributions to a dependent care flexible spending arrangement. Randall has elected to take the maximum $5,000 exclusion from his salary to cover dependent care expenses through this program.

Although the dollar limit for his work- related expenses is $6,000 (two or more qualifying persons), Randall figures his credit on only $1,000 of the $6,000 work-related expense paid. This is because his dollar limit is reduced as shown next.

Randall's Reduced Dollar Limit

1)	Maximum allowable expenses for two qualifying person	$6,000
2)	Minus: Dependent care benefits Randall excludes from income	−5,000
3)	Reduced dollar limit on expenses Randall can use for the credit	$1,000

Amount of Credit

To determine the amount of your credit, multiply your work-related expenses (after applying the earned income and dollar limits) by a percentage. This percentage depends on your adjusted gross income shown on Form 1040, line 38, or Form 1040A, line 22. The following table shows the percentage to use based on adjusted gross income.

IF your adjusted gross income is:		THEN the percentage is:
Over	But not over	
$ 0	$15,000	35%
15,000	17,000	34%
17,000	19,000	33%
19,000	21,000	32%
21,000	23,000	31%
23,000	25,000	30%
25,000	27,000	29%
27,000	29,000	28%
29,000	31,000	27%
31,000	33,000	26%
33,000	35,000	25%
35,000	37,000	24%
37,000	39,000	23%
39,000	41,000	22%
41,000	43,000	21%
43,000	No limit	20%

How To Claim the Credit

To claim the credit, you can file Form 1040 or Form 1040A. You cannot claim the credit on Form 1040EZ.

Form 1040 or 1040A. You must complete Form 2441 and attach it to your Form 1040 or 1040A. Enter the credit on Form 1040, line 48, or Form 1040A, line 29.

Limit on credit. The amount of credit you can claim is generally limited to the amount of your tax. For more information, see the Instructions for Form 2441.

Tax credit not refundable. You cannot get a refund for any part of the credit that is more than this limit.

Recordkeeping. You should keep records of your work-related expenses. Also, if your dependent or spouse is not able to care for himself or herself, your records should show both the nature and the length of the disability. Other records you should keep to support your claim for the credit are described earlier under *Provider Identification Test*.

Employment Taxes for Household Employers

If you pay someone to come to your home and care for your dependent or spouse, you may be a household employer. If you are a household employer, you will need an employer identification number (EIN) and you may have to pay employment taxes. If the individuals who work in your home are self-employed, you are not liable for any of the taxes discussed in this section. Self-employed persons who are in business for themselves are not household employees. Usually, you are not a household employer if the person who cares for your dependent or spouse does so at his or her home or place of business.

If you use a placement agency that exercises control over what work is done and how it will be done by a babysitter or companion who works in your home, the worker is not your employee. This control could include providing rules of conduct and appearance and requiring regular reports. In this case, you do not have to pay employment taxes. But, if an agency merely gives you a list of sitters and you hire one from that list, and pay the sitter directly, the sitter may be your employee.

If you have a household employee, you may be subject to:

1. Social security and Medicare taxes,
2. Federal unemployment tax, and
3. Federal income tax withholding.

Social security and Medicare taxes are generally withheld from the employee's pay and matched by the employer. Federal unemployment (FUTA) tax is paid by the employer only and provides for payments of unemployment compensation to workers who have lost their jobs. Federal income tax is withheld from the employee's total pay if the employee asks you to do so and you agree.

For more information on a household employer's tax responsibilities, see Publication 926 and Schedule H (Form 1040) and its instructions.

State employment tax. You may also have to pay state unemployment tax. Contact your state unemployment tax office for information. You should also find out whether you need to pay or collect other state employment taxes or carry workers' compensation insurance. A list of state employment tax agencies, including addresses and phone numbers, is in Publication 926.

32.

Credit for the Elderly or the Disabled

Introduction

If you qualify, you may be able to reduce the tax you owe by taking the credit for the elderly or the disabled which is figured on Schedule R (Form 1040A or 1040).

This chapter explains the following.

- Who qualifies for the credit for the elderly or the disabled.
- How to figure the credit.

You may be able to take the credit for the elderly or the disabled if:

- You are age 65 or older at the end of 2012, or
- You retired on permanent and total disability and have taxable disability income.

Useful Items

You may want to see:

Publication

- ❑ **524** Credit for the Elderly or the Disabled
- ❑ **554** Tax Guide for Seniors

Form (and Instruction)

- ❑ **Schedule R (Form 1040A or 1040)** Credit for the Elderly or the Disabled

Are You Eligible for the Credit?

You can take the credit for the elderly or the disabled if you meet both of the following requirements.

- You are a qualified individual.
- Your income is not more than certain limits.

You can use Figure 32-A and Table 32-1 as guides to see if you are eligible for the credit.

Use Figure 32-A first to see if you are a qualified individual. If you are, go to Table 32-1 to make sure your income is not too high to take the credit.

TIP *You can take the credit only if you file Form 1040 or Form 1040A. You cannot take the credit if you file Form 1040EZ.*

Qualified Individual

You are a qualified individual for this credit if you are a U.S. citizen or resident alien, and either of the following applies.

1. You were age 65 or older at the end of 2012.
2. You were under age 65 at the end of 2012 and all three of the following statements are true.
   a. You retired on permanent and total disability (explained later).
   b. You received taxable disability income for 2012.
   c. On January 1, 2012, you had not reached mandatory retirement age (defined later under *Disability income*).

Age 65. You are considered to be age 65 on the day before your 65th birthday. Therefore, if you were born on January 1, 1948, you are considered to be age 65 at the end of 2012.

U.S. Citizen or Resident Alien

You must be a U.S. citizen or resident alien (or be treated as a resident alien) to take the credit. Generally, you cannot take the credit if you were a nonresident alien at any time during the tax year.

Exceptions. You may be able to take the credit if you are a nonresident alien who is married to a U.S. citizen or resident alien at the end of the tax year and you and your spouse choose to treat you as a U.S. resident alien. If you make that choice, both you and your spouse are taxed on your worldwide incomes.

If you were a nonresident alien at the beginning of the year and a resident alien at the end of the year, and you were married to a U.S. citizen or resident alien at the end of the year, you may be able to choose to be treated as a U.S. resident alien for the entire year. In that case, you may be allowed to take the credit.

For information on these choices, see chapter 1 of Publication 519, U.S. Tax Guide for Aliens.

Married Persons

Generally, if you are married at the end of the tax year, you and your spouse must file a joint return to take the credit. However, if you and your spouse did not live in the same household at any time during the tax year, you can file either joint or separate returns and still take the credit.

Head of household. You can file as head of household and qualify to take the credit, even if your spouse lived with you during the first 6 months of the year, if you meet all the tests. See *Head of Household* in chapter 2 for the tests you must meet.

Under Age 65

If you are under age 65 at the end of 2012, you can qualify for the credit only if you are retired on permanent and total disability (discussed next) and have taxable disability income (discussed later under *Disability income*). You are retired on permanent and total disability if:

- You were permanently and totally disabled when you retired, and
- You retired on disability before the close of the tax year.

Even if you do not retire formally, you may be considered retired on disability when you have stopped working because of your disability.

If you retired on disability before 1977, and were not permanently and totally disabled at the time, you can qualify for the credit if you were permanently and totally disabled on January 1, 1976, or January 1, 1977.

Permanent and total disability. You are permanently and totally disabled if you cannot engage in any substantial gainful activity because of your physical or mental condition. A qualified physician must certify that the condition has lasted or can be expected to last continuously for 12 months or more, or that the condition can be expected to result in death. See *Physician's statement*, later.

Substantial gainful activity. Substantial gainful activity is the performance of significant duties over a reasonable period of time while working for pay or profit, or in work generally done for pay or profit. Full-time work (or part-time work done at your employer's convenience) in a competitive work situation for at least the minimum wage conclusively shows that you are able to engage in substantial gainful activity.

Substantial gainful activity is not work you do to take care of yourself or your home. It is not unpaid work on hobbies, institutional therapy or training, school attendance, clubs, social programs, and similar activities. However, doing this kind of work may show that you are able to engage in substantial gainful activity.

The fact that you have not worked for some time is not, of itself, conclusive evidence that you cannot engage in substantial gainful activity.

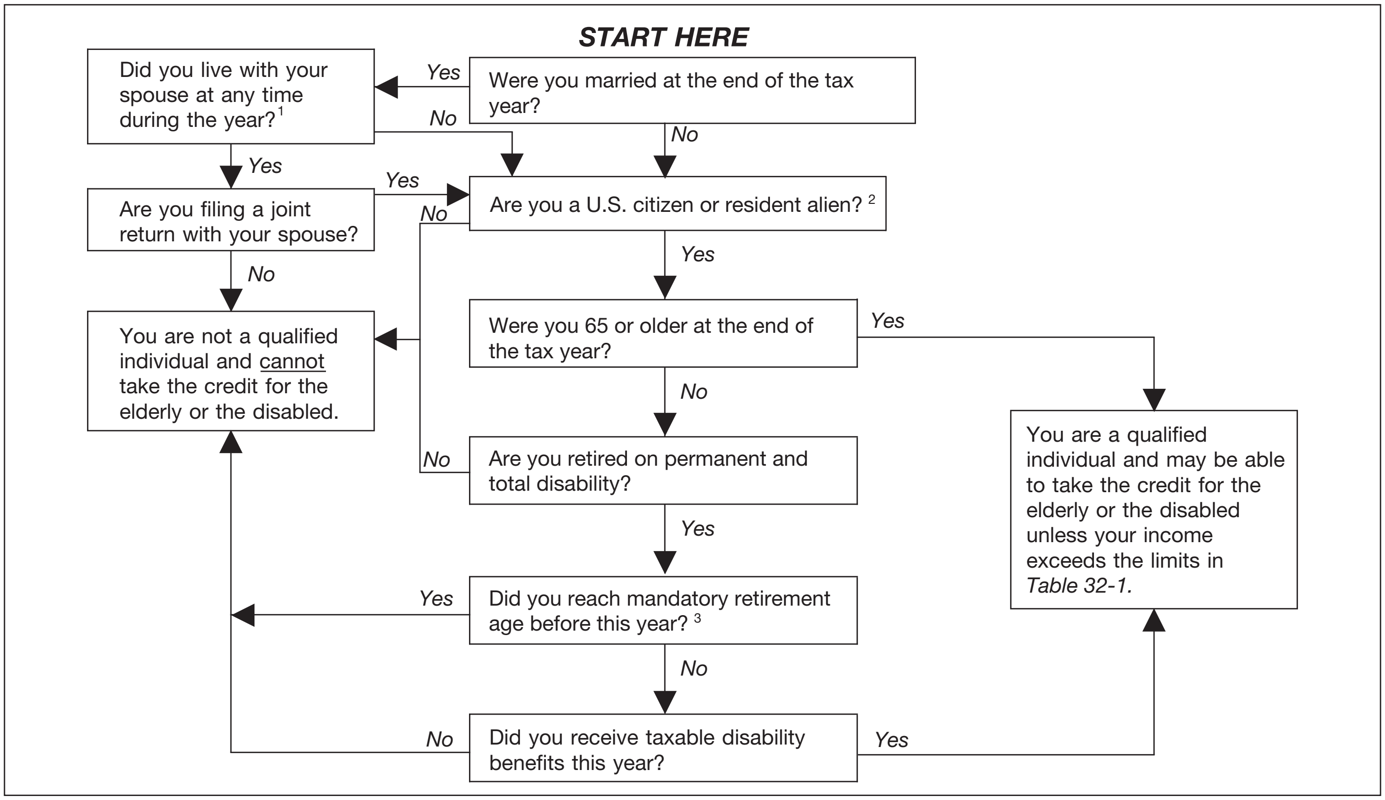
Sheltered employment. Certain work offered at qualified locations to physically or mentally impaired persons is considered sheltered employment. These qualified locations are in sheltered workshops, hospitals, and similar institutions, homebound programs, and Department of Veterans Affairs (VA) sponsored homes.

Compared to commercial employment, pay is lower for sheltered employment. Therefore, one usually does not look for sheltered employment if he or she can get other employment. The fact that one has accepted sheltered employment is not proof of the person's ability to engage in substantial gainful activity.

Physician's statement. If you are under age 65, you must have your physician complete a statement certifying that you were permanently and totally disabled on the date you retired. You can use the statement in the Instructions for Schedule R.

You do not have to file this statement with your Form 1040 or Form 1040A, but you must keep it for your records.

Figure 32-A. **Are You a Qualified Individual?**



[1] However, you may be able to claim this credit if you lived with your spouse during the first 6 months of the year and you qualify to file as head of household. You qualify to file as head of household if you are considered unmarried and meet certain other conditions. See Publication 501 for more information.

[2] If you were a nonresident alien at any time during the tax year and were married to a U.S. citizen or resident alien at the end of the tax year, see *U.S. Citizen or Resident Alien* under *Qualified Individual*. If you and your spouse choose to treat you as a U.S. resident alien, answer "Yes" to this question.

[3] Mandatory retirement age is the age set by your employer at which you would have been required to retire, had you not become disabled.

Table 32-1. **Income Limits**

	THEN, even if you qualify (see Figure 32-A), you CANNOT take the credit if...	
IF your filing status is ...	**Your adjusted gross income (AGI)* is equal to or more than...**	**OR the total of your nontaxable social security and other nontaxable pension(s), annuities, or disability income is equal to or more than...**
single, head of household, or qualifying widow(er) with dependent child	$17,500	$5,000
married filing jointly **and** only one spouse qualifies in Figure 32-A	$20,000	$5,000
married filing jointly **and** both spouses qualify in Figure 32-A	$25,000	$7,500
married filing separately **and** you lived apart from your spouse for all of 2012	$12,500	$3,750

* AGI is the amount on Form 1040A, line 22, or Form 1040, line 38.

Veterans. If the Department of Veterans Affairs (VA) certifies that you are permanently and totally disabled, you can substitute VA Form 21-0172, Certification of Permanent and Total Disability, for the physician's statement you are required to keep. VA Form 21-0172 must be signed by a person authorized by the VA to do so. You can get this form from your local VA regional office.

Physician's statement obtained in earlier year. If you got a physician's statement in an earlier year and, due to your continued disabled condition, you were unable to engage in any substantial gainful activity during 2012, you may not need to get another physician's statement for 2012. For a detailed explanation of the conditions you must meet, see the instructions for Schedule R, Part II. If you meet the required conditions, check the box on your Schedule R, Part II, line 2.

If you checked box 4, 5, or 6 in Part I of Schedule R, enter in the space above the box

Table 32-2. **Initial Amounts**

IF your filing status is ...	**THEN enter on line 10 of Schedule R...**
single, head of household, or **qualifying widow(er)** with dependent child and, by the end of 2012, you were	
• 65 or older	$5,000
• under 65 and retired on permanent and total disability[1]	$5,000
married filing a joint return and by the end of 2012	
• both of you were 65 or older	$7,500
• both of you were under 65 and one of you retired on permanent and total disability[1]	$5,000
• both of you were under 65 and both of you retired on permanent and total disability[2]	$7,500
• one of you was 65 or older, and the other was under 65 and retired on permanent and total disability[3]	$7,500
• one of you was 65 or older, and the other was under 65 and not retired on permanent and total disability	$5,000
married filing a separate return and you did not live with your spouse at any time during the year and, by the end of 2012, you were	
• 65 or older	$3,750
• under 65 and retired on permanent and total disability[1]	$3,750

[1]Amount cannot be more than the taxable disability income.

[2]Amount cannot be more than your combined taxable disability income.

[3]Amount is $5,000 plus the taxable disability income of the spouse under age 65, but not more than $7,500.

on line 2 in Part II the first name(s) of the spouse(s) for whom the box is checked.

Disability income. If you are under age 65, you must also have taxable disability income to qualify for the credit. Disability income must meet both of the following requirements.

- It must be paid under your employer's accident or health plan or pension plan.
- It must be included in your income as wages (or payments instead of wages) for the time you are absent from work because of permanent and total disability.

TIP *Social security disability is included in taxable income.*

Payments that are not disability income. Any payment you receive from a plan that does not provide for disability retirement is not disability income. Any lump-sum payment for accrued annual leave that you receive when you retire on disability is a salary payment and is not disability income.

For purposes of the credit for the elderly or the disabled, disability income does not include amounts you receive after you reach mandatory retirement age. Mandatory retirement age is the age set by your employer at which you would have had to retire, had you not become disabled.

Income Limits

To determine if you can claim the credit, you must consider two income limits. The first limit is the amount of your adjusted gross income (AGI). The second limit is the amount of nontaxable social security and other nontaxable pensions you received. The limits are shown in Table 32-1.

If both your AGI and nontaxable pensions are less than the income limits, you may be able to claim the credit. See *Figuring the Credit Yourself*, later.

CAUTION *If either your AGI or your nontaxable pensions are equal to or more than the income limits, you cannot take the credit.*

Credit Figured for You

You can figure the credit yourself, or the Internal Revenue Service (IRS) will figure it for you. See *Figuring the Credit Yourself* next.

If you choose to have the IRS figure the credit for you, read the following discussion for the form you will file (Form 1040 or 1040A).

If you want the IRS to figure your tax, see chapter 29.

Form 1040. If you want the IRS to figure your credit, see *Form 1040 Line Entries* under *Tax Figured by IRS* in chapter 29.

Form 1040A. If you want the IRS to figure your credit, see *Form 1040A Line Entries* under *Tax Figured by IRS* in chapter 29.

Figuring the Credit Yourself

If you figure the credit yourself, fill out the front of Schedule R. Next, fill out Schedule R, Part III. If you file Form 1040A, enter the amount from Schedule R, line 22, on Form 1040A, line 30. If you file Form 1040, include the amount from Schedule R, line 22, on line 53; check box **c,** and enter "Sch R" on the line next to that box.

There are five steps in Part III to determine the amount of your credit:

1. Determine your initial amount (lines 10–12).
2. Determine the total of any nontaxable social security and certain other nontaxable pensions, annuities, and disability benefits you received (lines 13a, 13b, and 13c).
3. Determine your excess adjusted gross income (lines 14–17).
4. Determine the total of Steps 2 and 3 (line 18).
5. Determine your credit (lines 19–22).

These steps are discussed in more detail next.

Step 1. Determine Initial Amount

To figure the credit, you must first determine your initial amount using lines 10 through 12. See Table 32-2. Your initial amount is on line 12.

Initial amounts for persons under age 65. If you are a qualified individual under age 65, your initial amount cannot be more than your taxable disability income.

Special rules for joint returns. If you are a qualified individual under age 65, and your spouse is also a qualified individual, your initial amount is your taxable disability income plus $5,000.

If you are a qualified individual, and both you and your spouse are under age 65, your initial amount cannot be more than your combined taxable disability income.

Step 2. Total Certain Nontaxable Pensions and Benefits

Step 2 is to figure the total amount of nontaxable social security and certain other nontaxable payments you received during the year. You must reduce your initial amount by these payments.

Enter these nontaxable payments on lines 13a or 13b, and total them on line 13c. If you are married filing jointly, you must enter the combined amount of nontaxable payments both you and your spouse receive.

Worksheets are provided in the instructions for Forms 1040 and 1040A to help you determine if any of your social security benefits (or equivalent railroad retirement benefits) are taxable.

Nontaxable payments. Include the following nontaxable payments in the amounts you enter on lines 13a and 13b.

- Nontaxable social security payments. This is the nontaxable part of the benefits shown in box 5 of Form SSA-1099, Social Security Benefit Statement, before deducting any amounts withheld to pay premiums on supplementary Medicare insurance, and before any reduction because of benefits received under workers' compensation. (Do not include a lump-sum death benefit payment you may receive as a surviving spouse, or a surviving child's insurance benefit payments you may receive as a guardian.)
- Nontaxable railroad retirement pension payments treated as social security. This is the nontaxable part of the benefits shown in box 5 of Form RRB-1099, Payments by the Railroad Retirement Board.
- Nontaxable pension or annuity payments or disability benefits that are paid under a law administered by the Department of Veterans Affairs (VA). (Do not include amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country or in the National Oceanic and Atmospheric Administration, or the Public Health Service, or as a disability annuity under section 808 of the Foreign Service Act of 1980.)
- Pension or annuity payments or disability benefits that are excluded from income under any provision of federal law other than the Internal Revenue Code. (Do not include amounts that are a return of your cost of a pension or annuity. These amounts do not reduce your initial amount.)

You should be sure to take into account all of the nontaxable amounts you receive. These amounts are verified by the IRS through information supplied by other government agencies.

Step 3. Determine Excess Adjusted Gross Income

You also must reduce your initial amount by your excess adjusted gross income. Figure your excess adjusted gross income on lines 14–17.

You figure your excess adjusted gross income as follows:

1. Subtract from your adjusted gross income (Form 1040, line 38 or Form 1040A, line 22) the amount shown for your filing status below.
   a. $7,500 if you are single, a head of household, or a qualifying widow(er) with dependent child,
   b. $10,000 if you are married filing jointly, or
   c. $5,000 if you are married filing separately and you and your spouse did not live in the same household at any time during the tax year.
2. Divide the result of (1) by 2.

Step 4. Determine the Total of Steps 2 and 3

To determine if you can take the credit, you must add (on line 18) the amounts you figured in Step 2 (line 13c) and Step 3 (line 17).

Step 5. Determine Your Credit

Subtract the amount determined in Step 4 (line 18) from the amount determined in Step 1 (line 12) and multiply the result by 15% (.15).

In certain cases, the amount of your credit may be limited. See *Limit on credit*, later.

Example. You are 66 years old and your spouse is 64. Your spouse is not disabled. You file a joint return on Form 1040. Your adjusted gross income is $14,630. Together you received $3,200 from social security, which was nontaxable. You figure the credit as follows:

Applying the 5 Step Process		Amount
1) Initial amount		$5,000
2) Total nontaxable social security and other nontaxable pensions	$3,200	
3) Excess adjusted gross income ($14,630 – $10,000) ÷ 2	2,315	
4) Add line 2 and line 3		5,515
5) Subtract line 4 from line 1 (Do not enter less than -0-)		-0-

You cannot take the credit because your nontaxable social security (line 2) plus your excess adjusted gross income (line 3) is more than your initial amount (line 1).

Limit on credit. The amount of credit you can claim is generally limited to the amount of your tax. Use the Credit Limit Worksheet in the Instructions for Schedule R to determine if your credit is limited.

Example

The following example illustrates the credit for the elderly or the disabled. The initial amount is taken from Table 32-2, shown earlier.

James Davis is 58 years old. In 2010 he retired on permanent and total disability, and he is still permanently and totally disabled. He got the required physician's statement in 2010, and kept it with his tax records. His physician signed on line B of the statement. This year James checks the box in Schedule R, Part II. He does not need to get another statement for 2012.

He received the following income for the year:

Nontaxable social security	$1,500
Interest (taxable)	100
Taxable disability pension	11,400

James' adjusted gross income is $11,500 ($11,400 + $100). He figures the credit on Schedule R as follows:

1) Initial amount		$5,000
2) Taxable disability pension		11,400
3) Smaller of (1) or (2)		5,000
4) Nontaxable social security benefits	$1,500	
5) Excess adjusted gross income ($11,500 – $7,500) ÷ 2	2,000	
6) Add lines 4 and 5		3,500
7) Subtract line 6 from line 3 (Do not enter less than -0-)		1,500
8) Multiply line 7 by 15% (.15)		225
9) Enter the amount from the Credit Limit Worksheet in the Instructions for Schedule R		201
10) Credit (Enter the smaller of line 8 or line 9)		$201

He enters $201 on line 30 of Form 1040A. The Schedule R for James Davis is not shown.

33.

Child Tax Credit

What's New

Form 8812. Form 8812 is no longer available to figure the additional child tax credit. Instead, use Parts II through IV of Schedule 8812 (Form 1040A or 1040) to figure the additional child tax credit for 2012.

Schedule 8812. Schedule 8812 (Form 1040A or 1040) is new for 2012. It includes a Part I to be completed by taxpayers claiming a child tax credit for a child identified by an IRS individual taxpayer identification number (ITIN) instead of a social security number (SSN). Parts II through IV of Schedule 8812 are used to figure the additional child tax credit for 2012.

Introduction

The child tax credit is a credit that may reduce your tax by as much as $1,000 for each of your qualifying children.

The additional child tax credit is a credit you may be able to take if you are not able to claim the full amount of the child tax credit.

This chapter explains the following.

- Who is a qualifying child.
- The amount of the credit.
- How to claim the credit.

CAUTION *The child tax credit and the additional child tax credit should not be confused with the child and dependent care credit discussed in chapter 31.*

If you have no tax. Credits, such as the child tax credit or the credit for child and dependent care expenses, are used to reduce tax. If your tax on Form 1040, line 46, or Form 1040A, line 28, is zero, do not figure the child tax credit because there is no tax to reduce. However, you may qualify for the additional child tax credit on line 65 (Form 1040) or line 39 (Form 1040A).

Useful Items

You may want to see:

Publication

❑ **972** Child Tax Credit

Form (and Instructions)

❑ **Schedule 8812 (Form 1040A or 1040)** Child Tax Credit

❑ **W-4** Employee's Withholding Allowance Certificate

Qualifying Child

A qualifying child for purposes of the child tax credit is a child who:

1. Is your son, daughter, stepchild, foster child, brother, sister, stepbrother, stepsister, or a descendant of any of them (for example, your grandchild, niece, or nephew),
2. Was under age 17 at the end of 2012,
3. Did not provide over half of his or her own support for 2012,
4. Lived with you for more than half of 2012 (see *Exceptions to time lived with you* later),
5. Is claimed as a dependent on your return,
6. Does not file a joint return for the year (or files it only as a claim for refund), and
7. Was a U.S. citizen, a U.S. national, or a resident of the United States. If the child was adopted, see *Adopted child* below.

For each qualifying child you must check the box on Form 1040 or Form 1040A, line 6c.

Example 1. Your son turned 17 on December 30, 2012. He is a citizen of the United States and you claimed him as a dependent on your return. He is not a qualifying child for the child tax credit because he was not under age 17 at the end of 2012.

Example 2. Your daughter turned 8 years old in 2012. She is not a citizen of the United States, has an ITIN, and lived in Mexico all of 2012. She is not a qualifying child for the child tax credit because she was not a resident of the United States for 2012.

Filers who have certain child dependents with an Individual Taxpayer Identification Number (ITIN). If you are claiming a child tax credit or additional child tax credit for a child you identified on your tax return with an ITIN instead of an SSN, you must complete Part I of Schedule 8812 (Form 1040A or 1040).

Although a child may be your dependent, you may only claim a child tax credit or additional child tax credit for a dependent who is a citizen, national, or resident of the United States. To be treated as a resident of the United States, a child generally will need to meet the requirements of the substantial presence test. For more information about the substantial presence test, see Publication 519, U.S. Tax Guide for Aliens.

Adopted child. An adopted child is always treated as your own child. An adopted child includes a child lawfully placed with you for legal adoption.

If you are a U.S. citizen or U.S. national and your adopted child lived with you all year as a member of your household in 2012, that child meets condition (7) above to be a qualifying child for the child tax credit.

Exceptions to time lived with you. A child is considered to have lived with you for more than half of 2012 if the child was born or died in 2012 and your home was this child's home for more than half the time he or she was alive. Temporary absences by you or the child for special circumstances, such as for school, vacation, business, medical care, military service, or detention in a juvenile facility, count as time the child lived with you.

There are also exceptions for kidnapped children and children of divorced or separated parents. For details, see *Residency Test* in chapter 3.

Qualifying child of more than one person. A special rule applies if your qualifying child is the qualifying child of more than one person. For details, see *Special Rule for Qualifying Child of More Than One Person* in chapter 3.

Amount of Credit

The maximum amount you can claim for the credit is $1,000 for each qualifying child.

Limits on the Credit

You must reduce your child tax credit if either (1) or (2) applies.

1. The amount on Form 1040, line 46, or Form 1040A, line 28, is less than the credit. If this amount is zero, you cannot take this credit because there is no tax to reduce. But you may be able to take the additional child tax credit. See *Additional Child Tax Credit*, later.
2. Your modified adjusted gross income (AGI) is above the amount shown below for your filing status.
   a. Married filing jointly - $110,000.
   b. Single, head of household, or qualifying widow(er) - $75,000.
   c. Married filing separately - $55,000.

Modified AGI. For purposes of the child tax credit, your modified AGI is your AGI plus the following amounts that may apply to you.

- Any amount excluded from income because of the exclusion of income from Puerto Rico. On the dotted line next to Form 1040, line 38, enter the amount excluded and identify it as “EPRI.” Also attach a copy of any Form(s) 499R-2/W-2PR to your return.
- Any amount on line 45 or line 50 of Form 2555, Foreign Earned Income.
- Any amount on line 18 of Form 2555-EZ, Foreign Earned Income Exclusion.
- Any amount on line 15 of Form 4563, Exclusion of Income for Bona Fide Residents of American Samoa.

If you do not have any of the above, your modified AGI is the same as your AGI.

AGI. Your AGI is the amount on Form 1040, line 38, or Form 1040A, line 22.

Claiming the Credit

To claim the child tax credit, you must file Form 1040 or Form 1040A. You cannot claim the child tax credit on Form 1040EZ. You must provide the name and identification number (usually a social security number) on your tax return for each qualifying child.

If you claim the child tax credit with a child identified by an ITIN, you must also file Schedule 8812.

To figure your credit, first review the Child Tax Credit Worksheet in your Form 1040 or 1040A instructions. If you are instructed to use Publication 972, you may not use the worksheet in your tax return instructions; instead, you must use Publication 972 to figure the credit. If you are not instructed to use Publication 972, you may use the Child Tax Credit Worksheet in your Form 1040 or 1040A instructions or Publication 972 to figure the credit.

Additional Child Tax Credit

This credit is for certain individuals who get less than the full amount of the child tax credit. The additional child tax credit may give you a refund even if you do not owe any tax.

How to claim the additional child tax credit. To claim the additional child tax credit, follow the steps below.

1. Make sure you figured the amount, if any, of your child tax credit. See *Claiming the Credit*, earlier.
2. If you answered "Yes" on line 9 or line 10 of the Child Tax Credit Worksheet in the Form 1040 or Form 1040A instructions, or line 13 of the Child Tax Credit Worksheet in Publication 972, use Parts II through IV of Schedule 8812 to see if you can take the additional child tax credit.
3. If you have an additional child tax credit on line 13 of Schedule 8812, carry it to Form 1040, line 65, or Form 1040A, line 39.

34. Education Credits

Introduction

For 2012, there are two tax credits available to persons who pay expenses for higher (postsecondary) education. They are:

- The American opportunity credit, and
- The lifetime learning credit.

The chapter will present an overview of these education credits. To get the detailed information you will need to claim either of the credits, and for examples illustrating that information, see chapters 2 and 3 of Publication 970.

Can you claim more than one education credit this year? For each student, you can choose for any year only one of the credits. For example, if you choose to take the American opportunity credit for a child on your 2012 tax return, you cannot, for that same child, also claim the lifetime learning credit for 2012.

If you are eligible to claim the American opportunity credit and you are also eligible to claim the lifetime learning credit for the same student in the same year, you can choose to claim either credit, but not both.

If you pay qualified education expenses for more than one student in the same year, you can choose to take the American opportunity and the lifetime learning credits on a per-student, per-year basis. This means that, for example, you can claim the American opportunity credit for one student and the lifetime learning credit for another student in the same year.

Differences between the American opportunity and lifetime learning credits. There are several differences between these two credits. These differences are summarized in Table 34-1, later.

Useful Items

You may want to see:

Publication

- ❏ **970** Tax Benefits for Education

Form (and Instructions)

- ❏ **8863** Education Credits (American Opportunity and Lifetime Learning Credits)

Table 34-1. **Comparison of Education Credits**

Caution. You can claim both the American opportunity credit and the lifetime learning credit on the same return—but not for the same student.

	American Opportunity Credit	**Lifetime Learning Credit**
Maximum credit	Up to $2,500 credit per **eligible student**	Up to $2,000 credit per **return**
Limit on modified adjusted gross income (MAGI)	$180,000 if married filing jointly; $90,000 if single, head of household, or qualifying widow(er)	$124,000 if married filing jointly; $62,000 if single, head of household, or qualifying widow(er)
Refundable or nonrefundable	40% of credit may be refundable	Credit limited to the amount of tax you must pay on your taxable income
Number of years of postsecondary education	Available **ONLY** if the student had not completed the first 4 years of postsecondary education before 2012	Available for all years of postsecondary education and for courses to acquire or improve job skills
Number of tax years credit available	Available **ONLY** for **4** tax years per eligible student (including any year(s) the Hope credit was claimed)	Available for an unlimited number of years
Type of program required	Student must be pursuing a program leading to a degree or other recognized education credential	Student does not need to be pursuing a program leading to a degree or other recognized education credential
Number of courses	Student must be enrolled at least half time for at least one academic period beginning during the tax year	Available for one or more courses
Felony drug conviction	At the end of 2012, the student had not been convicted of a felony for possessing or distributing a controlled substance	Felony drug convictions do not make the student ineligible
Qualified expenses	Tuition, required enrollment fees, and course materials that the student needs for a course of study whether or not the materials are bought at the educational institution as a condition of enrollment or attendance	Tuition and fees required for enrollment or attendance (including amounts required to be paid to the institution for course-related books, supplies, and equipment)
Payments for academic periods	Payments made in 2012 for academic periods beginning in 2012 or beginning in the first 3 months of 2013	

Who Can Claim an Education Credit

You may be able to claim an education credit if you, your spouse, or a dependent you claim on your tax return was a student enrolled at or attending an eligible educational institution. The credits are based on the amount of qualified education expenses paid for the student in 2012 for academic periods beginning in 2012 and in the first 3 months of 2013.

For example, if you paid $1,500 in December 2012 for qualified tuition for the spring 2013 semester beginning in January 2013, you may be able to use that $1,500 in figuring your 2012 education credit(s).

Academic period. An academic period includes a semester, trimester, quarter, or other period of study (such as a summer school session) as reasonably determined by an educational institution. In the case of an educational institution that uses credit hours or clock hours and does not have academic terms, each payment period can be treated as an academic period.

Eligible educational institution. An eligible educational institution is any college, university, vocational school, or other postsecondary educational institution eligible to participate in a student aid program administered by the U.S. Department of Education. It includes virtually all accredited public, nonprofit, and proprietary (privately owned profit-making) postsecondary institutions. The educational institution should be able to tell you if it is an eligible educational institution.

Certain educational institutions located outside the United States also participate in the U.S. Department of Education's Federal Student Aid (FSA) programs.

Who can claim a dependent's expenses. If an exemption is allowed as a deduction for any person who claims the student as a dependent, all qualified education expenses of the student are treated as having been paid by that person. Therefore, only that person can claim an education credit for the student. If a student is not claimed as a dependent on another person's tax return, only the student can claim a credit.

Expenses paid by a third party. Qualified education expenses paid on behalf of the student by someone other than the student (such as a relative) are treated as paid by the student. However, qualified education expenses paid (or treated as paid) by a student who is claimed as a dependent on your tax return are treated as paid by you. Therefore, you are treated as having paid expenses that were paid by the third party. For more information and an example see *Who Can Claim a Dependent's Expenses* in Pub. 970, chapter 2 or 3.

Who cannot claim a credit. You cannot take an education credit if any of the following apply.

1. You are claimed as a dependent on another person's tax return, such as your parent's return.
2. Your filing status is married filing separately.
3. You (or your spouse) were a nonresident alien for any part of 2012 and did not elect to be treated as a resident alien for tax purposes.
4. Your MAGI is one of the following.
   a. American opportunity credit: $180,000 or more if married filing jointly, or $90,000 or more if single, head of household, or qualifying widow(er).
   b. Lifetime learning credit: $124,000 or more if married filing jointly, or $62,000 or more if single, head of household, or qualifying widow(er).

Generally, your MAGI is the amount on your Form 1040, line 38, or Form 1040A, line 22. However, if you are filing Form 2555, Form 2555–EZ, or Form 4563, or are excluding income from Puerto RIco, add to the amount on your Form 1040, line 38, or Form 1040A, line 22, the amount of income you excluded. For details, see Pub. 970.

Figure 34-A may be helpful in determining if you can claim an education credit on your tax return.

TIP *The American opportunity credit will always be greater than or equal to the lifetime learning credit for any student who is eligible for both credits. However, if any of the conditions for the American opportunity credit, listed in Table 34-1 earlier, are not met for any student, you cannot take the American opportunity credit for that student. You may be able to take the lifetime learning credit for part or all of that student's qualified education expenses instead. See Pub. 970 for information on other education benefits.*

Qualified Education Expenses

Generally, qualified education expenses are amounts paid in 2012 for tuition and fees required for the student's enrollment or attendance at an eligible educational institution. It does not matter whether the expenses were paid in cash, by check, by credit or debit card, or with borrowed funds.

For course-related books, supplies, and equipment, only certain expenses qualify.

- American opportunity credit: Qualified education expenses include amounts spent on books, supplies, and equipment needed for a course of study, whether or not the materials are purchased from the educational institution as a condition of enrollment or attendance.
- Lifetime learning credit: Qualified education expenses include amounts for books, supplies, and equipment **only if** required to be paid to the institution as a condition of enrollment or attendance.

Qualified education expenses include nonacademic fees, such as student activity fees, athletic fees, or other expenses unrelated to the academic course of instruction, **only if** the fee must be paid to the institution as a condition of enrollment or attendance. However, fees for personal expenses (described below) are never qualified education expenses.

Qualified education expenses for either credit **do not** include amounts paid for:

- Personal expenses. This means room and board, insurance, medical expenses (including student health fees), transportation, and other similar personal, living, or family expenses.
- Any course or other education involving sports, games, or hobbies, or any noncredit course, unless such course or other education is part of the student's degree program or (for the lifetime learning credit only) helps the student acquire or improve job skills.

You should receive Form 1098–T, Tuition Statement, from the institution reporting either payments received in 2012 (box 1) or amounts billed in 2012 (box 2). However, the amount in box 1 or 2 of Form 1098–T may be different from the amount you paid (or are treated as having paid). In completing Form 8863, use only the amounts you actually paid (plus any amounts you are treated as having paid) in 2012 (reduced, as necessary, as described in *Adjustments to Qualified Education Expenses*, later.

Qualified education expenses paid on behalf of the student by someone other than the student (such as a relative) are treated as paid by the student. Qualified education expenses paid (or treated as paid) by a student who is claimed as a dependent on your tax return are treated as paid by you.

If you or the student takes a deduction for higher education expenses, such as on Schedule A or C (Form 1040), you cannot use those expenses in your qualified education expenses when figuring your education credits.

CAUTION *Qualified education expenses for any academic period must be reduced by any tax-free educational assistance allocable to that academic period. See Adjustments to Qualified Education Expenses, later.*

Prepaid Expenses. Qualified education expenses paid in 2012 for an academic period that begins in the first 3 months of 2013 can be used in figuring an education credit for 2012 only. See *Academic period*, earlier. For example, if you pay $2,000 in December 2012 for qualified tuition for the 2013 winter quarter that begins in January 2013, you can use that $2,000 in figuring an education credit for 2012 only (if you meet all the other requirements).

CAUTION *You cannot use any amount you paid in 2011 or 2013 to figure the qualified education expenses you use to figure your 2012 education credit(s).*

Paid with borrowed funds. You can claim an education credit for qualified education expenses paid with the proceeds of a loan. Use the expenses to figure the credit for the year in which the expenses are paid, not the year in which the loan is repaid. Treat loan payments sent directly to the educational institution as paid on the date the institution credits the student's account.

Student withdraws from class(es). You can claim an education credit for qualified education expenses not refunded when a student withdraws.

No Double Benefit Allowed

You cannot do any of the following.

- Deduct higher education expenses on your income tax return (as, for example, a business expense) and also claim an education credit based on those same expenses.
- Claim more than one education credit based on the same qualified education expenses.
- Claim an education credit based on the same expenses used to figure the tax-free portion of a distribution from a Coverdell education savings account (ESA) or qualified tuition program (QTP).
- Claim an education credit based on qualified education expenses paid with educational assistance, such as a tax-free scholarship, grant, or employer-provided educational assistance. See *Adjustments to Qualified Education Expenses*, next.

Adjustments to Qualified Education Expenses

For each student, reduce the qualified education expenses paid in 2012 by or on behalf of that student under the following rules. The result is the amount of adjusted qualified education expenses for each student.

Tax-free educational assistance. For tax-free educational assistance received in 2012, reduce the qualified educational expenses for each academic period by the amount of tax-free educational assistance allocable to that academic period. See *Academic period*, earlier.

Tax-free educational assistance includes:

- Tax-free parts of scholarships and fellowships (see chapter 12 of this publication and chapter 1 of Pub. 970),
- The tax-free part of Pell grants (see chapter 1 of Pub. 970),
- The tax-free part of employer-provided educational assistance (see Pub. 970),
- Veterans' educational assistance (see chapter 1 of Pub. 970), and
- Any other nontaxable (tax-free) payments (other than gifts or inheritances) received as educational assistance.

Generally, any scholarship or fellowship is treated as tax-free educational assistance. However, a scholarship or fellowship is not treated as tax-free educational assistance to the extent the **student** includes it in gross income (if the **student** is required to file a tax return) for the year the scholarship or fellowship is received and either:

- The scholarship or fellowship (or any part of it) **must** be applied (by its terms) to expenses (such as room and board) other than qualified education expenses as defined in Qualified education expenses in Pub. 970, chapter 1; or
- The scholarship or fellowship (or any part of it) **may** be applied (by its terms) to expenses (such as room and board) other than qualified education expenses as defined in Qualified education expenses in Pub. 970, chapter 1.

TIP *You may be able to increase the combined value of an education credit and certain educational assistance if the student includes some or all of the educational assistance in income in the year received. For details, see* Adjustments of Qualified Education Expenses, *in chapters 2 and 3 of Pub. 970.*

Some tax-free educational assistance received after 2012 may be treated as a refund of qualified education expenses paid in 2012. This tax-free educational assistance is any tax-free educational assistance received by you or anyone else after 2012 for qualified education expenses paid on behalf of a student in 2012 (or attributable to enrollment at an eligible educational institution during 2012).

If this tax-free educational assistance is received after 2012 but before you file your 2012 income tax return, see *Refunds received after 2012 but before your income tax return is filed,* later. If this tax-free educational assistance is received after 2012 and after you file your 2012 income tax return, see *Refunds received after 2012 and after your income tax return is filed,* later.

Refunds. A refund of qualified education expenses may reduce qualified education expenses for the tax year or may require you to repay (recapture) the credit that you claimed in an earlier year. Some tax-free educational assistance received after 2012 may be treated as a refund. See Tax-free educational assistance, earlier

Refunds received in 2012. For each student, figure the adjusted qualified education expenses for 2012 by adding all the qualified education expenses paid in 2012 and subtracting any refunds of those expenses received from the eligible educational institution during 2012.

Refunds received after 2012 but before your income tax return is filed. If anyone receives a refund after 2012 of qualified education expenses paid on behalf of a student in 2012 and the refund is received before you file your 2012 income tax return, reduce the amount of qualified education expenses for 2012 by the amount of the refund.

Refunds received after 2012 and after your income tax return is filed. If anyone receives a refund after 2012 of qualified education expenses paid on behalf of a student in 2012 and the refund is received after you file your 2012 income tax return, you may need to repay some or all of the credit that you claimed. See Credit recapture, next.

Credit recapture. If any tax-free educational assistance for the qualified education expenses paid in 2012, or any refund of your qualified education expenses paid in 2012, is received after you file your 2012 income tax return, you must recapture (repay) any excess credit. You do this by refiguring the amount of your adjusted qualified education expenses for 2012 by reducing the expenses by the amount of the refund or tax-free educational assistance. You then refigure your education credit(s) for 2012 and figure the amount by which your 2012 tax liability would have increased if you had claimed the refigured credit(s). Include that amount as an additional tax for the year the refund or tax-free assistance was received.

Example. You paid $8,000 tuition and fees in December 2012 for your child's Spring semester beginning in January 2013. You filed your 2012 tax return on February 2, 2013, and claimed a lifetime learning credit of $1,600 ($8,000 qualified education expense paid x .20). You claimed no other tax credits. After you filed your return, your child withdrew from two courses and you received a refund of $1,400. You must refigure your 2012 lifetime learning credit using $6,600 ($8,000 qualified education expenses − $1,400 refund). The refigured credit is $1,320 and your tax liability increased by $280. You must include the difference of $280 ($1,600 credit originally claimed − $1,320 refigured credit) as additional tax on your 2013 income tax return. See the instructions for your 2013 income tax return to determine where to include this tax.

CAUTION *If you also pay qualified education expenses in 2013 for an academic period that begins in the first 3 months of 2013 and you receive tax-free educational assistance, or a refund, as described above, you may choose to reduce your qualified education expenses for 2013 instead of reducing your expenses for 2012.*

Amounts that do not reduce qualified education expenses. Do not reduce qualified education expenses by amounts paid with funds the student receives as:

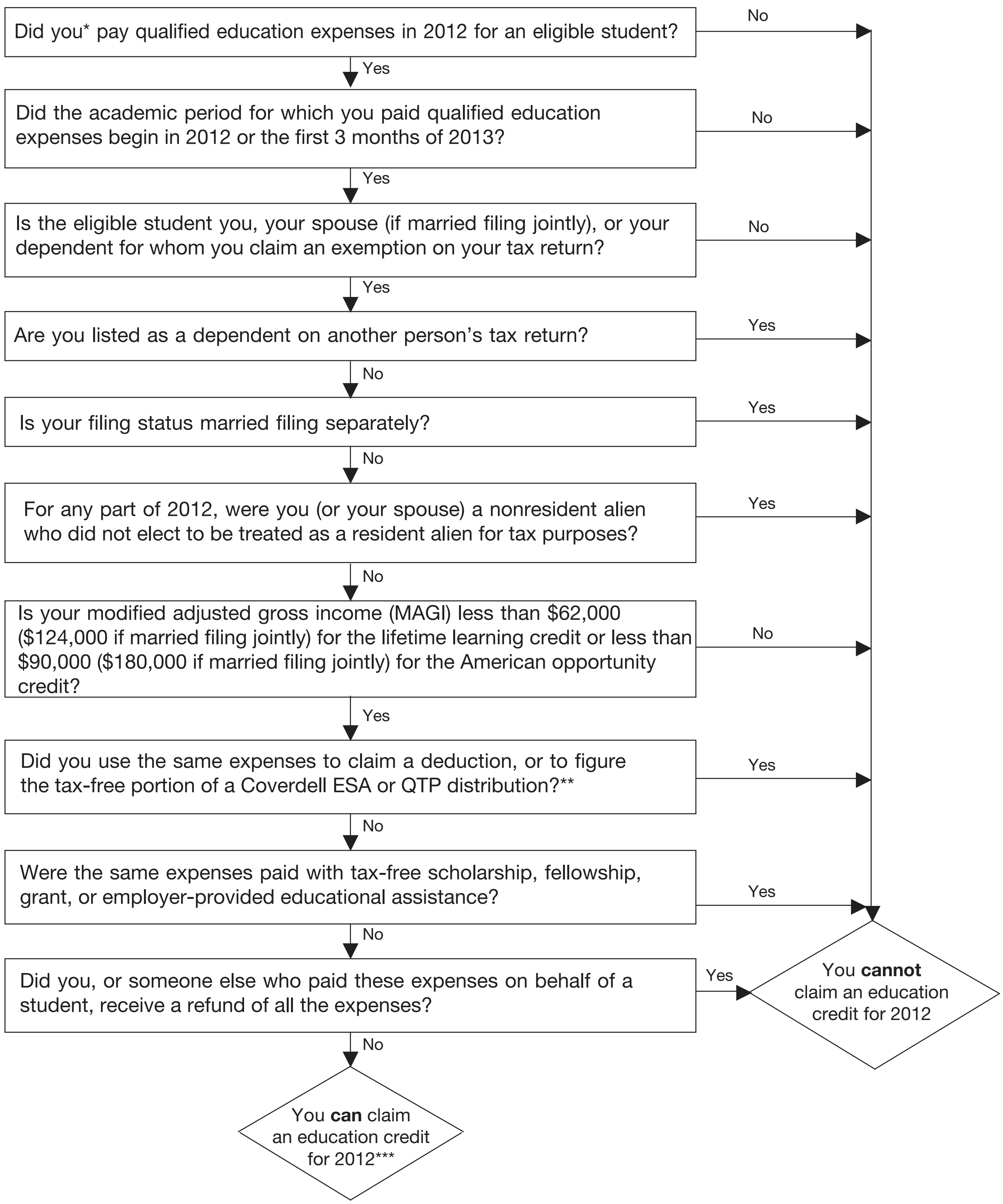
- Payment for services, such as wages,
- A loan,
- A gift,
- An inheritance, or
- A withdrawal from the student's personal savings.

Do not reduce the qualified education expenses by any scholarship or fellowship reported as income on the student's tax return in the following situations.

- The use of the money is restricted, by the terms of the scholarship or fellowship, to costs of attendance (such as room and board) other than qualified education expenses, as defined in Chapter 1 of Pub. 970.
- The use of the money is not restricted.

For examples, see chapter 2 in Pub. 970.

Figure 34-A. Can You Claim an Education Credit for 2012?



* Qualified education expenses paid by a dependent for whom you claim an exemption, or by a third party for that dependent, are considered paid by you.

** You cannot use the same expenses to claim both a lifetime learning credit and an American opportunity credit.

*** Your education credits may be limited to your tax liability minus certain credits. See Form 8863 for more details.

35. Earned Income Credit (EIC)

What's New

Earned income amount is more. The maximum amount of income you can earn and still get the credit has increased. You may be able to take the credit if:

- You have three or more qualifying children and you earned less than $45,060 ($50,270 if married filing jointly),
- You have two qualifying children and you earned less than $41,952 ($47,162 if married filing jointly),
- You have one qualifying child and you earned less than $36,920 ($42,130 if married filing jointly), or
- You do not have a qualifying child and you earned less than $13,980 ($19,190 if married filing jointly).

Your adjusted gross income also must be less than the amount in the above list that applies to you. For details, see *Rules 1* and *15*.

Investment income amount is more. The maximum amount of investment income you can have and still get the credit has increased to $3,200. See *Rule 6*.

Reminders

Increased EIC on certain joint returns. A married person filing a joint return may get more EIC than someone with the same income but a different filing status. As a result, the EIC table has different columns for married persons filing jointly than for everyone else. When you look up your EIC in the EIC Table, be sure to use the correct column for your filing status and the number of children you have.

Online help. You can use the EITC Assistant at *www.irs.gov/eitc* to find out if you are eligible for the credit. The EITC Assistant is available in English and Spanish.

EIC questioned by IRS. The IRS may ask you to provide documents to prove you are entitled to claim the EIC. We will tell you what documents to send us. These may include: birth certificates, school records, medical records, etc. The process of establishing your eligibility will delay your refund.

Introduction

The earned income credit (EIC) is a tax credit for certain people who work and have less than $50,270 of earned income. A tax credit usually means more money in your pocket. It reduces the amount of tax you owe. The EIC may also give you a refund.

How do you get the earned income credit? To claim the EIC, you must:

1. Qualify by meeting certain rules, and
2. File a tax return, even if you:
   a. Do not owe any tax,
   b. Did not earn enough money to file a return, or
   c. Did not have income taxes withheld from your pay.

When you complete your return, you can figure your EIC by using a worksheet in the instructions for Form 1040, Form 1040A, or Form 1040EZ. Or, if you prefer, you can let the IRS figure the credit for you.

How will this chapter help you? This chapter will explain the following.

- The rules you must meet to qualify for the EIC.
- How to figure the EIC.

Useful Items

You may want to see:

Publication

❑ **596** Earned Income Credit (EIC)

Form (and Instructions)

❑ **Schedule EIC** Earned Income Credit (Qualifying Child Information)

❑ **8862** Information To Claim Earned Income Credit After Disallowance

Do You Qualify for the Credit?

To qualify to claim the EIC, you must first meet all of the rules explained in Part A, *Rules for Everyone*. Then you must meet the rules in Part B, *Rules If You Have a Qualifying Child*, or Part C, *Rules If You Do Not Have a Qualifying Child*. There is one final rule you must meet in Part D, *Figuring and Claiming the EIC*. You qualify for the credit if you meet all the rules in each part that applies to you.

- If you have a qualifying child, the rules in *Parts A, B,* and *D* apply to you.
- If you do not have a qualifying child, the rules in *Parts A, C,* and *D* apply to you.

Table 35-1, Earned Income Credit in a Nutshell. Use Table 35-1 as a guide to *Parts A, B, C,* and *D*. The table is a summary of all the rules in each part.

Do you have a qualifying child? You have a qualifying child only if you have a child who meets the four tests described in *Rule 8* and illustrated in Figure 35-1.

If Improper Claim Made in Prior Year

If your EIC for any year after 1996 was denied or reduced for any reason other than a math or clerical error, you must attach a completed Form 8862 to your next tax return to claim the EIC. You must also qualify to claim the EIC by meeting all the rules described in this chapter.

However, if your EIC was denied or reduced as a result of a math or clerical error, do not attach Form 8862 to your next tax return. For example, if your arithmetic is incorrect, the IRS can correct it. If you do not provide a correct social security number, the IRS can deny the EIC. These kinds of errors are called math or clerical errors.

If your EIC for any year after 1996 was denied and it was determined that your error was due to reckless or intentional disregard of the EIC rules, then you cannot claim the EIC for the next 2 years. If your error was due to fraud, then you cannot claim the EIC for the next 10 years.

More information. See chapter 5 in Publication 596 for more detailed information about the disallowance period and Form 8862.

Part A. Rules for Everyone

This part of the chapter discusses *Rules 1* through *7*. You must meet all seven rules to qualify for the earned income credit. If you do not meet all seven rules, you cannot get the credit and you do not need to read the rest of the chapter.

If you meet all seven rules in this part, then read either *Part B* or *Part C* (whichever applies) for more rules you must meet.

Rule 1. Your AGI Must Be Less Than:

- $45,060 ($50,270 for married filing jointly) if you have three or more qualifying children,
- $41,952 ($47,162 for married filing jointly) if you have two qualifying children,
- $36,920 ($42,130 for married filing jointly) if you have one qualifying child, or
- $13,980 ($19,190 for married filing jointly) if you do not have a qualifying child.

Adjusted gross income (AGI). AGI is the amount on line 38 (Form 1040), line 22 (Form 1040A), or line 4 (Form 1040EZ). If your AGI is equal to or more than the applicable limit listed above, you cannot claim the EIC.

Example. Your AGI is $37,550, you are single, and you have one qualifying child. You cannot claim the EIC because your AGI is not less than $36,920. However, if your filing status was married filing jointly, you might be able to claim the EIC because your AGI is less than $42,130.

Community property. If you are married, but qualify to file as head of household under special rules for married taxpayers living apart

Table 35-1. **Earned Income Credit in a Nutshell**

First, you must meet all the rules in this column.		**Second, you must meet all the rules in *one* of these columns, whichever applies.**		**Third, you must meet the rule in this column.**
Part A. Rules for Everyone		**Part B. Rules If You Have a Qualifying Child**	**Part C. Rules If You Do Not Have a Qualifying Child**	**Part D. Figuring and Claiming the EIC**
1. Your adjusted gross income (AGI) must be less than: • $45,060 ($50,270 for married filing jointly) if you have three or more qualifying children, • $41,952 ($47,162 for married filing jointly) if you have two qualifying children, • $36,920 ($42,130 for married filing jointly) if you have one qualifying child, or • $13,980 ($19,190 for married filing jointly) if you do not have a qualifying child.	**2.** You must have a valid social security number. **3.** Your filing status cannot be "Married filing separately." **4.** You must be a U.S. citizen or resident alien all year. **5.** You cannot file Form 2555 or Form 2555-EZ (relating to foreign earned income). **6.** Your investment income must be $3,200 or less. **7.** You must have earned income.	**8.** Your child must meet the relationship, age, residency, and joint return tests. **9.** Your qualifying child cannot be used by more than one person to claim the EIC. **10.** You cannot be a qualifying child of another person.	**11.** You must be at least age 25 but under age 65. **12.** You cannot be the dependent of another person. **13.** You cannot be a qualifying child of another person. **14.** You must have lived in the United States more than half of the year.	**15.** Your earned income must be less than: • $45,060 ($50,270 for married filing jointly) if you have three or more qualifying children, • $41,952 ($47,162 for married filing jointly) if you have two qualifying children, • $36,920 ($42,130 for married filing jointly) if you have one qualifying child, or • $13,980 ($19,190 for married filing jointly) if you do not have a qualifying child.

(see *Rule 3*), and live in a state that has community property laws, your AGI includes that portion of both your and your spouse's wages that you are required to include in gross income. This is different from the community property rules that apply under *Rule 7*.

Rule 2. You Must Have a Valid Social Security Number (SSN)

To claim the EIC, you (and your spouse if filing a joint return) must have a valid SSN issued by the Social Security Administration (SSA). Any qualifying child listed on Schedule EIC also must have a valid SSN. (See *Rule 8* if you have a qualifying child.)

If your social security card (or your spouse's if filing a joint return) says "Not valid for employment" and your SSN was issued so that you (or your spouse) could get a federally funded benefit, you cannot get the EIC. An example of a federally funded benefit is Medicaid.

If you have a card with the legend "Not valid for employment" and your immigration status has changed so that you are now a U.S. citizen or permanent resident, ask the SSA for a new social security card without the legend.

U. S. citizen. If you were a U. S. citizen when you received your SSN, you have a valid SSN.

Valid for work only with INS or DHS authorization. If your social security card reads "Valid for work only with INS authorization" or "Valid for work only with DHS authorization," you have a valid SSN, but only if that authorization is still valid.

SSN missing or incorrect. If an SSN for you or your spouse is missing from your tax return or is incorrect, you may not get the EIC.

Other taxpayer identification number. You cannot get the EIC if, instead of an SSN, you (or your spouse if filing a joint return) have an individual taxpayer identification number (ITIN). ITINs are issued by the Internal Revenue Service to noncitizens who cannot get an SSN.

No SSN. If you do not have a valid SSN, put "No" next to line 64a (Form 1040), line 38a (Form 1040A), or line 8a (Form 1040EZ). You cannot claim the EIC.

Getting an SSN. If you (or your spouse if filing a joint return) do not have an SSN, you can apply for one by filing Form SS-5, Application for a Social Security Card, with the SSA. You can get Form SS-5 online at *www.socialsecurity.gov*, from your local SSA office, or by calling the SSA at 1-800-772-1213.

Filing deadline approaching and still no SSN. If the filing deadline is approaching and you still do not have an SSN, you have two choices.

1. Request an automatic 6-month extension of time to file your return. You can get this extension by filing Form 4868, Application for Automatic Extension of Time to File U.S. Individual Income Tax Return. For more information, see *chapter 1*.
2. File the return on time without claiming the EIC. After receiving the SSN, file an amended return (Form 1040X, Amended U.S. Individual Income Tax Return) claiming the EIC. Attach a filled-in Schedule EIC if you have a qualifying child.

Rule 3. Your Filing Status Cannot Be Married Filing Separately

If you are married, you usually must file a joint return to claim the EIC. Your filing status cannot be "Married filing separately."

Spouse did not live with you. If you are married and your spouse did not live in your home at any time during the last 6 months of the year, you may be able to file as head of household, instead of married filing separately. In that case, you may be able to claim the EIC. For detailed information about filing as head of household, see *chapter 2*.

Rule 4. You Must Be a U.S. Citizen or Resident Alien All Year

If you (or your spouse, if married) were a nonresident alien for any part of the year, you cannot claim the earned income credit unless your filing status is married filing jointly. You can use that filing status only if one spouse is a U.S. citizen or resident alien and you choose to treat the nonresident spouse as a U.S. resident. If you make this choice, you and your spouse are taxed on your worldwide income. If you (or your spouse, if married) were a nonresident alien for any part of the year and your filing status is not married filing jointly, enter "No" on the dotted line next to line 64a (Form 1040) or in the space to the left of line 38a (Form 1040A). If you need more information on making this choice, get Publication 519, U.S. Tax Guide for Aliens.

Rule 5. You Cannot File Form 2555 or Form 2555-EZ

You cannot claim the earned income credit if you file Form 2555, Foreign Earned Income, or Form 2555-EZ, Foreign Earned Income Exclusion. You file these forms to exclude income earned in foreign countries from your gross income, or to deduct or exclude a foreign housing amount. U.S. possessions are not foreign countries. See Publication 54, Tax Guide for U.S. Citizens and Resident Aliens Abroad, for more detailed information.

Rule 6. Your Investment Income Must Be $3,200 or Less

You cannot claim the earned income credit unless your investment income is $3,200 or less. If your investment income is more than $3,200, you cannot claim the credit. For most people, investment income is the total of the following amounts.

- Taxable interest (line 8a of Form 1040 or 1040A).
- Tax-exempt interest (line 8b of Form 1040 or 1040A).
- Dividend income (line 9a of Form 1040 or 1040A).
- Capital gain net income (line 13 of Form 1040, if more than zero, or line 10 of Form 1040A).

If you file Form 1040EZ, your investment income is the total of the amount of line 2 and the amount of any tax-exempt interest you wrote to the right of the words “Form 1040EZ” on line 2.

However, see *Rule 6* in chapter 1 of Publication 596 if:

- You are filing Schedule E (Form 1040), Form 4797, or Form 8814, or
- You are reporting income from the rental of personal property on Form 1040, line 21.

Rule 7. You Must Have Earned Income

This credit is called the “earned income” credit because, to qualify, you must work and have earned income. If you are married and file a joint return, you meet this rule if at least one spouse works and has earned income. If you are an employee, earned income includes all the taxable income you get from your employer. If you are self-employed or a statutory employee, you will figure your earned income on EIC Worksheet B in the instructions for Form 1040.

Earned Income

Earned income includes all of the following types of income.

1. Wages, salaries, tips, and other taxable employee pay. Employee pay is earned income only if it is taxable. Nontaxable employee pay, such as certain dependent care benefits and adoption benefits, is not earned income. But there is an exception for nontaxable combat pay, which you can choose to include in earned income, as explained below.
2. Net earnings from self-employment.
3. Gross income received as a statutory employee.

Wages, salaries, and tips. Wages, salaries, and tips you receive for working are reported to you on Form W-2, in box 1. You should report these on line 1 (Form 1040EZ) or line 7 (Forms 1040A and 1040).

Nontaxable combat pay election. You can elect to include your nontaxable combat pay in earned income for the earned income credit. Electing to include nontaxable combat pay in earned income may increase or decrease your EIC. Figure the credit with and without your nontaxable combat pay before making the election. If you make the election, you must include in earned income all nontaxable combat pay you received. If you are filing a joint return and both you and your spouse received nontaxable combat pay, you can each make your own election. The amount of your nontaxable combat pay should be shown in box 12 of your Form W-2 with code “Q”.

Self-employed persons and statutory employees. If you are self-employed or received income as a statutory employee, you must use the Form 1040 instructions to see if you qualify to get the EIC.

Approved Form 4361 or Form 4029

This section is for persons who have an approved:

- Form 4361, Application for Exemption From Self-Employment Tax for Use by Ministers, Members of Religious Orders and Christian Science Practitioners, or
- Form 4029, Application for Exemption From Social Security and Medicare Taxes and Waiver of Benefits.

Each approved form exempts certain income from social security taxes. Each form is discussed here in terms of what is or is not earned income for the EIC.

Form 4361. Even if you have an approved Form 4361, amounts you received for performing ministerial duties as an employee count as earned income. This includes wages, salaries, tips, and other taxable employee compensation. A nontaxable housing allowance or the nontaxable rental value of a home is not earned income. Also, amounts you received for performing ministerial duties, but not as an employee, do not count as earned income. Examples include fees for performing marriages and honoraria for delivering speeches.

Form 4029. Even if you have an approved Form 4029, all wages, salaries, tips, and other taxable employee compensation count as earned income. However, amounts you received as a self-employed individual do not count as earned income. Also, in figuring earned income, do not subtract losses on Schedule C, C-EZ, or F from wages on line 7 of Form 1040.

Disability Benefits

If you retired on disability, taxable benefits you receive under your employer's disability retirement plan are considered earned income until you reach minimum retirement age. Minimum retirement age generally is the earliest age at which you could have received a pension or annuity if you were not disabled. You must report your taxable disability payments on line 7 of either Form 1040 or Form 1040A until you reach minimum retirement age.

Beginning on the day after you reach minimum retirement age, payments you receive are taxable as a pension and are not considered earned income. Report taxable pension payments on Form 1040, lines 16a and 16b (or Form 1040A, lines 12a and 12b).

Disability insurance payments. Payments you received from a disability insurance policy that you paid the premiums for are not earned income. It does not matter whether you have reached minimum retirement age. If this policy is through your employer, the amount may be shown in box 12 of your Form W-2 with code “J.”

Income That Is Not Earned Income

Examples of items that are **not** earned income include interest and dividends, pensions and annuities, social security and railroad retirement benefits (including disability benefits), alimony and child support, welfare benefits, workers' compensation benefits, unemployment compensation (insurance), nontaxable foster care payments, and veterans' benefits, including VA rehabilitation payments. Do **not** include any of these items in your earned income.

Earnings while an inmate. Amounts received for work performed while an inmate in a penal institution are not earned income when figuring the earned income credit. This includes amounts for work performed while in a work release program or while in a halfway house.

Workfare payments. Nontaxable workfare payments are not earned income for the EIC. These are cash payments certain people receive from a state or local agency that administers public assistance programs funded under the federal Temporary Assistance for Needy Families (TANF) program in return for certain work activities such as (1) work experience activities (including remodeling or repairing public housing) if private sector employment is not available, or (2) community service program activities.

Community property. If you are married, but qualify to file as head of household under special rules for married taxpayers living apart (see *Rule 3*), and live in a state that has community property laws, your earned income for the EIC does not include any amount earned by your spouse that is treated as belonging to you under those laws. That amount is not earned income for the EIC, even though you must include it in your gross income on your income tax return. Your earned income includes the entire amount you earned, even if part of it is treated as belonging to your spouse under your state's community property laws.

Nevada, Washington, and California domestic partners. If you are a registered domestic partner in Nevada, Washington, or California (or a same-sex spouse in California), the same rules apply. Your earned income for the EIC does not include any amount earned by your partner (or same-sex spouse). Your earned income includes the entire amount you earned. For details, see Publication 555.

Conservation Reserve Program (CRP) payments. If you were receiving social security retirement benefits or social security disability benefits at the time you received any CRP payments, your CRP payments are not earned income for the EIC.

Nontaxable military pay. Nontaxable pay for members of the Armed Forces is not considered earned income for the EIC. Examples of nontaxable military pay are combat pay, the Basic Allowance for Housing (BAH), and the Basic Allowance for Subsistence (BAS). See Publication 3, Armed Forces' Tax Guide, for more information.

TIP *__Combat pay.__ You can elect to include your nontaxable combat pay in earned income for the EIC. See Nontaxable combat pay election, earlier.*

Part B. Rules If You Have a Qualifying Child

If you have met all of the rules in *Part A*, read *Part B* to see if you have a qualifying child.

Part B discusses *Rules 8* through *10*. You must meet all three of these rules, in addition to the rules in *Parts A* and *D*, to qualify for the earned income credit with a qualifying child.

You must file Form 1040 or Form 1040A to claim the EIC with a qualifying child. (You cannot file Form 1040EZ.) You also must complete Schedule EIC and attach it to your return. If you meet all the rules in *Part A* and this part, read *Part D* to find out what to do next.

CAUTION *If you do not meet Rule 8, you do not have a qualifying child. Read Part C to find out if you can get the earned income credit without a qualifying child.*

Rule 8. Your Child Must Meet the Relationship, Age, Residency, and Joint Return Tests

Your child is a qualifying child if your child meets four tests. The four tests are:

1. Relationship,
2. Age,
3. Residency, and
4. Joint return.

The four tests are illustrated in Figure 35-1. The paragraphs that follow contain more information about each test.

Relationship Test

To be your qualifying child, a child must be your:

- Son, daughter, stepchild, foster child, or a descendant of any of them (for example, your grandchild), or
- Brother, sister, half brother, half sister, stepbrother, stepsister, or a descendant of any of them (for example, your niece or nephew).

The following definitions clarify the relationship test.

Adopted child. An adopted child is always treated as your own child. The term "adopted child" includes a child who was lawfully placed with you for legal adoption.

Foster child. For the EIC, a person is your foster child if the child is placed with you by an authorized placement agency or by judgement, decree, or other order of any court of competent jurisdiction. An authorized placement agency includes a state or local government agency. It also includes a tax-exempt organization licensed by a state. In addition, it includes an Indian tribal government or an organization authorized by an Indian tribal government to place Indian children.

Example. Debbie, who is 12 years old, was placed in your care 2 years ago by an authorized agency responsible for placing children in foster homes. Debbie is your foster child.

Age Test

Your child must be:

1. Under age 19 at the end of 2012 and younger than you (or your spouse, if filing jointly),
2. Under age 24 at the end of 2012, a student, and younger than you (or your spouse, if filing jointly), or
3. Permanently and totally disabled at any time during 2012, regardless of age.

The following examples and definitions clarify the age test.

Example 1—child not under age 19. Your son turned 19 on December 10. Unless he was permanently and totally disabled or a student, he is not a qualifying child because, at the end of the year, he was not **under** age 19.

Example 2—child not younger than you or your spouse. Your 23-year-old brother, who is a full-time student and unmarried, lives with you and your spouse. He is not disabled. Both you and your spouse are 21 years old and you file a joint return. Your brother is not your qualifying child because he is not younger than you or your spouse.

Example 3—child younger than your spouse but not younger than you. The facts are the same as in *Example 2* except that your spouse is 25 years old. Because your brother is younger than your spouse, he is your qualifying child even though he is not younger than you.

Student defined. To qualify as a student, your child must be, during some part of each of any 5 calendar months during the calendar year:

1. A full-time student at a school that has a regular teaching staff, course of study, and regular student body at the school, or
2. A student taking a full-time, on-farm training course given by a school described in (1), or a state, county, or local government.

The 5 calendar months need not be consecutive.

A full-time student is a student who is enrolled for the number of hours or courses the school considers to be full-time attendance.

School defined. A school can be an elementary school, junior or senior high school, college, university, or technical, trade, or mechanical school. However, on-the-job training courses, correspondence schools, and schools offering courses only through the Internet do not count as schools for the EIC.

Vocational high school students. Students who work in co-op jobs in private industry as a part of a school's regular course of classroom and practical training are considered full-time students.

Permanently and totally disabled. Your child is permanently and totally disabled if both of the following apply.

1. He or she cannot engage in any substantial gainful activity because of a physical or mental condition.
2. A doctor determines the condition has lasted or can be expected to last continuously for at least a year or can lead to death.

Residency Test

Your child must have lived with you in the United States for more than half of 2012. The following definitions clarify the residency test.

United States. This means the 50 states and the District of Columbia. It does not include Puerto Rico or U.S. possessions such as Guam.

Homeless shelter. Your home can be any location where you regularly live. You do not need a traditional home. For example, if your child lived with you for more than half the year in one or more homeless shelters, your child meets the residency test.

Military personnel stationed outside the United States. U.S. military personnel stationed outside the United States on extended active duty are considered to live in the United States during that duty period for purposes of the EIC.

Figure 35-1. **Tests for Qualifying Child**

Relationship

A qualifying child is a child who is your . . .

Son, daughter, stepchild, foster child, or a descendant of any of them (for example, your grandchild)

OR

Brother, sister, half brother, half sister, stepbrother, stepsister, or a descendant of any of them (for example, your niece or nephew)

AND

Age

was . . .

Under age 19 at the end of 2012 and younger than you (or your spouse, if filing jointly)

OR

Under age 24 at the end of 2012, a student, and younger than you (or your spouse, if filing jointly)

OR

Permanently and totally disabled at any time during the year, regardless of age

AND

Joint Return

Who is not filing a joint return for 2012 (or is filing a joint return for 2012 only to claim a refund of income tax withheld or estimated tax paid)

AND

Residency

Who lived with you in the United States for more than half of 2012.

Extended active duty. Extended active duty means you are called or ordered to duty for an indefinite period or for a period of more than 90 days. Once you begin serving your extended active duty, you are still considered to have been on extended active duty even if you do not serve more than 90 days.

Birth or death of a child. A child who was born or died in 2012 is treated as having lived with you for more than half of 2012 if your home was the child's home for more than half the time he or she was alive in 2012.

Temporary absences. Count time that you or your child is away from home on a temporary absence due to a special circumstance as time the child lived with you. Examples of a special circumstance include illness, school attendance, business, vacation, military service, and detention in a juvenile facility.

Kidnapped child. A kidnapped child is treated as living with you for more than half of the year if the child lived with you for more than half the part of the year before the date of the kidnapping. The child must be presumed by law enforcement authorities to have been kidnapped by someone who is not a member of your family or your child's family. This treatment applies for all years until the child is returned. However, the last year this treatment can apply is the earlier of:

1. The year there is a determination that the child is dead, or
2. The year the child would have reached age 18.

If your qualifying child has been kidnapped and meets these requirements, enter "KC," instead of a number, on line 6 of Schedule EIC.

Joint Return Test

To meet this test, the child cannot file a joint return for the year.

Exception. An exception to the joint return test applies if your child and his or her spouse file a joint return only to claim a refund of income tax withheld or estimated tax paid.

Example 1—child files joint return. You supported your 18-year-old daughter, and she lived with you all year while her husband was in the Armed Forces. The couple files a joint return. Because your daughter and her husband filed a joint return, she is not your qualifying child.

Example 2—child files joint return only to claim a refund of withheld tax. Your 18-year-old son and his 17-year-old wife had $800 of wages from part-time jobs and no other income. They do not have a child. Neither is required to file a tax return. Taxes were taken out of their pay, so they filed a joint return only to get a refund of the withheld taxes. The exception to the joint return test applies, so your son may be your qualifying child if all the other tests are met.

Example 3—child files joint return to claim American opportunity credit. The facts are the same as in *Example 2* except no taxes were taken out of your son's pay. He and his wife are not required to file a tax return, but they file a joint return to claim an American opportunity credit of $124 and get a refund of that amount. Because claiming the American opportunity credit is their reason for filing the return, they are not filing it only to get a refund of income tax withheld or estimated tax paid. The exception to the joint return test does not apply, so your son is not your qualifying child.

Married child. Even if your child does not file a joint return, if your child was married at the end of the year, he or she cannot be your qualifying child unless:

1. You can claim an exemption for the child, or
2. The reason you cannot claim an exemption for the child is that you let the child's other parent claim the exemption under the *Special rule for divorced or separated parents (or parents who live apart)*, described later.

Social security number. The qualifying child must have a valid social security number (SSN) unless the child was born and died in 2012 and you attach to your return a copy of the child's birth certificate, death certificate, or hospital records showing a live birth. You cannot claim the EIC on the basis of a qualifying child if:

1. The qualifying child's SSN is missing from your tax return or is incorrect,
2. The qualifying child's social security card says "Not valid for employment" and was issued for use in getting a federally funded benefit, or
3. Instead of an SSN, the qualifying child has:
   a. An individual taxpayer identification number (ITIN), which is issued to a noncitizen who cannot get an SSN, or
   b. An adoption taxpayer identification number (ATIN), which is issued to adopting parents who cannot get an SSN for the child being adopted until the adoption is final.

If you have more than one qualifying child and only one has a valid SSN, you can claim the EIC only on the basis of that child. For more information about SSNs, see *Rule 2*.

Rule 9. Your Qualifying Child Cannot Be Used By More Than One Person To Claim the EIC

Sometimes a child meets the tests to be a qualifying child of more than one person. However, only one of these persons can actually treat the child as a qualifying child. Only that person can use the child as a qualifying child to take all of the following tax benefits (provided the person is eligible for each benefit).

1. The exemption for the child.
2. The child tax credit.
3. Head of household filing status.
4. The credit for child and dependent care expenses.
5. The exclusion for dependent care benefits.
6. The EIC.

The other person cannot take any of these benefits based on this qualifying child. In other words, you and the other person cannot agree to divide these tax benefits between you. The other person cannot take any of these tax benefits unless he or she has a different qualifying child.

The tiebreaker rules explained next explain who, if anyone, can claim the EIC when more than one person has the same qualifying child. However, the tiebreaker rules do not apply if the other person is your spouse and you file a joint return.

Tiebreaker rules. To determine which person can treat the child as a qualifying child to claim the six tax benefits just listed, the following tiebreaker rules apply.

- If only one of the persons is the child's parent, the child is treated as the qualifying child of the parent.
- If the parents do not file a joint return together but both parents claim the child as a qualifying child, the IRS will treat the child as the qualifying child of the parent with whom the child lived for the longer period of time during the year. If the child lived with each parent for the same amount of time, the IRS will treat the child as the qualifying child of the parent who had the higher adjusted gross income (AGI) for the year.
- If no parent can claim the child as a qualifying child, the child is treated as the qualifying child of the person who had the highest AGI for the year.
- If a parent can claim the child as a qualifying child but no parent does so claim the child, the child is treated as the qualifying child of the person who had the highest AGI for the year, but only if that person's AGI is higher than the highest AGI of any of the child's parents who can claim the child. If the child's parents file a joint return with each other, this rule can be applied by treating the parents' total AGI as divided evenly between them. See *Example 8*.

Subject to these tiebreaker rules, you and the other person may be able to choose which of you claims the child as a qualifying child. See *Examples 1* through *13*.

If you cannot claim the EIC because your qualifying child is treated under the tiebreaker rules as the qualifying child of another person for 2012, you may be able to take the EIC using a different qualifying child, but you cannot take the EIC using the rules in *Part C* for people who do not have a qualifying child.

If the other person cannot claim the EIC. If you and someone else have the same qualifying child but the other person cannot claim the EIC because he or she is not eligible or his or her earned income or AGI is too high, you may be able to treat the child as a qualifying child. See *Examples 6* and *7*. But you cannot treat the child as a qualifying child to claim the EIC if the other person uses the child to claim any of the other six tax benefits listed earlier.

Examples. The following examples may help you in determining whether you can claim the EIC when you and someone else have the same qualifying child.

Example 1. You and your 2-year-old son Jimmy lived with your mother all year. You are 25 years old, unmarried, and your AGI is $9,000. Your only income was $9,000 from a part-time job. Your mother's only income was $20,000 from her job, and her AGI is $20,000. Jimmy's father did not live with you or Jimmy. The special rule explained later for divorced or separated parents (or parents who live apart) does not apply. Jimmy is a qualifying child of both you and your mother because he meets the relationship, age, residency, and joint return tests for both you and your mother. However, only one of you can treat him as a qualifying child to claim the EIC (and the other tax benefits listed earlier for which that person qualifies). He is not a qualifying child of anyone else, including his father. If you do not claim Jimmy as a qualifying child for the EIC or any of the other tax benefits listed earlier, your mother can treat him as a qualifying child to claim the EIC (and any of the other tax benefits listed earlier for which she qualifies).

Example 2. The facts are the same as in *Example 1* except your AGI is $25,000. Because your mother's AGI is not higher than yours, she cannot claim Jimmy as a qualifying child. Only you can claim him.

Example 3. The facts are the same as in *Example 1* except that you and your mother both claim Jimmy as a qualifying child. In this case, you as the child's parent will be the only one allowed to claim Jimmy as a qualifying child for the EIC and the other tax benefits listed earlier for which you qualify. The IRS will disallow your mother's claim to the EIC and any of the other tax benefits listed earlier unless she has another qualifying child.

Example 4. The facts are the same as in *Example 1* except that you also have two other young children who are qualifying children of both you and your mother. Only one of you can claim each child. However, if your mother's AGI is higher than yours, you can allow your mother to claim one or more of the children. For example, if you claim one child, your mother can claim the other two.

Example 5. The facts are the same as in *Example 1* except that you are only 18 years old. This means you are a qualifying child of your mother. Because of *Rule 10*, discussed next, you cannot claim the EIC and cannot claim Jimmy as a qualifying child. Only your mother may be able to treat Jimmy as a qualifying child to claim the EIC. If your mother meets all the other requirements for claiming the EIC and you do not claim Jimmy as a qualifying child for any of the other tax benefits listed earlier, your mother can claim both you and Jimmy as qualifying children for the EIC.

Example 6. The facts are the same as in *Example 1* except that your mother earned $50,000 from her job. Because your mother's earned income is too high for her to claim the EIC, only you can claim the EIC using your son.

Example 7. The facts are the same as in *Example 1* except that you earned $50,000 from your job and your AGI is $50,500. Your earned income is too high for you to claim the EIC. But your mother cannot claim the EIC either, because her AGI is not higher than yours.

Example 8. The facts are the same as in *Example 1* except that you and Jimmy's father are married to each other, live with Jimmy and your mother, and have an AGI of $30,000 on a joint return. If you and your husband do not claim Jimmy as a qualifying child for the EIC or any of the other tax benefits listed earlier, your mother can claim him instead. Even though the AGI on your joint return, $30,000, is more than your mother's AGI of $20,000, for this purpose half of the joint AGI can be treated as yours and half as your husband's. In other words, each parent's AGI can be treated as $15,000.

Example 9. You, your husband, and your 10-year-old son Joey lived together until August 1, 2012, when your husband moved out of the household. In August and September, Joey lived with you. For the rest of the year, Joey lived with your husband, who is Joey's father. Joey is a qualifying child of both you and your husband because he lived with each of you for more than half the year and because he met the relationship, age, and joint return tests for both of you. At the end of the year, you and your husband still were not divorced, legally separated, or separated under a written separation agreement, so the special rule for divorced or separated parents (or parents who live apart) does not apply.

You and your husband will file separate returns. Your husband agrees to let you treat Joey as a qualifying child. This means, if your husband does not claim Joey as a qualifying child for any of the tax benefits listed earlier, you can claim him as a qualifying child for any tax benefit listed earlier for which you qualify. However, your filing status is married filing separately, so you cannot claim the EIC or the credit for child and dependent care expenses. See *Rule 3*.

Example 10. The facts are the same as in *Example 9* except that you and your husband both claim Joey as a qualifying child. In this case, only your husband will be allowed to treat Joey as a qualifying child. This is because, during 2012, the boy lived with him longer than with you. You cannot claim the EIC (either with or without a qualifying child). However, your husband's filing status is married filing separately, so he cannot claim the EIC or the credit for child and dependent care expenses. See *Rule 3*.

Example 11. You, your 5-year-old son and your son's father lived together all year. You and your son's father are not married. Your son is a qualifying child of both you and his father because he meets the relationship, age, residency, and joint return tests for both you and his father. Your earned income and AGI are $12,000, and your son's father's earned income and AGI are $14,000. Neither of you had any other income. Your son's father agrees to let you treat the child as a qualifying child. This means, if your son's father does not claim your son as a qualifying child for the EIC or any of the other tax benefits listed earlier, you can claim him as a qualifying child for the EIC and any of the other tax benefits listed earlier for which you qualify.

Example 12. The facts are the same as in *Example 11* except that you and your son's father both claim your son as a qualifying child. In this case, only your son's father will be allowed to treat your son as a qualifying child. This is because his AGI, $14,000, is more than your AGI, $12,000. You cannot claim the EIC (either with or without a qualifying child).

Example 13. You and your 7-year-old niece, your sister's child, lived with your mother all year. You are 25 years old, and your AGI is $9,300. Your only income was from a part-time job. Your mother's AGI is $15,000. Her only income was from her job. Your niece's parents file jointly, have an AGI of less than $9,000, and do not live with you or their child. Your niece is a qualifying child of both you and your mother because she meets the relationship, age, residency, and joint return tests for both you and your mother. However, only your mother can treat her as a qualifying child. This is because your mother's AGI, $15,000, is more than your AGI, $9,300.

Special rule for divorced or separated parents (or parents who live apart). A child will be treated as the qualifying child of his or her noncustodial parent (for purposes of claiming an exemption and the child tax credit, but not for the EIC) if all of the following apply.

1. The parents:
   a. Are divorced or legally separated under a decree of divorce or separate maintenance,
   b. Are separated under a written separation agreement, or
   c. Lived apart at all times during the last 6 months of 2012, whether or not they are or were married.
2. The child received over half of his or her support for the year from the parents.
3. The child is in the custody of one or both parents for more than half of 2012.
4. Either of the following statements is true.
   a. The custodial parent signs Form 8332 or a substantially similar statement that he or she will not claim the child as a dependent for the year, and the noncustodial parent attaches the form or statement to his or her return. If the divorce decree or separation agreement went into effect after 1984 and before 2009, the noncustodial parent may be able to attach certain pages from the decree or agreement instead of Form 8332.
   b. A pre-1985 decree of divorce or separate maintenance or written separation agreement that applies to 2012

provides that the noncustodial parent can claim the child as a dependent, and the noncustodial parent provides at least $600 for support of the child during 2012.

For details, see chapter 3. Also see *Applying Rule 9 to divorced or separated parents (or parents who live apart)*, next.

Applying Rule 9 to divorced or separated parents (or parents who live apart). If a child is treated as the qualifying child of the noncustodial parent under the special rule just described for children of divorced or separated parents (or parents who live apart), only the noncustodial parent can claim an exemption and the child tax credit for the child. However, the custodial parent, if eligible, or another eligible taxpayer can claim the child as a qualifying child for the EIC and other tax benefits listed earlier in this chapter. If the child is the qualifying child of more than one person for these benefits, then the tiebreaker rules determine which person can treat the child as a qualifying child.

Example 1. You and your 5-year-old son lived all year with your mother, who paid the entire cost of keeping up the home. Your AGI is $10,000. Your mother's AGI is $25,000. Your son's father did not live with you or your son. Under the special rule for children of divorced or separated parents (or parents who live apart), your son is treated as the qualifying child of his father, who can claim an exemption and the child tax credit for the child. However, your son's father cannot claim your son as a qualifying child for head of household filing status, the credit for child and dependent care expenses, the exclusion for dependent care benefits, or the EIC. You and your mother did not have any child care expenses or dependent care benefits. If you do not claim your son as a qualifying child, your mother can claim him as a qualifying child for the EIC and head of household filing status, if she qualifies for these tax benefits.

Example 2. The facts are the same as in *Example 1* except that your AGI is $25,000 and your mother's AGI is $21,000. Your mother cannot claim your son as a qualifying child for any purpose because her AGI is not higher than yours.

Example 3. The facts are the same as in *Example 1* except that you and your mother both claim your son as a qualifying child for the EIC. Your mother also claims him as a qualifying child for head of household filing status. You as the child's parent will be the only one allowed to claim your son as a qualifying child for the EIC. The IRS will disallow your mother's claim to the EIC and head of household filing status unless she has another qualifying child.

Rule 10. You Cannot Be a Qualifying Child of Another Taxpayer

You are a qualifying child of another taxpayer (your parent, guardian, foster parent, etc.) if all of the following statements are true.

1. You are that person's son, daughter, stepchild, grandchild, or foster child. Or, you are that person's brother, sister, half brother, half sister, stepbrother, or stepsister (or the child or grandchild of that person's brother, sister, half brother, half sister, stepbrother, or stepsister).
2. You were:
   a. Under age 19 at the end of the year and younger than that person (or that person's spouse, if the person files jointly),
   b. Under age 24 at the end of the year, a student, and younger than that person (or that person's spouse, if the person files jointly), or
   c. Permanently and totally disabled, regardless of age.
3. You lived with that person in the United States for more than half of the year.
4. You are not filing a joint return for the year (or are filing a joint return only as a claim for refund).

For more details about the tests to be a qualifying child, see *Rule 8*.

If you (or your spouse, if filing a joint return) are a qualifying child of another taxpayer, you cannot claim the EIC. This is true even if the person for whom you are a qualifying child does not claim the EIC or meet all of the rules to claim the EIC. Put "No" beside line 64a (Form 1040) or line 38a (Form 1040A).

Example. You and your daughter lived with your mother all year. You are 22 years old, unmarried, and attended a trade school full time. You had a part-time job and earned $5,700. You had no other income. Because you meet the relationship, age, residency, and joint return tests, you are a qualifying child of your mother. She can claim the EIC if she meets all the other requirements. Because you are your mother's qualifying child, you cannot claim the EIC. This is so even if your mother cannot or does not claim the EIC.

Child of person not required to file a return. You are not the qualifying child of another taxpayer (and so may qualify to claim the EIC) if your parent (or other person for whom you meet the relationship, age, residency, and joint return tests) is not required to file an income tax return and either:

- Does not file an income tax return, or
- Files a return only to get a refund of income tax withheld or estimated tax paid.

Example. The facts are the same as in the last example except your mother had no gross income, is not required to file a 2012 tax return, and does not file a 2012 tax return. As a result, you are not your mother's qualifying child. You can claim the EIC if you meet all the other requirements to do so.

See *Rule 10* in Publication 596 for additional examples.

Part C. Rules If You Do Not Have a Qualifying Child

Read this part if you:

1. Do not have a qualifying child, and
2. Have met all the rules in *Part A*.

Part C discusses *Rules 11* through *14.* You must meet all four of these rules, in addition to the rules in *Parts A* and *D*, to qualify for the earned income credit without a qualifying child.

If you have a qualifying child, the rules in this part do not apply to you. You can claim the credit only if you meet all the rules in Parts A, B, *and* D. *See* Rule 8 *to find out if you have a qualifying child.*

Rule 11. You Must Be at Least Age 25 but Under Age 65

You must be at least age 25 but under age 65 at the end of 2012. If you are married filing a joint return, either you or your spouse must be at least age 25 but under age 65 at the end of 2012. It does not matter which spouse meets the age test, as long as one of the spouses does.

You meet the age test if you were born after December 31, 1947, and before January 2, 1988. If you are married filing a joint return, you meet the age test if either you or your spouse was born after December 31, 1947, and before January 2, 1988.

If neither you nor your spouse meets the age test, you cannot claim the EIC. Put "No" next to line 64a (Form 1040), line 38a (Form 1040A), or line 8a (Form 1040EZ).

Death of spouse. If you are filing a joint return with your spouse who died in 2012, you meet the age test if your spouse was at least age 25 but under age 65 at the time of death.

Example 1. You are age 28 and unmarried. You meet the age test.

Example 2. You are married and filing a joint return. You are age 23 and your spouse is age 27. You meet the age test because your spouse is at least age 25 but under age 65.

Example 3. You are married and filing a joint return with your spouse who died in August 2012. You are age 67. Your spouse would have been age 65 in November 2012. Because your spouse was under age 65 when she died, you meet the age test.

Rule 12. You Cannot Be the Dependent of Another Person

If you are **not** filing a joint return, you meet this rule if:

- You checked box 6a on Form 1040 or 1040A, or
- You did not check the "You" box on line 5 of Form 1040EZ, and you entered $9,750 on that line.

If you are filing a joint return, you meet this rule if:

- You checked both box 6a and box 6b on Form 1040 or 1040A, or
- You and your spouse did not check either the "You" box or the "Spouse" box on line 5 of Form 1040EZ, and you entered $19,500 on that line.

If you are not sure whether someone else can claim you (or your spouse if filing a joint return) as a dependent, read the rules for claiming a dependent in chapter 3.

If someone else can claim you (or your spouse if filing a joint return) as a dependent on his or her return, but does not, you still cannot claim the credit.

Example 1. In 2012, you were age 25, single, and living at home with your parents. You worked and were not a student. You earned $7,500. Your parents cannot claim you as a dependent. When you file your return, you claim an exemption for yourself by not checking the "You" box on line 5 of your Form 1040EZ and by entering $9,750 on that line. You meet this rule. You can claim the EIC if you meet all the other requirements.

Example 2. The facts are the same as in *Example 1*, except that you earned $2,000. Your parents can claim you as a dependent but decide not to. You do not meet this rule. You cannot claim the credit because your parents could have claimed you as a dependent.

Joint returns. You generally cannot be claimed as a dependent by another person if you are married and file a joint return.

However, another person may be able to claim you as a dependent if you and your spouse file a joint return only to get a refund of income tax withheld or estimated tax paid. But neither you nor your spouse can be claimed as a dependent by another person if you claim the EIC on your joint return.

Example 1. You are 26 years old. You and your wife live with your parents and had $800 of wages from part-time jobs and no other income. Neither you nor your wife is required to file a tax return. You do not have a child. Taxes were taken out of your pay, so you file a joint return only to get a refund of the withheld taxes. Your parents are not disqualified from claiming an exemption for you just because you filed a joint return. They can claim exemptions for you and your wife if all the other tests to do so are met.

Example 2. The facts are the same as in Example 1 except no taxes were taken out of your pay. Also, you and your wife are not required to file a tax return, but you file a joint return to claim an EIC of $63 and get a refund of that amount. Because claiming the EIC is your reason for filing the return, you are not filing it only to get a refund of income tax withheld or estimated tax paid. Your parents cannot claim an exemption for either you or your wife.

Rule 13. You Cannot Be a Qualifying Child of Another Taxpayer

You are a qualifying child of another taxpayer (your parent, guardian, foster parent, etc.) if all of the following statements are true.

1. You are that person's son, daughter, stepchild, grandchild, or foster child. Or, you are that person's brother, sister, half brother, half sister, stepbrother, or stepsister (or the child or grandchild of that person's brother, sister, half brother, half sister, stepbrother, or stepsister).
2. You were:
   a. Under age 19 at the end of the year and younger than that person (or that person's spouse, if the person files jointly),
   b. Under age 24 at the end of the year, a student (as defined in *Rule 8*), and younger than that person (or that person's spouse, if the person files jointly), or
   c. Permanently and totally disabled, regardless of age.
3. You lived with that person in the United States for more than half of the year.
4. You are not filing a joint return for the year (or are filing a joint return only as a claim for refund).

For more details about the tests to be a qualifying child, see *Rule 8*.

If you (or your spouse if filing a joint return) are a qualifying child of another taxpayer, you cannot claim the EIC. This is true even if the person for whom you are a qualifying child does not claim the EIC or meet all of the rules to claim the EIC. Put "No" next to line 64a (Form 1040), line 38a (Form 1040A), or line 8a (Form 1040EZ).

Example. You lived with your mother all year. You are age 26, unmarried, and permanently and totally disabled. Your only income was from a community center where you went three days a week to answer telephones. You earned $5,000 for the year and provided more than half of your own support. Because you meet the relationship, age, residency, and joint return tests, you are a qualifying child of your mother for the EIC. She can claim the EIC if she meets all the other requirements. Because you are a qualifying child of your mother, you cannot claim the EIC. This is so even if your mother cannot or does not claim the EIC.

Joint returns. You generally cannot be a qualifying child of another taxpayer if you are married and file a joint return.

However, you may be a qualifying child of another taxpayer if you and your spouse file a joint return for the year only to get a refund of income tax withheld or estimated tax paid. But neither you nor your spouse can be a qualifying child of another taxpayer if you claim the EIC on your joint return.

Child of person not required to file a return. You are not the qualifying child of another taxpayer (and so may qualify to claim the EIC) if your parent (or other person for whom you meet the relationship, age, residency, and joint return tests) is not required to file an income tax return and either:

- Does not file an income tax return, or
- Files a return only to get a refund of income tax withheld or estimated tax paid.

Example. You lived all year with your father. You are 27 years old, unmarried, permanently and totally disabled, and earned $13,000. You have no other income, no children, and provided more than half of your own support. Your father had no gross income, is not required to file a 2012 tax return, and does not file a 2012 tax return. As a result, you are not your father's qualifying child. You can claim the EIC if you meet all the other requirements to do so.

See *Rule 13* in Publication 596 for additional examples.

Rule 14. You Must Have Lived in the United States More Than Half of the Year

Your home (and your spouse's, if filing a joint return) must have been in the United States for more than half the year.

If it was not, put "No" next to line 64a (Form 1040), line 38a (Form 1040A), or line 8a (Form 1040EZ).

United States. This means the 50 states and the District of Columbia. It does not include Puerto Rico or U.S. possessions such as Guam.

Homeless shelter. Your home can be any location where you regularly live. You do not need a traditional home. If you lived in one or more homeless shelters in the United States for more than half the year, you meet this rule.

Military personnel stationed outside the United States. U.S. military personnel stationed outside the United States on extended active duty (defined in *Rule 8*) are considered to live in the United States during that duty period for purposes of the EIC.

Part D. Figuring and Claiming the EIC

Read this part if you have met all the rules in *Parts A* and *B*, or all the rules in *Parts A* and *C*.

Part D discusses *Rule 15*. You must meet this rule, in addition to the rules in *Parts A* and *B*, or *Parts A* and *C*, to qualify for the earned income credit.

This part of the chapter also explains how to figure the amount of your credit. You have two choices.

1. Have the IRS figure the EIC for you. If you want to do this, see *IRS Will Figure the EIC for You*.
2. Figure the EIC yourself. If you want to do this, see *How To Figure the EIC Yourself*.

Rule 15. Your Earned Income Must Be Less Than:

- $45,060 ($50,270 for married filing jointly) if you have three or more qualifying children,
- $41,952 ($47,162 for married filing jointly) if you have two qualifying children,
- $36,920 ($42,130 for married filing jointly) if you have one qualifying child, or
- $13,980 ($19,190 for married filing jointly) if you do not have a qualifying child.

Earned income generally means wages, salaries, tips, other taxable employee pay, and net earnings from self-employment. Employee pay is earned income only if it is taxable. Nontaxable employee pay, such as certain dependent care benefits and adoption benefits, is not earned income. But there is an exception for nontaxable combat pay, which you can choose to include in earned income. Earned income is explained in detail in *Rule 7*.

Figuring earned income. If you are self-employed, a statutory employee, or a member of the clergy or a church employee who files Schedule SE (Form 1040), you will figure your earned income when you fill out Part 4 of EIC Worksheet B in the Form 1040 instructions.

Otherwise, figure your earned income by using the worksheet in *Step 5* of the Form 1040 instructions for lines 64a and 64b or the Form 1040A instructions for lines 38a and 38b, or the worksheet in *Step 2* of the Form 1040EZ instructions for lines 8a and 8b.

When using one of those worksheets to figure your earned income, you will start with the amount on line 7 (Form 1040 or Form 1040A) or line 1 (Form 1040EZ). You will then reduce that amount by any amount included on that line and described in the following list.

- Scholarship or fellowship grants not reported on a Form W-2,
- Inmate's income, and
- Pension or annuity from deferred compensation plans.

Scholarship or fellowship grants not reported on a Form W-2. A scholarship or fellowship grant that was not reported to you on a Form W-2 is not considered earned income for the earned income credit.

Inmate's income. Amounts received for work performed while an inmate in a penal institution are not earned income for the earned income credit. This includes amounts received for work performed while in a work release program or while in a halfway house. If you received any amount for work done while an inmate in a penal institution and that amount is included in the total on line 7 (Form 1040 or Form 1040A) or line 1 (Form 1040EZ), put "PRI" and the amount on the dotted line next to line 7 (Form 1040), in the space to the left of the entry space for line 7 (Form 1040A), or in the space to the left of line 1 (Form 1040EZ).

Pension or annuity from deferred compensation plans. A pension or annuity from a nonqualified deferred compensation plan or a nongovernmental section 457 plan is not considered earned income for the earned income credit. If you received such an amount and it was included in the total on line 7 (Form 1040 or Form 1040A) or line 1 (Form 1040EZ), put "DFC" and the amount on the dotted line next to line 7 (Form 1040), in the space to the left of the entry space for line 7 (Form 1040A), or in the space to the left of line 1 (Form 1040EZ). This amount may be reported in box 11 of your Form W-2. If you received such an amount but box 11 is blank, contact your employer for the amount received as a pension or annuity.

Clergy. If you are a member of the clergy who files Schedule SE and the amount on line 2 of that schedule includes an amount that was also reported on line 7 (Form 1040), subtract that amount from the amount on line 7 (Form 1040) and enter the result in the first space of the worksheet in *Step 5* of the Form 1040 instructions for lines 64a and 64b. Put "Clergy" on the dotted line next to line 64a (Form 1040).

Church employees. A church employee means an employee (other than a minister or member of a religious order) of a church or qualified church-controlled organization that is exempt from employer social security and Medicare taxes. If you received wages as a church employee and included any amount on both line 5a of Schedule SE and line 7 (Form 1040), subtract that amount from the amount on line 7 (Form 1040) and enter the result in the first space of the worksheet in *Step 5* of the Form 1040 instructions for lines 64a and 64b.

IRS Will Figure the EIC for You

TIP *If you want the IRS to figure the amount of your EIC, see chapter 29.*

How To Figure the EIC Yourself

To figure the EIC yourself, use the EIC Worksheet in the instructions for the form you are using (Form 1040, Form 1040A, or Form 1040EZ). If you have a qualifying child, complete Schedule EIC and attach it to your return.

Special Instructions for Form 1040 Filers

If you file Form 1040, you will need to decide whether to use EIC Worksheet A or EIC Worksheet B to figure the amount of your EIC. This section explains how to use these worksheets and how to report the EIC on your return.

EIC Worksheet A. Use EIC Worksheet A if you were not self-employed at any time in 2012 and are not a member of the clergy, a church employee who files Schedule SE, or a statutory employee filing Schedule C or C-EZ.

EIC Worksheet B. Use EIC Worksheet B if you were self-employed at any time in 2012 or are a member of the clergy, a church employee who files Schedule SE, or a statutory employee filing Schedule C or C-EZ. If any of the following situations apply to you, read the paragraph and then complete EIC Worksheet B.

Net earnings from self-employment $400 or more. If your net earnings from self-employment are $400 or more, be sure to correctly fill out Schedule SE (Form 1040) and pay the proper amount of self-employment tax. If you do not, you may not get all the EIC you are entitled to.

CAUTION *When figuring your net earnings from self-employment, you must claim all your allowable business expenses.*

When to use the optional methods of figuring net earnings. Using the optional methods on Schedule SE to figure your net earnings from self-employment may qualify you for the EIC or give you a larger credit. If your net earnings (without using the optional methods) are less than $4,520, see the instructions for Schedule SE for details about the optional methods.

More information. If you and your spouse both have self-employment income or either of you is a statutory employee, see *How To Figure the EIC Yourself* in Publication 596.

Examples

The following two comprehensive examples (complete with filled-in forms) may be helpful.

1. John and Janet Smith, a married couple with one qualifying child and using Form 1040A.
2. Kelly Green, age 30, a student, with no qualifying child and using Form 1040EZ.

Example 1. John and Janet Smith (Form 1040A)

John and Janet Smith are married and will file a joint return. They have one child, Amy, who is 3 years old. Amy lived with John and Janet for all of 2012. John worked and earned $9,500. Janet worked part of the year and earned $1,500. Their earned income and AGI are $11,000. John and Janet qualify for the earned income credit and fill out the EIC Worksheet and Schedule EIC. The Smiths will attach Schedule EIC to Form 1040A when they send their completed return to the IRS.

They took the following steps to complete Schedule EIC and the EIC Worksheet.

Completing Schedule EIC

The Smiths complete Schedule EIC because they have a qualifying child. They enter "John and Janet Smith" and John's SSN (the SSN that appears first on their Form 1040A) on the line at the top of Schedule EIC. The Smiths then fill out *Qualifying Child Information* (lines 1 – 6).

Completing the EIC Worksheet

Next, the Smiths will complete the EIC Worksheet to figure their earned income credit.

Line 1. The Smiths enter $11,000 (their earned income).

Line 2. The Smiths go to the Earned Income Credit Table in the Form 1040A instructions. The Smiths find their income of $11,000 within the range of $11,000 to $11,050. They follow this line across to the column that describes their filing status and number of children and find $3,169. They enter $3,169 on line 2.

Line 3. The Smiths enter their AGI of $11,000.

Line 4. The Smiths check the “Yes” box because lines 1 and 3 are the same ($11,000). They skip line 5 and enter the amount from line 2 ($3,169) on line 6.

Line 6. The Smiths' EIC is $3,169.

SCHEDULE EIC
(Form 1040A or 1040)

Department of the Treasury
Internal Revenue Service (99)

Earned Income Credit

Qualifying Child Information

▶ *Complete and attach to Form 1040A or 1040 only if you have a qualifying child.*

▶ Information about Schedule EIC (Form 1040A or 1040) and its instructions is at *www.irs.gov/form1040.*

1040A
1040
EIC

OMB No. 1545-0074

2012

Attachment Sequence No. **43**

Name(s) shown on return	**Your social security number**
John and Janet Smith	222-00-2222

Before you begin:

- See the instructions for Form 1040A, lines 38a and 38b, or Form 1040, lines 64a and 64b, to make sure that **(a)** you can take the EIC, and **(b)** you have a qualifying child.
- Be sure the child's name on line 1 and social security number (SSN) on line 2 agree with the child's social security card. Otherwise, at the time we process your return, we may reduce or disallow your EIC. If the name or SSN on the child's social security card is not correct, call the Social Security Administration at 1-800-772-1213.

CAUTION

- If you take the EIC even though you are not eligible, you may not be allowed to take the credit for up to 10 years. See page 2 for details.
- It will take us longer to process your return and issue your refund if you do not fill in all lines that apply for each qualifying child.

Qualifying Child Information	**Child 1**	**Child 2**	**Child 3**
1 Child's name If you have more than three qualifying children, you only have to list three to get the maximum credit.	First name Last name Amy Smith	First name Last name	First name Last name
2 Child's SSN The child must have an SSN as defined in the instructions for Form 1040A, lines 38a and 38b, or Form 1040, lines 64a and 64b, unless the child was born and died in 2012. If your child was born and died in 2012 and did not have an SSN, enter "Died" on this line and attach a copy of the child's birth certificate, death certificate, or hospital medical records.	000-00-2223		
3 Child's year of birth	Year 2 0 0 9 *If born after 1993 **and** the child was younger than you (or your spouse, if filing jointly), skip lines 4a and 4b; go to line 5.*	Year ___ ___ ___ ___ *If born after 1993 **and** the child was younger than you (or your spouse, if filing jointly), skip lines 4a and 4b; go to line 5.*	Year ___ ___ ___ ___ *If born after 1993 **and** the child was younger than you (or your spouse, if filing jointly), skip lines 4a and 4b; go to line 5.*
4 a Was the child under age 24 at the end of 2012, a student, and younger than you (or your spouse, if filing jointly)?	☐ **Yes.** *Go to line 5.* ☐ **No.** *Go to line 4b.*	☐ **Yes.** *Go to line 5.* ☐ **No.** *Go to line 4b.*	☐ **Yes.** *Go to line 5.* ☐ **No.** *Go to line 4b.*
b Was the child permanently and totally disabled during any part of 2012?	☐ **Yes.** *Go to line 5.* ☐ **No.** The child is not a qualifying child.	☐ **Yes.** *Go to line 5.* ☐ **No.** The child is not a qualifying child.	☐ **Yes.** *Go to line 5.* ☐ **No.** The child is not a qualifying child.
5 Child's relationship to you (for example, son, daughter, grandchild, niece, nephew, foster child, etc.)	daughter		
6 Number of months child lived with you in the United States during 2012 • If the child lived with you for more than half of 2012 but less than 7 months, enter "7." • If the child was born or died in 2012 and your home was the child's home for more than half the time he or she was alive during 2012, enter "12."	12 months *Do not enter more than 12 months.*	____ months *Do not enter more than 12 months.*	____ months *Do not enter more than 12 months.*

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 13339M **Schedule EIC (Form 1040A or 1040) 2012**

Earned Income Credit (EIC) Worksheet—Lines 38a and 38b

Keep for Your Records

Part 1

All Filers

1. Enter your earned income from Step 5. **1** 11,000

2. Look up the amount on line 1 in the EIC Table to find the credit. Be sure you use the correct column for your filing status and the number of children you have. Enter the credit here. **2** 3,169

   If line 2 is zero, STOP You cannot take the credit. Enter "No" to the left of the entry space for line 38a.

3. Enter the amount from Form 1040A, line 22. **3** 11,000

4. Are the amounts on lines 3 and 1 the same?

   ☑ **Yes.** Skip line 5; enter the amount from line 2 on line 6.

   ☐ **No.** Go to line 5.

Part 2

Filers Who Answered "No" on Line 4

5. If you have:
   - No qualifying children, is the amount on line 3 less than $7,800 ($13,000 if married filing jointly)?
   - 1 or more qualifying children, is the amount on line 3 less than $17,100 ($22,300 if married filing jointly)?

   ☐ **Yes.** Leave line 5 blank; enter the amount from line 2 on line 6.

   ☐ **No.** Look up the amount on line 3 in the EIC Table to find the credit. Be sure you use the correct column for your filing status and the number of children you have. Enter the credit here. **5**

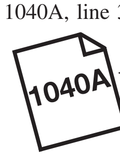
   Look at the amounts on lines 5 and 2. Then, enter the smaller amount on line 6.

Part 3

Your Earned Income Credit

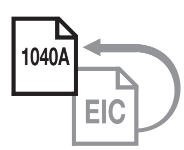
6. This is your earned income credit. **6** 3,169

Enter this amount on Form 1040A, line 38a.



Reminder—

√ If you have a qualifying child, complete and attach Schedule EIC.



CAUTION *If your EIC for a year after 1996 was reduced or disallowed, see Form 8862, who must file, earlier to find out if you must file Form 8862 to take the credit for 2012.*

Example 2. Kelly Green (Form 1040EZ)

Kelly Green is age 30 and a full-time student. She lived with her parents in the United States for all of 2012. She had a part-time job and earned $6,240. She earned $20 interest on a savings account. She is not eligible to be claimed as a dependent on her parents' return. Although she lived with her parents, she is not their qualifying child because she does not meet the age test. She does not have any children.

Kelly qualifies for the earned income credit. Kelly will file Form 1040EZ and complete the EIC Worksheet.

Completing the EIC Worksheet

Kelly figures the amount of her earned income credit on the EIC Worksheet as follows.

Line 1. She enters $6,240 (her earned income).

Line 2. Kelly goes to the Earned Income Credit Table in the forms instruction booklet. She finds her earned income of $6,240 in the range of $6,200 to $6,250. Kelly follows this line across to the column that describes her filing status and finds $475. She enters $475 on line 2.

Line 3. Kelly enters $6,260 (her AGI).

Line 4. Kelly checks the "No" box because lines 1 and 3 are not the same.

Line 5. Kelly checks the "Yes" box because the amount on line 3 ($6,260) is less than $7,800. She leaves line 5 blank and enters the amount from line 2, $475, on line 6.

Line 6. She enters $475 here and on Form 1040EZ, line 9a. Kelly's earned income credit is $475.

Earned Income Credit (EIC) Worksheet—Lines 8a and 8b

Keep for Your Records

1. Enter your earned income from Step 2 on page 14 . . . . . **1.** 6,240

2. Look up the amount on line 1 above in the EIC Table on page 16 to find the credit. Be sure you use the correct column for your filing status (Single or Married filing jointly).
Enter the credit here **2.** 475

If line 2 is zero, STOP You cannot take the credit. Enter "No" in the space to the left of line 8a.

3. Enter the amount from Form 1040EZ, line 4 . . . . . **3.** 6,260

4. Are the amounts on lines 3 and 1 the same?

☐ **Yes.** Skip line 5; enter the amount from line 2 on line 6.

☑ **No.** Go to line 5.

5. Is the amount on line 3 less than $7,800 ($13,000 if married filing jointly)?

☑ **Yes.** Leave line 5 blank; enter the amount from line 2 on line 6.

☐ **No.** Look up the amount on line 3 in the EIC Table on page 16 to find the credit. Be sure you use the correct column for your filing status (Single or Married filing jointly).
Enter the credit here . . . . . **5.** ______

Look at the amounts on lines 5 and 2. Then, enter the **smaller** amount on line 6.

6. **Earned income credit.** Enter this amount on Form 1040EZ, **line 8a** **6.** 475

CAUTION

If your EIC for a year after 1996 was reduced or disallowed, see above to find out if you must file Form 8862 to take the credit for 2012.

EIC Eligibility Checklist

Keep for Your Records

You may claim the EIC if you answer "Yes" to all the following questions.*

	Yes	No
1. Is your AGI less than: • $13,980 ($19,190 for married filing jointly) if you do not have a qualifying child, • $36,920 ($42,130 for married filing jointly) if you have one qualifying child, • $41,952 ($47,162 for married filing jointly) if you have two qualifying children, or • $45,060 ($50,270 for married filing jointly) if you have more than two qualifying children? (See *Rule 1*.)	☐	☐
2. Do you, your spouse, and your qualifying child each have a valid SSN? (See *Rule 2*.)	☐	☐
3. Is your filing status married filing jointly, head of household, qualifying widow(er), or single? (See *Rule 3*.) **Caution:** If you or your spouse is a nonresident alien, answer **"Yes"** only if your filing status is married filing jointly. (See *Rule 4*.)	☐	☐
4. Answer **"Yes"** if you are not filing Form 2555 or Form 2555-EZ. Otherwise, answer **"No."** (See *Rule 5*.)	☐	☐
5. Is your investment income $3,200 or less? (See *Rule 6*.)	☐	☐
6. Is your total earned income at least $1 but less than: • $13,980 ($19,190 for married filing jointly) if you do not have a qualifying child, • $36,920 ($42,130 for married filing jointly) if you have one qualifying child, • $41,952 ($47,162 for married filing jointly) if you have two qualifying children, or • $45,060 ($50,270 for married filing jointly) if you have more than two qualifying children? (See *Rules 7* and *15*.)	☐	☐
7. Answer **"Yes"** if you (and your spouse if filing a joint return) are not a qualifying child of another taxpayer. Otherwise, answer **"No."** (See *Rules 10* and *13*.)	☐	☐
STOP: If you have a qualifying child, answer questions 8 and 9 and skip 10 – 12. If you do not have a qualifying child, skip questions 8 and 9 and answer 10 – 12.*		
8. Does your child meet the relationship, age, residency, and joint return tests for a qualifying child? (See *Rule 8*.)	☐	☐
9. Is your child a qualifying child only for you? Answer **"Yes"** if (a) your qualifying child does not meet the tests to be a qualifying child of any other person or (b) your qualifying child meets the tests to be a qualifying child of another person but you are the person entitled to treat the child as a qualifying child under the tiebreaker rules explained in *Rule 9*. Answer **"No"** if the other person is the one entitled to treat the child as a qualifying child under the tiebreaker rules.	☐	☐
10. Were you (or your spouse if filing a joint return) at least age 25 but under 65 at the end of 2012? (See *Rule 11*.)	☐	☐
11. Answer **"Yes"** if you (and your spouse if filing a joint return) cannot be claimed as a dependent on anyone else's return. Answer **"No"** if you (or your spouse if filing a joint return) can be claimed as a dependent on someone else's return. (See *Rule 12*.)	☐	☐
12. Was your main home (and your spouse's if filing a joint return) in the United States for more than half the year? (See *Rule 14*.)	☐	☐

* **PERSONS WITH A QUALIFYING CHILD:** If you answered **"Yes"** to questions 1 through 9, you can claim the EIC. Remember to fill out Schedule EIC and attach it to your Form 1040 or Form 1040A. You cannot use Form 1040EZ. If you answered **"Yes"** to questions 1 through 7 and **"No"** to question 8, answer questions 10 through 12 to see if you can claim the EIC without a qualifying child.

PERSONS WITHOUT A QUALIFYING CHILD: If you answered **"Yes"** to questions 1 through 7, and 10 through 12, you can claim the EIC.

If you answered "No" to any question that applies to you: You cannot claim the EIC.

36.

Other Credits

What's New

Adoption credit. The maximum adoption credit is $12,650 for 2012. The credit is nonrefundable after 2011. See *Adoption Credit*.

Alternative motor vehicle credit. You cannot claim this credit for plug-in electric motor vehicle conversions after 2011. See *Alternative Motor Vehicle Credit*.

Plug-in electric drive motor vehicle credit. The credit is now available for certain two- or three-wheeled vehicles acquired after 2011 and before 2014. See *Plug-in Electric Drive Motor Vehicle Credit*.

First-time homebuyer credit. This credit has expired. If you have to repay this credit, see Form 5405, Repayment of the First-Time Homebuyer Credit, and its instructions. You may be able to repay the credit without filing Form 5405. For more information, see the Form 1040 instructions for line 59b.

Excess withholding of social security and railroad retirement tax. Social security tax and tier 1 railroad retirement (RRTA) tax were both withheld during 2012 at a rate of 4.2% of wages up to $110,100. If you worked for more than one employer and had too much social security or RRTA tax withheld during 2012, you may be entitled to a credit for the excess withholding. See *Credit for Excess Social Security Tax or Railroad Retirement Tax Withheld*.

Introduction

This chapter discusses the following nonrefundable credits.

- Adoption credit.
- Alternative motor vehicle credit.
- Alternative fuel vehicle refueling property credit.
- Credit to holders of tax credit bonds.
- Foreign tax credit.
- Mortgage interest credit.
- Nonrefundable credit for prior year minimum tax.
- Plug-in electric drive motor vehicle credit.
- Plug-in electric vehicle credit.
- Residential energy credits.
- Retirement savings contributions credit.

This chapter also discusses the following refundable credits.

- Credit for tax on undistributed capital gain.
- Health coverage tax credit.
- Refundable credit for prior year minimum tax.
- Credit for excess social security tax or railroad retirement tax withheld.

Several other credits are discussed in other chapters in this publication.

- Child and dependent care credit (chapter 31).
- Credit for the elderly or the disabled (chapter 32).
- Child tax credit (chapter 33).
- Education credits (chapter 34).
- Earned income credit (chapter 35).

Nonrefundable credits. The first part of this chapter, *Nonrefundable Credits,* covers eleven credits that you subtract from your tax. These credits may reduce your tax to zero. If these credits are more than your tax, the excess is not refunded to you.

Refundable credits. The second part of this chapter, *Refundable Credits,* covers four credits that are treated as payments and are refundable to you. These credits are added to the federal income tax withheld and any estimated tax payments you made. If this total is more than your total tax, the excess will be refunded to you.

Useful Items

You may want to see:

Publication

❑ **502** Medical and Dental Expenses

❑ **514** Foreign Tax Credit for Individuals

❑ **530** Tax Information for Homeowners

❑ **590** Individual Retirement Arrangements (IRAs)

Form (and Instructions)

❑ **1116** Foreign Tax Credit

❑ **2439** Notice to Shareholder of Undistributed Long-Term Capital Gains

❑ **5405** Repayment of the First-Time Homebuyer Credit

❑ **5695** Residential Energy Credits

❑ **8396** Mortgage Interest Credit

❑ **8801** Credit For Prior Year Minimum Tax — Individuals, Estates, and Trusts

❑ **8828** Recapture of Federal Mortgage Subsidy

❑ **8834** Qualified Plug-in Electric and Electric Vehicle Credit

❑ **8839** Qualified Adoption Expenses

❑ **8880** Credit for Qualified Retirement Savings Contributions

❑ **8885** Health Coverage Tax Credit

❑ **8910** Alternative Motor Vehicle Credit

❑ **8911** Alternative Fuel Vehicle Refueling Property Credit

❑ **8912** Credit to Holders of Tax Credit Bonds

❑ **8936** Qualified Plug-in Electric Drive Motor Vehicle Credit

Nonrefundable Credits

The credits discussed in this part of the chapter can reduce your tax. However, if the total of these credits is more than your tax, the excess is not refunded to you.

Adoption Credit

You may be able to take a tax credit of up to $12,650 for qualified expenses paid to adopt an eligible child. The credit may be allowed for the adoption of a child with special needs even if you do not have any qualified expenses.

If your modified adjusted gross income (AGI) is more than $189,710, your credit is reduced. If your modified AGI is $229,710 or more, you cannot take the credit.

CAUTION *If you are filing Form 8839, you cannot file your income tax return and Form 8839 electronically. You must file a paper return. Mail your return to the address listed in your tax return instructions.*

Documentation requirements. You should keep documentation that supports your claim for the adoption credit, but you no longer need to include any documentation when you file your tax return.

Qualified adoption expenses. Qualified adoption expenses are reasonable and necessary expenses directly related to, and whose principal purpose is for, the legal adoption of an eligible child. These expenses include:

- Adoption fees,
- Court costs,
- Attorney fees,
- Travel expenses (including amounts spent for meals and lodging) while away from home, and
- Re-adoption expenses to adopt a foreign child.

Nonqualified expenses. Qualified adoption expenses do not include expenses:

- That violate state or federal law,
- For carrying out any surrogate parenting arrangement,
- For the adoption of your spouse's child,
- For which you received funds under any federal, state, or local program,
- Allowed as a credit or deduction under any other federal income tax rule, or
- Paid or reimbursed by your employer or any other person or organization.

Eligible child. The term “eligible child” means any individual:

- Under 18 years old, or
- Physically or mentally incapable of caring for himself or herself.

Child with special needs. An eligible child is a child with special needs if all three of the following apply.

1. The child was a citizen or resident of the United States (including U.S. possessions) at the time the adoption process began.
2. A state (including the District of Columbia) has determined that the child cannot or should not be returned to his or her parents' home.
3. The state has determined that the child will not be adopted unless assistance is provided to the adoptive parents. Factors used by states to make this determination include:
    a. The child's ethnic background,
    b. The child's age,
    c. Whether the child is a member of a minority or sibling group, and
    d. Whether the child has a medical condition or a physical, mental, or emotional handicap.

When to take the credit. Generally, until the adoption becomes final, you take the credit in the year after your qualified expenses were paid or incurred. If the adoption becomes final, you take the credit in the year your expenses were paid or incurred. See the Instructions for Form 8839 for more specific information on when to take the credit.

Foreign child. If the child is not a U.S. citizen or resident at the time the adoption process began, you cannot take the credit unless the adoption becomes final. You treat all adoption expenses paid or incurred in years before the adoption becomes final as paid or incurred in the year it becomes final.

How to take the credit. To take the credit, you must complete Form 8839 and attach it to your Form 1040. Include the credit in your total for Form 1040, line 53. Check box c and enter “8839” on the line next to that box.

More information. For more information, see the Instructions for Form 8839.

Alternative Motor Vehicle Credit

You may be able to take this credit if you place a qualified fuel cell vehicle in service in 2012.

The credit has expired for plug-in electric motor vehicle conversions made after 2011.

Amount of credit. Generally, you can rely on the manufacturer's certification that a specific make, model, and model year vehicle qualifies for the credit and the amount of the credit for which it qualifies. In the case of a foreign manufacturer, you generally can rely on its domestic distributor's certification.

Ordinarily the amount of the credit is 100% of the manufacturer's (or domestic distributor's) certification of the maximum credit allowable.

How to take the credit. To take the credit, you must complete Form 8910 and attach it to your Form 1040. Include the credit in your total for Form 1040, line 53. Check box c and enter “8910” on the line next to that box.

More information. For more information on the credit, see the Instructions for Form 8910.

Alternative Fuel Vehicle Refueling Property Credit

You may be able to take a credit if you place qualified alternative fuel vehicle refueling property in service in 2012.

Qualified alternative fuel vehicle refueling property. Qualified alternative fuel vehicle refueling property is any property (other than a building or its structural components) used to store or dispense alternative fuel into the fuel tank of a motor vehicle propelled by the fuel, but only if the storage or dispensing is at the point where the fuel is delivered into that tank.

The following are alternative fuels.

- Any fuel at least 85% of the volume of which consists of one or more of the following: ethanol, natural gas, compressed natural gas, liquefied natural gas, liquefied petroleum gas, or hydrogen.
- Any mixture which consists of two or more of the following: biodiesel, diesel fuel, or kerosene, and at least 20% of the volume of which consists of biodiesel determined without regard to any kerosene.
- Electricity.

Amount of the credit. For personal use property, the credit is generally the smaller of 30% of the property's cost or $1,000. For business use property, the credit is generally the smaller of 30% of the property's cost or $30,000.

How to take the credit. To take the credit, you must complete Form 8911 and attach it to your Form 1040. Include the credit in your total for Form 1040, line 53. Check box c and enter “8911” on the line next to that box.

More information. For more information on the credit, see the Form 8911 instructions.

Credit to Holders of Tax Credit Bonds

Tax credit bonds are bonds in which the holder receives a tax credit in lieu of some or all of the interest on the bond.

You may be able to take a credit if you are a holder of one of the following bonds.

- Clean renewable energy bonds (issued before 2010).
- New clean renewable energy bonds.
- Qualified energy conservation bonds.
- Qualified school construction bonds.
- Qualified zone academy bonds.
- Build America bonds.

In some instances, an issuer may elect to receive a credit for interest paid on the bond. If the issuer makes this election, you cannot also claim a credit.

Interest income. The amount of any tax credit allowed (figured before applying tax liability limits) must be included as interest income on your tax return.

How to take the credit. Complete Form 8912 and attach it to your Form 1040. Include the credit in your total for Form 1040, line 53. Check box c and enter “8912” on the line next to that box.

More information. For more information, see the Instructions for Form 8912.

Foreign Tax Credit

You generally can choose to take income taxes you paid or accrued during the year to a foreign country or U.S. possession as a credit against your U.S. income tax. Or, you can deduct them as an itemized deduction (see chapter 22).

You cannot take a credit (or deduction) for foreign income taxes paid on income that you exclude from U.S. tax under any of the following.

1. Foreign earned income exclusion.
2. Foreign housing exclusion.
3. Income from Puerto Rico exempt from U.S. tax.
4. Possession exclusion.

Limit on the credit. Unless you can elect not to file Form 1116 (see *Exception*, later), your foreign tax credit cannot be more than your U.S. tax liability (Form 1040, line 44), multiplied by a fraction. The numerator of the fraction is your taxable income from sources outside the United States. The denominator is your total taxable income from U.S. and foreign sources. See Publication 514 for more information.

How to take the credit. Complete Form 1116 and attach it to your Form 1040. Enter the credit on Form 1040, line 47.

Exception. You do not have to complete Form 1116 to take the credit if all of the following apply.

1. All of your gross foreign source income was from interest and dividends and all of that income and the foreign tax paid on it were reported to you on Form 1099-INT, Form 1099-DIV, or Schedule K-1 (or substitute statement).
2. If you had dividend income from shares of stock, you held those shares for at least 16 days.
3. You are not filing Form 4563 or excluding income from sources within Puerto Rico.
4. The total of your foreign taxes was not more than $300 (not more than $600 if married filing jointly).
5. All of your foreign taxes were:
    a. Legally owed and not eligible for a refund, and

b. Paid to countries that are recognized by the United States and do not support terrorism.

More information. For more information on the credit and these requirements, see the Instructions for Form 1116.

Mortgage Interest Credit

The mortgage interest credit is intended to help lower-income individuals own a home. If you qualify, you can take the credit each year for part of the home mortgage interest you pay.

Who qualifies. You may be eligible for the credit if you were issued a qualified mortgage credit certificate (MCC) from your state or local government. Generally, an MCC is issued only in connection with a new mortgage for the purchase of your main home.

Amount of credit. Figure your credit on Form 8396. If your mortgage loan amount is equal to (or smaller than) the certified indebtedness (loan) amount shown on your MCC, enter on Form 8396, line 1, all the interest you paid on your mortgage during the year.

If your mortgage loan amount is larger than the certified indebtedness amount shown on your MCC, you can figure the credit on only part of the interest you paid. To find the amount to enter on line 1, multiply the total interest you paid during the year on your mortgage by the following fraction.

$$\frac{\text{Certified indebtedness amount on your MCC}}{\text{Original amount of your mortgage}}$$

Limit based on credit rate. If the certificate credit rate is more than 20%, the credit you are allowed cannot be more than $2,000. If two or more persons (other than a married couple filing a joint return) hold an interest in the home to which the MCC relates, this $2,000 limit must be divided based on the interest held by each person. See Publication 530 for more information.

Carryforward. Your credit (after applying the limit based on the credit rate) is also subject to a limit based on your tax that is figured using Form 8396. If your allowable credit is reduced because of this tax liability limit, you can carry forward the unused portion of the credit to the next 3 years or until used, whichever comes first.

If you are subject to the $2,000 limit because your certificate credit rate is more than 20%, you cannot carry forward any amount more than $2,000 (or your share of the $2,000 if you must divide the credit).

How to take the credit. Figure your 2012 credit and any carryforward to 2013 on Form 8396, and attach it to your Form 1040. Be sure to include any credit carryforward from 2009, 2010, and 2011.

Include the credit in your total for Form 1040, line 53. Check box c and enter “8396” on the line next to that box.

Reduced home mortgage interest deduction. If you itemize your deductions on Schedule A (Form 1040), you must reduce your home mortgage interest deduction by the amount of the mortgage interest credit shown on Form 8396, line 3. You must do this even if part of that amount is to be carried forward to 2013. For more information about the home mortgage interest deduction, see chapter 23.

Recapture of federal mortgage subsidy. If you received an MCC with your mortgage loan, you may have to recapture (pay back) all or part of the benefit you received from that program. The recapture may be required if you sell or dispose of your home at a gain during the first 9 years after the date you closed your mortgage loan. See the Instructions for Form 8828 and chapter 15 for more information.

More information. For more information on the credit, see the Form 8396 instructions.

Nonrefundable Credit for Prior Year Minimum Tax

The tax laws give special treatment to some kinds of income and allow special deductions and credits for some kinds of expenses. If you benefit from these laws, you may have to pay at least a minimum amount of tax in addition to any other tax on these items. This is called the alternative minimum tax.

The special treatment of some items of income and expenses only allows you to postpone paying tax until a later year. If in prior years you paid alternative minimum tax because of these tax postponement items, you may be able to take a credit for prior year minimum tax against your current year's regular tax.

You may be able to take a credit against your regular tax if for 2011 you had:

- An alternative minimum tax liability and adjustments or preferences other than exclusion items,
- A minimum tax credit that you are carrying forward to 2012, or
- An unallowed qualified electric vehicle credit.

Refundable credit. If you had a minimum tax credit carryforward to 2010 (on your 2009 Form 8801, line 30), you may qualify for a refund of that credit amount. For more information, see *Refundable Credit for Prior Year Minimum Tax*, later.

How to take the credit. Figure your 2012 nonrefundable credit (if any), and any carryforward to 2013 on Form 8801, and attach it to your Form 1040. Include the credit in your total for Form 1040, line 53, and check box b. You can carry forward any unused credit for prior year minimum tax to later years until it is completely used.

More information. For more information on the credit, see the Instructions for Form 8801.

Plug-in Electric Drive Motor Vehicle Credit

You may be able to take this credit if you placed in service for business or personal use a qualified plug-in electric drive motor vehicle or a qualified two- or three-wheeled plug-in electric vehicle in 2012 and you meet some other requirements.

Qualified plug-in electric drive motor vehicle. This is a new vehicle with at least four wheels that:

- Is propelled to a significant extent by an electric motor that draws electricity from a battery that has a capacity of not less than 4 kilowatt hours and is capable of being recharged from an external source of electricity, and
- Has a gross vehicle weight of less than 14,000 pounds.

Qualified two- or three-wheeled plug-in electric vehicle. This is a new vehicle with two or three wheels that:

- Is capable of achieving a speed of 45 miles per hour or greater,
- Is propelled to a significant extent by an electric motor that draws electricity from a battery that has a capacity of not less than 2.5 kilowatt hours and is capable of being recharged from an external source of electricity, and
- Has a gross vehicle weight of less than 14,000 pounds.

Certification and other requirements. Generally, you can rely on the manufacturer's (or, in the case of a foreign manufacturer, its domestic distributor's) certification that a specific make, model, and model year vehicle qualifies for the credit and, if applicable, the amount of the credit for which it qualifies. However, if the IRS publishes an announcement that the certification for any specific make, model, and model year vehicle has been withdrawn, you cannot rely on the certification for such a vehicle purchased after the date of publication of the withdrawal announcement.

The following requirements must also be met to qualify for the credit.

- You are the owner of the vehicle. If the vehicle is leased, only the lessor and not the lessee, is entitled to the credit.
- You placed the vehicle in service during 2012.
- The vehicle is manufactured primarily for use on public streets, roads, and highways.
- The original use of the vehicle began with you.
- You acquired the vehicle for your use or to lease to others, and not for resale.
- In the case of the qualified two- or three-wheeled plug-in electric vehicle, the vehicle is acquired after 2011.
- You use the vehicle primarily in the United States.

How to take the credit. To take the credit, you must complete Form 8936 and attach it to your Form 1040. Include the credit in your total for Form 1040, line 53. Check box c and enter “8936” on the line next to that box.

More information. For more information on the credit, see the Form 8936 instructions.

Plug-in Electric Vehicle Credit

This credit has expired for plug-in electric vehicles acquired after 2011. However, if you acquired the plug-in electric vehicle in 2011, but placed it in service during 2012, you may still be able to claim the credit for 2012. For this credit, the vehicle can have 2, 3, or 4 wheels. A vehicle with 4 wheels must be a low speed vehicle.

Generally, you can rely on the manufacturer's certification that a vehicle qualifies for the credit. In the case of a foreign manufacturer, you generally can rely on its domestic distributor's certification.

Amount of credit. The credit is 10% of the cost of the vehicle, limited to $2,500 per vehicle.

Qualified vehicle. A qualified plug-in electric vehicle is a motor vehicle the original use of which starts with you and that:

1. Is acquired for your use or to lease to others and not for resale,
2. Is made by a manufacturer,
3. Is manufactured primarily for use on public streets, roads, and highways,
4. Has a gross vehicle weight rating of less than 3,000 pounds if it has 4 wheels or less than 14,000 pounds if it has 2 or 3 wheels,
5. Is a low speed vehicle if it has 4 wheels, and
6. Is propelled to a significant extent by an electric motor that draws electricity from a battery that:
   a. Has a capacity of at least 4 kilowatt hours (2.5 kilowatt hours in the case of a vehicle with 2 or 3 wheels), and
   b. Can be recharged from an external source of electricity.

How to take the credit. To take the credit, you must complete Form 8834 and attach it to your Form 1040. Include the credit in your total for Form 1040, line 53. Check box c and enter “8834” on the line next to that box.

More information. For more information on the credit, see the Form 8834 instructions.

Residential Energy Credits

You may be able to take one or both of the following credits if you made energy saving improvements to your home located in the United States in 2012.

- Nonbusiness energy property credit.
- Residential energy efficient property credit.

If you are a member of a condominium management association for a condominium you own or a tenant-stockholder in a cooperative housing corporation, you are treated as having paid your proportionate share of any costs of the association or corporation for purposes of these credits.

Nonbusiness energy property credit. You may be able to take a credit equal to the sum of:

1. 10% of the amount paid or incurred for qualified energy efficiency improvements installed during 2012, and
2. Any residential energy property costs paid or incurred in 2012.

There is a lifetime limit of $500 for all years after 2005, of which only $200 can be for windows; $50 for any advanced main air circulating fan; $150 for any qualified natural gas, propane, or oil furnace or hot water boiler; and $300 for any item of energy efficient building property.

CAUTION *If the total of nonbusiness energy property credits you have taken in previous years (after 2005) is more than $500, you cannot take this credit in 2012.*

Qualified energy efficiency improvements are the following improvements that are new, can be expected to remain in use at least 5 years, and meet certain requirements for energy efficiency.

- Any insulation material or system that is specifically and primarily designed to reduce heat loss or gain of a home.
- Exterior window (including skylights).
- Exterior doors.
- Any metal or asphalt roof that has appropriate pigmented coatings or cooling granules specifically and primarily designed to reduce heat gain of the home.

Residential energy property is any of the following.

- Certain electric heat pump water heaters; electric heat pumps; central air conditioners; natural gas, propane, or oil water heater; and stoves that use biomass fuel.
- Qualified natural gas, propane, or oil furnaces; and qualified natural gas, propane, or oil hot water boilers.
- Certain advanced main air circulating fans used in natural gas, propane, or oil furnaces.

Residential energy efficient property credit. You may be able to take a credit of 30% of your costs of qualified solar electric property, solar water heating property, fuel cell property, small wind energy property, and geothermal heat pump property. The credit amount for costs paid for qualified fuel cell property is limited to $500 for each one-half kilowatt of capacity of the property.

Basis reduction. You must reduce the basis of your home by the amount of any credit allowed.

How to take the credit. Complete Form 5695 and attach it to your Form 1040. Enter the credit on Form 1040, line 52.

More information. For more information on these credits, see the Form 5695 instructions.

Retirement Savings Contributions Credit (Saver's Credit)

You may be able to take this credit if you, or your spouse if filing jointly, made:

- Contributions (other than rollover contributions) to a traditional or Roth IRA,
- Elective deferrals to a 401(k) or 403(b) plan (including designated Roth contributions) or to a governmental 457, SEP, or SIMPLE plan,
- Voluntary employee contributions to a qualified retirement plan (including the federal Thrift Savings Plan), or
- Contributions to a 501(c)(18)(D) plan.

However, you cannot take the credit if either of the following applies.

1. The amount on Form 1040, line 38, or Form 1040A, line 22, is more than $28,750 ($43,125 if head of household; $57,500 if married filing jointly).
2. The person(s) who made the qualified contribution or elective deferral (a) was born after January 1, 1995, (b) is claimed as a dependent on someone else's 2012 tax return, or (c) was a student (defined next).

Student. You were a student if during any part of 5 calendar months of 2012 you:

- Were enrolled as a full-time student at a school, or
- Took a full-time, on-farm training course given by a school or a state, county, or local government agency.

School. A school includes a technical, trade, or mechanical school. It does not include an on-the-job training course, correspondence school, or school offering courses only through the Internet.

How to take the credit. Figure the credit on Form 8880. Enter the credit on your Form 1040, line 50, or your Form 1040A, line 32, and attach Form 8880 to your return.

More information. For more information on the credit, see the Form 8880 instructions.

Refundable Credits

The credits discussed in this part of the chapter are treated as payments of tax. If the total of these credits, withheld federal income tax, and estimated tax payments is more than your total tax, the excess can be refunded to you.

Credit for Tax on Undistributed Capital Gain

You must include in your income any amounts that regulated investment companies (commonly called mutual funds) or real estate investment trusts (REITs) allocated to you as capital gain distributions, even if you did not actually receive them. If the mutual fund or REIT paid a tax on the capital gain, you are allowed a credit for the tax since it is considered paid by you. The mutual fund or REIT will send you Form 2439 showing your share of the undistributed capital gains and the tax paid, if any.

How to take the credit. To take the credit, attach Copy B of Form 2439 to your Form 1040. Include the amount from box 2 of your Form 2439 in the total for Form 1040, line 71, and check box a.

More information. See *Capital Gain Distributions* in chapter 8 for more information on undistributed capital gains.

Health Coverage Tax Credit

You may be able to take this credit for any month in which all the following statements were true on the first day of the month.

- You were an eligible trade adjustment assistance (TAA) recipient, alternative TAA (ATAA) recipient, reemployment TAA (RTAA) recipient, or Pension Benefit Guaranty Corporation (PBGC) pension recipient (defined later); or you were a qualified family member of one of these individuals when the individual died or you finalized a divorce with one of these individuals.
- You and/or your family members were covered by a qualified health insurance plan for which you paid the entire premiums, or your portion of the premiums, directly to your health plan or to "U.S. Treasury–HCTC."
- You were not enrolled in Medicare Part A, B, or C, or you were enrolled in Medicare but your family member(s) qualified for the HCTC.
- You were not enrolled in Medicaid or the Children's Health Insurance Program (CHIP).
- You were not enrolled in the Federal Employees Health Benefits program (FEHBP) or eligible to receive benefits under the U.S. military health system (TRICARE).
- You were not imprisoned under federal, state, or local authority.
- Your employer did not pay 50% or more of the cost of coverage.
- You did not receive a 65% COBRA premium reduction from your former employer or COBRA administrator.

But, you cannot take the credit if you can be claimed as a dependent on someone else's 2012 tax return. If you meet all of these conditions, you may be able to take a credit of up to 72.5% of the amount you paid directly to a qualified health plan for you and any qualifying family members. You cannot take the credit for insurance premiums on coverage that was actually paid for with a National Emergency Grant. The amount you paid for qualified health insurance coverage must be reduced by any Archer MSA and health savings account distributions used to pay for the coverage.

You can take this credit on your tax return or have it paid on your behalf in advance to your insurance company. If the credit is paid on your behalf in advance, that amount will reduce the amount of the credit you can take on your tax return.

TAA recipient. You were an eligible TAA recipient on the first day of the month if, for any day in that month or the prior month, you:

- Received a trade readjustment allowance, or
- Would have been entitled to receive such an allowance except that you had not exhausted all rights to any unemployment insurance (except additional compensation that is funded by a state and is not reimbursed from any federal funds) to which you were entitled (or would be entitled if you applied).

Example. You received a trade adjustment allowance for January 2012. You were an eligible TAA recipient on the first day of January and February.

Alternative TAA recipient. You were an eligible alternative TAA recipient on the first day of the month if, for that month or the prior month, you received benefits under an alternative trade adjustment assistance program for older workers established by the Department of Labor.

Example. You received benefits under an alternative trade adjustment assistance program for older workers for October 2012. The program was established by the Department of Labor. You were an eligible alternative TAA recipient on the first day of October and November.

RTAA recipient. You were an eligible RTAA recipient on the first day of the month if, for that month or the prior month, you received benefits under a reemployment trade adjustment assistance program for older workers established by the Department of Labor.

PBGC pension recipient. You were an eligible PBGC pension recipient on the first day of the month, if both of the following apply.

1. You were age 55 or older on the first day of the month.
2. You received a benefit for that month paid by the PBGC under title IV of the Employee Retirement Income Security Act of 1974 (ERISA).

If you received a lump-sum payment from the PBGC after August 5, 2002, you meet item (2) above for any month that you would have received a PBGC benefit if you had not received the lump-sum payment.

How to take the credit. To take the credit, complete Form 8885 and attach it to your Form 1040. Include your credit in the total for Form 1040, line 71, and check box d.

You must attach health insurance bills (or COBRA payment coupons) and proof of payment for any amounts you include on Form 8885, line 2. For details, see Publication 502 or Form 8885.

More information. For definitions and special rules, including those relating to qualified health insurance plans, qualifying family members, the effect of certain life events, and employer-sponsored health insurance plans, see Publication 502 and the Form 8885 instructions.

Refundable Credit for Prior Year Minimum Tax

If you paid the alternative minimum tax for 2011 or you had a minimum tax credit carryforward to 2012, you may be able to take a credit for prior year minimum tax. For information about the nonrefundable credit for prior year minimum tax you may be able to take, see *Nonrefundable Credit for Prior Year Minimum Tax*, earlier. However, for 2012, you may qualify for a refundable credit for prior year minimum tax if you had a minimum tax credit carryforward to 2010 (on your 2009 Form 8801, line 30) and you have not used all of that carryforward, even if the total amount of your current year credit is more than your total tax liability. To figure the amount of any 2012 refundable credit, complete Part IV of Form 8801. Include any refundable credit on Form 1040, line 71, and check box c.

Credit for Excess Social Security Tax or Railroad Retirement Tax Withheld

Most employers must withhold social security tax from your wages. If you work for a railroad employer, that employer must withhold tier 1 railroad retirement (RRTA) tax and tier 2 RRTA tax.

If you worked for two or more employers in 2012, you may have had too much social security or tier 1 RRTA tax withheld from your pay. You can claim the excess social security or tier 1 RRTA tax as a credit against your income tax. The following table shows the maximum amount of wages subject to tax and the maximum amount of tax that should have been withheld for 2012.

Type of tax	Maximum wages subject to tax	Maximum tax that should have been withheld
Social security or RRTA tier 1	$110,100	$4,624.20
RRTA tier 2	$81,900	$3,194.10

CAUTION: *All wages are subject to Medicare tax withholding.*

TIP *Use Form 843, Claim for Refund and Request for Abatement, to claim a refund of excess tier 2 RRTA tax. Be sure to attach a copy of all of your W-2 forms. Use Worksheet 3-3 in Publication 505, Tax Withholding and Estimated Tax, to help you figure the excess amount.*

Employer's error. If any one employer withheld too much social security or tier 1 RRTA tax, you cannot take the excess as a credit against your income tax. The employer should adjust the tax for you. If the employer does not adjust the overcollection, you can file a claim for refund using Form 843.

Joint return. If you are filing a joint return, you cannot add the social security or tier 1 RRTA tax withheld from your spouse's wages to the amount withheld from your wages. Figure the withholding separately for you and your spouse to determine if either of you has excess withholding.

How to figure the credit if you did not work for a railroad. If you did not work for a railroad during 2012, figure the credit as follows:

1. Add all social security tax withheld (but not more than $4,624.20 for each employer). Enter the total here	________
2. Enter any uncollected social security tax on tips or group-term life insurance included in the total on Form 1040, line 60, identified by "UT"	________
3. Add lines 1 and 2. If $4,624.20 or less, stop here. You cannot take the credit	________
4. Social security tax limit	4,624.20
5. Credit. Subtract line 4 from line 3. Enter the result here and on Form 1040, line 69 (or Form 1040A, line 41)	$ ________

Example. You are married and file a joint return with your spouse who had no gross income in 2012. During 2012, you worked for the Brown Technology Company and earned $60,000 in wages. Social security tax of $2,520 was withheld. You also worked for another employer in 2012 and earned $55,000 in wages. $2,310 of social security tax was withheld from these wages. Because you worked for more than one employer and your total wages were more than $110,100, you can take a credit of $205.80 for the excess social security tax withheld.

1. Add all social security tax withheld (but not more than $4,624.20 for each employer). Enter the total here	$4,830.00
2. Enter any uncollected social security tax on tips or group-term life insurance included in the total on Form 1040, line 60, identified by "UT"	-0-
3. Add lines 1 and 2. If $4,624.20 or less, stop here. You cannot take the credit	4,830.00
4. Social security tax limit	4,624.20
5. Credit. Subtract line 4 from line 3. Enter the result here and on Form 1040, line 69 (or Form 1040A, line 41)	$205.80

How to figure the credit if you worked for a railroad. If you were a railroad employee at any time during 2012, figure the credit as follows:

1. Add all social security and tier 1 RRTA tax withheld (but not more than $4,624.20 for each employer). Enter the total here	________
2. Enter any uncollected social security and tier 1 RRTA tax on tips or group-term life insurance included in the total on Form 1040, line 60, identified by "UT"	________
3. Add lines 1 and 2. If $4,624.20 or less, stop here. You cannot take the credit	________
4. Social security and tier 1 RRTA tax limit	4,624.20
5. Credit. Subtract line 4 from line 3. Enter the result here and on Form 1040, line 69 (or Form 1040A, line 41)	$ ________

How to take the credit. Enter the credit on Form 1040, line 69, or include it in the total for Form 1040A, line 41.

More information. For more information on the credit, see Publication 505.

2012 Tax Table

CAUTION *See the instructions for line 44 in the Instructions for Form 1040 to see if you must use the Tax Table below to figure your tax.*

Example. Mr. and Mrs. Brown are filing a joint return. Their taxable income on Form 1040, line 43, is $25,300. First, they find the $25,300–25,350 taxable income line. Next, they find the column for married filing jointly and read down the column. The amount shown where the taxable income line and filing status column meet is $2,929. This is the tax amount they should enter on Form 1040, line 44.

Sample Table

At Least	But Less Than	Single	Married filing jointly *	Married filing sepa-rately	Head of a house-hold
		Your tax is—			
25,200	**25,250**	3,349	2,914	3,349	3,164
25,250	**25,300**	3,356	2,921	3,356	3,171
25,300	**25,350**	3,364	2,929	3,364	3,179
25,350	**25,400**	3,371	2,936	3,371	3,186

If line 43 (taxable income) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing sepa-rately	Head of a house-hold
		Your tax is—			
0	**5**	0	0	0	0
5	**15**	1	1	1	1
15	**25**	2	2	2	2
25	**50**	4	4	4	4
50	**75**	6	6	6	6
75	**100**	9	9	9	9
100	**125**	11	11	11	11
125	**150**	14	14	14	14
150	**175**	16	16	16	16
175	**200**	19	19	19	19
200	**225**	21	21	21	21
225	**250**	24	24	24	24
250	**275**	26	26	26	26
275	**300**	29	29	29	29
300	**325**	31	31	31	31
325	**350**	34	34	34	34
350	**375**	36	36	36	36
375	**400**	39	39	39	39
400	**425**	41	41	41	41
425	**450**	44	44	44	44
450	**475**	46	46	46	46
475	**500**	49	49	49	49
500	**525**	51	51	51	51
525	**550**	54	54	54	54
550	**575**	56	56	56	56
575	**600**	59	59	59	59
600	**625**	61	61	61	61
625	**650**	64	64	64	64
650	**675**	66	66	66	66
675	**700**	69	69	69	69
700	**725**	71	71	71	71
725	**750**	74	74	74	74
750	**775**	76	76	76	76
775	**800**	79	79	79	79
800	**825**	81	81	81	81
825	**850**	84	84	84	84
850	**875**	86	86	86	86
875	**900**	89	89	89	89
900	**925**	91	91	91	91
925	**950**	94	94	94	94
950	**975**	96	96	96	96
975	**1,000**	99	99	99	99

If line 43 (taxable income) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing sepa-rately	Head of a house-hold
		Your tax is—			
1,000					
1,000	**1,025**	101	101	101	101
1,025	**1,050**	104	104	104	104
1,050	**1,075**	106	106	106	106
1,075	**1,100**	109	109	109	109
1,100	**1,125**	111	111	111	111
1,125	**1,150**	114	114	114	114
1,150	**1,175**	116	116	116	116
1,175	**1,200**	119	119	119	119
1,200	**1,225**	121	121	121	121
1,225	**1,250**	124	124	124	124
1,250	**1,275**	126	126	126	126
1,275	**1,300**	129	129	129	129
1,300	**1,325**	131	131	131	131
1,325	**1,350**	134	134	134	134
1,350	**1,375**	136	136	136	136
1,375	**1,400**	139	139	139	139
1,400	**1,425**	141	141	141	141
1,425	**1,450**	144	144	144	144
1,450	**1,475**	146	146	146	146
1,475	**1,500**	149	149	149	149
1,500	**1,525**	151	151	151	151
1,525	**1,550**	154	154	154	154
1,550	**1,575**	156	156	156	156
1,575	**1,600**	159	159	159	159
1,600	**1,625**	161	161	161	161
1,625	**1,650**	164	164	164	164
1,650	**1,675**	166	166	166	166
1,675	**1,700**	169	169	169	169
1,700	**1,725**	171	171	171	171
1,725	**1,750**	174	174	174	174
1,750	**1,775**	176	176	176	176
1,775	**1,800**	179	179	179	179
1,800	**1,825**	181	181	181	181
1,825	**1,850**	184	184	184	184
1,850	**1,875**	186	186	186	186
1,875	**1,900**	189	189	189	189
1,900	**1,925**	191	191	191	191
1,925	**1,950**	194	194	194	194
1,950	**1,975**	196	196	196	196
1,975	**2,000**	199	199	199	199

If line 43 (taxable income) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing sepa-rately	Head of a house-hold
		Your tax is—			
2,000					
2,000	**2,025**	201	201	201	201
2,025	**2,050**	204	204	204	204
2,050	**2,075**	206	206	206	206
2,075	**2,100**	209	209	209	209
2,100	**2,125**	211	211	211	211
2,125	**2,150**	214	214	214	214
2,150	**2,175**	216	216	216	216
2,175	**2,200**	219	219	219	219
2,200	**2,225**	221	221	221	221
2,225	**2,250**	224	224	224	224
2,250	**2,275**	226	226	226	226
2,275	**2,300**	229	229	229	229
2,300	**2,325**	231	231	231	231
2,325	**2,350**	234	234	234	234
2,350	**2,375**	236	236	236	236
2,375	**2,400**	239	239	239	239
2,400	**2,425**	241	241	241	241
2,425	**2,450**	244	244	244	244
2,450	**2,475**	246	246	246	246
2,475	**2,500**	249	249	249	249
2,500	**2,525**	251	251	251	251
2,525	**2,550**	254	254	254	254
2,550	**2,575**	256	256	256	256
2,575	**2,600**	259	259	259	259
2,600	**2,625**	261	261	261	261
2,625	**2,650**	264	264	264	264
2,650	**2,675**	266	266	266	266
2,675	**2,700**	269	269	269	269
2,700	**2,725**	271	271	271	271
2,725	**2,750**	274	274	274	274
2,750	**2,775**	276	276	276	276
2,775	**2,800**	279	279	279	279
2,800	**2,825**	281	281	281	281
2,825	**2,850**	284	284	284	284
2,850	**2,875**	286	286	286	286
2,875	**2,900**	289	289	289	289
2,900	**2,925**	291	291	291	291
2,925	**2,950**	294	294	294	294
2,950	**2,975**	296	296	296	296
2,975	**3,000**	299	299	299	299

(Continued)

* This column must also be used by a qualifying widow(er).

If line 43 (taxable income) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing sepa-rately	Head of a house-hold
		Your tax is—			
3,000					
3,000	3,050	303	303	303	303
3,050	3,100	308	308	308	308
3,100	3,150	313	313	313	313
3,150	3,200	318	318	318	318
3,200	3,250	323	323	323	323
3,250	3,300	328	328	328	328
3,300	3,350	333	333	333	333
3,350	3,400	338	338	338	338
3,400	3,450	343	343	343	343
3,450	3,500	348	348	348	348
3,500	3,550	353	353	353	353
3,550	3,600	358	358	358	358
3,600	3,650	363	363	363	363
3,650	3,700	368	368	368	368
3,700	3,750	373	373	373	373
3,750	3,800	378	378	378	378
3,800	3,850	383	383	383	383
3,850	3,900	388	388	388	388
3,900	3,950	393	393	393	393
3,950	4,000	398	398	398	398
4,000					
4,000	4,050	403	403	403	403
4,050	4,100	408	408	408	408
4,100	4,150	413	413	413	413
4,150	4,200	418	418	418	418
4,200	4,250	423	423	423	423
4,250	4,300	428	428	428	428
4,300	4,350	433	433	433	433
4,350	4,400	438	438	438	438
4,400	4,450	443	443	443	443
4,450	4,500	448	448	448	448
4,500	4,550	453	453	453	453
4,550	4,600	458	458	458	458
4,600	4,650	463	463	463	463
4,650	4,700	468	468	468	468
4,700	4,750	473	473	473	473
4,750	4,800	478	478	478	478
4,800	4,850	483	483	483	483
4,850	4,900	488	488	488	488
4,900	4,950	493	493	493	493
4,950	5,000	498	498	498	498
5,000					
5,000	5,050	503	503	503	503
5,050	5,100	508	508	508	508
5,100	5,150	513	513	513	513
5,150	5,200	518	518	518	518
5,200	5,250	523	523	523	523
5,250	5,300	528	528	528	528
5,300	5,350	533	533	533	533
5,350	5,400	538	538	538	538
5,400	5,450	543	543	543	543
5,450	5,500	548	548	548	548
5,500	5,550	553	553	553	553
5,550	5,600	558	558	558	558
5,600	5,650	563	563	563	563
5,650	5,700	568	568	568	568
5,700	5,750	573	573	573	573
5,750	5,800	578	578	578	578
5,800	5,850	583	583	583	583
5,850	5,900	588	588	588	588
5,900	5,950	593	593	593	593
5,950	6,000	598	598	598	598

If line 43 (taxable income) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing sepa-rately	Head of a house-hold
		Your tax is—			
6,000					
6,000	6,050	603	603	603	603
6,050	6,100	608	608	608	608
6,100	6,150	613	613	613	613
6,150	6,200	618	618	618	618
6,200	6,250	623	623	623	623
6,250	6,300	628	628	628	628
6,300	6,350	633	633	633	633
6,350	6,400	638	638	638	638
6,400	6,450	643	643	643	643
6,450	6,500	648	648	648	648
6,500	6,550	653	653	653	653
6,550	6,600	658	658	658	658
6,600	6,650	663	663	663	663
6,650	6,700	668	668	668	668
6,700	6,750	673	673	673	673
6,750	6,800	678	678	678	678
6,800	6,850	683	683	683	683
6,850	6,900	688	688	688	688
6,900	6,950	693	693	693	693
6,950	7,000	698	698	698	698
7,000					
7,000	7,050	703	703	703	703
7,050	7,100	708	708	708	708
7,100	7,150	713	713	713	713
7,150	7,200	718	718	718	718
7,200	7,250	723	723	723	723
7,250	7,300	728	728	728	728
7,300	7,350	733	733	733	733
7,350	7,400	738	738	738	738
7,400	7,450	743	743	743	743
7,450	7,500	748	748	748	748
7,500	7,550	753	753	753	753
7,550	7,600	758	758	758	758
7,600	7,650	763	763	763	763
7,650	7,700	768	768	768	768
7,700	7,750	773	773	773	773
7,750	7,800	778	778	778	778
7,800	7,850	783	783	783	783
7,850	7,900	788	788	788	788
7,900	7,950	793	793	793	793
7,950	8,000	798	798	798	798
8,000					
8,000	8,050	803	803	803	803
8,050	8,100	808	808	808	808
8,100	8,150	813	813	813	813
8,150	8,200	818	818	818	818
8,200	8,250	823	823	823	823
8,250	8,300	828	828	828	828
8,300	8,350	833	833	833	833
8,350	8,400	838	838	838	838
8,400	8,450	843	843	843	843
8,450	8,500	848	848	848	848
8,500	8,550	853	853	853	853
8,550	8,600	858	858	858	858
8,600	8,650	863	863	863	863
8,650	8,700	868	868	868	868
8,700	8,750	874	873	874	873
8,750	8,800	881	878	881	878
8,800	8,850	889	883	889	883
8,850	8,900	896	888	896	888
8,900	8,950	904	893	904	893
8,950	9,000	911	898	911	898

If line 43 (taxable income) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing sepa-rately	Head of a house-hold
		Your tax is—			
9,000					
9,000	9,050	919	903	919	903
9,050	9,100	926	908	926	908
9,100	9,150	934	913	934	913
9,150	9,200	941	918	941	918
9,200	9,250	949	923	949	923
9,250	9,300	956	928	956	928
9,300	9,350	964	933	964	933
9,350	9,400	971	938	971	938
9,400	9,450	979	943	979	943
9,450	9,500	986	948	986	948
9,500	9,550	994	953	994	953
9,550	9,600	1,001	958	1,001	958
9,600	9,650	1,009	963	1,009	963
9,650	9,700	1,016	968	1,016	968
9,700	9,750	1,024	973	1,024	973
9,750	9,800	1,031	978	1,031	978
9,800	9,850	1,039	983	1,039	983
9,850	9,900	1,046	988	1,046	988
9,900	9,950	1,054	993	1,054	993
9,950	10,000	1,061	998	1,061	998
10,000					
10,000	10,050	1,069	1,003	1,069	1,003
10,050	10,100	1,076	1,008	1,076	1,008
10,100	10,150	1,084	1,013	1,084	1,013
10,150	10,200	1,091	1,018	1,091	1,018
10,200	10,250	1,099	1,023	1,099	1,023
10,250	10,300	1,106	1,028	1,106	1,028
10,300	10,350	1,114	1,033	1,114	1,033
10,350	10,400	1,121	1,038	1,121	1,038
10,400	10,450	1,129	1,043	1,129	1,043
10,450	10,500	1,136	1,048	1,136	1,048
10,500	10,550	1,144	1,053	1,144	1,053
10,550	10,600	1,151	1,058	1,151	1,058
10,600	10,650	1,159	1,063	1,159	1,063
10,650	10,700	1,166	1,068	1,166	1,068
10,700	10,750	1,174	1,073	1,174	1,073
10,750	10,800	1,181	1,078	1,181	1,078
10,800	10,850	1,189	1,083	1,189	1,083
10,850	10,900	1,196	1,088	1,196	1,088
10,900	10,950	1,204	1,093	1,204	1,093
10,950	11,000	1,211	1,098	1,211	1,098
11,000					
11,000	11,050	1,219	1,103	1,219	1,103
11,050	11,100	1,226	1,108	1,226	1,108
11,100	11,150	1,234	1,113	1,234	1,113
11,150	11,200	1,241	1,118	1,241	1,118
11,200	11,250	1,249	1,123	1,249	1,123
11,250	11,300	1,256	1,128	1,256	1,128
11,300	11,350	1,264	1,133	1,264	1,133
11,350	11,400	1,271	1,138	1,271	1,138
11,400	11,450	1,279	1,143	1,279	1,143
11,450	11,500	1,286	1,148	1,286	1,148
11,500	11,550	1,294	1,153	1,294	1,153
11,550	11,600	1,301	1,158	1,301	1,158
11,600	11,650	1,309	1,163	1,309	1,163
11,650	11,700	1,316	1,168	1,316	1,168
11,700	11,750	1,324	1,173	1,324	1,173
11,750	11,800	1,331	1,178	1,331	1,178
11,800	11,850	1,339	1,183	1,339	1,183
11,850	11,900	1,346	1,188	1,346	1,188
11,900	11,950	1,354	1,193	1,354	1,193
11,950	12,000	1,361	1,198	1,361	1,198

(Continued)

* This column must also be used by a qualifying widow(er).

If line 43 (taxable income) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing sepa-rately	Head of a house-hold
		Your tax is—			
12,000					
12,000	12,050	1,369	1,203	1,369	1,203
12,050	12,100	1,376	1,208	1,376	1,208
12,100	12,150	1,384	1,213	1,384	1,213
12,150	12,200	1,391	1,218	1,391	1,218
12,200	12,250	1,399	1,223	1,399	1,223
12,250	12,300	1,406	1,228	1,406	1,228
12,300	12,350	1,414	1,233	1,414	1,233
12,350	12,400	1,421	1,238	1,421	1,238
12,400	12,450	1,429	1,243	1,429	1,244
12,450	12,500	1,436	1,248	1,436	1,251
12,500	12,550	1,444	1,253	1,444	1,259
12,550	12,600	1,451	1,258	1,451	1,266
12,600	12,650	1,459	1,263	1,459	1,274
12,650	12,700	1,466	1,268	1,466	1,281
12,700	12,750	1,474	1,273	1,474	1,289
12,750	12,800	1,481	1,278	1,481	1,296
12,800	12,850	1,489	1,283	1,489	1,304
12,850	12,900	1,496	1,288	1,496	1,311
12,900	12,950	1,504	1,293	1,504	1,319
12,950	13,000	1,511	1,298	1,511	1,326
13,000					
13,000	13,050	1,519	1,303	1,519	1,334
13,050	13,100	1,526	1,308	1,526	1,341
13,100	13,150	1,534	1,313	1,534	1,349
13,150	13,200	1,541	1,318	1,541	1,356
13,200	13,250	1,549	1,323	1,549	1,364
13,250	13,300	1,556	1,328	1,556	1,371
13,300	13,350	1,564	1,333	1,564	1,379
13,350	13,400	1,571	1,338	1,571	1,386
13,400	13,450	1,579	1,343	1,579	1,394
13,450	13,500	1,586	1,348	1,586	1,401
13,500	13,550	1,594	1,353	1,594	1,409
13,550	13,600	1,601	1,358	1,601	1,416
13,600	13,650	1,609	1,363	1,609	1,424
13,650	13,700	1,616	1,368	1,616	1,431
13,700	13,750	1,624	1,373	1,624	1,439
13,750	13,800	1,631	1,378	1,631	1,446
13,800	13,850	1,639	1,383	1,639	1,454
13,850	13,900	1,646	1,388	1,646	1,461
13,900	13,950	1,654	1,393	1,654	1,469
13,950	14,000	1,661	1,398	1,661	1,476
14,000					
14,000	14,050	1,669	1,403	1,669	1,484
14,050	14,100	1,676	1,408	1,676	1,491
14,100	14,150	1,684	1,413	1,684	1,499
14,150	14,200	1,691	1,418	1,691	1,506
14,200	14,250	1,699	1,423	1,699	1,514
14,250	14,300	1,706	1,428	1,706	1,521
14,300	14,350	1,714	1,433	1,714	1,529
14,350	14,400	1,721	1,438	1,721	1,536
14,400	14,450	1,729	1,443	1,729	1,544
14,450	14,500	1,736	1,448	1,736	1,551
14,500	14,550	1,744	1,453	1,744	1,559
14,550	14,600	1,751	1,458	1,751	1,566
14,600	14,650	1,759	1,463	1,759	1,574
14,650	14,700	1,766	1,468	1,766	1,581
14,700	14,750	1,774	1,473	1,774	1,589
14,750	14,800	1,781	1,478	1,781	1,596
14,800	14,850	1,789	1,483	1,789	1,604
14,850	14,900	1,796	1,488	1,796	1,611
14,900	14,950	1,804	1,493	1,804	1,619
14,950	15,000	1,811	1,498	1,811	1,626

If line 43 (taxable income) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing sepa-rately	Head of a house-hold
		Your tax is—			
15,000					
15,000	15,050	1,819	1,503	1,819	1,634
15,050	15,100	1,826	1,508	1,826	1,641
15,100	15,150	1,834	1,513	1,834	1,649
15,150	15,200	1,841	1,518	1,841	1,656
15,200	15,250	1,849	1,523	1,849	1,664
15,250	15,300	1,856	1,528	1,856	1,671
15,300	15,350	1,864	1,533	1,864	1,679
15,350	15,400	1,871	1,538	1,871	1,686
15,400	15,450	1,879	1,543	1,879	1,694
15,450	15,500	1,886	1,548	1,886	1,701
15,500	15,550	1,894	1,553	1,894	1,709
15,550	15,600	1,901	1,558	1,901	1,716
15,600	15,650	1,909	1,563	1,909	1,724
15,650	15,700	1,916	1,568	1,916	1,731
15,700	15,750	1,924	1,573	1,924	1,739
15,750	15,800	1,931	1,578	1,931	1,746
15,800	15,850	1,939	1,583	1,939	1,754
15,850	15,900	1,946	1,588	1,946	1,761
15,900	15,950	1,954	1,593	1,954	1,769
15,950	16,000	1,961	1,598	1,961	1,776
16,000					
16,000	16,050	1,969	1,603	1,969	1,784
16,050	16,100	1,976	1,608	1,976	1,791
16,100	16,150	1,984	1,613	1,984	1,799
16,150	16,200	1,991	1,618	1,991	1,806
16,200	16,250	1,999	1,623	1,999	1,814
16,250	16,300	2,006	1,628	2,006	1,821
16,300	16,350	2,014	1,633	2,014	1,829
16,350	16,400	2,021	1,638	2,021	1,836
16,400	16,450	2,029	1,643	2,029	1,844
16,450	16,500	2,036	1,648	2,036	1,851
16,500	16,550	2,044	1,653	2,044	1,859
16,550	16,600	2,051	1,658	2,051	1,866
16,600	16,650	2,059	1,663	2,059	1,874
16,650	16,700	2,066	1,668	2,066	1,881
16,700	16,750	2,074	1,673	2,074	1,889
16,750	16,800	2,081	1,678	2,081	1,896
16,800	16,850	2,089	1,683	2,089	1,904
16,850	16,900	2,096	1,688	2,096	1,911
16,900	16,950	2,104	1,693	2,104	1,919
16,950	17,000	2,111	1,698	2,111	1,926
17,000					
17,000	17,050	2,119	1,703	2,119	1,934
17,050	17,100	2,126	1,708	2,126	1,941
17,100	17,150	2,134	1,713	2,134	1,949
17,150	17,200	2,141	1,718	2,141	1,956
17,200	17,250	2,149	1,723	2,149	1,964
17,250	17,300	2,156	1,728	2,156	1,971
17,300	17,350	2,164	1,733	2,164	1,979
17,350	17,400	2,171	1,738	2,171	1,986
17,400	17,450	2,179	1,744	2,179	1,994
17,450	17,500	2,186	1,751	2,186	2,001
17,500	17,550	2,194	1,759	2,194	2,009
17,550	17,600	2,201	1,766	2,201	2,016
17,600	17,650	2,209	1,774	2,209	2,024
17,650	17,700	2,216	1,781	2,216	2,031
17,700	17,750	2,224	1,789	2,224	2,039
17,750	17,800	2,231	1,796	2,231	2,046
17,800	17,850	2,239	1,804	2,239	2,054
17,850	17,900	2,246	1,811	2,246	2,061
17,900	17,950	2,254	1,819	2,254	2,069
17,950	18,000	2,261	1,826	2,261	2,076

If line 43 (taxable income) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing sepa-rately	Head of a house-hold
		Your tax is—			
18,000					
18,000	18,050	2,269	1,834	2,269	2,084
18,050	18,100	2,276	1,841	2,276	2,091
18,100	18,150	2,284	1,849	2,284	2,099
18,150	18,200	2,291	1,856	2,291	2,106
18,200	18,250	2,299	1,864	2,299	2,114
18,250	18,300	2,306	1,871	2,306	2,121
18,300	18,350	2,314	1,879	2,314	2,129
18,350	18,400	2,321	1,886	2,321	2,136
18,400	18,450	2,329	1,894	2,329	2,144
18,450	18,500	2,336	1,901	2,336	2,151
18,500	18,550	2,344	1,909	2,344	2,159
18,550	18,600	2,351	1,916	2,351	2,166
18,600	18,650	2,359	1,924	2,359	2,174
18,650	18,700	2,366	1,931	2,366	2,181
18,700	18,750	2,374	1,939	2,374	2,189
18,750	18,800	2,381	1,946	2,381	2,196
18,800	18,850	2,389	1,954	2,389	2,204
18,850	18,900	2,396	1,961	2,396	2,211
18,900	18,950	2,404	1,969	2,404	2,219
18,950	19,000	2,411	1,976	2,411	2,226
19,000					
19,000	19,050	2,419	1,984	2,419	2,234
19,050	19,100	2,426	1,991	2,426	2,241
19,100	19,150	2,434	1,999	2,434	2,249
19,150	19,200	2,441	2,006	2,441	2,256
19,200	19,250	2,449	2,014	2,449	2,264
19,250	19,300	2,456	2,021	2,456	2,271
19,300	19,350	2,464	2,029	2,464	2,279
19,350	19,400	2,471	2,036	2,471	2,286
19,400	19,450	2,479	2,044	2,479	2,294
19,450	19,500	2,486	2,051	2,486	2,301
19,500	19,550	2,494	2,059	2,494	2,309
19,550	19,600	2,501	2,066	2,501	2,316
19,600	19,650	2,509	2,074	2,509	2,324
19,650	19,700	2,516	2,081	2,516	2,331
19,700	19,750	2,524	2,089	2,524	2,339
19,750	19,800	2,531	2,096	2,531	2,346
19,800	19,850	2,539	2,104	2,539	2,354
19,850	19,900	2,546	2,111	2,546	2,361
19,900	19,950	2,554	2,119	2,554	2,369
19,950	20,000	2,561	2,126	2,561	2,376
20,000					
20,000	20,050	2,569	2,134	2,569	2,384
20,050	20,100	2,576	2,141	2,576	2,391
20,100	20,150	2,584	2,149	2,584	2,399
20,150	20,200	2,591	2,156	2,591	2,406
20,200	20,250	2,599	2,164	2,599	2,414
20,250	20,300	2,606	2,171	2,606	2,421
20,300	20,350	2,614	2,179	2,614	2,429
20,350	20,400	2,621	2,186	2,621	2,436
20,400	20,450	2,629	2,194	2,629	2,444
20,450	20,500	2,636	2,201	2,636	2,451
20,500	20,550	2,644	2,209	2,644	2,459
20,550	20,600	2,651	2,216	2,651	2,466
20,600	20,650	2,659	2,224	2,659	2,474
20,650	20,700	2,666	2,231	2,666	2,481
20,700	20,750	2,674	2,239	2,674	2,489
20,750	20,800	2,681	2,246	2,681	2,496
20,800	20,850	2,689	2,254	2,689	2,504
20,850	20,900	2,696	2,261	2,696	2,511
20,900	20,950	2,704	2,269	2,704	2,519
20,950	21,000	2,711	2,276	2,711	2,526

(Continued)

* This column must also be used by a qualifying widow(er).

If line 43 (taxable income) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing separately	Head of a household
		Your tax is—			
21,000					
21,000	**21,050**	2,719	2,284	2,719	2,534
21,050	**21,100**	2,726	2,291	2,726	2,541
21,100	**21,150**	2,734	2,299	2,734	2,549
21,150	**21,200**	2,741	2,306	2,741	2,556
21,200	**21,250**	2,749	2,314	2,749	2,564
21,250	**21,300**	2,756	2,321	2,756	2,571
21,300	**21,350**	2,764	2,329	2,764	2,579
21,350	**21,400**	2,771	2,336	2,771	2,586
21,400	**21,450**	2,779	2,344	2,779	2,594
21,450	**21,500**	2,786	2,351	2,786	2,601
21,500	**21,550**	2,794	2,359	2,794	2,609
21,550	**21,600**	2,801	2,366	2,801	2,616
21,600	**21,650**	2,809	2,374	2,809	2,624
21,650	**21,700**	2,816	2,381	2,816	2,631
21,700	**21,750**	2,824	2,389	2,824	2,639
21,750	**21,800**	2,831	2,396	2,831	2,646
21,800	**21,850**	2,839	2,404	2,839	2,654
21,850	**21,900**	2,846	2,411	2,846	2,661
21,900	**21,950**	2,854	2,419	2,854	2,669
21,950	**22,000**	2,861	2,426	2,861	2,676
22,000					
22,000	**22,050**	2,869	2,434	2,869	2,684
22,050	**22,100**	2,876	2,441	2,876	2,691
22,100	**22,150**	2,884	2,449	2,884	2,699
22,150	**22,200**	2,891	2,456	2,891	2,706
22,200	**22,250**	2,899	2,464	2,899	2,714
22,250	**22,300**	2,906	2,471	2,906	2,721
22,300	**22,350**	2,914	2,479	2,914	2,729
22,350	**22,400**	2,921	2,486	2,921	2,736
22,400	**22,450**	2,929	2,494	2,929	2,744
22,450	**22,500**	2,936	2,501	2,936	2,751
22,500	**22,550**	2,944	2,509	2,944	2,759
22,550	**22,600**	2,951	2,516	2,951	2,766
22,600	**22,650**	2,959	2,524	2,959	2,774
22,650	**22,700**	2,966	2,531	2,966	2,781
22,700	**22,750**	2,974	2,539	2,974	2,789
22,750	**22,800**	2,981	2,546	2,981	2,796
22,800	**22,850**	2,989	2,554	2,989	2,804
22,850	**22,900**	2,996	2,561	2,996	2,811
22,900	**22,950**	3,004	2,569	3,004	2,819
22,950	**23,000**	3,011	2,576	3,011	2,826
23,000					
23,000	**23,050**	3,019	2,584	3,019	2,834
23,050	**23,100**	3,026	2,591	3,026	2,841
23,100	**23,150**	3,034	2,599	3,034	2,849
23,150	**23,200**	3,041	2,606	3,041	2,856
23,200	**23,250**	3,049	2,614	3,049	2,864
23,250	**23,300**	3,056	2,621	3,056	2,871
23,300	**23,350**	3,064	2,629	3,064	2,879
23,350	**23,400**	3,071	2,636	3,071	2,886
23,400	**23,450**	3,079	2,644	3,079	2,894
23,450	**23,500**	3,086	2,651	3,086	2,901
23,500	**23,550**	3,094	2,659	3,094	2,909
23,550	**23,600**	3,101	2,666	3,101	2,916
23,600	**23,650**	3,109	2,674	3,109	2,924
23,650	**23,700**	3,116	2,681	3,116	2,931
23,700	**23,750**	3,124	2,689	3,124	2,939
23,750	**23,800**	3,131	2,696	3,131	2,946
23,800	**23,850**	3,139	2,704	3,139	2,954
23,850	**23,900**	3,146	2,711	3,146	2,961
23,900	**23,950**	3,154	2,719	3,154	2,969
23,950	**24,000**	3,161	2,726	3,161	2,976
24,000					
24,000	**24,050**	3,169	2,734	3,169	2,984
24,050	**24,100**	3,176	2,741	3,176	2,991
24,100	**24,150**	3,184	2,749	3,184	2,999
24,150	**24,200**	3,191	2,756	3,191	3,006
24,200	**24,250**	3,199	2,764	3,199	3,014
24,250	**24,300**	3,206	2,771	3,206	3,021
24,300	**24,350**	3,214	2,779	3,214	3,029
24,350	**24,400**	3,221	2,786	3,221	3,036
24,400	**24,450**	3,229	2,794	3,229	3,044
24,450	**24,500**	3,236	2,801	3,236	3,051
24,500	**24,550**	3,244	2,809	3,244	3,059
24,550	**24,600**	3,251	2,816	3,251	3,066
24,600	**24,650**	3,259	2,824	3,259	3,074
24,650	**24,700**	3,266	2,831	3,266	3,081
24,700	**24,750**	3,274	2,839	3,274	3,089
24,750	**24,800**	3,281	2,846	3,281	3,096
24,800	**24,850**	3,289	2,854	3,289	3,104
24,850	**24,900**	3,296	2,861	3,296	3,111
24,900	**24,950**	3,304	2,869	3,304	3,119
24,950	**25,000**	3,311	2,876	3,311	3,126
25,000					
25,000	**25,050**	3,319	2,884	3,319	3,134
25,050	**25,100**	3,326	2,891	3,326	3,141
25,100	**25,150**	3,334	2,899	3,334	3,149
25,150	**25,200**	3,341	2,906	3,341	3,156
25,200	**25,250**	3,349	2,914	3,349	3,164
25,250	**25,300**	3,356	2,921	3,356	3,171
25,300	**25,350**	3,364	2,929	3,364	3,179
25,350	**25,400**	3,371	2,936	3,371	3,186
25,400	**25,450**	3,379	2,944	3,379	3,194
25,450	**25,500**	3,386	2,951	3,386	3,201
25,500	**25,550**	3,394	2,959	3,394	3,209
25,550	**25,600**	3,401	2,966	3,401	3,216
25,600	**25,650**	3,409	2,974	3,409	3,224
25,650	**25,700**	3,416	2,981	3,416	3,231
25,700	**25,750**	3,424	2,989	3,424	3,239
25,750	**25,800**	3,431	2,996	3,431	3,246
25,800	**25,850**	3,439	3,004	3,439	3,254
25,850	**25,900**	3,446	3,011	3,446	3,261
25,900	**25,950**	3,454	3,019	3,454	3,269
25,950	**26,000**	3,461	3,026	3,461	3,276
26,000					
26,000	**26,050**	3,469	3,034	3,469	3,284
26,050	**26,100**	3,476	3,041	3,476	3,291
26,100	**26,150**	3,484	3,049	3,484	3,299
26,150	**26,200**	3,491	3,056	3,491	3,306
26,200	**26,250**	3,499	3,064	3,499	3,314
26,250	**26,300**	3,506	3,071	3,506	3,321
26,300	**26,350**	3,514	3,079	3,514	3,329
26,350	**26,400**	3,521	3,086	3,521	3,336
26,400	**26,450**	3,529	3,094	3,529	3,344
26,450	**26,500**	3,536	3,101	3,536	3,351
26,500	**26,550**	3,544	3,109	3,544	3,359
26,550	**26,600**	3,551	3,116	3,551	3,366
26,600	**26,650**	3,559	3,124	3,559	3,374
26,650	**26,700**	3,566	3,131	3,566	3,381
26,700	**26,750**	3,574	3,139	3,574	3,389
26,750	**26,800**	3,581	3,146	3,581	3,396
26,800	**26,850**	3,589	3,154	3,589	3,404
26,850	**26,900**	3,596	3,161	3,596	3,411
26,900	**26,950**	3,604	3,169	3,604	3,419
26,950	**27,000**	3,611	3,176	3,611	3,426
27,000					
27,000	**27,050**	3,619	3,184	3,619	3,434
27,050	**27,100**	3,626	3,191	3,626	3,441
27,100	**27,150**	3,634	3,199	3,634	3,449
27,150	**27,200**	3,641	3,206	3,641	3,456
27,200	**27,250**	3,649	3,214	3,649	3,464
27,250	**27,300**	3,656	3,221	3,656	3,471
27,300	**27,350**	3,664	3,229	3,664	3,479
27,350	**27,400**	3,671	3,236	3,671	3,486
27,400	**27,450**	3,679	3,244	3,679	3,494
27,450	**27,500**	3,686	3,251	3,686	3,501
27,500	**27,550**	3,694	3,259	3,694	3,509
27,550	**27,600**	3,701	3,266	3,701	3,516
27,600	**27,650**	3,709	3,274	3,709	3,524
27,650	**27,700**	3,716	3,281	3,716	3,531
27,700	**27,750**	3,724	3,289	3,724	3,539
27,750	**27,800**	3,731	3,296	3,731	3,546
27,800	**27,850**	3,739	3,304	3,739	3,554
27,850	**27,900**	3,746	3,311	3,746	3,561
27,900	**27,950**	3,754	3,319	3,754	3,569
27,950	**28,000**	3,761	3,326	3,761	3,576
28,000					
28,000	**28,050**	3,769	3,334	3,769	3,584
28,050	**28,100**	3,776	3,341	3,776	3,591
28,100	**28,150**	3,784	3,349	3,784	3,599
28,150	**28,200**	3,791	3,356	3,791	3,606
28,200	**28,250**	3,799	3,364	3,799	3,614
28,250	**28,300**	3,806	3,371	3,806	3,621
28,300	**28,350**	3,814	3,379	3,814	3,629
28,350	**28,400**	3,821	3,386	3,821	3,636
28,400	**28,450**	3,829	3,394	3,829	3,644
28,450	**28,500**	3,836	3,401	3,836	3,651
28,500	**28,550**	3,844	3,409	3,844	3,659
28,550	**28,600**	3,851	3,416	3,851	3,666
28,600	**28,650**	3,859	3,424	3,859	3,674
28,650	**28,700**	3,866	3,431	3,866	3,681
28,700	**28,750**	3,874	3,439	3,874	3,689
28,750	**28,800**	3,881	3,446	3,881	3,696
28,800	**28,850**	3,889	3,454	3,889	3,704
28,850	**28,900**	3,896	3,461	3,896	3,711
28,900	**28,950**	3,904	3,469	3,904	3,719
28,950	**29,000**	3,911	3,476	3,911	3,726
29,000					
29,000	**29,050**	3,919	3,484	3,919	3,734
29,050	**29,100**	3,926	3,491	3,926	3,741
29,100	**29,150**	3,934	3,499	3,934	3,749
29,150	**29,200**	3,941	3,506	3,941	3,756
29,200	**29,250**	3,949	3,514	3,949	3,764
29,250	**29,300**	3,956	3,521	3,956	3,771
29,300	**29,350**	3,964	3,529	3,964	3,779
29,350	**29,400**	3,971	3,536	3,971	3,786
29,400	**29,450**	3,979	3,544	3,979	3,794
29,450	**29,500**	3,986	3,551	3,986	3,801
29,500	**29,550**	3,994	3,559	3,994	3,809
29,550	**29,600**	4,001	3,566	4,001	3,816
29,600	**29,650**	4,009	3,574	4,009	3,824
29,650	**29,700**	4,016	3,581	4,016	3,831
29,700	**29,750**	4,024	3,589	4,024	3,839
29,750	**29,800**	4,031	3,596	4,031	3,846
29,800	**29,850**	4,039	3,604	4,039	3,854
29,850	**29,900**	4,046	3,611	4,046	3,861
29,900	**29,950**	4,054	3,619	4,054	3,869
29,950	**30,000**	4,061	3,626	4,061	3,876

(Continued)

* This column must also be used by a qualifying widow(er).

If line 43 (taxable income) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing sepa-rately	Head of a house-hold
		Your tax is—			
30,000					
30,000	**30,050**	4,069	3,634	4,069	3,884
30,050	**30,100**	4,076	3,641	4,076	3,891
30,100	**30,150**	4,084	3,649	4,084	3,899
30,150	**30,200**	4,091	3,656	4,091	3,906
30,200	**30,250**	4,099	3,664	4,099	3,914
30,250	**30,300**	4,106	3,671	4,106	3,921
30,300	**30,350**	4,114	3,679	4,114	3,929
30,350	**30,400**	4,121	3,686	4,121	3,936
30,400	**30,450**	4,129	3,694	4,129	3,944
30,450	**30,500**	4,136	3,701	4,136	3,951
30,500	**30,550**	4,144	3,709	4,144	3,959
30,550	**30,600**	4,151	3,716	4,151	3,966
30,600	**30,650**	4,159	3,724	4,159	3,974
30,650	**30,700**	4,166	3,731	4,166	3,981
30,700	**30,750**	4,174	3,739	4,174	3,989
30,750	**30,800**	4,181	3,746	4,181	3,996
30,800	**30,850**	4,189	3,754	4,189	4,004
30,850	**30,900**	4,196	3,761	4,196	4,011
30,900	**30,950**	4,204	3,769	4,204	4,019
30,950	**31,000**	4,211	3,776	4,211	4,026
31,000					
31,000	**31,050**	4,219	3,784	4,219	4,034
31,050	**31,100**	4,226	3,791	4,226	4,041
31,100	**31,150**	4,234	3,799	4,234	4,049
31,150	**31,200**	4,241	3,806	4,241	4,056
31,200	**31,250**	4,249	3,814	4,249	4,064
31,250	**31,300**	4,256	3,821	4,256	4,071
31,300	**31,350**	4,264	3,829	4,264	4,079
31,350	**31,400**	4,271	3,836	4,271	4,086
31,400	**31,450**	4,279	3,844	4,279	4,094
31,450	**31,500**	4,286	3,851	4,286	4,101
31,500	**31,550**	4,294	3,859	4,294	4,109
31,550	**31,600**	4,301	3,866	4,301	4,116
31,600	**31,650**	4,309	3,874	4,309	4,124
31,650	**31,700**	4,316	3,881	4,316	4,131
31,700	**31,750**	4,324	3,889	4,324	4,139
31,750	**31,800**	4,331	3,896	4,331	4,146
31,800	**31,850**	4,339	3,904	4,339	4,154
31,850	**31,900**	4,346	3,911	4,346	4,161
31,900	**31,950**	4,354	3,919	4,354	4,169
31,950	**32,000**	4,361	3,926	4,361	4,176
32,000					
32,000	**32,050**	4,369	3,934	4,369	4,184
32,050	**32,100**	4,376	3,941	4,376	4,191
32,100	**32,150**	4,384	3,949	4,384	4,199
32,150	**32,200**	4,391	3,956	4,391	4,206
32,200	**32,250**	4,399	3,964	4,399	4,214
32,250	**32,300**	4,406	3,971	4,406	4,221
32,300	**32,350**	4,414	3,979	4,414	4,229
32,350	**32,400**	4,421	3,986	4,421	4,236
32,400	**32,450**	4,429	3,994	4,429	4,244
32,450	**32,500**	4,436	4,001	4,436	4,251
32,500	**32,550**	4,444	4,009	4,444	4,259
32,550	**32,600**	4,451	4,016	4,451	4,266
32,600	**32,650**	4,459	4,024	4,459	4,274
32,650	**32,700**	4,466	4,031	4,466	4,281
32,700	**32,750**	4,474	4,039	4,474	4,289
32,750	**32,800**	4,481	4,046	4,481	4,296
32,800	**32,850**	4,489	4,054	4,489	4,304
32,850	**32,900**	4,496	4,061	4,496	4,311
32,900	**32,950**	4,504	4,069	4,504	4,319
32,950	**33,000**	4,511	4,076	4,511	4,326

If line 43 (taxable income) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing sepa-rately	Head of a house-hold
		Your tax is—			
33,000					
33,000	**33,050**	4,519	4,084	4,519	4,334
33,050	**33,100**	4,526	4,091	4,526	4,341
33,100	**33,150**	4,534	4,099	4,534	4,349
33,150	**33,200**	4,541	4,106	4,541	4,356
33,200	**33,250**	4,549	4,114	4,549	4,364
33,250	**33,300**	4,556	4,121	4,556	4,371
33,300	**33,350**	4,564	4,129	4,564	4,379
33,350	**33,400**	4,571	4,136	4,571	4,386
33,400	**33,450**	4,579	4,144	4,579	4,394
33,450	**33,500**	4,586	4,151	4,586	4,401
33,500	**33,550**	4,594	4,159	4,594	4,409
33,550	**33,600**	4,601	4,166	4,601	4,416
33,600	**33,650**	4,609	4,174	4,609	4,424
33,650	**33,700**	4,616	4,181	4,616	4,431
33,700	**33,750**	4,624	4,189	4,624	4,439
33,750	**33,800**	4,631	4,196	4,631	4,446
33,800	**33,850**	4,639	4,204	4,639	4,454
33,850	**33,900**	4,646	4,211	4,646	4,461
33,900	**33,950**	4,654	4,219	4,654	4,469
33,950	**34,000**	4,661	4,226	4,661	4,476
34,000					
34,000	**34,050**	4,669	4,234	4,669	4,484
34,050	**34,100**	4,676	4,241	4,676	4,491
34,100	**34,150**	4,684	4,249	4,684	4,499
34,150	**34,200**	4,691	4,256	4,691	4,506
34,200	**34,250**	4,699	4,264	4,699	4,514
34,250	**34,300**	4,706	4,271	4,706	4,521
34,300	**34,350**	4,714	4,279	4,714	4,529
34,350	**34,400**	4,721	4,286	4,721	4,536
34,400	**34,450**	4,729	4,294	4,729	4,544
34,450	**34,500**	4,736	4,301	4,736	4,551
34,500	**34,550**	4,744	4,309	4,744	4,559
34,550	**34,600**	4,751	4,316	4,751	4,566
34,600	**34,650**	4,759	4,324	4,759	4,574
34,650	**34,700**	4,766	4,331	4,766	4,581
34,700	**34,750**	4,774	4,339	4,774	4,589
34,750	**34,800**	4,781	4,346	4,781	4,596
34,800	**34,850**	4,789	4,354	4,789	4,604
34,850	**34,900**	4,796	4,361	4,796	4,611
34,900	**34,950**	4,804	4,369	4,804	4,619
34,950	**35,000**	4,811	4,376	4,811	4,626
35,000					
35,000	**35,050**	4,819	4,384	4,819	4,634
35,050	**35,100**	4,826	4,391	4,826	4,641
35,100	**35,150**	4,834	4,399	4,834	4,649
35,150	**35,200**	4,841	4,406	4,841	4,656
35,200	**35,250**	4,849	4,414	4,849	4,664
35,250	**35,300**	4,856	4,421	4,856	4,671
35,300	**35,350**	4,864	4,429	4,864	4,679
35,350	**35,400**	4,874	4,436	4,874	4,686
35,400	**35,450**	4,886	4,444	4,886	4,694
35,450	**35,500**	4,899	4,451	4,899	4,701
35,500	**35,550**	4,911	4,459	4,911	4,709
35,550	**35,600**	4,924	4,466	4,924	4,716
35,600	**35,650**	4,936	4,474	4,936	4,724
35,650	**35,700**	4,949	4,481	4,949	4,731
35,700	**35,750**	4,961	4,489	4,961	4,739
35,750	**35,800**	4,974	4,496	4,974	4,746
35,800	**35,850**	4,986	4,504	4,986	4,754
35,850	**35,900**	4,999	4,511	4,999	4,761
35,900	**35,950**	5,011	4,519	5,011	4,769
35,950	**36,000**	5,024	4,526	5,024	4,776

If line 43 (taxable income) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing sepa-rately	Head of a house-hold
		Your tax is—			
36,000					
36,000	**36,050**	5,036	4,534	5,036	4,784
36,050	**36,100**	5,049	4,541	5,049	4,791
36,100	**36,150**	5,061	4,549	5,061	4,799
36,150	**36,200**	5,074	4,556	5,074	4,806
36,200	**36,250**	5,086	4,564	5,086	4,814
36,250	**36,300**	5,099	4,571	5,099	4,821
36,300	**36,350**	5,111	4,579	5,111	4,829
36,350	**36,400**	5,124	4,586	5,124	4,836
36,400	**36,450**	5,136	4,594	5,136	4,844
36,450	**36,500**	5,149	4,601	5,149	4,851
36,500	**36,550**	5,161	4,609	5,161	4,859
36,550	**36,600**	5,174	4,616	5,174	4,866
36,600	**36,650**	5,186	4,624	5,186	4,874
36,650	**36,700**	5,199	4,631	5,199	4,881
36,700	**36,750**	5,211	4,639	5,211	4,889
36,750	**36,800**	5,224	4,646	5,224	4,896
36,800	**36,850**	5,236	4,654	5,236	4,904
36,850	**36,900**	5,249	4,661	5,249	4,911
36,900	**36,950**	5,261	4,669	5,261	4,919
36,950	**37,000**	5,274	4,676	5,274	4,926
37,000					
37,000	**37,050**	5,286	4,684	5,286	4,934
37,050	**37,100**	5,299	4,691	5,299	4,941
37,100	**37,150**	5,311	4,699	5,311	4,949
37,150	**37,200**	5,324	4,706	5,324	4,956
37,200	**37,250**	5,336	4,714	5,336	4,964
37,250	**37,300**	5,349	4,721	5,349	4,971
37,300	**37,350**	5,361	4,729	5,361	4,979
37,350	**37,400**	5,374	4,736	5,374	4,986
37,400	**37,450**	5,386	4,744	5,386	4,994
37,450	**37,500**	5,399	4,751	5,399	5,001
37,500	**37,550**	5,411	4,759	5,411	5,009
37,550	**37,600**	5,424	4,766	5,424	5,016
37,600	**37,650**	5,436	4,774	5,436	5,024
37,650	**37,700**	5,449	4,781	5,449	5,031
37,700	**37,750**	5,461	4,789	5,461	5,039
37,750	**37,800**	5,474	4,796	5,474	5,046
37,800	**37,850**	5,486	4,804	5,486	5,054
37,850	**37,900**	5,499	4,811	5,499	5,061
37,900	**37,950**	5,511	4,819	5,511	5,069
37,950	**38,000**	5,524	4,826	5,524	5,076
38,000					
38,000	**38,050**	5,536	4,834	5,536	5,084
38,050	**38,100**	5,549	4,841	5,549	5,091
38,100	**38,150**	5,561	4,849	5,561	5,099
38,150	**38,200**	5,574	4,856	5,574	5,106
38,200	**38,250**	5,586	4,864	5,586	5,114
38,250	**38,300**	5,599	4,871	5,599	5,121
38,300	**38,350**	5,611	4,879	5,611	5,129
38,350	**38,400**	5,624	4,886	5,624	5,136
38,400	**38,450**	5,636	4,894	5,636	5,144
38,450	**38,500**	5,649	4,901	5,649	5,151
38,500	**38,550**	5,661	4,909	5,661	5,159
38,550	**38,600**	5,674	4,916	5,674	5,166
38,600	**38,650**	5,686	4,924	5,686	5,174
38,650	**38,700**	5,699	4,931	5,699	5,181
38,700	**38,750**	5,711	4,939	5,711	5,189
38,750	**38,800**	5,724	4,946	5,724	5,196
38,800	**38,850**	5,736	4,954	5,736	5,204
38,850	**38,900**	5,749	4,961	5,749	5,211
38,900	**38,950**	5,761	4,969	5,761	5,219
38,950	**39,000**	5,774	4,976	5,774	5,226

(Continued)

* This column must also be used by a qualifying widow(er).

If line 43 (taxable income) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing sepa-rately	Head of a house-hold
		Your tax is—			
39,000					
39,000	**39,050**	5,786	4,984	5,786	5,234
39,050	**39,100**	5,799	4,991	5,799	5,241
39,100	**39,150**	5,811	4,999	5,811	5,249
39,150	**39,200**	5,824	5,006	5,824	5,256
39,200	**39,250**	5,836	5,014	5,836	5,264
39,250	**39,300**	5,849	5,021	5,849	5,271
39,300	**39,350**	5,861	5,029	5,861	5,279
39,350	**39,400**	5,874	5,036	5,874	5,286
39,400	**39,450**	5,886	5,044	5,886	5,294
39,450	**39,500**	5,899	5,051	5,899	5,301
39,500	**39,550**	5,911	5,059	5,911	5,309
39,550	**39,600**	5,924	5,066	5,924	5,316
39,600	**39,650**	5,936	5,074	5,936	5,324
39,650	**39,700**	5,949	5,081	5,949	5,331
39,700	**39,750**	5,961	5,089	5,961	5,339
39,750	**39,800**	5,974	5,096	5,974	5,346
39,800	**39,850**	5,986	5,104	5,986	5,354
39,850	**39,900**	5,999	5,111	5,999	5,361
39,900	**39,950**	6,011	5,119	6,011	5,369
39,950	**40,000**	6,024	5,126	6,024	5,376
40,000					
40,000	**40,050**	6,036	5,134	6,036	5,384
40,050	**40,100**	6,049	5,141	6,049	5,391
40,100	**40,150**	6,061	5,149	6,061	5,399
40,150	**40,200**	6,074	5,156	6,074	5,406
40,200	**40,250**	6,086	5,164	6,086	5,414
40,250	**40,300**	6,099	5,171	6,099	5,421
40,300	**40,350**	6,111	5,179	6,111	5,429
40,350	**40,400**	6,124	5,186	6,124	5,436
40,400	**40,450**	6,136	5,194	6,136	5,444
40,450	**40,500**	6,149	5,201	6,149	5,451
40,500	**40,550**	6,161	5,209	6,161	5,459
40,550	**40,600**	6,174	5,216	6,174	5,466
40,600	**40,650**	6,186	5,224	6,186	5,474
40,650	**40,700**	6,199	5,231	6,199	5,481
40,700	**40,750**	6,211	5,239	6,211	5,489
40,750	**40,800**	6,224	5,246	6,224	5,496
40,800	**40,850**	6,236	5,254	6,236	5,504
40,850	**40,900**	6,249	5,261	6,249	5,511
40,900	**40,950**	6,261	5,269	6,261	5,519
40,950	**41,000**	6,274	5,276	6,274	5,526
41,000					
41,000	**41,050**	6,286	5,284	6,286	5,534
41,050	**41,100**	6,299	5,291	6,299	5,541
41,100	**41,150**	6,311	5,299	6,311	5,549
41,150	**41,200**	6,324	5,306	6,324	5,556
41,200	**41,250**	6,336	5,314	6,336	5,564
41,250	**41,300**	6,349	5,321	6,349	5,571
41,300	**41,350**	6,361	5,329	6,361	5,579
41,350	**41,400**	6,374	5,336	6,374	5,586
41,400	**41,450**	6,386	5,344	6,386	5,594
41,450	**41,500**	6,399	5,351	6,399	5,601
41,500	**41,550**	6,411	5,359	6,411	5,609
41,550	**41,600**	6,424	5,366	6,424	5,616
41,600	**41,650**	6,436	5,374	6,436	5,624
41,650	**41,700**	6,449	5,381	6,449	5,631
41,700	**41,750**	6,461	5,389	6,461	5,639
41,750	**41,800**	6,474	5,396	6,474	5,646
41,800	**41,850**	6,486	5,404	6,486	5,654
41,850	**41,900**	6,499	5,411	6,499	5,661
41,900	**41,950**	6,511	5,419	6,511	5,669
41,950	**42,000**	6,524	5,426	6,524	5,676

If line 43 (taxable income) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing sepa-rately	Head of a house-hold
		Your tax is—			
42,000					
42,000	**42,050**	6,536	5,434	6,536	5,684
42,050	**42,100**	6,549	5,441	6,549	5,691
42,100	**42,150**	6,561	5,449	6,561	5,699
42,150	**42,200**	6,574	5,456	6,574	5,706
42,200	**42,250**	6,586	5,464	6,586	5,714
42,250	**42,300**	6,599	5,471	6,599	5,721
42,300	**42,350**	6,611	5,479	6,611	5,729
42,350	**42,400**	6,624	5,486	6,624	5,736
42,400	**42,450**	6,636	5,494	6,636	5,744
42,450	**42,500**	6,649	5,501	6,649	5,751
42,500	**42,550**	6,661	5,509	6,661	5,759
42,550	**42,600**	6,674	5,516	6,674	5,766
42,600	**42,650**	6,686	5,524	6,686	5,774
42,650	**42,700**	6,699	5,531	6,699	5,781
42,700	**42,750**	6,711	5,539	6,711	5,789
42,750	**42,800**	6,724	5,546	6,724	5,796
42,800	**42,850**	6,736	5,554	6,736	5,804
42,850	**42,900**	6,749	5,561	6,749	5,811
42,900	**42,950**	6,761	5,569	6,761	5,819
42,950	**43,000**	6,774	5,576	6,774	5,826
43,000					
43,000	**43,050**	6,786	5,584	6,786	5,834
43,050	**43,100**	6,799	5,591	6,799	5,841
43,100	**43,150**	6,811	5,599	6,811	5,849
43,150	**43,200**	6,824	5,606	6,824	5,856
43,200	**43,250**	6,836	5,614	6,836	5,864
43,250	**43,300**	6,849	5,621	6,849	5,871
43,300	**43,350**	6,861	5,629	6,861	5,879
43,350	**43,400**	6,874	5,636	6,874	5,886
43,400	**43,450**	6,886	5,644	6,886	5,894
43,450	**43,500**	6,899	5,651	6,899	5,901
43,500	**43,550**	6,911	5,659	6,911	5,909
43,550	**43,600**	6,924	5,666	6,924	5,916
43,600	**43,650**	6,936	5,674	6,936	5,924
43,650	**43,700**	6,949	5,681	6,949	5,931
43,700	**43,750**	6,961	5,689	6,961	5,939
43,750	**43,800**	6,974	5,696	6,974	5,946
43,800	**43,850**	6,986	5,704	6,986	5,954
43,850	**43,900**	6,999	5,711	6,999	5,961
43,900	**43,950**	7,011	5,719	7,011	5,969
43,950	**44,000**	7,024	5,726	7,024	5,976
44,000					
44,000	**44,050**	7,036	5,734	7,036	5,984
44,050	**44,100**	7,049	5,741	7,049	5,991
44,100	**44,150**	7,061	5,749	7,061	5,999
44,150	**44,200**	7,074	5,756	7,074	6,006
44,200	**44,250**	7,086	5,764	7,086	6,014
44,250	**44,300**	7,099	5,771	7,099	6,021
44,300	**44,350**	7,111	5,779	7,111	6,029
44,350	**44,400**	7,124	5,786	7,124	6,036
44,400	**44,450**	7,136	5,794	7,136	6,044
44,450	**44,500**	7,149	5,801	7,149	6,051
44,500	**44,550**	7,161	5,809	7,161	6,059
44,550	**44,600**	7,174	5,816	7,174	6,066
44,600	**44,650**	7,186	5,824	7,186	6,074
44,650	**44,700**	7,199	5,831	7,199	6,081
44,700	**44,750**	7,211	5,839	7,211	6,089
44,750	**44,800**	7,224	5,846	7,224	6,096
44,800	**44,850**	7,236	5,854	7,236	6,104
44,850	**44,900**	7,249	5,861	7,249	6,111
44,900	**44,950**	7,261	5,869	7,261	6,119
44,950	**45,000**	7,274	5,876	7,274	6,126

If line 43 (taxable income) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing sepa-rately	Head of a house-hold
		Your tax is—			
45,000					
45,000	**45,050**	7,286	5,884	7,286	6,134
45,050	**45,100**	7,299	5,891	7,299	6,141
45,100	**45,150**	7,311	5,899	7,311	6,149
45,150	**45,200**	7,324	5,906	7,324	6,156
45,200	**45,250**	7,336	5,914	7,336	6,164
45,250	**45,300**	7,349	5,921	7,349	6,171
45,300	**45,350**	7,361	5,929	7,361	6,179
45,350	**45,400**	7,374	5,936	7,374	6,186
45,400	**45,450**	7,386	5,944	7,386	6,194
45,450	**45,500**	7,399	5,951	7,399	6,201
45,500	**45,550**	7,411	5,959	7,411	6,209
45,550	**45,600**	7,424	5,966	7,424	6,216
45,600	**45,650**	7,436	5,974	7,436	6,224
45,650	**45,700**	7,449	5,981	7,449	6,231
45,700	**45,750**	7,461	5,989	7,461	6,239
45,750	**45,800**	7,474	5,996	7,474	6,246
45,800	**45,850**	7,486	6,004	7,486	6,254
45,850	**45,900**	7,499	6,011	7,499	6,261
45,900	**45,950**	7,511	6,019	7,511	6,269
45,950	**46,000**	7,524	6,026	7,524	6,276
46,000					
46,000	**46,050**	7,536	6,034	7,536	6,284
46,050	**46,100**	7,549	6,041	7,549	6,291
46,100	**46,150**	7,561	6,049	7,561	6,299
46,150	**46,200**	7,574	6,056	7,574	6,306
46,200	**46,250**	7,586	6,064	7,586	6,314
46,250	**46,300**	7,599	6,071	7,599	6,321
46,300	**46,350**	7,611	6,079	7,611	6,329
46,350	**46,400**	7,624	6,086	7,624	6,336
46,400	**46,450**	7,636	6,094	7,636	6,344
46,450	**46,500**	7,649	6,101	7,649	6,351
46,500	**46,550**	7,661	6,109	7,661	6,359
46,550	**46,600**	7,674	6,116	7,674	6,366
46,600	**46,650**	7,686	6,124	7,686	6,374
46,650	**46,700**	7,699	6,131	7,699	6,381
46,700	**46,750**	7,711	6,139	7,711	6,389
46,750	**46,800**	7,724	6,146	7,724	6,396
46,800	**46,850**	7,736	6,154	7,736	6,404
46,850	**46,900**	7,749	6,161	7,749	6,411
46,900	**46,950**	7,761	6,169	7,761	6,419
46,950	**47,000**	7,774	6,176	7,774	6,426
47,000					
47,000	**47,050**	7,786	6,184	7,786	6,434
47,050	**47,100**	7,799	6,191	7,799	6,441
47,100	**47,150**	7,811	6,199	7,811	6,449
47,150	**47,200**	7,824	6,206	7,824	6,456
47,200	**47,250**	7,836	6,214	7,836	6,464
47,250	**47,300**	7,849	6,221	7,849	6,471
47,300	**47,350**	7,861	6,229	7,861	6,479
47,350	**47,400**	7,874	6,236	7,874	6,489
47,400	**47,450**	7,886	6,244	7,886	6,501
47,450	**47,500**	7,899	6,251	7,899	6,514
47,500	**47,550**	7,911	6,259	7,911	6,526
47,550	**47,600**	7,924	6,266	7,924	6,539
47,600	**47,650**	7,936	6,274	7,936	6,551
47,650	**47,700**	7,949	6,281	7,949	6,564
47,700	**47,750**	7,961	6,289	7,961	6,576
47,750	**47,800**	7,974	6,296	7,974	6,589
47,800	**47,850**	7,986	6,304	7,986	6,601
47,850	**47,900**	7,999	6,311	7,999	6,614
47,900	**47,950**	8,011	6,319	8,011	6,626
47,950	**48,000**	8,024	6,326	8,024	6,639

(Continued)

* This column must also be used by a qualifying widow(er).

If line 43 (taxable income) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing sepa-rately	Head of a house-hold
		Your tax is—			
48,000					
48,000	**48,050**	8,036	6,334	8,036	6,651
48,050	**48,100**	8,049	6,341	8,049	6,664
48,100	**48,150**	8,061	6,349	8,061	6,676
48,150	**48,200**	8,074	6,356	8,074	6,689
48,200	**48,250**	8,086	6,364	8,086	6,701
48,250	**48,300**	8,099	6,371	8,099	6,714
48,300	**48,350**	8,111	6,379	8,111	6,726
48,350	**48,400**	8,124	6,386	8,124	6,739
48,400	**48,450**	8,136	6,394	8,136	6,751
48,450	**48,500**	8,149	6,401	8,149	6,764
48,500	**48,550**	8,161	6,409	8,161	6,776
48,550	**48,600**	8,174	6,416	8,174	6,789
48,600	**48,650**	8,186	6,424	8,186	6,801
48,650	**48,700**	8,199	6,431	8,199	6,814
48,700	**48,750**	8,211	6,439	8,211	6,826
48,750	**48,800**	8,224	6,446	8,224	6,839
48,800	**48,850**	8,236	6,454	8,236	6,851
48,850	**48,900**	8,249	6,461	8,249	6,864
48,900	**48,950**	8,261	6,469	8,261	6,876
48,950	**49,000**	8,274	6,476	8,274	6,889
49,000					
49,000	**49,050**	8,286	6,484	8,286	6,901
49,050	**49,100**	8,299	6,491	8,299	6,914
49,100	**49,150**	8,311	6,499	8,311	6,926
49,150	**49,200**	8,324	6,506	8,324	6,939
49,200	**49,250**	8,336	6,514	8,336	6,951
49,250	**49,300**	8,349	6,521	8,349	6,964
49,300	**49,350**	8,361	6,529	8,361	6,976
49,350	**49,400**	8,374	6,536	8,374	6,989
49,400	**49,450**	8,386	6,544	8,386	7,001
49,450	**49,500**	8,399	6,551	8,399	7,014
49,500	**49,550**	8,411	6,559	8,411	7,026
49,550	**49,600**	8,424	6,566	8,424	7,039
49,600	**49,650**	8,436	6,574	8,436	7,051
49,650	**49,700**	8,449	6,581	8,449	7,064
49,700	**49,750**	8,461	6,589	8,461	7,076
49,750	**49,800**	8,474	6,596	8,474	7,089
49,800	**49,850**	8,486	6,604	8,486	7,101
49,850	**49,900**	8,499	6,611	8,499	7,114
49,900	**49,950**	8,511	6,619	8,511	7,126
49,950	**50,000**	8,524	6,626	8,524	7,139
50,000					
50,000	**50,050**	8,536	6,634	8,536	7,151
50,050	**50,100**	8,549	6,641	8,549	7,164
50,100	**50,150**	8,561	6,649	8,561	7,176
50,150	**50,200**	8,574	6,656	8,574	7,189
50,200	**50,250**	8,586	6,664	8,586	7,201
50,250	**50,300**	8,599	6,671	8,599	7,214
50,300	**50,350**	8,611	6,679	8,611	7,226
50,350	**50,400**	8,624	6,686	8,624	7,239
50,400	**50,450**	8,636	6,694	8,636	7,251
50,450	**50,500**	8,649	6,701	8,649	7,264
50,500	**50,550**	8,661	6,709	8,661	7,276
50,550	**50,600**	8,674	6,716	8,674	7,289
50,600	**50,650**	8,686	6,724	8,686	7,301
50,650	**50,700**	8,699	6,731	8,699	7,314
50,700	**50,750**	8,711	6,739	8,711	7,326
50,750	**50,800**	8,724	6,746	8,724	7,339
50,800	**50,850**	8,736	6,754	8,736	7,351
50,850	**50,900**	8,749	6,761	8,749	7,364
50,900	**50,950**	8,761	6,769	8,761	7,376
50,950	**51,000**	8,774	6,776	8,774	7,389

If line 43 (taxable income) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing sepa-rately	Head of a house-hold
		Your tax is—			
51,000					
51,000	**51,050**	8,786	6,784	8,786	7,401
51,050	**51,100**	8,799	6,791	8,799	7,414
51,100	**51,150**	8,811	6,799	8,811	7,426
51,150	**51,200**	8,824	6,806	8,824	7,439
51,200	**51,250**	8,836	6,814	8,836	7,451
51,250	**51,300**	8,849	6,821	8,849	7,464
51,300	**51,350**	8,861	6,829	8,861	7,476
51,350	**51,400**	8,874	6,836	8,874	7,489
51,400	**51,450**	8,886	6,844	8,886	7,501
51,450	**51,500**	8,899	6,851	8,899	7,514
51,500	**51,550**	8,911	6,859	8,911	7,526
51,550	**51,600**	8,924	6,866	8,924	7,539
51,600	**51,650**	8,936	6,874	8,936	7,551
51,650	**51,700**	8,949	6,881	8,949	7,564
51,700	**51,750**	8,961	6,889	8,961	7,576
51,750	**51,800**	8,974	6,896	8,974	7,589
51,800	**51,850**	8,986	6,904	8,986	7,601
51,850	**51,900**	8,999	6,911	8,999	7,614
51,900	**51,950**	9,011	6,919	9,011	7,626
51,950	**52,000**	9,024	6,926	9,024	7,639
52,000					
52,000	**52,050**	9,036	6,934	9,036	7,651
52,050	**52,100**	9,049	6,941	9,049	7,664
52,100	**52,150**	9,061	6,949	9,061	7,676
52,150	**52,200**	9,074	6,956	9,074	7,689
52,200	**52,250**	9,086	6,964	9,086	7,701
52,250	**52,300**	9,099	6,971	9,099	7,714
52,300	**52,350**	9,111	6,979	9,111	7,726
52,350	**52,400**	9,124	6,986	9,124	7,739
52,400	**52,450**	9,136	6,994	9,136	7,751
52,450	**52,500**	9,149	7,001	9,149	7,764
52,500	**52,550**	9,161	7,009	9,161	7,776
52,550	**52,600**	9,174	7,016	9,174	7,789
52,600	**52,650**	9,186	7,024	9,186	7,801
52,650	**52,700**	9,199	7,031	9,199	7,814
52,700	**52,750**	9,211	7,039	9,211	7,826
52,750	**52,800**	9,224	7,046	9,224	7,839
52,800	**52,850**	9,236	7,054	9,236	7,851
52,850	**52,900**	9,249	7,061	9,249	7,864
52,900	**52,950**	9,261	7,069	9,261	7,876
52,950	**53,000**	9,274	7,076	9,274	7,889
53,000					
53,000	**53,050**	9,286	7,084	9,286	7,901
53,050	**53,100**	9,299	7,091	9,299	7,914
53,100	**53,150**	9,311	7,099	9,311	7,926
53,150	**53,200**	9,324	7,106	9,324	7,939
53,200	**53,250**	9,336	7,114	9,336	7,951
53,250	**53,300**	9,349	7,121	9,349	7,964
53,300	**53,350**	9,361	7,129	9,361	7,976
53,350	**53,400**	9,374	7,136	9,374	7,989
53,400	**53,450**	9,386	7,144	9,386	8,001
53,450	**53,500**	9,399	7,151	9,399	8,014
53,500	**53,550**	9,411	7,159	9,411	8,026
53,550	**53,600**	9,424	7,166	9,424	8,039
53,600	**53,650**	9,436	7,174	9,436	8,051
53,650	**53,700**	9,449	7,181	9,449	8,064
53,700	**53,750**	9,461	7,189	9,461	8,076
53,750	**53,800**	9,474	7,196	9,474	8,089
53,800	**53,850**	9,486	7,204	9,486	8,101
53,850	**53,900**	9,499	7,211	9,499	8,114
53,900	**53,950**	9,511	7,219	9,511	8,126
53,950	**54,000**	9,524	7,226	9,524	8,139

If line 43 (taxable income) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing sepa-rately	Head of a house-hold
		Your tax is—			
54,000					
54,000	**54,050**	9,536	7,234	9,536	8,151
54,050	**54,100**	9,549	7,241	9,549	8,164
54,100	**54,150**	9,561	7,249	9,561	8,176
54,150	**54,200**	9,574	7,256	9,574	8,189
54,200	**54,250**	9,586	7,264	9,586	8,201
54,250	**54,300**	9,599	7,271	9,599	8,214
54,300	**54,350**	9,611	7,279	9,611	8,226
54,350	**54,400**	9,624	7,286	9,624	8,239
54,400	**54,450**	9,636	7,294	9,636	8,251
54,450	**54,500**	9,649	7,301	9,649	8,264
54,500	**54,550**	9,661	7,309	9,661	8,276
54,550	**54,600**	9,674	7,316	9,674	8,289
54,600	**54,650**	9,686	7,324	9,686	8,301
54,650	**54,700**	9,699	7,331	9,699	8,314
54,700	**54,750**	9,711	7,339	9,711	8,326
54,750	**54,800**	9,724	7,346	9,724	8,339
54,800	**54,850**	9,736	7,354	9,736	8,351
54,850	**54,900**	9,749	7,361	9,749	8,364
54,900	**54,950**	9,761	7,369	9,761	8,376
54,950	**55,000**	9,774	7,376	9,774	8,389
55,000					
55,000	**55,050**	9,786	7,384	9,786	8,401
55,050	**55,100**	9,799	7,391	9,799	8,414
55,100	**55,150**	9,811	7,399	9,811	8,426
55,150	**55,200**	9,824	7,406	9,824	8,439
55,200	**55,250**	9,836	7,414	9,836	8,451
55,250	**55,300**	9,849	7,421	9,849	8,464
55,300	**55,350**	9,861	7,429	9,861	8,476
55,350	**55,400**	9,874	7,436	9,874	8,489
55,400	**55,450**	9,886	7,444	9,886	8,501
55,450	**55,500**	9,899	7,451	9,899	8,514
55,500	**55,550**	9,911	7,459	9,911	8,526
55,550	**55,600**	9,924	7,466	9,924	8,539
55,600	**55,650**	9,936	7,474	9,936	8,551
55,650	**55,700**	9,949	7,481	9,949	8,564
55,700	**55,750**	9,961	7,489	9,961	8,576
55,750	**55,800**	9,974	7,496	9,974	8,589
55,800	**55,850**	9,986	7,504	9,986	8,601
55,850	**55,900**	9,999	7,511	9,999	8,614
55,900	**55,950**	10,011	7,519	10,011	8,626
55,950	**56,000**	10,024	7,526	10,024	8,639
56,000					
56,000	**56,050**	10,036	7,534	10,036	8,651
56,050	**56,100**	10,049	7,541	10,049	8,664
56,100	**56,150**	10,061	7,549	10,061	8,676
56,150	**56,200**	10,074	7,556	10,074	8,689
56,200	**56,250**	10,086	7,564	10,086	8,701
56,250	**56,300**	10,099	7,571	10,099	8,714
56,300	**56,350**	10,111	7,579	10,111	8,726
56,350	**56,400**	10,124	7,586	10,124	8,739
56,400	**56,450**	10,136	7,594	10,136	8,751
56,450	**56,500**	10,149	7,601	10,149	8,764
56,500	**56,550**	10,161	7,609	10,161	8,776
56,550	**56,600**	10,174	7,616	10,174	8,789
56,600	**56,650**	10,186	7,624	10,186	8,801
56,650	**56,700**	10,199	7,631	10,199	8,814
56,700	**56,750**	10,211	7,639	10,211	8,826
56,750	**56,800**	10,224	7,646	10,224	8,839
56,800	**56,850**	10,236	7,654	10,236	8,851
56,850	**56,900**	10,249	7,661	10,249	8,864
56,900	**56,950**	10,261	7,669	10,261	8,876
56,950	**57,000**	10,274	7,676	10,274	8,889

(Continued)

* This column must also be used by a qualifying widow(er).

If line 43 (taxable income) is— At least	But less than	And you are— Single	Married filing jointly *	Married filing separately	Head of a household
		Your tax is—			
57,000					
57,000	**57,050**	10,286	7,684	10,286	8,901
57,050	**57,100**	10,299	7,691	10,299	8,914
57,100	**57,150**	10,311	7,699	10,311	8,926
57,150	**57,200**	10,324	7,706	10,324	8,939
57,200	**57,250**	10,336	7,714	10,336	8,951
57,250	**57,300**	10,349	7,721	10,349	8,964
57,300	**57,350**	10,361	7,729	10,361	8,976
57,350	**57,400**	10,374	7,736	10,374	8,989
57,400	**57,450**	10,386	7,744	10,386	9,001
57,450	**57,500**	10,399	7,751	10,399	9,014
57,500	**57,550**	10,411	7,759	10,411	9,026
57,550	**57,600**	10,424	7,766	10,424	9,039
57,600	**57,650**	10,436	7,774	10,436	9,051
57,650	**57,700**	10,449	7,781	10,449	9,064
57,700	**57,750**	10,461	7,789	10,461	9,076
57,750	**57,800**	10,474	7,796	10,474	9,089
57,800	**57,850**	10,486	7,804	10,486	9,101
57,850	**57,900**	10,499	7,811	10,499	9,114
57,900	**57,950**	10,511	7,819	10,511	9,126
57,950	**58,000**	10,524	7,826	10,524	9,139
58,000					
58,000	**58,050**	10,536	7,834	10,536	9,151
58,050	**58,100**	10,549	7,841	10,549	9,164
58,100	**58,150**	10,561	7,849	10,561	9,176
58,150	**58,200**	10,574	7,856	10,574	9,189
58,200	**58,250**	10,586	7,864	10,586	9,201
58,250	**58,300**	10,599	7,871	10,599	9,214
58,300	**58,350**	10,611	7,879	10,611	9,226
58,350	**58,400**	10,624	7,886	10,624	9,239
58,400	**58,450**	10,636	7,894	10,636	9,251
58,450	**58,500**	10,649	7,901	10,649	9,264
58,500	**58,550**	10,661	7,909	10,661	9,276
58,550	**58,600**	10,674	7,916	10,674	9,289
58,600	**58,650**	10,686	7,924	10,686	9,301
58,650	**58,700**	10,699	7,931	10,699	9,314
58,700	**58,750**	10,711	7,939	10,711	9,326
58,750	**58,800**	10,724	7,946	10,724	9,339
58,800	**58,850**	10,736	7,954	10,736	9,351
58,850	**58,900**	10,749	7,961	10,749	9,364
58,900	**58,950**	10,761	7,969	10,761	9,376
58,950	**59,000**	10,774	7,976	10,774	9,389
59,000					
59,000	**59,050**	10,786	7,984	10,786	9,401
59,050	**59,100**	10,799	7,991	10,799	9,414
59,100	**59,150**	10,811	7,999	10,811	9,426
59,150	**59,200**	10,824	8,006	10,824	9,439
59,200	**59,250**	10,836	8,014	10,836	9,451
59,250	**59,300**	10,849	8,021	10,849	9,464
59,300	**59,350**	10,861	8,029	10,861	9,476
59,350	**59,400**	10,874	8,036	10,874	9,489
59,400	**59,450**	10,886	8,044	10,886	9,501
59,450	**59,500**	10,899	8,051	10,899	9,514
59,500	**59,550**	10,911	8,059	10,911	9,526
59,550	**59,600**	10,924	8,066	10,924	9,539
59,600	**59,650**	10,936	8,074	10,936	9,551
59,650	**59,700**	10,949	8,081	10,949	9,564
59,700	**59,750**	10,961	8,089	10,961	9,576
59,750	**59,800**	10,974	8,096	10,974	9,589
59,800	**59,850**	10,986	8,104	10,986	9,601
59,850	**59,900**	10,999	8,111	10,999	9,614
59,900	**59,950**	11,011	8,119	11,011	9,626
59,950	**60,000**	11,024	8,126	11,024	9,639
60,000					
60,000	**60,050**	11,036	8,134	11,036	9,651
60,050	**60,100**	11,049	8,141	11,049	9,664
60,100	**60,150**	11,061	8,149	11,061	9,676
60,150	**60,200**	11,074	8,156	11,074	9,689
60,200	**60,250**	11,086	8,164	11,086	9,701
60,250	**60,300**	11,099	8,171	11,099	9,714
60,300	**60,350**	11,111	8,179	11,111	9,726
60,350	**60,400**	11,124	8,186	11,124	9,739
60,400	**60,450**	11,136	8,194	11,136	9,751
60,450	**60,500**	11,149	8,201	11,149	9,764
60,500	**60,550**	11,161	8,209	11,161	9,776
60,550	**60,600**	11,174	8,216	11,174	9,789
60,600	**60,650**	11,186	8,224	11,186	9,801
60,650	**60,700**	11,199	8,231	11,199	9,814
60,700	**60,750**	11,211	8,239	11,211	9,826
60,750	**60,800**	11,224	8,246	11,224	9,839
60,800	**60,850**	11,236	8,254	11,236	9,851
60,850	**60,900**	11,249	8,261	11,249	9,864
60,900	**60,950**	11,261	8,269	11,261	9,876
60,950	**61,000**	11,274	8,276	11,274	9,889
61,000					
61,000	**61,050**	11,286	8,284	11,286	9,901
61,050	**61,100**	11,299	8,291	11,299	9,914
61,100	**61,150**	11,311	8,299	11,311	9,926
61,150	**61,200**	11,324	8,306	11,324	9,939
61,200	**61,250**	11,336	8,314	11,336	9,951
61,250	**61,300**	11,349	8,321	11,349	9,964
61,300	**61,350**	11,361	8,329	11,361	9,976
61,350	**61,400**	11,374	8,336	11,374	9,989
61,400	**61,450**	11,386	8,344	11,386	10,001
61,450	**61,500**	11,399	8,351	11,399	10,014
61,500	**61,550**	11,411	8,359	11,411	10,026
61,550	**61,600**	11,424	8,366	11,424	10,039
61,600	**61,650**	11,436	8,374	11,436	10,051
61,650	**61,700**	11,449	8,381	11,449	10,064
61,700	**61,750**	11,461	8,389	11,461	10,076
61,750	**61,800**	11,474	8,396	11,474	10,089
61,800	**61,850**	11,486	8,404	11,486	10,101
61,850	**61,900**	11,499	8,411	11,499	10,114
61,900	**61,950**	11,511	8,419	11,511	10,126
61,950	**62,000**	11,524	8,426	11,524	10,139
62,000					
62,000	**62,050**	11,536	8,434	11,536	10,151
62,050	**62,100**	11,549	8,441	11,549	10,164
62,100	**62,150**	11,561	8,449	11,561	10,176
62,150	**62,200**	11,574	8,456	11,574	10,189
62,200	**62,250**	11,586	8,464	11,586	10,201
62,250	**62,300**	11,599	8,471	11,599	10,214
62,300	**62,350**	11,611	8,479	11,611	10,226
62,350	**62,400**	11,624	8,486	11,624	10,239
62,400	**62,450**	11,636	8,494	11,636	10,251
62,450	**62,500**	11,649	8,501	11,649	10,264
62,500	**62,550**	11,661	8,509	11,661	10,276
62,550	**62,600**	11,674	8,516	11,674	10,289
62,600	**62,650**	11,686	8,524	11,686	10,301
62,650	**62,700**	11,699	8,531	11,699	10,314
62,700	**62,750**	11,711	8,539	11,711	10,326
62,750	**62,800**	11,724	8,546	11,724	10,339
62,800	**62,850**	11,736	8,554	11,736	10,351
62,850	**62,900**	11,749	8,561	11,749	10,364
62,900	**62,950**	11,761	8,569	11,761	10,376
62,950	**63,000**	11,774	8,576	11,774	10,389
63,000					
63,000	**63,050**	11,786	8,584	11,786	10,401
63,050	**63,100**	11,799	8,591	11,799	10,414
63,100	**63,150**	11,811	8,599	11,811	10,426
63,150	**63,200**	11,824	8,606	11,824	10,439
63,200	**63,250**	11,836	8,614	11,836	10,451
63,250	**63,300**	11,849	8,621	11,849	10,464
63,300	**63,350**	11,861	8,629	11,861	10,476
63,350	**63,400**	11,874	8,636	11,874	10,489
63,400	**63,450**	11,886	8,644	11,886	10,501
63,450	**63,500**	11,899	8,651	11,899	10,514
63,500	**63,550**	11,911	8,659	11,911	10,526
63,550	**63,600**	11,924	8,666	11,924	10,539
63,600	**63,650**	11,936	8,674	11,936	10,551
63,650	**63,700**	11,949	8,681	11,949	10,564
63,700	**63,750**	11,961	8,689	11,961	10,576
63,750	**63,800**	11,974	8,696	11,974	10,589
63,800	**63,850**	11,986	8,704	11,986	10,601
63,850	**63,900**	11,999	8,711	11,999	10,614
63,900	**63,950**	12,011	8,719	12,011	10,626
63,950	**64,000**	12,024	8,726	12,024	10,639
64,000					
64,000	**64,050**	12,036	8,734	12,036	10,651
64,050	**64,100**	12,049	8,741	12,049	10,664
64,100	**64,150**	12,061	8,749	12,061	10,676
64,150	**64,200**	12,074	8,756	12,074	10,689
64,200	**64,250**	12,086	8,764	12,086	10,701
64,250	**64,300**	12,099	8,771	12,099	10,714
64,300	**64,350**	12,111	8,779	12,111	10,726
64,350	**64,400**	12,124	8,786	12,124	10,739
64,400	**64,450**	12,136	8,794	12,136	10,751
64,450	**64,500**	12,149	8,801	12,149	10,764
64,500	**64,550**	12,161	8,809	12,161	10,776
64,550	**64,600**	12,174	8,816	12,174	10,789
64,600	**64,650**	12,186	8,824	12,186	10,801
64,650	**64,700**	12,199	8,831	12,199	10,814
64,700	**64,750**	12,211	8,839	12,211	10,826
64,750	**64,800**	12,224	8,846	12,224	10,839
64,800	**64,850**	12,236	8,854	12,236	10,851
64,850	**64,900**	12,249	8,861	12,249	10,864
64,900	**64,950**	12,261	8,869	12,261	10,876
64,950	**65,000**	12,274	8,876	12,274	10,889
65,000					
65,000	**65,050**	12,286	8,884	12,286	10,901
65,050	**65,100**	12,299	8,891	12,299	10,914
65,100	**65,150**	12,311	8,899	12,311	10,926
65,150	**65,200**	12,324	8,906	12,324	10,939
65,200	**65,250**	12,336	8,914	12,336	10,951
65,250	**65,300**	12,349	8,921	12,349	10,964
65,300	**65,350**	12,361	8,929	12,361	10,976
65,350	**65,400**	12,374	8,936	12,374	10,989
65,400	**65,450**	12,386	8,944	12,386	11,001
65,450	**65,500**	12,399	8,951	12,399	11,014
65,500	**65,550**	12,411	8,959	12,411	11,026
65,550	**65,600**	12,424	8,966	12,424	11,039
65,600	**65,650**	12,436	8,974	12,436	11,051
65,650	**65,700**	12,449	8,981	12,449	11,064
65,700	**65,750**	12,461	8,989	12,461	11,076
65,750	**65,800**	12,474	8,996	12,474	11,089
65,800	**65,850**	12,486	9,004	12,486	11,101
65,850	**65,900**	12,499	9,011	12,499	11,114
65,900	**65,950**	12,511	9,019	12,511	11,126
65,950	**66,000**	12,524	9,026	12,524	11,139

(Continued)

* This column must also be used by a qualifying widow(er).

If line 43 (taxable income) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing sepa-rately	Head of a house-hold
		Your tax is—			
66,000					
66,000	**66,050**	12,536	9,034	12,536	11,151
66,050	**66,100**	12,549	9,041	12,549	11,164
66,100	**66,150**	12,561	9,049	12,561	11,176
66,150	**66,200**	12,574	9,056	12,574	11,189
66,200	**66,250**	12,586	9,064	12,586	11,201
66,250	**66,300**	12,599	9,071	12,599	11,214
66,300	**66,350**	12,611	9,079	12,611	11,226
66,350	**66,400**	12,624	9,086	12,624	11,239
66,400	**66,450**	12,636	9,094	12,636	11,251
66,450	**66,500**	12,649	9,101	12,649	11,264
66,500	**66,550**	12,661	9,109	12,661	11,276
66,550	**66,600**	12,674	9,116	12,674	11,289
66,600	**66,650**	12,686	9,124	12,686	11,301
66,650	**66,700**	12,699	9,131	12,699	11,314
66,700	**66,750**	12,711	9,139	12,711	11,326
66,750	**66,800**	12,724	9,146	12,724	11,339
66,800	**66,850**	12,736	9,154	12,736	11,351
66,850	**66,900**	12,749	9,161	12,749	11,364
66,900	**66,950**	12,761	9,169	12,761	11,376
66,950	**67,000**	12,774	9,176	12,774	11,389
67,000					
67,000	**67,050**	12,786	9,184	12,786	11,401
67,050	**67,100**	12,799	9,191	12,799	11,414
67,100	**67,150**	12,811	9,199	12,811	11,426
67,150	**67,200**	12,824	9,206	12,824	11,439
67,200	**67,250**	12,836	9,214	12,836	11,451
67,250	**67,300**	12,849	9,221	12,849	11,464
67,300	**67,350**	12,861	9,229	12,861	11,476
67,350	**67,400**	12,874	9,236	12,874	11,489
67,400	**67,450**	12,886	9,244	12,886	11,501
67,450	**67,500**	12,899	9,251	12,899	11,514
67,500	**67,550**	12,911	9,259	12,911	11,526
67,550	**67,600**	12,924	9,266	12,924	11,539
67,600	**67,650**	12,936	9,274	12,936	11,551
67,650	**67,700**	12,949	9,281	12,949	11,564
67,700	**67,750**	12,961	9,289	12,961	11,576
67,750	**67,800**	12,974	9,296	12,974	11,589
67,800	**67,850**	12,986	9,304	12,986	11,601
67,850	**67,900**	12,999	9,311	12,999	11,614
67,900	**67,950**	13,011	9,319	13,011	11,626
67,950	**68,000**	13,024	9,326	13,024	11,639
68,000					
68,000	**68,050**	13,036	9,334	13,036	11,651
68,050	**68,100**	13,049	9,341	13,049	11,664
68,100	**68,150**	13,061	9,349	13,061	11,676
68,150	**68,200**	13,074	9,356	13,074	11,689
68,200	**68,250**	13,086	9,364	13,086	11,701
68,250	**68,300**	13,099	9,371	13,099	11,714
68,300	**68,350**	13,111	9,379	13,111	11,726
68,350	**68,400**	13,124	9,386	13,124	11,739
68,400	**68,450**	13,136	9,394	13,136	11,751
68,450	**68,500**	13,149	9,401	13,149	11,764
68,500	**68,550**	13,161	9,409	13,161	11,776
68,550	**68,600**	13,174	9,416	13,174	11,789
68,600	**68,650**	13,186	9,424	13,186	11,801
68,650	**68,700**	13,199	9,431	13,199	11,814
68,700	**68,750**	13,211	9,439	13,211	11,826
68,750	**68,800**	13,224	9,446	13,224	11,839
68,800	**68,850**	13,236	9,454	13,236	11,851
68,850	**68,900**	13,249	9,461	13,249	11,864
68,900	**68,950**	13,261	9,469	13,261	11,876
68,950	**69,000**	13,274	9,476	13,274	11,889

If line 43 (taxable income) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing sepa-rately	Head of a house-hold
		Your tax is—			
69,000					
69,000	**69,050**	13,286	9,484	13,286	11,901
69,050	**69,100**	13,299	9,491	13,299	11,914
69,100	**69,150**	13,311	9,499	13,311	11,926
69,150	**69,200**	13,324	9,506	13,324	11,939
69,200	**69,250**	13,336	9,514	13,336	11,951
69,250	**69,300**	13,349	9,521	13,349	11,964
69,300	**69,350**	13,361	9,529	13,361	11,976
69,350	**69,400**	13,374	9,536	13,374	11,989
69,400	**69,450**	13,386	9,544	13,386	12,001
69,450	**69,500**	13,399	9,551	13,399	12,014
69,500	**69,550**	13,411	9,559	13,411	12,026
69,550	**69,600**	13,424	9,566	13,424	12,039
69,600	**69,650**	13,436	9,574	13,436	12,051
69,650	**69,700**	13,449	9,581	13,449	12,064
69,700	**69,750**	13,461	9,589	13,461	12,076
69,750	**69,800**	13,474	9,596	13,474	12,089
69,800	**69,850**	13,486	9,604	13,486	12,101
69,850	**69,900**	13,499	9,611	13,499	12,114
69,900	**69,950**	13,511	9,619	13,511	12,126
69,950	**70,000**	13,524	9,626	13,524	12,139
70,000					
70,000	**70,050**	13,536	9,634	13,536	12,151
70,050	**70,100**	13,549	9,641	13,549	12,164
70,100	**70,150**	13,561	9,649	13,561	12,176
70,150	**70,200**	13,574	9,656	13,574	12,189
70,200	**70,250**	13,586	9,664	13,586	12,201
70,250	**70,300**	13,599	9,671	13,599	12,214
70,300	**70,350**	13,611	9,679	13,611	12,226
70,350	**70,400**	13,624	9,686	13,624	12,239
70,400	**70,450**	13,636	9,694	13,636	12,251
70,450	**70,500**	13,649	9,701	13,649	12,264
70,500	**70,550**	13,661	9,709	13,661	12,276
70,550	**70,600**	13,674	9,716	13,674	12,289
70,600	**70,650**	13,686	9,724	13,686	12,301
70,650	**70,700**	13,699	9,731	13,699	12,314
70,700	**70,750**	13,711	9,741	13,711	12,326
70,750	**70,800**	13,724	9,754	13,724	12,339
70,800	**70,850**	13,736	9,766	13,736	12,351
70,850	**70,900**	13,749	9,779	13,749	12,364
70,900	**70,950**	13,761	9,791	13,761	12,376
70,950	**71,000**	13,774	9,804	13,774	12,389
71,000					
71,000	**71,050**	13,786	9,816	13,786	12,401
71,050	**71,100**	13,799	9,829	13,799	12,414
71,100	**71,150**	13,811	9,841	13,811	12,426
71,150	**71,200**	13,824	9,854	13,824	12,439
71,200	**71,250**	13,836	9,866	13,836	12,451
71,250	**71,300**	13,849	9,879	13,849	12,464
71,300	**71,350**	13,861	9,891	13,861	12,476
71,350	**71,400**	13,874	9,904	13,875	12,489
71,400	**71,450**	13,886	9,916	13,889	12,501
71,450	**71,500**	13,899	9,929	13,903	12,514
71,500	**71,550**	13,911	9,941	13,917	12,526
71,550	**71,600**	13,924	9,954	13,931	12,539
71,600	**71,650**	13,936	9,966	13,945	12,551
71,650	**71,700**	13,949	9,979	13,959	12,564
71,700	**71,750**	13,961	9,991	13,973	12,576
71,750	**71,800**	13,974	10,004	13,987	12,589
71,800	**71,850**	13,986	10,016	14,001	12,601
71,850	**71,900**	13,999	10,029	14,015	12,614
71,900	**71,950**	14,011	10,041	14,029	12,626
71,950	**72,000**	14,024	10,054	14,043	12,639

If line 43 (taxable income) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing sepa-rately	Head of a house-hold
		Your tax is—			
72,000					
72,000	**72,050**	14,036	10,066	14,057	12,651
72,050	**72,100**	14,049	10,079	14,071	12,664
72,100	**72,150**	14,061	10,091	14,085	12,676
72,150	**72,200**	14,074	10,104	14,099	12,689
72,200	**72,250**	14,086	10,116	14,113	12,701
72,250	**72,300**	14,099	10,129	14,127	12,714
72,300	**72,350**	14,111	10,141	14,141	12,726
72,350	**72,400**	14,124	10,154	14,155	12,739
72,400	**72,450**	14,136	10,166	14,169	12,751
72,450	**72,500**	14,149	10,179	14,183	12,764
72,500	**72,550**	14,161	10,191	14,197	12,776
72,550	**72,600**	14,174	10,204	14,211	12,789
72,600	**72,650**	14,186	10,216	14,225	12,801
72,650	**72,700**	14,199	10,229	14,239	12,814
72,700	**72,750**	14,211	10,241	14,253	12,826
72,750	**72,800**	14,224	10,254	14,267	12,839
72,800	**72,850**	14,236	10,266	14,281	12,851
72,850	**72,900**	14,249	10,279	14,295	12,864
72,900	**72,950**	14,261	10,291	14,309	12,876
72,950	**73,000**	14,274	10,304	14,323	12,889
73,000					
73,000	**73,050**	14,286	10,316	14,337	12,901
73,050	**73,100**	14,299	10,329	14,351	12,914
73,100	**73,150**	14,311	10,341	14,365	12,926
73,150	**73,200**	14,324	10,354	14,379	12,939
73,200	**73,250**	14,336	10,366	14,393	12,951
73,250	**73,300**	14,349	10,379	14,407	12,964
73,300	**73,350**	14,361	10,391	14,421	12,976
73,350	**73,400**	14,374	10,404	14,435	12,989
73,400	**73,450**	14,386	10,416	14,449	13,001
73,450	**73,500**	14,399	10,429	14,463	13,014
73,500	**73,550**	14,411	10,441	14,477	13,026
73,550	**73,600**	14,424	10,454	14,491	13,039
73,600	**73,650**	14,436	10,466	14,505	13,051
73,650	**73,700**	14,449	10,479	14,519	13,064
73,700	**73,750**	14,461	10,491	14,533	13,076
73,750	**73,800**	14,474	10,504	14,547	13,089
73,800	**73,850**	14,486	10,516	14,561	13,101
73,850	**73,900**	14,499	10,529	14,575	13,114
73,900	**73,950**	14,511	10,541	14,589	13,126
73,950	**74,000**	14,524	10,554	14,603	13,139
74,000					
74,000	**74,050**	14,536	10,566	14,617	13,151
74,050	**74,100**	14,549	10,579	14,631	13,164
74,100	**74,150**	14,561	10,591	14,645	13,176
74,150	**74,200**	14,574	10,604	14,659	13,189
74,200	**74,250**	14,586	10,616	14,673	13,201
74,250	**74,300**	14,599	10,629	14,687	13,214
74,300	**74,350**	14,611	10,641	14,701	13,226
74,350	**74,400**	14,624	10,654	14,715	13,239
74,400	**74,450**	14,636	10,666	14,729	13,251
74,450	**74,500**	14,649	10,679	14,743	13,264
74,500	**74,550**	14,661	10,691	14,757	13,276
74,550	**74,600**	14,674	10,704	14,771	13,289
74,600	**74,650**	14,686	10,716	14,785	13,301
74,650	**74,700**	14,699	10,729	14,799	13,314
74,700	**74,750**	14,711	10,741	14,813	13,326
74,750	**74,800**	14,724	10,754	14,827	13,339
74,800	**74,850**	14,736	10,766	14,841	13,351
74,850	**74,900**	14,749	10,779	14,855	13,364
74,900	**74,950**	14,761	10,791	14,869	13,376
74,950	**75,000**	14,774	10,804	14,883	13,389

(Continued)

* This column must also be used by a qualifying widow(er).

If line 43 (taxable income) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing sepa-rately	Head of a house-hold
		Your tax is—			
75,000					
75,000	**75,050**	14,786	10,816	14,897	13,401
75,050	**75,100**	14,799	10,829	14,911	13,414
75,100	**75,150**	14,811	10,841	14,925	13,426
75,150	**75,200**	14,824	10,854	14,939	13,439
75,200	**75,250**	14,836	10,866	14,953	13,451
75,250	**75,300**	14,849	10,879	14,967	13,464
75,300	**75,350**	14,861	10,891	14,981	13,476
75,350	**75,400**	14,874	10,904	14,995	13,489
75,400	**75,450**	14,886	10,916	15,009	13,501
75,450	**75,500**	14,899	10,929	15,023	13,514
75,500	**75,550**	14,911	10,941	15,037	13,526
75,550	**75,600**	14,924	10,954	15,051	13,539
75,600	**75,650**	14,936	10,966	15,065	13,551
75,650	**75,700**	14,949	10,979	15,079	13,564
75,700	**75,750**	14,961	10,991	15,093	13,576
75,750	**75,800**	14,974	11,004	15,107	13,589
75,800	**75,850**	14,986	11,016	15,121	13,601
75,850	**75,900**	14,999	11,029	15,135	13,614
75,900	**75,950**	15,011	11,041	15,149	13,626
75,950	**76,000**	15,024	11,054	15,163	13,639
76,000					
76,000	**76,050**	15,036	11,066	15,177	13,651
76,050	**76,100**	15,049	11,079	15,191	13,664
76,100	**76,150**	15,061	11,091	15,205	13,676
76,150	**76,200**	15,074	11,104	15,219	13,689
76,200	**76,250**	15,086	11,116	15,233	13,701
76,250	**76,300**	15,099	11,129	15,247	13,714
76,300	**76,350**	15,111	11,141	15,261	13,726
76,350	**76,400**	15,124	11,154	15,275	13,739
76,400	**76,450**	15,136	11,166	15,289	13,751
76,450	**76,500**	15,149	11,179	15,303	13,764
76,500	**76,550**	15,161	11,191	15,317	13,776
76,550	**76,600**	15,174	11,204	15,331	13,789
76,600	**76,650**	15,186	11,216	15,345	13,801
76,650	**76,700**	15,199	11,229	15,359	13,814
76,700	**76,750**	15,211	11,241	15,373	13,826
76,750	**76,800**	15,224	11,254	15,387	13,839
76,800	**76,850**	15,236	11,266	15,401	13,851
76,850	**76,900**	15,249	11,279	15,415	13,864
76,900	**76,950**	15,261	11,291	15,429	13,876
76,950	**77,000**	15,274	11,304	15,443	13,889
77,000					
77,000	**77,050**	15,286	11,316	15,457	13,901
77,050	**77,100**	15,299	11,329	15,471	13,914
77,100	**77,150**	15,311	11,341	15,485	13,926
77,150	**77,200**	15,324	11,354	15,499	13,939
77,200	**77,250**	15,336	11,366	15,513	13,951
77,250	**77,300**	15,349	11,379	15,527	13,964
77,300	**77,350**	15,361	11,391	15,541	13,976
77,350	**77,400**	15,374	11,404	15,555	13,989
77,400	**77,450**	15,386	11,416	15,569	14,001
77,450	**77,500**	15,399	11,429	15,583	14,014
77,500	**77,550**	15,411	11,441	15,597	14,026
77,550	**77,600**	15,424	11,454	15,611	14,039
77,600	**77,650**	15,436	11,466	15,625	14,051
77,650	**77,700**	15,449	11,479	15,639	14,064
77,700	**77,750**	15,461	11,491	15,653	14,076
77,750	**77,800**	15,474	11,504	15,667	14,089
77,800	**77,850**	15,486	11,516	15,681	14,101
77,850	**77,900**	15,499	11,529	15,695	14,114
77,900	**77,950**	15,511	11,541	15,709	14,126
77,950	**78,000**	15,524	11,554	15,723	14,139

If line 43 (taxable income) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing sepa-rately	Head of a house-hold
		Your tax is—			
78,000					
78,000	**78,050**	15,536	11,566	15,737	14,151
78,050	**78,100**	15,549	11,579	15,751	14,164
78,100	**78,150**	15,561	11,591	15,765	14,176
78,150	**78,200**	15,574	11,604	15,779	14,189
78,200	**78,250**	15,586	11,616	15,793	14,201
78,250	**78,300**	15,599	11,629	15,807	14,214
78,300	**78,350**	15,611	11,641	15,821	14,226
78,350	**78,400**	15,624	11,654	15,835	14,239
78,400	**78,450**	15,636	11,666	15,849	14,251
78,450	**78,500**	15,649	11,679	15,863	14,264
78,500	**78,550**	15,661	11,691	15,877	14,276
78,550	**78,600**	15,674	11,704	15,891	14,289
78,600	**78,650**	15,686	11,716	15,905	14,301
78,650	**78,700**	15,699	11,729	15,919	14,314
78,700	**78,750**	15,711	11,741	15,933	14,326
78,750	**78,800**	15,724	11,754	15,947	14,339
78,800	**78,850**	15,736	11,766	15,961	14,351
78,850	**78,900**	15,749	11,779	15,975	14,364
78,900	**78,950**	15,761	11,791	15,989	14,376
78,950	**79,000**	15,774	11,804	16,003	14,389
79,000					
79,000	**79,050**	15,786	11,816	16,017	14,401
79,050	**79,100**	15,799	11,829	16,031	14,414
79,100	**79,150**	15,811	11,841	16,045	14,426
79,150	**79,200**	15,824	11,854	16,059	14,439
79,200	**79,250**	15,836	11,866	16,073	14,451
79,250	**79,300**	15,849	11,879	16,087	14,464
79,300	**79,350**	15,861	11,891	16,101	14,476
79,350	**79,400**	15,874	11,904	16,115	14,489
79,400	**79,450**	15,886	11,916	16,129	14,501
79,450	**79,500**	15,899	11,929	16,143	14,514
79,500	**79,550**	15,911	11,941	16,157	14,526
79,550	**79,600**	15,924	11,954	16,171	14,539
79,600	**79,650**	15,936	11,966	16,185	14,551
79,650	**79,700**	15,949	11,979	16,199	14,564
79,700	**79,750**	15,961	11,991	16,213	14,576
79,750	**79,800**	15,974	12,004	16,227	14,589
79,800	**79,850**	15,986	12,016	16,241	14,601
79,850	**79,900**	15,999	12,029	16,255	14,614
79,900	**79,950**	16,011	12,041	16,269	14,626
79,950	**80,000**	16,024	12,054	16,283	14,639
80,000					
80,000	**80,050**	16,036	12,066	16,297	14,651
80,050	**80,100**	16,049	12,079	16,311	14,664
80,100	**80,150**	16,061	12,091	16,325	14,676
80,150	**80,200**	16,074	12,104	16,339	14,689
80,200	**80,250**	16,086	12,116	16,353	14,701
80,250	**80,300**	16,099	12,129	16,367	14,714
80,300	**80,350**	16,111	12,141	16,381	14,726
80,350	**80,400**	16,124	12,154	16,395	14,739
80,400	**80,450**	16,136	12,166	16,409	14,751
80,450	**80,500**	16,149	12,179	16,423	14,764
80,500	**80,550**	16,161	12,191	16,437	14,776
80,550	**80,600**	16,174	12,204	16,451	14,789
80,600	**80,650**	16,186	12,216	16,465	14,801
80,650	**80,700**	16,199	12,229	16,479	14,814
80,700	**80,750**	16,211	12,241	16,493	14,826
80,750	**80,800**	16,224	12,254	16,507	14,839
80,800	**80,850**	16,236	12,266	16,521	14,851
80,850	**80,900**	16,249	12,279	16,535	14,864
80,900	**80,950**	16,261	12,291	16,549	14,876
80,950	**81,000**	16,274	12,304	16,563	14,889

If line 43 (taxable income) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing sepa-rately	Head of a house-hold
		Your tax is—			
81,000					
81,000	**81,050**	16,286	12,316	16,577	14,901
81,050	**81,100**	16,299	12,329	16,591	14,914
81,100	**81,150**	16,311	12,341	16,605	14,926
81,150	**81,200**	16,324	12,354	16,619	14,939
81,200	**81,250**	16,336	12,366	16,633	14,951
81,250	**81,300**	16,349	12,379	16,647	14,964
81,300	**81,350**	16,361	12,391	16,661	14,976
81,350	**81,400**	16,374	12,404	16,675	14,989
81,400	**81,450**	16,386	12,416	16,689	15,001
81,450	**81,500**	16,399	12,429	16,703	15,014
81,500	**81,550**	16,411	12,441	16,717	15,026
81,550	**81,600**	16,424	12,454	16,731	15,039
81,600	**81,650**	16,436	12,466	16,745	15,051
81,650	**81,700**	16,449	12,479	16,759	15,064
81,700	**81,750**	16,461	12,491	16,773	15,076
81,750	**81,800**	16,474	12,504	16,787	15,089
81,800	**81,850**	16,486	12,516	16,801	15,101
81,850	**81,900**	16,499	12,529	16,815	15,114
81,900	**81,950**	16,511	12,541	16,829	15,126
81,950	**82,000**	16,524	12,554	16,843	15,139
82,000					
82,000	**82,050**	16,536	12,566	16,857	15,151
82,050	**82,100**	16,549	12,579	16,871	15,164
82,100	**82,150**	16,561	12,591	16,885	15,176
82,150	**82,200**	16,574	12,604	16,899	15,189
82,200	**82,250**	16,586	12,616	16,913	15,201
82,250	**82,300**	16,599	12,629	16,927	15,214
82,300	**82,350**	16,611	12,641	16,941	15,226
82,350	**82,400**	16,624	12,654	16,955	15,239
82,400	**82,450**	16,636	12,666	16,969	15,251
82,450	**82,500**	16,649	12,679	16,983	15,264
82,500	**82,550**	16,661	12,691	16,997	15,276
82,550	**82,600**	16,674	12,704	17,011	15,289
82,600	**82,650**	16,686	12,716	17,025	15,301
82,650	**82,700**	16,699	12,729	17,039	15,314
82,700	**82,750**	16,711	12,741	17,053	15,326
82,750	**82,800**	16,724	12,754	17,067	15,339
82,800	**82,850**	16,736	12,766	17,081	15,351
82,850	**82,900**	16,749	12,779	17,095	15,364
82,900	**82,950**	16,761	12,791	17,109	15,376
82,950	**83,000**	16,774	12,804	17,123	15,389
83,000					
83,000	**83,050**	16,786	12,816	17,137	15,401
83,050	**83,100**	16,799	12,829	17,151	15,414
83,100	**83,150**	16,811	12,841	17,165	15,426
83,150	**83,200**	16,824	12,854	17,179	15,439
83,200	**83,250**	16,836	12,866	17,193	15,451
83,250	**83,300**	16,849	12,879	17,207	15,464
83,300	**83,350**	16,861	12,891	17,221	15,476
83,350	**83,400**	16,874	12,904	17,235	15,489
83,400	**83,450**	16,886	12,916	17,249	15,501
83,450	**83,500**	16,899	12,929	17,263	15,514
83,500	**83,550**	16,911	12,941	17,277	15,526
83,550	**83,600**	16,924	12,954	17,291	15,539
83,600	**83,650**	16,936	12,966	17,305	15,551
83,650	**83,700**	16,949	12,979	17,319	15,564
83,700	**83,750**	16,961	12,991	17,333	15,576
83,750	**83,800**	16,974	13,004	17,347	15,589
83,800	**83,850**	16,986	13,016	17,361	15,601
83,850	**83,900**	16,999	13,029	17,375	15,614
83,900	**83,950**	17,011	13,041	17,389	15,626
83,950	**84,000**	17,024	13,054	17,403	15,639

(Continued)

* This column must also be used by a qualifying widow(er).

If line 43 (taxable income) is— At least	But less than	And you are— Single	Married filing jointly *	Married filing separately	Head of a household
		Your tax is—			
84,000					
84,000	**84,050**	17,036	13,066	17,417	15,651
84,050	**84,100**	17,049	13,079	17,431	15,664
84,100	**84,150**	17,061	13,091	17,445	15,676
84,150	**84,200**	17,074	13,104	17,459	15,689
84,200	**84,250**	17,086	13,116	17,473	15,701
84,250	**84,300**	17,099	13,129	17,487	15,714
84,300	**84,350**	17,111	13,141	17,501	15,726
84,350	**84,400**	17,124	13,154	17,515	15,739
84,400	**84,450**	17,136	13,166	17,529	15,751
84,450	**84,500**	17,149	13,179	17,543	15,764
84,500	**84,550**	17,161	13,191	17,557	15,776
84,550	**84,600**	17,174	13,204	17,571	15,789
84,600	**84,650**	17,186	13,216	17,585	15,801
84,650	**84,700**	17,199	13,229	17,599	15,814
84,700	**84,750**	17,211	13,241	17,613	15,826
84,750	**84,800**	17,224	13,254	17,627	15,839
84,800	**84,850**	17,236	13,266	17,641	15,851
84,850	**84,900**	17,249	13,279	17,655	15,864
84,900	**84,950**	17,261	13,291	17,669	15,876
84,950	**85,000**	17,274	13,304	17,683	15,889
85,000					
85,000	**85,050**	17,286	13,316	17,697	15,901
85,050	**85,100**	17,299	13,329	17,711	15,914
85,100	**85,150**	17,311	13,341	17,725	15,926
85,150	**85,200**	17,324	13,354	17,739	15,939
85,200	**85,250**	17,336	13,366	17,753	15,951
85,250	**85,300**	17,349	13,379	17,767	15,964
85,300	**85,350**	17,361	13,391	17,781	15,976
85,350	**85,400**	17,374	13,404	17,795	15,989
85,400	**85,450**	17,386	13,416	17,809	16,001
85,450	**85,500**	17,399	13,429	17,823	16,014
85,500	**85,550**	17,411	13,441	17,837	16,026
85,550	**85,600**	17,424	13,454	17,851	16,039
85,600	**85,650**	17,436	13,466	17,865	16,051
85,650	**85,700**	17,450	13,479	17,879	16,064
85,700	**85,750**	17,464	13,491	17,893	16,076
85,750	**85,800**	17,478	13,504	17,907	16,089
85,800	**85,850**	17,492	13,516	17,921	16,101
85,850	**85,900**	17,506	13,529	17,935	16,114
85,900	**85,950**	17,520	13,541	17,949	16,126
85,950	**86,000**	17,534	13,554	17,963	16,139
86,000					
86,000	**86,050**	17,548	13,566	17,977	16,151
86,050	**86,100**	17,562	13,579	17,991	16,164
86,100	**86,150**	17,576	13,591	18,005	16,176
86,150	**86,200**	17,590	13,604	18,019	16,189
86,200	**86,250**	17,604	13,616	18,033	16,201
86,250	**86,300**	17,618	13,629	18,047	16,214
86,300	**86,350**	17,632	13,641	18,061	16,226
86,350	**86,400**	17,646	13,654	18,075	16,239
86,400	**86,450**	17,660	13,666	18,089	16,251
86,450	**86,500**	17,674	13,679	18,103	16,264
86,500	**86,550**	17,688	13,691	18,117	16,276
86,550	**86,600**	17,702	13,704	18,131	16,289
86,600	**86,650**	17,716	13,716	18,145	16,301
86,650	**86,700**	17,730	13,729	18,159	16,314
86,700	**86,750**	17,744	13,741	18,173	16,326
86,750	**86,800**	17,758	13,754	18,187	16,339
86,800	**86,850**	17,772	13,766	18,201	16,351
86,850	**86,900**	17,786	13,779	18,215	16,364
86,900	**86,950**	17,800	13,791	18,229	16,376
86,950	**87,000**	17,814	13,804	18,243	16,389

If line 43 (taxable income) is— At least	But less than	And you are— Single	Married filing jointly *	Married filing separately	Head of a household
		Your tax is—			
87,000					
87,000	**87,050**	17,828	13,816	18,257	16,401
87,050	**87,100**	17,842	13,829	18,271	16,414
87,100	**87,150**	17,856	13,841	18,285	16,426
87,150	**87,200**	17,870	13,854	18,299	16,439
87,200	**87,250**	17,884	13,866	18,313	16,451
87,250	**87,300**	17,898	13,879	18,327	16,464
87,300	**87,350**	17,912	13,891	18,341	16,476
87,350	**87,400**	17,926	13,904	18,355	16,489
87,400	**87,450**	17,940	13,916	18,369	16,501
87,450	**87,500**	17,954	13,929	18,383	16,514
87,500	**87,550**	17,968	13,941	18,397	16,526
87,550	**87,600**	17,982	13,954	18,411	16,539
87,600	**87,650**	17,996	13,966	18,425	16,551
87,650	**87,700**	18,010	13,979	18,439	16,564
87,700	**87,750**	18,024	13,991	18,453	16,576
87,750	**87,800**	18,038	14,004	18,467	16,589
87,800	**87,850**	18,052	14,016	18,481	16,601
87,850	**87,900**	18,066	14,029	18,495	16,614
87,900	**87,950**	18,080	14,041	18,509	16,626
87,950	**88,000**	18,094	14,054	18,523	16,639
88,000					
88,000	**88,050**	18,108	14,066	18,537	16,651
88,050	**88,100**	18,122	14,079	18,551	16,664
88,100	**88,150**	18,136	14,091	18,565	16,676
88,150	**88,200**	18,150	14,104	18,579	16,689
88,200	**88,250**	18,164	14,116	18,593	16,701
88,250	**88,300**	18,178	14,129	18,607	16,714
88,300	**88,350**	18,192	14,141	18,621	16,726
88,350	**88,400**	18,206	14,154	18,635	16,739
88,400	**88,450**	18,220	14,166	18,649	16,751
88,450	**88,500**	18,234	14,179	18,663	16,764
88,500	**88,550**	18,248	14,191	18,677	16,776
88,550	**88,600**	18,262	14,204	18,691	16,789
88,600	**88,650**	18,276	14,216	18,705	16,801
88,650	**88,700**	18,290	14,229	18,719	16,814
88,700	**88,750**	18,304	14,241	18,733	16,826
88,750	**88,800**	18,318	14,254	18,747	16,839
88,800	**88,850**	18,332	14,266	18,761	16,851
88,850	**88,900**	18,346	14,279	18,775	16,864
88,900	**88,950**	18,360	14,291	18,789	16,876
88,950	**89,000**	18,374	14,304	18,803	16,889
89,000					
89,000	**89,050**	18,388	14,316	18,817	16,901
89,050	**89,100**	18,402	14,329	18,831	16,914
89,100	**89,150**	18,416	14,341	18,845	16,926
89,150	**89,200**	18,430	14,354	18,859	16,939
89,200	**89,250**	18,444	14,366	18,873	16,951
89,250	**89,300**	18,458	14,379	18,887	16,964
89,300	**89,350**	18,472	14,391	18,901	16,976
89,350	**89,400**	18,486	14,404	18,915	16,989
89,400	**89,450**	18,500	14,416	18,929	17,001
89,450	**89,500**	18,514	14,429	18,943	17,014
89,500	**89,550**	18,528	14,441	18,957	17,026
89,550	**89,600**	18,542	14,454	18,971	17,039
89,600	**89,650**	18,556	14,466	18,985	17,051
89,650	**89,700**	18,570	14,479	18,999	17,064
89,700	**89,750**	18,584	14,491	19,013	17,076
89,750	**89,800**	18,598	14,504	19,027	17,089
89,800	**89,850**	18,612	14,516	19,041	17,101
89,850	**89,900**	18,626	14,529	19,055	17,114
89,900	**89,950**	18,640	14,541	19,069	17,126
89,950	**90,000**	18,654	14,554	19,083	17,139

If line 43 (taxable income) is— At least	But less than	And you are— Single	Married filing jointly *	Married filing separately	Head of a household
		Your tax is—			
90,000					
90,000	**90,050**	18,668	14,566	19,097	17,151
90,050	**90,100**	18,682	14,579	19,111	17,164
90,100	**90,150**	18,696	14,591	19,125	17,176
90,150	**90,200**	18,710	14,604	19,139	17,189
90,200	**90,250**	18,724	14,616	19,153	17,201
90,250	**90,300**	18,738	14,629	19,167	17,214
90,300	**90,350**	18,752	14,641	19,181	17,226
90,350	**90,400**	18,766	14,654	19,195	17,239
90,400	**90,450**	18,780	14,666	19,209	17,251
90,450	**90,500**	18,794	14,679	19,223	17,264
90,500	**90,550**	18,808	14,691	19,237	17,276
90,550	**90,600**	18,822	14,704	19,251	17,289
90,600	**90,650**	18,836	14,716	19,265	17,301
90,650	**90,700**	18,850	14,729	19,279	17,314
90,700	**90,750**	18,864	14,741	19,293	17,326
90,750	**90,800**	18,878	14,754	19,307	17,339
90,800	**90,850**	18,892	14,766	19,321	17,351
90,850	**90,900**	18,906	14,779	19,335	17,364
90,900	**90,950**	18,920	14,791	19,349	17,376
90,950	**91,000**	18,934	14,804	19,363	17,389
91,000					
91,000	**91,050**	18,948	14,816	19,377	17,401
91,050	**91,100**	18,962	14,829	19,391	17,414
91,100	**91,150**	18,976	14,841	19,405	17,426
91,150	**91,200**	18,990	14,854	19,419	17,439
91,200	**91,250**	19,004	14,866	19,433	17,451
91,250	**91,300**	19,018	14,879	19,447	17,464
91,300	**91,350**	19,032	14,891	19,461	17,476
91,350	**91,400**	19,046	14,904	19,475	17,489
91,400	**91,450**	19,060	14,916	19,489	17,501
91,450	**91,500**	19,074	14,929	19,503	17,514
91,500	**91,550**	19,088	14,941	19,517	17,526
91,550	**91,600**	19,102	14,954	19,531	17,539
91,600	**91,650**	19,116	14,966	19,545	17,551
91,650	**91,700**	19,130	14,979	19,559	17,564
91,700	**91,750**	19,144	14,991	19,573	17,576
91,750	**91,800**	19,158	15,004	19,587	17,589
91,800	**91,850**	19,172	15,016	19,601	17,601
91,850	**91,900**	19,186	15,029	19,615	17,614
91,900	**91,950**	19,200	15,041	19,629	17,626
91,950	**92,000**	19,214	15,054	19,643	17,639
92,000					
92,000	**92,050**	19,228	15,066	19,657	17,651
92,050	**92,100**	19,242	15,079	19,671	17,664
92,100	**92,150**	19,256	15,091	19,685	17,676
92,150	**92,200**	19,270	15,104	19,699	17,689
92,200	**92,250**	19,284	15,116	19,713	17,701
92,250	**92,300**	19,298	15,129	19,727	17,714
92,300	**92,350**	19,312	15,141	19,741	17,726
92,350	**92,400**	19,326	15,154	19,755	17,739
92,400	**92,450**	19,340	15,166	19,769	17,751
92,450	**92,500**	19,354	15,179	19,783	17,764
92,500	**92,550**	19,368	15,191	19,797	17,776
92,550	**92,600**	19,382	15,204	19,811	17,789
92,600	**92,650**	19,396	15,216	19,825	17,801
92,650	**92,700**	19,410	15,229	19,839	17,814
92,700	**92,750**	19,424	15,241	19,853	17,826
92,750	**92,800**	19,438	15,254	19,867	17,839
92,800	**92,850**	19,452	15,266	19,881	17,851
92,850	**92,900**	19,466	15,279	19,895	17,864
92,900	**92,950**	19,480	15,291	19,909	17,876
92,950	**93,000**	19,494	15,304	19,923	17,889

(Continued)

* This column must also be used by a qualifying widow(er).

If line 43 (taxable income) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing sepa-rately	Head of a house-hold
		Your tax is—			
93,000					
93,000	**93,050**	19,508	15,316	19,937	17,901
93,050	**93,100**	19,522	15,329	19,951	17,914
93,100	**93,150**	19,536	15,341	19,965	17,926
93,150	**93,200**	19,550	15,354	19,979	17,939
93,200	**93,250**	19,564	15,366	19,993	17,951
93,250	**93,300**	19,578	15,379	20,007	17,964
93,300	**93,350**	19,592	15,391	20,021	17,976
93,350	**93,400**	19,606	15,404	20,035	17,989
93,400	**93,450**	19,620	15,416	20,049	18,001
93,450	**93,500**	19,634	15,429	20,063	18,014
93,500	**93,550**	19,648	15,441	20,077	18,026
93,550	**93,600**	19,662	15,454	20,091	18,039
93,600	**93,650**	19,676	15,466	20,105	18,051
93,650	**93,700**	19,690	15,479	20,119	18,064
93,700	**93,750**	19,704	15,491	20,133	18,076
93,750	**93,800**	19,718	15,504	20,147	18,089
93,800	**93,850**	19,732	15,516	20,161	18,101
93,850	**93,900**	19,746	15,529	20,175	18,114
93,900	**93,950**	19,760	15,541	20,189	18,126
93,950	**94,000**	19,774	15,554	20,203	18,139
94,000					
94,000	**94,050**	19,788	15,566	20,217	18,151
94,050	**94,100**	19,802	15,579	20,231	18,164
94,100	**94,150**	19,816	15,591	20,245	18,176
94,150	**94,200**	19,830	15,604	20,259	18,189
94,200	**94,250**	19,844	15,616	20,273	18,201
94,250	**94,300**	19,858	15,629	20,287	18,214
94,300	**94,350**	19,872	15,641	20,301	18,226
94,350	**94,400**	19,886	15,654	20,315	18,239
94,400	**94,450**	19,900	15,666	20,329	18,251
94,450	**94,500**	19,914	15,679	20,343	18,264
94,500	**94,550**	19,928	15,691	20,357	18,276
94,550	**94,600**	19,942	15,704	20,371	18,289
94,600	**94,650**	19,956	15,716	20,385	18,301
94,650	**94,700**	19,970	15,729	20,399	18,314
94,700	**94,750**	19,984	15,741	20,413	18,326
94,750	**94,800**	19,998	15,754	20,427	18,339
94,800	**94,850**	20,012	15,766	20,441	18,351
94,850	**94,900**	20,026	15,779	20,455	18,364
94,900	**94,950**	20,040	15,791	20,469	18,376
94,950	**95,000**	20,054	15,804	20,483	18,389
95,000					
95,000	**95,050**	20,068	15,816	20,497	18,401
95,050	**95,100**	20,082	15,829	20,511	18,414
95,100	**95,150**	20,096	15,841	20,525	18,426
95,150	**95,200**	20,110	15,854	20,539	18,439
95,200	**95,250**	20,124	15,866	20,553	18,451
95,250	**95,300**	20,138	15,879	20,567	18,464
95,300	**95,350**	20,152	15,891	20,581	18,476
95,350	**95,400**	20,166	15,904	20,595	18,489
95,400	**95,450**	20,180	15,916	20,609	18,501
95,450	**95,500**	20,194	15,929	20,623	18,514
95,500	**95,550**	20,208	15,941	20,637	18,526
95,550	**95,600**	20,222	15,954	20,651	18,539
95,600	**95,650**	20,236	15,966	20,665	18,551
95,650	**95,700**	20,250	15,979	20,679	18,564
95,700	**95,750**	20,264	15,991	20,693	18,576
95,750	**95,800**	20,278	16,004	20,707	18,589
95,800	**95,850**	20,292	16,016	20,721	18,601
95,850	**95,900**	20,306	16,029	20,735	18,614
95,900	**95,950**	20,320	16,041	20,749	18,626
95,950	**96,000**	20,334	16,054	20,763	18,639

If line 43 (taxable income) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing sepa-rately	Head of a house-hold
		Your tax is—			
96,000					
96,000	**96,050**	20,348	16,066	20,777	18,651
96,050	**96,100**	20,362	16,079	20,791	18,664
96,100	**96,150**	20,376	16,091	20,805	18,676
96,150	**96,200**	20,390	16,104	20,819	18,689
96,200	**96,250**	20,404	16,116	20,833	18,701
96,250	**96,300**	20,418	16,129	20,847	18,714
96,300	**96,350**	20,432	16,141	20,861	18,726
96,350	**96,400**	20,446	16,154	20,875	18,739
96,400	**96,450**	20,460	16,166	20,889	18,751
96,450	**96,500**	20,474	16,179	20,903	18,764
96,500	**96,550**	20,488	16,191	20,917	18,776
96,550	**96,600**	20,502	16,204	20,931	18,789
96,600	**96,650**	20,516	16,216	20,945	18,801
96,650	**96,700**	20,530	16,229	20,959	18,814
96,700	**96,750**	20,544	16,241	20,973	18,826
96,750	**96,800**	20,558	16,254	20,987	18,839
96,800	**96,850**	20,572	16,266	21,001	18,851
96,850	**96,900**	20,586	16,279	21,015	18,864
96,900	**96,950**	20,600	16,291	21,029	18,876
96,950	**97,000**	20,614	16,304	21,043	18,889
97,000					
97,000	**97,050**	20,628	16,316	21,057	18,901
97,050	**97,100**	20,642	16,329	21,071	18,914
97,100	**97,150**	20,656	16,341	21,085	18,926
97,150	**97,200**	20,670	16,354	21,099	18,939
97,200	**97,250**	20,684	16,366	21,113	18,951
97,250	**97,300**	20,698	16,379	21,127	18,964
97,300	**97,350**	20,712	16,391	21,141	18,976
97,350	**97,400**	20,726	16,404	21,155	18,989
97,400	**97,450**	20,740	16,416	21,169	19,001
97,450	**97,500**	20,754	16,429	21,183	19,014
97,500	**97,550**	20,768	16,441	21,197	19,026
97,550	**97,600**	20,782	16,454	21,211	19,039
97,600	**97,650**	20,796	16,466	21,225	19,051
97,650	**97,700**	20,810	16,479	21,239	19,064
97,700	**97,750**	20,824	16,491	21,253	19,076
97,750	**97,800**	20,838	16,504	21,267	19,089
97,800	**97,850**	20,852	16,516	21,281	19,101
97,850	**97,900**	20,866	16,529	21,295	19,114
97,900	**97,950**	20,880	16,541	21,309	19,126
97,950	**98,000**	20,894	16,554	21,323	19,139
98,000					
98,000	**98,050**	20,908	16,566	21,337	19,151
98,050	**98,100**	20,922	16,579	21,351	19,164
98,100	**98,150**	20,936	16,591	21,365	19,176
98,150	**98,200**	20,950	16,604	21,379	19,189
98,200	**98,250**	20,964	16,616	21,393	19,201
98,250	**98,300**	20,978	16,629	21,407	19,214
98,300	**98,350**	20,992	16,641	21,421	19,226
98,350	**98,400**	21,006	16,654	21,435	19,239
98,400	**98,450**	21,020	16,666	21,449	19,251
98,450	**98,500**	21,034	16,679	21,463	19,264
98,500	**98,550**	21,048	16,691	21,477	19,276
98,550	**98,600**	21,062	16,704	21,491	19,289
98,600	**98,650**	21,076	16,716	21,505	19,301
98,650	**98,700**	21,090	16,729	21,519	19,314
98,700	**98,750**	21,104	16,741	21,533	19,326
98,750	**98,800**	21,118	16,754	21,547	19,339
98,800	**98,850**	21,132	16,766	21,561	19,351
98,850	**98,900**	21,146	16,779	21,575	19,364
98,900	**98,950**	21,160	16,791	21,589	19,376
98,950	**99,000**	21,174	16,804	21,603	19,389

If line 43 (taxable income) is—		And you are—			
At least	But less than	Single	Married filing jointly *	Married filing sepa-rately	Head of a house-hold
		Your tax is—			
99,000					
99,000	**99,050**	21,188	16,816	21,617	19,401
99,050	**99,100**	21,202	16,829	21,631	19,414
99,100	**99,150**	21,216	16,841	21,645	19,426
99,150	**99,200**	21,230	16,854	21,659	19,439
99,200	**99,250**	21,244	16,866	21,673	19,451
99,250	**99,300**	21,258	16,879	21,687	19,464
99,300	**99,350**	21,272	16,891	21,701	19,476
99,350	**99,400**	21,286	16,904	21,715	19,489
99,400	**99,450**	21,300	16,916	21,729	19,501
99,450	**99,500**	21,314	16,929	21,743	19,514
99,500	**99,550**	21,328	16,941	21,757	19,526
99,550	**99,600**	21,342	16,954	21,771	19,539
99,600	**99,650**	21,356	16,966	21,785	19,551
99,650	**99,700**	21,370	16,979	21,799	19,564
99,700	**99,750**	21,384	16,991	21,813	19,576
99,750	**99,800**	21,398	17,004	21,827	19,589
99,800	**99,850**	21,412	17,016	21,841	19,601
99,850	**99,900**	21,426	17,029	21,855	19,614
99,900	**99,950**	21,440	17,041	21,869	19,626
99,950	**100,000**	21,454	17,054	21,883	19,639

$100,000 or over — use the Tax Computation Worksheet on next page

* This column must also be used by a qualifying widow(er).

2012 Tax Computation Worksheet—Line 44

CAUTION

See the instructions for line 44 in the Instructions for Form 1040 to see if you must use the worksheet below to figure your tax.

Note. If you are required to use this worksheet to figure the tax on an amount from another form or worksheet, such as the Qualified Dividends and Capital Gain Tax Worksheet, the Schedule D Tax Worksheet, Schedule J, Form 8615, or the Foreign Earned Income Tax Worksheet, enter the amount from that form or worksheet in column (a) of the row that applies to the amount you are looking up. Enter the result on the appropriate line of the form or worksheet that you are completing.

Section A—Use if your filing status is **Single.** Complete the row below that applies to you.

Taxable income. If line 43 is—	**(a)** Enter the amount from line 43	**(b)** Multiplication amount	**(c)** Multiply (a) by (b)	**(d)** Subtraction amount	**Tax.** Subtract (d) from (c). Enter the result here and on Form 1040, line 44
At least $100,000 but not over $178,650	$	× 28% (.28)	$	$ 6,539.50	$
Over $178,650 but not over $388,350	$	× 33% (.33)	$	$ 15,472.00	$
Over $388,350	$	× 35% (.35)	$	$ 23,239.00	$

Section B—Use if your filing status is **Married filing jointly** or **Qualifying widow(er).** Complete the row below that applies to you.

Taxable income. If line 43 is—	**(a)** Enter the amount from line 43	**(b)** Multiplication amount	**(c)** Multiply (a) by (b)	**(d)** Subtraction amount	**Tax.** Subtract (d) from (c). Enter the result here and on Form 1040, line 44
At least $100,000 but not over $142,700	$	× 25% (.25)	$	$ 7,940.00	$
Over $142,700 but not over $217,450	$	× 28% (.28)	$	$ 12,221.00	$
Over $217,450 but not over $388,350	$	× 33% (.33)	$	$ 23,093.50	$
Over $388,350	$	× 35% (.35)	$	$ 30,860.50	$

Section C—Use if your filing status is **Married filing separately.** Complete the row below that applies to you.

Taxable income. If line 43 is—	**(a)** Enter the amount from line 43	**(b)** Multiplication amount	**(c)** Multiply (a) by (b)	**(d)** Subtraction amount	**Tax.** Subtract (d) from (c). Enter the result here and on Form 1040, line 44
At least $100,000 but not over $108,725	$	× 28% (.28)	$	$ 6,110.50	$
At least $108,725 but not over $194,175	$	× 33% (.33)	$	$ 11,546.75	$
Over $194,175	$	× 35% (.35)	$	$ 15,430.25	$

Section D—Use if your filing status is **Head of household.** Complete the row below that applies to you.

Taxable income. If line 43 is—	**(a)** Enter the amount from line 43	**(b)** Multiplication amount	**(c)** Multiply (a) by (b)	**(d)** Subtraction amount	**Tax.** Subtract (d) from (c). Enter the result here and on Form 1040, line 44
At least $100,000 but not over $122,300	$	× 25% (.25)	$	$ 5,355.00	$
Over $122,300 but not over $198,050	$	× 28% (.28)	$	$ 9,024.00	$
Over $198,050 but not over $388,350	$	× 33% (.33)	$	$ 18,926.50	$
Over $388,350	$	× 35% (.35)	$	$ 26,693.50	$

2012 Tax Rate Schedules

CAUTION

The Tax Rate Schedules are shown so you can see the tax rate that applies to all levels of taxable income. Do not use them to figure your tax. Instead, see chapter 29.

Schedule X—If your filing status is **Single**

If your taxable income is: Over—	But not over—	The tax is:	of the amount over—
$0	$8,700	- - - - - - - - - 10%	$0
8,700	35,350	$870.00 + 15%	8,700
35,350	85,650	4,867.50 + 25%	35,350
85,650	178,650	17,442.50 + 28%	85,650
178,650	388,350	43,482.50 + 33%	178,650
388,350	- - - - - - - -	112,683.50 + 35%	388,350

Schedule Y-1—If your filing status is **Married filing jointly** or **Qualifying widow(er)**

If your taxable income is: Over—	But not over—	The tax is:	of the amount over—
$0	$17,400	- - - - - - - - - 10%	$0
17,400	70,700	$1,740.00 + 15%	17,400
70,700	142,700	9,735.00 + 25%	70,700
142,700	217,450	27,735.00 + 28%	142,700
217,450	388,350	48,665.00 + 33%	217,450
388,350	- - - - - - - -	105,062.00 + 35%	388,350

Schedule Y-2—If your filing status is **Married filing separately**

If your taxable income is: Over—	But not over—	The tax is:	of the amount over—
$0	$8,700	- - - - - - - - - 10%	$0
8,700	35,350	$870.00 + 15%	8,700
35,350	71,350	4,867.50 + 25%	35,350
71,350	108,725	13,867.50 + 28%	71,350
108,725	194,175	24,332.50 + 33%	108,725
194,175	- - - - - - - -	52,531.00 + 35%	194,175

Schedule Z—If your filing status is **Head of household**

If your taxable income is: Over—	But not over—	The tax is:	of the amount over—
$0	$12,400	- - - - - - - - - 10%	$0
12,400	47,350	$1,240.00 + 15%	12,400
47,350	122,300	6,482.50 + 25%	47,350
122,300	198,050	25,220.00 + 28%	122,300
198,050	388,350	46,430.00 + 33%	198,050
388,350	- - - - - - - -	109,229.00 + 35%	388,350

Your Rights as a Taxpayer

This section explains some of your most important rights as a taxpayer, including the examination, appeal, collection, and refund processes.

Declaration of Taxpayer Rights

Protection of your rights. IRS employees will explain and protect your rights as a taxpayer throughout your contact with us.

Privacy and confidentiality. The IRS will not disclose to anyone the information you give us, except as authorized by law. You have the right to know why we are asking you for information, how we will use it, and what happens if you do not provide requested information.

Professional and courteous service. If you believe that an IRS employee has not treated you in a professional, fair, and courteous manner, you should tell that employee's supervisor. If the supervisor's response is not satisfactory, you should write to the IRS director for your area or the center where you filed your return.

Representation. You may either represent yourself or, with proper written authorization, have someone else represent you in your place. Your representative must be a person allowed to practice before the IRS, such as an attorney, certified public accountant, or enrolled agent. If you are in an interview and ask to consult such a person, then we must stop and reschedule the interview in most cases.

You can have someone accompany you at an interview. You may make sound recordings of any meetings with our examination, appeal, or collection personnel, provided you tell us in writing 10 days before the meeting.

Payment of only the correct amount of tax. You are responsible for paying only the correct amount of tax due under the law—no more, no less. If you cannot pay all of your tax when it is due, you may be able to make monthly installment payments.

Help with unresolved tax problems. The Taxpayer Advocate Service can help you if you have tried unsuccessfully to resolve a problem with the IRS. Your local Taxpayer Advocate can offer you special help if you have a significant hardship as a result of a tax problem. For more information, see *Taxpayer Advocate Service* under *How To Get Tax Help.*

Appeals and judicial review. If you disagree with us about the amount of your tax liability or certain collection actions, you have the right to ask the Appeals Office to review your case. You may also ask a court to review your case.

Relief from certain penalties and interest. The IRS will waive penalties when allowed by law if you can show you acted reasonably and in good faith or relied on the incorrect advice of an IRS employee. We will waive interest that is the result of certain errors or delays caused by an IRS employee.

Examinations (Audits)

We accept most taxpayers' returns as filed. If we inquire about your return or select it for examination, it does not suggest that you are dishonest. The inquiry or examination may or may not result in more tax. We may close your case without change; or, you may receive a refund.

The process of selecting a return for examination usually begins in one of two ways. First, we use computer programs to identify returns that may have incorrect amounts. These programs may be based on information returns, such as Forms 1099 and W-2, on studies of past examinations, or on certain issues identified by compliance projects. Second, we use information from outside sources that indicates that a return may have incorrect amounts. These sources may include newspapers, public records, and individuals. If we determine that the information is accurate and reliable, we may use it to select a return for examination.

Publication 556, Examination of Returns, Appeal Rights, and Claims for Refund, explains the rules and procedures that we follow in examinations. The following sections give an overview of how we conduct examinations.

By mail. We handle many examinations and inquiries by mail. We will send you a letter with either a request for more information or a reason why we believe a change to your return may be needed. You can respond by mail or you can request a personal interview with an examiner. If you mail us the requested information or provide an explanation, we may or may not agree with you, and we will explain the reasons for any changes. Please do not hesitate to write to us about anything you do not understand.

By interview. If we notify you that we will conduct your examination through a personal interview, or you request such an interview, you have the right to ask that the examination take place at a reasonable time and place that is convenient for both you and the IRS. If our examiner proposes any changes to your return, he or she will explain the reasons for the changes. If you do not agree with these changes, you can meet with the examiner's supervisor.

Repeat examinations. If we examined your return for the same items in either of the 2 previous years and proposed no change to your tax liability, please contact us as soon as possible so we can see if we should discontinue the examination.

Appeals

If you do not agree with the examiner's proposed changes, you can appeal them to the Appeals Office of IRS. Most differences can be settled without expensive and time-consuming court trials. Your appeal rights are explained in detail in both Publication 5, Your Appeal Rights and How To Prepare a Protest If You Don't Agree, and Publication 556, Examination of Returns, Appeal Rights, and Claims for Refund.

If you do not wish to use the Appeals Office or disagree with its findings, you may be able to take your case to the U.S. Tax Court, U.S. Court of Federal Claims, or the U.S. District Court where you live. If you take your case to court, the IRS will have the burden of proving certain facts if you kept adequate records to show your tax liability, cooperated with the IRS, and meet certain other conditions. If the court agrees with you on most issues in your case and finds that our position was largely unjustified, you may be able to recover some of your administrative and litigation costs. You will not be eligible to recover these costs unless you tried to resolve your case administratively, including going through the appeals system, and you gave us the information necessary to resolve the case.

Collections

Publication 594, The IRS Collection Process, explains your rights and responsibilities regarding payment of federal taxes. It describes:

- What to do when you owe taxes. It describes what to do if you get a tax bill and what to do if you think your bill is wrong. It also covers making installment payments, delaying collection action, and submitting an offer in compromise.
- IRS collection actions. It also covers liens, releasing a lien, levies, releasing a levy, seizures and sales, and release of property.

Your collection appeal rights are explained in detail in Publication 1660, Collection Appeal Rights.

Innocent spouse relief. Generally, both you and your spouse are each responsible for paying the full amount of tax, interest, and penalties due on your joint return. However, if you qualify for innocent spouse relief, you may be relieved of part or all of the joint liability. To request relief, you must file Form 8857, Request for Innocent Spouse Relief. For more information on innocent spouse relief, see Publication 971, Innocent Spouse Relief, and Form 8857.

Potential Third Party Contacts

Generally, the IRS will deal directly with you or your duly authorized representative. However, we sometimes talk with other persons if we need information that you have been unable to provide, or to verify information we have received. If we do contact other persons, such as a neighbor, bank, employer, or employees, we will generally need to tell them limited information, such as your name. The law prohibits us from disclosing any more information than is necessary to obtain or verify the information we are seeking. Our need to contact other persons may continue as long as there is activity in your case. If we do contact other persons, you have a right to request a list of those contacted.

Refunds

You may file a claim for refund if you think you paid too much tax.

You must generally file the claim within 3 years from the date you filed your original return or 2 years from the date you paid the tax, whichever is later. The law generally provides for interest on your refund if it is not paid within 45 days of the date you filed your return or claim for refund. Publication 556, Examination of Returns, Appeal Rights, and Claims for Refund, has more information on refunds.

If you were due a refund but you did not file a return, you generally must file within 3 years from the date the return was due (including extensions) to get that refund.

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How To Get Tax Help

You can get help with unresolved tax issues, order free publications and forms, ask tax questions, and get information from the IRS in several ways. By selecting the method that is best for you, you will have quick and easy access to tax help.

Free help with your tax return. Free help in preparing your return is available nationwide from IRS-certified volunteers. The Volunteer Income Tax Assistance (VITA) program is designed to help low-moderate income, elderly, disabled, and limited English proficient taxpayers. The Tax Counseling for the Elderly (TCE) program is designed to assist taxpayers age 60 and older with their tax returns. Most VITA and TCE sites offer free electronic filing and all volunteers will let you know about credits and deductions you may be entitled to claim. Some VITA and TCE sites provide taxpayers the opportunity to prepare their return with the assistance of an IRS-certified volunteer. To find the nearest VITA or TCE site, visit IRS.gov or call 1-800-906-9887 or 1-800-829-1040.

As part of the TCE program, AARP offers the Tax-Aide counseling program. To find the nearest AARP Tax-Aide site, visit AARP's website at www.aarp.org/money/taxaide or call 1-888-227-7669.

For more information on these programs, go to IRS.gov and enter "VITA" in the search box.

Internet. You can access the IRS website at IRS.gov 24 hours a day, 7 days a week to:

- *E-file* your return. Find out about commercial tax preparation and *e-file* services available free to eligible taxpayers.
- Check the status of your 2012 refund. Go to IRS.gov and click on *Where's My Refund?* Information about your return will generally be available within 24 hours after the IRS receives your e-filed return, or 4 weeks after you mail your paper return. If you filed Form 8379 with your return, wait 14 weeks (11 weeks if you filed electronically). Have your 2012 tax return handy so you can provide your social security number, your filing status, and the exact whole dollar amount of your refund.
- *Where's My Refund?* has a new look this year! The tool will include a tracker that displays progress through three stages: (1) return received, (2) refund approved and (3) refund sent. *Where's My Refund?* will provide an actual personalized refund date as soon as the IRS processes your tax return and approves your refund. So in a change from previous filing seasons, you won't get an estimated refund date right away. *Where's My Refund?* includes information for the most recent return filed in the current year and does not include information about amended returns.
- You can obtain a free transcript online at IRS.gov by clicking on *Order a Return or Account Transcript* under "Tools." For a transcript by phone, call 1-800-908-9946 and follow the prompts in the recorded message. You will be prompted to provide your SSN or Individual Taxpayer Identification Number (ITIN), date of birth, street address and Zip Code.
- Download forms, including talking tax forms, instructions, and publications.
- Order IRS products.
- Research your tax questions.
- Search publications by topic or keyword.
- Use the Internal Revenue Code, regulations, or other official guidance.
- View Internal Revenue Bulletins (IRBs) published in the last few years.
- Figure your withholding allowances using the IRS Withholding Calculator at www.irs.gov/individuals.
- Determine if Form 6251 (Alternative Minimum Tax— Individuals) must be filed by using our Alternative Minimum Tax (AMT) Assistant available at IRS.gov by typing *Alternative Minimum Tax Assistant* in the search box.
- Sign up to receive local and national tax news by email.
- Get information on starting and operating a small business.

Phone. Many services are available by phone.

- *Ordering forms, instructions, and publications.* Call 1-800-TAX-FORM (1-800-829-3676) to order current-year forms, instructions, and publications, and prior-year forms and instructions (limited to 5 years). You should receive your order within 10 days.
- *Asking tax questions.* Call the IRS with your tax questions at 1-800-829-1040.
- *Solving problems.* You can get face-to-face help solving tax problems most business days in IRS Taxpayer Assistance Centers (TAC). An employee can explain IRS letters, request adjustments to your account, or help you set up a payment plan. Call your local Taxpayer Assistance Center for an appointment. To find the number, go to www.irs.gov/localcontacts or look in the phone book under *United States Government, Internal Revenue Service*.
- *TTY/TDD equipment.* If you have access to TTY/TDD equipment, call 1-800-829-4059 to ask tax questions or to order forms and publications. The TTY/TDD telephone number is for individuals who are deaf, hard of hearing, or have a speech disability. These individuals can also access the IRS through relay services such as the Federal Relay Service at www.gsa.gov/fedrelay.
- *TeleTax topics.* Call 1-800-829-4477 to listen to pre-recorded messages covering various tax topics.
- *Checking the status of your 2012 refund.* To check the status of your 2012 refund, call 1-800-829-1954 or 1-800-829-4477 (automated *Where's My Refund?* information 24 hours a day, 7 days a week). Information about your return will generally be available within 24 hours after the IRS receives your e-filed return, or 4 weeks after you mail your paper return. If you filed Form 8379 with your return, wait 14 weeks (11 weeks if you filed electronically). Have your 2012 tax return handy so you can provide your social security number, your filing status, and the exact whole dollar amount of your refund. *Where's My Refund?* will provide an actual personalized refund date as soon as the IRS processes your tax return and approves your refund. *Where's My Refund?* includes information for the most recent return filed in the current year and does not include information about amended returns.

Evaluating the quality of our telephone services. To ensure IRS representatives give accurate, courteous, and professional answers, we use several methods to evaluate the quality of our telephone services. One method is for a second IRS representative to listen in on or record random telephone calls. Another is to ask some callers to complete a short survey at the end of the call.

Walk-in. Some products and services are available on a walk-in basis.

- *Products.* You can walk in to some post offices, libraries, and IRS offices to pick up certain forms, instructions, and publications. Some IRS offices, libraries, and city and county government offices have a collection of products available to photocopy from reproducible proofs. Also, some IRS offices and libraries have the Internal Revenue

Code, regulations, Internal Revenue Bulletins, and Cumulative Bulletins available for research purposes.

- *Services.* You can walk in to your local TAC most business days for personal, face-to-face tax help. An employee can explain IRS letters, request adjustments to your tax account, or help you set up a payment plan. If you need to resolve a tax problem, have questions about how the tax law applies to your individual tax return, or you are more comfortable talking with someone in person, visit your local TAC where you can talk with an IRS representative face-to-face. No appointment is necessary—just walk in. Before visiting, check www.irs.gov/localcontacts for hours of operation and services provided. If you have an ongoing, complex tax account problem or a special need, such as a disability, an appointment can be requested by calling your local TAC. You can leave a message and a representative will call you back within 2 business days. All other issues will be handled without an appointment. To call your local TAC, go to www.irs.gov/localcontacts or look in the phone book under *United States Government, Internal Revenue Service*.

Mail. You can send your order for forms, instructions, and publications to the address below. You should receive a response within 10 days after your request is received.

Internal Revenue Service
1201 N. Mitsubishi Motorway
Bloomington, IL 61705-6613

Taxpayer Advocate Service. The Taxpayer Advocate Service (TAS) is your voice at the IRS. Its job is to ensure that every taxpayer is treated fairly, and that you know and understand your rights. TAS offers free help to guide you through the often-confusing process of resolving tax problems that you haven't been able to solve on your own. Remember, the worst thing you can do is nothing at all.

TAS can help if you can't resolve your problem with the IRS and:

- Your problem is causing financial difficulties for you, your family, or your business.
- You face (or your business is facing) an immediate threat of adverse action.
- You have tried repeatedly to contact the IRS but no one has responded, or the IRS has not responded to you by the date promised.

If you qualify for help, they will do everything they can to get your problem resolved. You will be assigned to one advocate who will be with you at every turn. TAS has offices in every state, the District of Columbia, and Puerto Rico. Although TAS is independent within the IRS, their advocates know how to work with the IRS to get your problems resolved. And its services are always free.

As a taxpayer, you have rights that the IRS must abide by in its dealings with you. The TAS tax toolkit at www.TaxpayerAdvocate.irs.gov can help you understand these rights.

If you think TAS might be able to help you, call your local advocate, whose number is in your phone book and on our website at www.irs.gov/advocate. You can also call the toll-free number at 1-877-777-4778. Deaf and hard of hearing individuals who have access to TTY/TDD equipment can call 1-800-829-4059. These individuals can also access the IRS through relay services such as the Federal Relay Service at www.gsa.gov/fedrelay.

TAS also handles large-scale or systemic problems that affect many taxpayers. If you know of one of these broad issues, please report it to us through the Systemic Advocacy Management System at www.irs.gov/advocate.

Low Income Taxpayer Clinics (LITCs). Low Income Taxpayer Clinics (LITCs) are independent from the IRS. Some clinics serve individuals whose income is below a certain level and who need to resolve a tax problem. These clinics provide professional representation before the IRS or in court on audits, appeals, tax collection disputes, and other issues for free or for a small fee. Some clinics can provide information about taxpayer rights and responsibilities in many different languages for individuals who speak English as a second language. For more information and to find a clinic near you, see the LITC page on www.irs.gov/advocate or IRS Publication 4134, *Low Income Taxpayer Clinic List*. This publication is also available by calling 1-800-TAX-FORM (1-800-829-3676) or at your local IRS office.

Free tax services. Publication 910, IRS Guide to Free Tax Services, is your guide to IRS services and resources. Learn about free tax information from the IRS, including publications, services, and education and assistance programs. The publication also has an index of over 100 TeleTax topics (recorded tax information) you can listen to on the telephone. The majority of the information and services listed in this publication are available to you free of charge. If there is a fee associated with a resource or service, it is listed in the publication.

Accessible versions of IRS published products are available on request in a variety of alternative formats for people with disabilities.

DVD for tax products. You can order Publication 1796, IRS Tax Products DVD, and obtain:

- Current-year forms, instructions, and publications.
- Prior-year forms, instructions, and publications.
- Tax Map: an electronic research tool and finding aid.
- Tax law frequently asked questions.
- Tax Topics from the IRS telephone response system.
- Internal Revenue Code—Title 26 of the U.S. Code.
- Links to other Internet-based tax research materials.
- Fill-in, print, and save features for most tax forms.
- Internal Revenue Bulletins.
- Toll-free and email technical support.
- Two releases during the year.
  – The first release will ship the beginning of January 2013.
  – The final release will ship the beginning of March 2013.

Purchase the DVD from National Technical Information Service (NTIS) at www.irs.gov/cdorders for $30 (no handling fee) or call 1-877-233-6767 toll free to buy the DVD for $30 (plus a $6 handling fee).

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Index

To help us develop a more useful index, please let us know if you have ideas for index entries. See “Comments and Suggestions” in the “Introduction” for the ways you can reach us.

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Where To File

Note. Use this table only if you are an individual taxpayer filing your own return. Envelopes without enough postage will be returned to you by the post office. Your envelope may need additional postage if it contains more than five pages or is oversized (for example, it is over 1/4 inch thick). Also, include your complete return address.

			AND use the zip code below according to the form you are filing and whether you are enclosing payment					
			Form 1040		Form 1040A		Form 1040EZ	
IF you live in...	**THEN send your return to the address below if you are NOT enclosing a payment...**	**OR send your return to the address below if you ARE enclosing a payment (check or money order...)**	**No payment enclosed**	**Payment enclosed**	**No payment enclosed**	**Payment enclosed**	**No payment enclosed**	**Payment enclosed**
Florida, Louisiana, Mississippi, Texas	Department of the Treasury Internal Revenue Service Austin, TX	Internal Revenue Service P.O. Box 1214 Charlotte, NC	73301–0002	28201–1214	73301–0015	28201–1214	73301–0014	28201–1214
Alaska, Arizona, California, Colorado, Hawaii, Idaho, Nevada, New Mexico, Oregon, Utah, Washington, Wyoming	Department of the Treasury Internal Revenue Service Fresno, CA	Internal Revenue Service P.O. Box 7704 San Francisco, CA	93888–0002	94120–7704	93888–0015	94120–7704	93888–0014	94120–7704
Arkansas, Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Montana, Nebraska, North Dakota, Ohio, Oklahoma, South Dakota, Wisconsin	Department of the Treasury Internal Revenue Service Fresno, CA	Internal Revenue Service P.O. Box 802501 Cincinnati, OH	93888–0002	45280–2501	93888–0015	45280–2501	93888–0014	45280–2501
Alabama, Georgia, Kentucky, Missouri, New Jersey, North Carolina, South Carolina, Tennessee, Virginia	Department of the Treasury Internal Revenue Service Kansas City, MO	Internal Revenue Service P.O. Box 931000 Louisville, KY	64999–0002	40293–1000	64999–0015	40293–1000	64999–0014	40293–1000
Connecticut, Delaware, District of Columbia, Maine, Maryland, Massachusetts, New Hampshire, New York, Pennsylvania, Rhode Island, Vermont, West Virginia	Department of the Treasury Internal Revenue Service Kansas City, MO	Internal Revenue Service P.O. Box 37008 Hartford, CT	64999–0002	06176–0008	64999–0015	06176–0008	64999–0014	06176–0008
A foreign country, U.S. possession or territory*, or use an APO or FPO address, or file Form 2555, 2555-EZ, or 4563, or are a dual status alien	Department of the Treasury Internal Revenue Service Austin, TX	Internal Revenue Service P.O. Box 1303 Charlotte, NC	73301–0215	28201–1303	73301–0215	28201–1303	73301–0215	28201–1303

* If you live in American Samoa, Puerto Rico, Guam, the U.S. Virgin Islands, or the Northern Mariana Islands, see Pub. 570.

Order Form for Forms and Publications

The most frequently ordered forms and publications are listed on the order form below. You will receive two copies of each form, one copy of the instructions, and one copy of each publication you order. To help reduce waste, please order only the items you need to prepare your return.

TIP *For faster ways of getting the items you need, go to* www.irs.gov/formspubs.

How To Use the Order Form

Circle the items you need on the order form below. Use the blank spaces to order items not listed. If you need more space, attach a separate sheet of paper.

Print or type your name and address accurately in the space provided below to ensure delivery of your order. Enclose the order form in an envelope and mail it to the IRS address shown on this page. You should receive your order within 10 days after receipt of your request.

Do not send your tax return to the address listed below. Instead, see *Where To File.*

Mail Your Order Form To:
Internal Revenue Service
1201 N. Mitsubishi Motorway
Bloomington, IL 61705-6613

▲ ***Cut here*** ▲

Save Money and Time by Going Online!
Download or order these and other tax products at www.irs.gov/formspubs

Order Form

Please print.

Name

Postal mailing address | Apt./Suite/Room

City | State | ZIP code

Foreign country | International postal code

Daytime phone number
( )

Circle the forms and publications you need. The instructions for any form you order will be included.

Use the **blank spaces** to order items not listed.

1040	Schedule F (1040)	1040-V	4868	Pub. 1	Pub. 526	Pub. 583	Pub. 4681
Schedule A (1040)	Schedule H (1040)	1040X	5405	Pub. 17	Pub. 527	Pub. 587	
Schedule B (1040A or 1040)	Schedule J (1040)	2106	6251	Pub. 334	Pub. 529	Pub. 590	
Schedule C (1040)	Schedule R (1040A or 1040)	2441	8283	Pub. 463	Pub. 535	Pub. 596	
Schedule C-EZ (1040)	Schedule SE (1040)	3903	8606	Pub. 501	Pub. 547	Pub. 910	
Schedule D (1040)	Schedule 8812 (1040A or 1040)	4506	8822	Pub. 502	Pub. 550	Pub. 915	
Form 8949	1040A	4506-T	8829	Pub. 505	Pub. 551	Pub. 946	
Schedule E (1040)	1040EZ	4562	8863	Pub. 523	Pub. 554	Pub. 970	
Schedule EIC (1040A or 1040)	1040-ES (2013)	4684	8917	Pub. 525	Pub. 575	Pub. 972	