Chapter **Four**

Adjustments *for* Adjusted Gross Income

Taxpayers can deduct certain items from total income for purposes of computing Adjusted Gross Income (AGI). In this chapter, we introduce you to most of these *for* AGI deductions. This is a key step in determining the actual tax liability of the individual.

Learning Objectives

When you have completed this chapter, you should understand the following learning objectives (LO):

LO 4-1 Describe the tax rules for student loan interest.
LO 4-2 Be able to determine eligibility requirements and applicable dollar limits related to the Health Savings Account deduction.
LO 4-3 Determine the deduction for moving expenses.
LO 4-4 Explain the deduction for half of self-employment taxes.
LO 4-5 Discuss the self-employed health insurance deduction.
LO 4-6 Explain the penalty on early withdrawal of savings.
LO 4-7 Be able to calculate the deduction for alimony paid.
LO 4-8 Determine the deduction for educator expenses.

INTRODUCTION

In previous chapters, we primarily discussed tax rules and the presentation of many components of total income (line 22 on Form 1040). Taxpayers can also deduct certain items from total income to arrive at Adjusted Gross Income (AGI). These deductible items are *for* AGI deductions, commonly referred to as *above-the-line* deductions (AGI is considered to be "the line"). AGI is critically important to the calculation of other key items on the tax return. *For* AGI deductions are on Form 1040, lines 23 to 35, or Form 1040A, lines 16 to 19.[1] See Exhibit 4-1 for the AGI portion of Form 1040.

You may recall that certain deductions are also subtracted from AGI to arrive at taxable income. These *from* AGI deductions, or *below-the-line* deductions, are standard or itemized deductions and personal exemptions. In effect, gross income minus *for* AGI (above-the-line) deductions equals AGI. If you then subtract *from* AGI (below-the-line) deductions, you will get taxable income.

[1] We do not discuss all *for* AGI deductions in this chapter. Taxpayers may also take *for* AGI deductions for contributions to Individual Retirement Accounts (Form 1040, line 32) and to retirement plans for self-employed individuals (Form 1040, line 28). We discuss these deductions in Chapter 11.

EXHIBIT 4-1

Adjusted Gross Income	23	Educator expenses	23
	24	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ	24
	25	Health savings account deduction. Attach Form 8889	25
	26	Moving expenses. Attach Form 3903	26
	27	Deductible part of self-employment tax. Attach Schedule SE	27
	28	Self-employed SEP, SIMPLE, and qualified plans	28
	29	Self-employed health insurance deduction	29
	30	Penalty on early withdrawal of savings	30
	31a	Alimony paid **b** Recipient's SSN ▶	31a
	32	IRA deduction	32
	33	Student loan interest deduction	33
	34	Reserved for future use	34
	35	Domestic production activities deduction. Attach Form 8903	35
	36	Add lines 23 through 35	36
	37	Subtract line 36 from line 22. This is your **adjusted gross income** ▶	37

Source: U.S. Department of the Treasury, Internal Revenue Service, Form 1040. Washington, DC: 2017.

STUDENT LOAN INTEREST (FORM 1040, LINE 33, OR FORM 1040A, LINE 18)

LO 4-1

Tax law provides numerous tax benefits for expenses associated with obtaining education beyond high school. These benefits are available for individuals saving for higher education (Coverdell Education Savings Accounts, state tuition programs, and qualified U.S. savings bonds), for many expenses incurred while attending a qualified educational institution (American opportunity/Hope and lifetime learning credits), and for interest paid on loans incurred for higher education expenses.[2]

Paying higher education expenses often requires students or their parents or guardians to borrow money from lending institutions such as banks or from federal or state student loan programs. An individual can take a deduction for "an amount equal to the interest paid by the taxpayer during the taxable year on any qualified education loan."[3] Only the person legally obligated to make the interest payments can take the deduction.[4] *A person who is claimed as a dependent on another person's return cannot claim the deduction,*[5] *nor can persons whose filing status is married filing separately.*[6]

EXAMPLE 4-1

In 2013 Juana borrowed $5,000 for higher education expenses on a qualified education loan. In 2017, when she began making payments on the loan, she was still living at home and her parents appropriately claimed her as a dependent. Juana cannot claim the student interest deduction. Although she was the person legally obligated to repay the loan, she was claimed on the return of another person.

The amount of this deduction is limited to $2,500 per year.[7] The deduction may be further limited based on the modified Adjusted Gross Income of the taxpayer.

[2] Coverdell Education Savings Accounts and the American opportunity (AOTC) and lifetime learning credits are discussed in Chapters 9 and 11, respectively.

[3] IRC § 221(a).

[4] Reg. § 1.221-1(b).

[5] IRC § 221(c).

[6] IRC § 221(e)(2).

[7] IRC § 221(b)(1).

Qualified Education Loan

A *qualified education loan* is one incurred by the taxpayer solely to pay qualified education expenses on behalf of the taxpayer, taxpayer's spouse, or any dependent of the taxpayer at the time the loan was incurred.[8] Note that the loan must be *solely* to pay for educational expenses. Thus home equity loans or revolving lines of credit often do not qualify. Qualified education expenses must be paid or incurred within a reasonable period before or after the loan date.[9] Expenses meet this test if the proceeds of the loan are disbursed within 90 days of the start or 90 days after the end of the academic period. Federal education loan programs meet this criterion. The expenses also must occur during the period the recipient was carrying at least half the normal full-time workload for the intended course of study.[10] The course of study can be at the undergraduate or graduate level.

Qualified Education Expenses

Qualified education expenses are the costs of attending an eligible educational institution.[11] These costs include tuition, fees, books, supplies, equipment, room, board, transportation, and other necessary expenses of attendance. However, taxpayers must reduce qualified expenses by the amount of income excluded from gross income in each of the following cases. In each instance, because the income is not included, the item does *not* create a deduction:

- An employer-paid educational assistance program.[12]
- Redemption of U.S. savings bonds used to pay higher education tuition and fees.[13]
- Funds withdrawn from a Coverdell Education Savings Account.[14]
- Qualified tax-free scholarships and fellowships.[15]
- Armed forces' or veterans' educational assistance allowances.[16]
- Any other educational assistance excludable from gross income (not including gifts, bequests, devises, or inheritances).[17] This category includes a state-qualified tuition plan.

EXAMPLE 4-2

In September Reggie spent $3,000 on qualified educational expenses. He received a loan for $2,800 in the same month as he paid the expenses. During the semester, he received a scholarship of $500 that she properly excluded from income. Reggie's qualified educational expenses are $2,500 ($3,000 − $500). As a result, interest on $2,500 of the $2,800 loan will be eligible for student loan interest treatment while interest on the remaining $300 is nondeductible personal interest.

Other Provisions and Limitations

As noted earlier, deductible education expenses must occur in conjunction with attendance at an eligible educational institution. An *eligible institution* is generally a postsecondary educational institution that meets the requirements to participate in the federal student loan program.[18] The Health Care and Reconciliation Act of 2010 made some substantial changes to the administration of the federal student loan program. This includes almost all four-year colleges and

[8] IRC § 221(d)(1)(A).
[9] IRC § 221(d)(1)(B), Reg. § 1.221-1(e)(3)(ii).
[10] IRC § 221(d)(3), IRC § 25A(b)(3).
[11] IRC § 221(d)(2).
[12] IRC § 127.
[13] IRC § 135.
[14] IRC § 530.
[15] IRC § 117.
[16] IRC § 25A(g)(2)(B).
[17] IRC § 25A(g)(2)(C).
[18] IRC § 221(d)(2), IRC § 25A(f)(2).

universities, two-year community colleges, and many trade and technical schools. The classification also incorporates institutions with an internship or residency program leading to a degree or certificate awarded by an institute of higher education, a hospital, or a health care facility that offers postgraduate training.[19] Qualified expenses must be for an academic period during which the student was enrolled at least half-time in one of these qualifying programs.

The deduction for interest on qualified education loans may be limited based on the modified Adjusted Gross Income of the taxpayer.[20] *Modified AGI* is equal to the AGI on the taxpayer's tax return plus (a) any deduction for student loan interest, (b) any foreign, U.S. possession, or Puerto Rican income excluded from taxable income, (c) any deduction taken for tuition and fees, and (d) any deduction taken with regard to domestic activities production.[21]

The deductible amount of student loan interest is reduced when modified AGI reaches \$135,000 on a joint return (\$65,000 for a single return) and is totally eliminated when modified AGI reaches \$165,000 (\$80,0000 for single returns).[22] The following formula is used:

$$\text{Preliminary deduction} \times \text{Fraction (see below)} = \text{Disallowed interest}$$

For married taxpayers, the fraction is (Modified AGI − \$135,000)/\$30,000.

For single taxpayers, the fraction is (Modified AGI − \$65,000)/\$15,000.

The denominators in these fractions represent the difference between the beginning and the end of the phaseout range (that is, for married filing jointly, the \$30,000 denominator is the difference between \$135,000 and \$165,000). These fractions represent the disallowed proportion of the preliminary deduction.

Note that the preliminary deduction amount cannot exceed the \$2,500 maximum allowed deduction.

EXAMPLE 4-3

Al and Marian borrowed \$30,000 on a qualified educational loan to pay for qualified higher education expenses for their two children. During 2017 they paid \$1,800 interest on the loan. Al and Marian's modified AGI on their joint return was \$155,000. They are entitled to deduct \$600 as follows:

$$\$1{,}800 \times \frac{\$155{,}000 - \$135{,}000}{\$30{,}000} = \$1{,}200 \text{ disallowed}$$

Permitted deduction = \$1,800 − \$1,200 = \$600.

TAX YOUR BRAIN

If Al and Marian paid \$3,200 interest on the loan in 2017, what is the allowed deduction for student loan interest?

ANSWER

Because the interest deduction is limited to a total of \$2,500 before the AGI limitation, the couple would be entitled to an \$833 deduction as follows:

$$\$2{,}500 \times \frac{\$155{,}000 - \$135{,}000}{\$30{,}000} = \$1{,}667 \text{ disallowed}$$

Permitted deduction = \$2,500 − \$1,667 = \$833.

[19] IRC § 221(d)(2)(B).

[20] IRC § 221(b)(2).

[21] IRC § 221(b)(2)(C)(i).

[22] These limitation amounts are adjusted for inflation under IRC § 221(f).

From Shoebox to Software

There are generally four critical issues concerning student loan interest:

- Whether the loan was taken out solely for education expenses.
- Whether loan funds were used for education expenses.
- The amount of the interest payment for the year.
- Limitation of the deduction based on AGI phaseouts.

Identifying applicable loans and maintaining (or in some cases obtaining) proper documentation is more difficult because a number of years usually transpire between the date that the loan is created, the date that the expenses are paid, and the date the interest deduction is sought. On many student loans, the student can elect to defer payments while enrolled in college and even after that point for certain economic hardship reasons. Be careful, however; deferral does not prevent interest from accruing.

Loans made through the federal student loan program usually meet the first two critical issues because the U.S. government intends that these loans cover education expenses not paid by student earnings or parental contributions. The federal government provides an annual report to the taxpayer (often a substitute Form 1099-INT) that provides the amount of interest paid during the year.

Loans from financial institutions require a higher level of documentation. The taxpayer should review loan documents and canceled checks to determine whether the loan and the expenditures qualify for favored treatment. Lenders normally provide Form 1098-E (see Exhibit 4-2) indicating the amount of interest paid by the taxpayer in a year.

In both cases, when preparing a return using tax software, you enter applicable information on a Student Loan Interest Deduction worksheet. The Student Loan Interest Deduction worksheet can be found in IRS Publication 970, Tax Benefits for Education (Exhibit 4-3).

EXHIBIT 4-2

☐ CORRECTED (if checked)

RECIPIENT'S/LENDER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone number		OMB No. 1545-1576 2017 Form **1098-E**	**Student Loan Interest Statement**
RECIPIENT'S federal identification no. | BORROWER'S social security number		**1** Student loan interest received by lender $	**Copy B** **For Borrower**
BORROWER'S name Street address (including apt. no.) City or town, state or province, country, and ZIP or foreign postal code			This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if the IRS determines that an underpayment of tax results because you overstated a deduction for student loan interest.
Account number (see instructions)		**2** If checked, box 1 does **not** include loan origination fees and/or capitalized interest for loans made before September 1, 2004 . . . . ☐	

Form **1098-E** (keep for your records) www.irs.gov/form1098e Department of the Treasury - Internal Revenue Service

Source: U.S. Department of the Treasury, Internal Revenue Service, Form 1098-E. Washington, DC: 2017.

(continued)

EXHIBIT 4-3

Student Loan Interest Deduction Worksheet—Line 33 *Keep for Your Records*

Before you begin: ✓ Figure any write-in adjustments to be entered on the dotted line next to line 36 (see the instructions for line 36).
✓ Be sure you have read the **Exception** in the instructions for this line to see if you can use this worksheet instead of Pub. 970 to figure your deduction.

1. Enter the total interest you paid in 2017 on qualified student loans (see the instructions for line 33). **Don't** enter more than $2,500 . . . . . **1.** ______

2. Enter the amount from Form 1040, line 22 . . . . . **2.** ______

3. Enter the total of the amounts from Form 1040, lines 23 through 32, plus any write-in adjustments you entered on the dotted line next to line 36 . . . . . **3.** ______

4. Subtract line 3 from line 2 . . . . . **4.** ______

5. Enter the amount shown below for your filing status.
- Single, head of household, or qualifying widow(er)—$65,000
- Married filing jointly—$135,000

} . . . . . **5.** ______

6. Is the amount on line 4 more than the amount on line 5?

☐ **No.** Skip lines 6 and 7, enter -0- on line 8, and go to line 9.

☐ **Yes.** Subtract line 5 from line 4 . . . . . **6.** ______

7. Divide line 6 by $15,000 ($30,000 if married filing jointly). Enter the result as a decimal (rounded to at least three places). If the result is 1.000 or more, enter 1.000 . . . . . **7.** ___.___

8. Multiply line 1 by line 7 . . . . . **8.** ______

9. **Student loan interest deduction.** Subtract line 8 from line 1. Enter the result here and on Form 1040, line 33. **Don't** include this amount in figuring any other deduction on your return (such as on Schedule A, C, E, etc.) . . . . . **9.** ______

Source: IRS *Publication 970*

CONCEPT CHECK 4-1— LO 4-1

1. For the interest on a student loan to qualify for the deduction, the student must be enrolled at least ______________.
2. Under the student loan program, qualified educational expenses include ______________ and ______________.
3. The deductible amount of student loan interest is reduced when modified AGI for those filing married jointly reaches ______________.

HEALTH SAVINGS ACCOUNT DEDUCTION (FORM 1040, LINE 25)

LO 4-2

A Health Savings Account (HSA) is a tax-exempt savings account used for qualified medical expenses for the account holder, his or her spouse, and dependents. In general, qualified taxpayers can take a *for* AGI deduction for contributions to the HSA.[23] Contributions grow tax-free, and distributions are not taxable if used for qualified medical expenses.

To be eligible to fund an HSA, a taxpayer, under the age of 65, must be self-employed; an employee (or spouse) of an employer who maintains a high-deductible health plan (HDHP); or an employee of a company that has no health coverage, and the employee has purchased a high-deductible policy on his or her own. In addition, the individual cannot have other health insurance except for coverage for accidents, disability, dental care, vision care, long-term care, or workers' compensation.[24] In addition, the taxpayer cannot be enrolled in Medicare and cannot be claimed as a dependent on someone else's return. No permission or authorization from the IRS is required to establish an HSA. In order to set up an HSA, the taxpayer must work with a trustee who serves as custodian of the account.

[23] IRC § 223(a).

[24] IRC § 223(c)(1)(B).

From Shoebox to Software

Taxpayers who contribute to or withdraw from an HSA during the year must file Form 8889 and attach it to their Form 1040. Form 8889 is shown in Exhibit 4-4.

EXHIBIT 4-4

Form **8889**

Department of the Treasury
Internal Revenue Service

Health Savings Accounts (HSAs)

▶ Attach to Form 1040 or Form 1040NR.
▶ Go to *www.irs.gov/Form8889* for instructions and the latest information.

OMB No. 1545-0074
20**17**
Attachment Sequence No. **52**

Name(s) shown on Form 1040 or Form 1040NR | Social security number of HSA beneficiary. If both spouses have HSAs, see instructions ▶

Before you begin: Complete Form 8853, Archer MSAs and Long-Term Care Insurance Contracts, if required.

Part I **HSA Contributions and Deduction.** See the instructions before completing this part. If you are filing jointly and both you and your spouse each have separate HSAs, complete a separate Part I for each spouse.

Line	Description	Box
1	Check the box to indicate your coverage under a high-deductible health plan (HDHP) during 2017 (see instructions) . . . ▶ ☐ Self-only ☐ Family	
2	HSA contributions you made for 2017 (or those made on your behalf), including those made from January 1, 2018, through April 17, 2018, that were for 2017. **Do not** include employer contributions, contributions through a cafeteria plan, or rollovers (see instructions) . . .	2
3	If you were under age 55 at the end of 2017, and on the first day of **every** month during 2017, you were, or were considered, an eligible individual with the **same** coverage, enter $3,400 ($6,750 for family coverage). **All others,** see the instructions for the amount to enter . . .	3
4	Enter the amount you and your employer contributed to your Archer MSAs for 2017 from Form 8853, lines 1 and 2. If you or your spouse had family coverage under an HDHP at any time during 2017, also include any amount contributed to your spouse's Archer MSAs . . .	4
5	Subtract line 4 from line 3. If zero or less, enter -0- . . .	5
6	Enter the amount from line 5. But if you and your spouse each have separate HSAs and had family coverage under an HDHP at any time during 2017, see the instructions for the amount to enter . . .	6
7	If you were age 55 or older at the end of 2017, married, and you or your spouse had family coverage under an HDHP at any time during 2017, enter your additional contribution amount (see instructions) . . .	7
8	Add lines 6 and 7 . . .	8
9	Employer contributions made to your HSAs for 2017 . . . 9	
10	Qualified HSA funding distributions . . . 10	
11	Add lines 9 and 10 . . .	11
12	Subtract line 11 from line 8. If zero or less, enter -0- . . .	12
13	**HSA deduction.** Enter the **smaller** of line 2 or line 12 here and on Form 1040, line 25, or Form 1040NR, line 25 . . .	13
	Caution: *If line 2 is more than line 13, you may have to pay an additional tax (see instructions).*	

Part II **HSA Distributions.** If you are filing jointly and both you and your spouse each have separate HSAs, complete a separate Part II for each spouse.

Line	Description	Box
14a	Total distributions you received in 2017 from all HSAs (see instructions) . . .	14a
b	Distributions included on line 14a that you rolled over to another HSA. Also include any excess contributions (and the earnings on those excess contributions) included on line 14a that were withdrawn by the due date of your return (see instructions) . . .	14b
c	Subtract line 14b from line 14a . . .	14c
15	Qualified medical expenses paid using HSA distributions (see instructions) . . .	15
16	**Taxable HSA distributions.** Subtract line 15 from line 14c. If zero or less, enter -0-. Also, include this amount in the total on Form 1040, line 21, or Form 1040NR, line 21. On the dotted line next to line 21, enter "HSA" and the amount . . .	16
17a	If any of the distributions included on line 16 meet any of the **Exceptions to the Additional 20% Tax** (see instructions), check here . . . ▶ ☐	
b	**Additional 20% tax** (see instructions). Enter 20% (0.20) of the distributions included on line 16 that are subject to the additional 20% tax. Also include this amount in the total on Form 1040, line 62, or Form 1040NR, line 60. Check box c on Form 1040, line 62, or box b on Form 1040NR, line 60. Enter "HSA" and the amount on the line next to the box . . .	17b

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 37621P Form **8889** (2017)

Source: U.S. Department of the Treasury, Internal Revenue Service, Form 8889. Washington, DC: 2017.

(continued)

A trustee, normally a bank or insurance company, administers the HSA. Trustees are required to provide HSA holders contribution and distribution information. Contributions are reported on Form 5498-SA (see Exhibit 4-5). Taxpayers use contribution information to prepare Part I of Form 8889.

Distributions are reported by the trustee on Form 1099-SA, shown in Exhibit 4-6. The distributions are reported on Part II of Form 8889 (see Exhibit 4-4).

EXHIBIT 4-5

☐ CORRECTED (if checked)

TRUSTEE'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone number		1 Employee or self-employed person's Archer MSA contributions made in 2017 and 2018 for 2017 $ 2 Total contributions made in 2017 $	OMB No. 1545-1518 2017 Form 5498-SA	**HSA, Archer MSA, or Medicare Advantage MSA Information**
TRUSTEE'S federal identification number	PARTICIPANT'S social security number	3 Total HSA or Archer MSA contributions made in 2018 for 2017 $		**Copy B**
PARTICIPANT'S name Street address (including apt. no.) City or town, state or province, country, and ZIP or foreign postal code		4 Rollover contributions $ 6 HSA ☐ Archer MSA ☐ MA MSA ☐	5 Fair market value of HSA, Archer MSA, or MA MSA $	**For Participant** This information is being furnished to the Internal Revenue Service.
Account number (see instructions)				

Form **5498-SA** (keep for your records) www.irs.gov/form5498sa Department of the Treasury - Internal Revenue Service

Source: U.S. Department of the Treasury, Internal Revenue Service, Form 5498-SA. Washington, DC: 2017.

EXHIBIT 4-6

☐ CORRECTED (if checked)

TRUSTEE'S/PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone number			OMB No. 1545-1517 2017 Form 1099-SA	**Distributions From an HSA, Archer MSA, or Medicare Advantage MSA**
PAYER'S federal identification number	RECIPIENT'S identification number	1 Gross distribution $	2 Earnings on excess cont. $	**Copy B** **For Recipient**
RECIPIENT'S name Street address (including apt. no.) City or town, state or province, country, and ZIP or foreign postal code		3 Distribution code 5 HSA ☐ Archer MSA ☐ MA MSA ☐	4 FMV on date of death $	This information is being furnished to the Internal Revenue Service.
Account number (see instructions)				

Form **1099-SA** (keep for your records) www.irs.gov/form1099sa Department of the Treasury - Internal Revenue Service

Source: U.S. Department of the Treasury, Internal Revenue Service, Form 1099-SA. Washington, DC: 2017.

Any insurance company or any bank (including a similar financial institution as defined in section 408(n)) can be an HSA trustee or custodian. In addition, any other person already approved by the IRS to be a trustee or custodian of IRAs or Archer MSAs is automatically approved to be an HSA trustee or custodian. Other persons may request approval to be a

trustee or custodian in accordance with the procedures set forth in Treas. Reg. § 1.408-2(e) (relating to IRA nonbank trustees).

An HDHP is a health plan with specified minimum deductible amounts and a maximum annual deductible and out-of-pocket expense limitation.[25] *Out-of-pocket expense* represents the amount the health plan requires the policyholder to pay for covered benefits (other than the premium). Essentially, an HDHP is a health insurance plan with lower premiums and higher deductibles than a traditional health plan. It is a form of catastrophic coverage. For calendar year 2017, these amounts are as follows:

	Minimum Deductible	Maximum Deductible and Annual Out-of-Pocket Expenses
Individual coverage	$1,300	$ 6,550
Family coverage	$2,600	$13,100

The employee or employer contributes to the HSA. For individual coverage maximum, the aggregate contribution an individual under age 55 can make to an HSA is $3,400. For family coverage, with a contributor under age 55, the maximum aggregate annual contribution is $6,750.[26]

If the taxpayer is 55 or older, he or she may contribute an additional $1,000 in 2017. This assumes that only one spouse has an HSA. If both spouses have separate HSAs, see IRS Publication 969 for further information. Individuals are now allowed to make a one-time contribution to an HSA of an amount distributed from their IRA. The contribution must be made in a direct trustee-to-trustee transfer. Amounts distributed from the IRA are not includable in the individual's income to the extent that the distribution would otherwise be includable in income. Such distributions are not subject to the 20% additional tax on early distributions. An individual who becomes covered by a high-deductible plan during the year can make a contribution to an HSA as if he or she was eligible for the entire year. Contributions for a tax year must be made by the due date of the return.

Contributions made by a qualified individual are a *for* AGI deduction, assuming that the limitations are met. If an employer contributes, the amount is not deductible (because the employee paid nothing), but the payment is not counted as income to the employee. The funds in the account are allowed to accumulate from year to year and the interest or other earnings on the assets in the account are tax free.

Distributions from HSAs are tax-free if they are used to pay for qualified medical expenses.[27] Part I of Form 8889, Health Savings Accounts, is used to report the amount of the deduction that is reported on line 25. Form 8889 must be attached to the taxpayer's return. The form is also used to report the taxable and nontaxable amounts of a distribution from an HSA. You can find additional information about HSAs in IRS Publication 969.

Funds contained within an HSA account are exempt from tax. An employee is always 100% vested in his or her HSA. Amounts that remain in the HSA at the end of the year are carried over to the next year. Earnings on amounts in an HSA are not included in income while held in the HSA.

CONCEPT CHECK 4-2—
LO 4-2

1. To be eligible to fund an HSA, a taxpayer must be ____________, an employee (or spouse) of an employer who maintains a high-deductible health plan, or an uninsured employee who has purchased a high-deductible policy on his or her own.
2. If they are used to pay for qualified medical expenses, distributions from HSAs are ____________.
3. If taxpayers make contributions to or withdrawals from an HSA during the year, they must file Form ____________ and attach it to their Form ____________.

[25] IRC § 223(c)(2).
[26] IRC § 223(b).
[27] IRC § 223(d)(2).

MOVING EXPENSES (FORM 1040, LINE 26)

LO 4-3

An employee or self-employed individual who moves his or her principal residence because of a change in employment may deduct certain moving expenses.[28] *Moving expenses* are reasonable expenses for the following:

- Moving household goods and personal effects from the old residence to the new residence.
- Traveling from the old residence to the new residence (including lodging but excluding meals).[29]

Additionally, moving expenses include temporary storage of household goods within a consecutive 30-day period after items are moved from the former home and actual expenses or mileage for driving a personal auto at a rate of 17 cents per mile for 2017. Nonqualified moving expenses generally include house-hunting costs before the move, costs incurred in buying and selling a home, and temporary living expenses and costs of meals incurred while moving.

Moving expenses of persons other than the taxpayer are permitted if the other persons are members of the taxpayer's household and both the old and new residences are the persons' principal place of abode.[30] This situation most often occurs in the case of family members or other dependents who also move with the taxpayer. Travel is limited to one trip per person.

Tests for Moving Expense Deductibility

To qualify for a moving expense deduction, taxpayers must meet three tests.

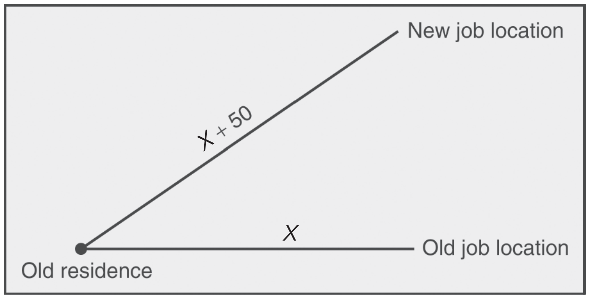
Change in Employment Test

For the first test, the move must be the result of a change in the taxpayer's principal place of work.[31] The move will be considered due to a new work location if the move is within one year of the date the taxpayer started working at the new location. If there is no change of job location, the taxpayer cannot take the moving expense deduction. However, a taxpayer starting work for the first time qualifies provided he or she meets the distance test outlined next. In addition, there is no requirement that the new job be in the same line of work as the old job.

Distance Test

The second test is the distance test. The new job location must be at least 50 miles farther from the taxpayer's old residence than was the old job location.[32] For example, if the old residence was 15 miles from the old job, the new job must be at least 65 miles away from the old residence. If the taxpayer had no old job (that is, the taxpayer was unemployed), the new job must be more than 50 miles away from his or her old residence.[33] A diagram illustrating the application of the distance test is shown in Exhibit 4-7.

EXHIBIT 4-7
Distance Test Diagram



[28] IRC § 217(a).
[29] IRC § 217(b)(1).
[30] IRC § 217(b)(2).
[31] IRC § 217(a).
[32] IRC § 217(c)(1).
[33] IRC § 217(c)(1)(B).

So if the distance between the old residence and the old job is defined as X miles, the new job must be at least $X + 50$ miles from the old residence. An easy way to determine whether this test is met is to use the following table:

Worksheet 1. **Distance Test**

	Note. Members of the U.S. armed forces may not have to meet this test. See *Members of the Armed Forces.*		
1.	Enter the number of miles from your old home to your new workplace	**1.**	______ miles
2.	Enter the number of miles from your old home to your old workplace	**2.**	______ miles
3.	Subtract line 2 from line 1. If zero or less, enter -0-	**3.**	______ miles
4.	Is line 3 at least 50 miles? ☐ Yes. You meet this test. ☐ No. You do not meet this test. You cannot deduct your moving expenses.		

Time Test

The third test is the time test. To meet this test, a taxpayer must meet either of the following:

- Be a full-time employee for a period of 39 weeks during the 12 months immediately following arrival in the new area.
- Be self-employed for at least 78 weeks during the 24 months immediately following arrival in the new area. At least 39 of the 78 weeks must be during the first 12-month period.[34]

To meet the time test, the taxpayer need not remain employed in the new job for the entire 39- or 78-week period; but the full-time employment (or self-employment) must be in the same general location as the new job for which the taxpayer moved.[35] Therefore, a taxpayer who gets a job in a new city, moves there, works for the new employer for 2 months, and then obtains a different full-time job in the same area for the next 10 months meets the time test.

For a married couple, if both obtain new jobs in a new area, the taxpayers can deduct moving expenses if either spouse satisfies the time test.[36] However, spouses must separately account for their weeks worked (weeks worked by one spouse cannot be added to weeks worked by the other spouse).

Moving expenses are deductible only in the year incurred. Often taxpayers do not meet the time test by the due date of the tax return for the appropriate tax year. If the taxpayer expects to be able to comply with the time test, the taxpayer can choose either to deduct the moving expenses in the year incurred or to wait until he or she meets the test and then file an amended return claiming the deduction.[37] If the taxpayer elects to deduct the moving expenses prior to satisfying the time test and later does not meet the test, the moving expenses are disallowed, and the taxpayer must include the previously deducted expenses in income in the subsequent year or file an amended return for the year in which the expenses were deducted.[38]

EXAMPLE 4-4

Becca moved from Atlanta to Chicago in October 2017 because of a new job and incurred moving expenses of $4,000. She filed her 2017 return in March 2018. As of that date, the time test was not satisfied. Becca was employed full time in Chicago from October 2017 to March 2018; thus it was still possible that the time test could be satisfied. Becca elected to deduct the $4,000 moving expenses on her 2017 tax return. If, by the end of 2018, she satisfied the time test, Becca would take no further action. However, if she did not satisfy the time test by the end of 2018, she must include $4,000 in her 2018 gross income or file an amended return for 2017.

[34] IRC § 217(c)(2).
[35] Reg. § 1.217-2(c)(4)(iii).
[36] Reg. § 1.217-2(c)(4)(v).
[37] IRC § 217(d)(2) and Reg. § 1.217-2(d)(2).
[38] Reg. § 1.217-2(d)(3).

From Shoebox to Software

When using tax software to report moving expenses, there are multiple sources of tax-related information and two different forms used by taxpayers. Open the tax software using any of the clients we have used in the book so you can look at the worksheets and forms used for moving expenses.

To determine whether a taxpayer can take the moving expense deduction, the first task is to provide information concerning the time and distance tests. *This information is usually provided on the Form 3903—Distance and Time Tests worksheet section.* On this worksheet, you enter information concerning the two tests. If the taxpayer does not meet one or both of the tests, it is not necessary to continue because no moving expense deduction is permitted.

If a taxpayer meets the tests, you must then provide information concerning the amount of moving expenses and associated reimbursement, if any. Form 3903 is used for this purpose (see Exhibit 4-8).

Note that lines 1 and 2 of Form 3903 are shown in green in the tax software. This means that you input the data for these lines directly on Form 3903. The amount on line 1 pertains to the cost of moving and storing the household goods, and line 2 is for reporting the travel and lodging expenses for the individuals being moved.

Employers report reimbursements (if any) to the employee on Form W-2. The reimbursement amount is in box 12 and will have a code of P. When you enter the W-2 data, any code P amount will automatically be shown on line 4 of Form 3903. If expenses exceed reimbursements, the software will show the excess on Form 1040, line 26. Similarly, the software will report reimbursements in excess of expenses on Form 1040, line 21, as other income.

Sources of information for moving expenses include canceled checks and credit card statements (accompanied by supporting documentation) and miscellaneous cash receipts. If the taxpayer obtains reimbursement from his or her employer, the documentation provided to the employer is often an excellent source document.

EXHIBIT 4-8

Form **3903**

Department of the Treasury
Internal Revenue Service (99)

Moving Expenses

▶ Go to *www.irs.gov/Form3903* for the latest information.
▶ Attach to Form 1040 or Form 1040NR.

OMB No. 1545-0074
2017
Attachment Sequence No. **170**

Name(s) shown on return | **Your social security number**

Before you begin: ✓ See the **Distance Test** and **Time Test** in the instructions to find out if you can deduct your moving expenses.
✓ See **Members of the Armed Forces** in the instructions, if applicable.

1	Transportation and storage of household goods and personal effects (see instructions) . . .	1	
2	Travel (including lodging) from your old home to your new home (see instructions). **Do not** include the cost of meals	2	
3	Add lines 1 and 2	3	
4	Enter the total amount your employer paid you for the expenses listed on lines 1 and 2 that is **not** included in box 1 of your Form W-2 (wages). This amount should be shown in box 12 of your Form W-2 with code **P**	4	
5	Is line 3 **more than** line 4?		
	☐ **No.** You **cannot** deduct your moving expenses. If line 3 is less than line 4, subtract line 3 from line 4 and include the result on Form 1040, line 7, or Form 1040NR, line 8.		
	☐ **Yes.** Subtract line 4 from line 3. Enter the result here and on Form 1040, line 26, or Form 1040NR, line 26. This is your **moving expense deduction**	5	

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 12490K Form **3903** (2017)

Source: U.S. Department of the Treasury, Internal Revenue Service, Form 3903. Washington, DC: 2017.

The time test does not apply if failure to meet the test was a result of any of the following:

- Death or disability of the taxpayer.
- Involuntary separation from employment (other than for willful misconduct).
- A retransfer of the employee for the benefit of the employer (that was not initiated by the employee).[39]

In each of the last two exceptions, the taxpayer must have had a reasonable expectation to meet the time test, absent the noted cause.

Neither the distance nor the time test applies to moves made by members of the U.S. armed forces who are on active duty and who have moved pursuant to a military order including a permanent change of station.[40] There are also some separate rules that apply to the moving expenses incurred by those moving to a new work location outside of the United States. Additional information on these and other issues can be found in IRS Publication 521.

Employer Moving Expense Reimbursements

Employers may reimburse employees for some or all of their moving expenses. If the taxpayer would have been able to deduct the reimbursed expenses had the taxpayer paid them directly, the taxpayer can exclude the reimbursement from income.[41] In such a case, the taxpayer cannot deduct the reimbursed moving expenses.[42] If the employer reimburses less than the amount of deductible expenses, the taxpayer can deduct the excess expenses. If the reimbursement is more than the amount of deductible expenses (for example, if the employer reimburses the employee for meals), the excess reimbursement is gross income.

CONCEPT CHECK 4-3— LO 4-3

1. Moving expenses can be deducted either as a *for* AGI deduction or as an itemized deduction on Schedule A. True or false?
2. A taxpayer who meets the time test does not have to be concerned about the distance test. True or false?
3. If an employer reimburses an employee for moving costs, the employee cannot deduct those expenses on the tax return. True or false?

DEDUCTION FOR HALF OF SELF-EMPLOYMENT TAX (FORM 1040, LINE 27)

LO 4-4

Self-employed individuals must normally pay self-employment tax equal to 15.3% of their net earnings from self-employment.[43] The self-employment tax is the FICA tax for social security and Medicare that W-2 employees have deducted from their paychecks at a rate of 7.65% and that employers must match at the same rate. Self-employed individuals are responsible for both halves of the tax, and the tax is calculated on the net earnings of the business. Self-employed persons are allowed a *for* AGI deduction equal to one-half of the self-employment tax imposed.[44] The tax software will automatically calculate the appropriate amount for line 27. Self-employment tax is calculated on Form SE; it is covered in more detail in Chapter 6.

One ObamaCare provision, that is now in effect, relates to the portion of FICA taxes pertaining to the Medicare tax. It requires that an additional Medicare tax of 0.9% be assessed for

[39] IRC § 217(d)(1).

[40] IRC § 217(g).

[41] IRC § 132(a)(6) and IRC § 132(g).

[42] See Reg. § 1.217-2(a)(2) for guidance when the reimbursement and moving expenses occur in different tax years.

[43] IRC § 1401.

[44] IRC § 164(f).

those individuals, according to filing status, whose income exceeds the following threshold amounts:

Filing Status	Threshold Amount
Married filing jointly	$250,000
Married filing separately	$125,000
Single	$200,000
Head of household	$200,000
Qualifying widow(er)	$200,000

An employer is required by law to withhold the additional Medicare tax from wages it pays to individuals in excess of $200,000 in a calendar year. This added tax raises the wage earner's Medicare portion of FICA compensation to 2.35 percent, above the regular 1.45 percent.

CONCEPT CHECK 4-4— LO 4-4

1. Self-employment tax is calculated on the ____________ earnings of the business.
2. For W-2 employees, for 2017 the total FICA tax is calculated at a rate of ____________ of their gross earnings.
3. An employer is required by law to withhold the additional Medicare tax from wages it pays to individuals in excess of $____________ in a calendar year.

SELF-EMPLOYED HEALTH INSURANCE DEDUCTION (FORM 1040, LINE 29) LO 4-5

Payments for health insurance for self-employed individuals, their spouse, and their dependents are not deductible as a business expense on Schedule C.[45] However, applicable taxpayers can deduct, as a *for* AGI deduction, 100% of self-employed health insurance premiums.[46]

The amount of the deduction may be limited in two respects. First, taxpayers cannot take a deduction for any amount in excess of net earnings from self-employment from the trade or business under which coverage is provided.[47] Net earnings from self-employment are determined by reducing gross income by the regular expenses of the business as well as the deduction for one-half of the self-employment tax and any deduction for contributions to qualified retirement plans.

EXAMPLE 4-5

Gia had net earnings of $2,800 from self-employment. She paid $160 per month for health insurance ($1,920 per year). Gia is entitled to a *for* AGI deduction of $1,920 for health insurance. If Gia net earnings from self-employment were $1,500, her deduction would have been limited to $1,500.

The second limitation pertains to availability of other health insurance coverage. If the taxpayer is entitled to participate in any subsidized health plan maintained by any employer of the taxpayer or of the taxpayer's spouse, a deduction is not allowed.[48] Eligibility for alternative coverage is determined on a monthly basis. A *subsidized health plan* is one in which someone other than the employee pays for part or all of the cost of the plan.

EXAMPLE 4-6

Wendy is self-employed and had net earnings from self-employment of $17,000 for the year. She has an individual-only health insurance policy through her business for which she pays $145 per month. An unrelated local business employs Taylor, her husband. Taylor's employer provides health insurance coverage for all employees and pays $100 toward the monthly premium of each employee. Taylor can cover Wendy under his policy, but the couple has chosen not to do so because the cost would be higher than Wendy's current policy. In this case, Wendy cannot deduct any of her health insurance premiums because she is entitled to participate under a subsidized plan. The fact that she chooses not to be covered does not matter.

[45] IRC § 162(l)(4). Chapter 6 covers the taxation of self-employed individuals.

[46] IRC § 162(l)(1)(B).

[47] Generally, net earnings from self-employment are defined in IRC § 1402(a). For purposes of the health insurance deduction, that definition is modified by IRC § 401(c)(2).

[48] IRC § 162(l)(2)(B).

TAX YOUR BRAIN

Using the information from Example 4-6, assume that Taylor did not begin work at the local business until April 1, 2017. Prior to that time, he was an employee of Wendy's business, and both he and Wendy were covered under a group policy that cost $300 per month. On April 1 Wendy changed to an individual policy at $145 per month. How much can Wendy deduct for self-employed health insurance in 2017?

ANSWER

$900. Wendy is entitled to deduct the health insurance costs for herself and her spouse for the first three months of the year ($300 × 3 months). After that time, she is eligible under Taylor's policy, so she cannot take any additional deductions.

The alternative coverage rule is applied separately to plans that provide long-term care services or are qualified long-term care insurance contracts and to plans that do not provide such services.[49]

EXAMPLE 4-7

Patrick is self-employed and is entitled to participate in a subsidized qualified long-term care insurance plan through his wife Jennifer's employer. The general health care plan offered by Jennifer's employer is not subsidized. Patrick is entitled to participate in both health plans. He chooses to obtain general health care and qualified long-term care insurance through his own business. Patrick will be able to deduct the cost of the general health care plan (subject to the income limitation), but he cannot deduct the cost of the long-term care insurance. The general rule is that if someone else is willing to pay for insurance coverage, fully or partially, the premiums are not deductible.

The self-employed health insurance deduction is also available to a partner in a partnership and to a shareholder in a Subchapter S corporation who owns more than 2% of the stock in the corporation.[50] In the case of a Subchapter S shareholder, wages from the corporation are included in self-employed income for purposes of determining the deduction limitation based on net earnings from self-employment.

CONCEPT CHECK 4-5—
LO 4-5

1. Self-employed individuals are allowed to take a *for* AGI deduction for up to 80% of the cost of their self-employed health insurance premiums. True or false?
2. One limitation on this deduction is that taxpayers cannot deduct the premium cost that exceeds gross earnings from self-employment. True or false?
3. Another limitation on this deduction is that eligible participation in a health plan subsidized by the employer of either the taxpayer or the taxpayer's spouse will prohibit the deduction.

PENALTY ON EARLY WITHDRAWAL OF SAVINGS (FORM 1040, LINE 30)
LO 4-6

Certificates of deposit (CDs) and time savings accounts normally require holding an investment for a fixed period ranging from three months to five years. Often the rules associated with these financial instruments state that a depositor who withdraws the funds prior to the end of the fixed term will forfeit a certain amount of interest to which he or she would otherwise be entitled. For example, a two-year CD might state that the depositor will forfeit three months of interest on the CD in the event the depositor withdraws the money before the end of the two-year period. If such a premature withdrawal occurs, the taxpayer will be credited with the entire amount of interest (and that amount must be reported as interest income), but the financial institution will deduct three months of interest as a penalty.

If a taxpayer incurs an early withdrawal of savings penalty, the taxpayer is entitled to report the penalty as a *for* AGI deduction on line 30 of Form 1040.[51]

[49] IRC § 162(l)(2)(B)(i)&(ii).

[50] IRC § 162(l)(5) and IRC § 1372(a).

[51] IRC § 62(a)(9).

From Shoebox to Software

Financial institutions report early withdrawal penalties in box 2 of Form 1099-INT (see Exhibit 4-9). When you record the Form 1099-INT, the software automatically carries forward the box 2 amount onto line 30 of Form 1040.

EXHIBIT 4-9

☐ CORRECTED (if checked)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.	Payer's RTN (optional) **1** Interest income $	OMB No. 1545-0112 **2017** Form **1099-INT**	**Interest Income**
	2 Early withdrawal penalty $		**Copy B** **For Recipient**
PAYER'S federal identification number | RECIPIENT'S identification number	**3** Interest on U.S. Savings Bonds and Treas. obligations $		
RECIPIENT'S name	**4** Federal income tax withheld $	**5** Investment expenses $	This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.
Street address (including apt. no.)	**6** Foreign tax paid $	**7** Foreign country or U.S. possession	
City or town, state or province, country, and ZIP or foreign postal code	**8** Tax-exempt interest $	**9** Specified private activity bond interest $	
	10 Market discount $	**11** Bond premium $	
FATCA filing requirement ☐	**12** Bond premium on Treasury obligations $	**13** Bond premium on tax-exempt bond $	
Account number (see instructions)	**14** Tax-exempt and tax credit bond CUSIP no.	**15** State | **16** State identification no.	**17** State tax withheld $ $

Form **1099-INT** (keep for your records) www.irs.gov/form1099int Department of the Treasury - Internal Revenue Service

Source: U.S. Department of the Treasury, Internal Revenue Service, Form 1099-INT. Washington, DC: 2017.

EXAMPLE 4-8

On February 1, 2017, Ricardo and Marie deposited $10,000 into a one-year CD earning 2% interest at State Bank and Trust. If the couple withdrew their money prior to the end of the term, they would forfeit one month's interest as a penalty. On October 1, 2017, they withdrew their money. Ricardo and Marie would report $133 interest income on line 8A of the 1040 or, if required, on Schedule B ($10,000 × 2% × 8/12). They would also report a *for* AGI deduction of $17 ($10,000 × 2% × 1/12) as a penalty on early withdrawal of savings.

CONCEPT CHECK 4-6— LO 4-6

1. The early withdrawal penalty is reported on Form 1040 as a(n) ________________ deduction.
2. The amount of the penalty is reported to the taxpayer by the financial institution on Form ________________.

ALIMONY PAID (FORM 1040, LINE 31A)

LO 4-7

In a divorce or legal separation, certain payments may flow from one party to the other. These payments are (a) alimony, (b) child support, or (c) a property settlement. Of the three, only alimony has a tax consequence, and it is important to be able to distinguish it from the other two types of payments.

Child support is a fixed payment (in terms of dollars or a proportion of the payment) that is payable for the support of children of the payer spouse.[52] A *property settlement* is a division of property of the marital community incident to a divorce.[53] For tax purposes, child support payments and property settlement payments do not result in income to either spouse; nor does either spouse receive a tax deduction.

The payment of alimony, however, has tax ramifications.[54] Alimony received is taxable to the payee (receiving) spouse in the year received.[55] It is income on line 11 of Form 1040. Alimony payments are deductible by the payer spouse in the year paid as a *for* AGI deduction.[56]

To qualify as *alimony,* a payment must be cash and must be required under the provisions of a decree of divorce or separate maintenance or the provisions of a written separation agreement or other decree requiring one spouse to make payments to support the other spouse.[57] All payments must occur after the decree or after the execution of the agreement. Any payments made prior to this time would be neither deductible by the payer spouse nor included in the income of the payee spouse.

All payments must end at the payee spouse's death. There can be no provisions to make payments to the estate of the spouse or in any other manner after the death of the spouse. If this rule is not satisfied, then none of the payments are alimony, even those made during the life of the spouse.[58]

Alimony includes payments made to third parties on behalf of the payee spouse under the terms of the divorce decree or separate maintenance agreement.[59] Such payments might include paying the spouse's rent, mortgage, car payment, or property taxes. Payments made to maintain property owned by the payer spouse but used by the payee spouse do not qualify as alimony.[60]

Payments are not alimony if the spouses file a joint return or if they live in the same household when payments occur.[61] However, if a payment is made when the spouses are living together and one spouse is preparing to leave the household and does so within one month after the payment, such payment will be considered alimony. Furthermore, if the spouses are not yet legally separated under a decree of divorce and a payment is made under a written separation agreement, such payment will count as alimony even if the spouses are members of the same household when the payment is made.[62]

Finally, if the divorce decree or separate maintenance agreement states that certain payments are not alimony, the agreement will control.[63]

[52] IRC § 71(c)(1).

[53] IRC § 1041.

[54] The IRC refers to payments for "alimony or separate maintenance." In general, *separate maintenance* refers to payments made by one spouse to another while separated but still married, whereas *alimony* payments are those made after the divorce becomes final. For purposes of this section, we will refer to these payments simply as *alimony.*

[55] IRC § 71.

[56] IRC § 62(a)(10) and IRC § 215(a).

[57] IRC § 71(b)(2).

[58] IRC § 71(b)(1)(D) and Reg. § 1.71-1T(b), Q&A-10.

[59] IRC § 71(b)(1).

[60] Reg. § 1.71-1T(b), Q&A-6.

[61] IRC § 71(e) and IRC § 71(b)(1)(C).

[62] Reg. § 1.71-T(b), Q&A-9.

[63] IRC § 71(b)(1)(B).

From Shoebox to Software

Alimony received is reported on line 11 of Form 1040. Alimony paid is reported on line 31a. Persons making alimony payments must report the taxpayer identification number of the recipient on line 31b.

In the tax software, you report information concerning alimony received or paid on a worksheet (Alimony Income or Alimony Paid Adjustment, as the case may be).

The tax software carries the information forward to the appropriate line on Form 1040.

Canceled checks or other forms of payment provide information about the amount of alimony payments. Whether the payments constitute alimony is determined by reference to the divorce decree or separation agreement. In particularly complex cases, the taxpayer should obtain the advice of an attorney.

EXAMPLE 4-9

Akeem, who had previously moved out of the home, and Taylor entered into a separation agreement on July 20, 2017. The agreement required Akeem to make payments of $300 per month to Taylor beginning on July 20, 2017. Their divorce decree was final on December 12, 2017. Under terms of the divorce, Akeem transferred title on the couple's house to Taylor's name. The house was worth $100,000 at the time of the transfer. The divorce decree also mandated that, beginning in December 2017, Akeem make payments on the 12th of each month of (a) $200 to Taylor for maintenance of the couple's only child, (b) $400 per month to Taylor, and (c) mortgage payments of $800 to the bank on behalf of Taylor. Payments for the child will continue until she reaches age 18; payments to or on behalf of Taylor will cease upon her death. They will file separate returns for 2017. How much can Akeem deduct in 2017 and 2018 for alimony?

In 2017, Akeem may deduct the $300 payments required under the separate maintenance agreement for July through November, one $400 payment to Taylor, and one $800 payment to the bank. The alimony payments total $2,700 for 2017. The value of the house is a property settlement, and the monthly $200 for their child is child support. Neither of these items has any tax effect for either party. For 2018, Akeem will be able to deduct $1,200 per month ($400 + $800), or $14,400 for the year. Note also that the amount of alimony income that Taylor must report is the same as the amount of alimony deduction calculated by Akeem.

TAX YOUR BRAIN

Would the answer to Example 4-9 change if Akeem did not move out until January 30, 2018?

ANSWER

Yes. The payments Akeem made on December 12 are not alimony because both he and Taylor were members of the same household on the date of the payment, and Akeem did not move out within one month thereafter. Deductible payments for 2018 would not change.

Alimony Recapture Rules

If alimony payments decrease sharply in the second or third year of payment, the payments may be subject to a recapture provision.[64] This relates to the concept of "substance over form"; the payments may be called alimony but are, in substance, a property settlement. Note that these recapture rules do not apply after the third year of payment.

[64] IRC § 71(f).

The recapture rules effectively reclassify payments from alimony to a property settlement. If recapture is required, the recipient (who previously recorded income) treats the recapture amount as a deduction, and the payer (who previously recorded a deduction) must count the recapture as income. The recapture occurs in the third postseparation year.[65]

TAX YOUR BRAIN

Why would the IRS care about the timing and magnitude of alimony payments?

ANSWER

Alimony payments create income for one taxpayer and a deduction for another, whereas property settlements have no tax effect on either party. In practice, it is likely that the tax rates of the spouses will differ after the divorce, perhaps significantly. For example, one spouse could be in the 35% bracket while the other one is in the 15% bracket. Taxpayers may try, in effect, to shift income from the high-tax spouse to the low-tax spouse.

CONCEPT CHECK 4-7— LO 4-7

1. Alimony may be paid in either cash or property, as long as the payments are made on a regular basis to a non-live-in ex-spouse. True or false?
2. For payments to qualify as alimony, the couple must be legally divorced at the time payments are made. True or false?
3. The goal of the alimony recapture rule is to properly define the substance of payments made to a former spouse to ensure proper tax treatment. True or false?

EDUCATOR EXPENSES (FORM 1040, LINE 23)
LO 4-8

Eligible educators may deduct up to $250 of qualified education expenses as an above-the-line AGI deduction.[66] The deduction is taken on Form 1040. If the taxpayer's filing status is married filing jointly and both individuals are eligible educators, the maximum deduction is $500, but neither spouse can deduct more than $250 of his or her expenses. Taxpayers must reduce otherwise permitted qualified expenses by any reimbursements received pertaining to the expenses.

An eligible educator is a teacher, instructor, counselor, principal, or aide in a kindergarten through 12th grade school who devotes at least 900 hours in the school year to that job.[67] Qualification under the 900-hour test is measured within the academic year while the $250 deduction applies to expenses paid for during the calendar year.

Qualified education expenses are those for books, supplies, equipment (including computers and software), and other materials used in the classroom. The expense must also be ordinary (common and accepted in the educational field) and necessary (helpful and appropriate in the taxpayer's educational profession). Expenses for home schooling or for nonathletic supplies for health or physical education courses do not qualify. The Protecting Americans from Tax Hikes (PATH) Act of 2015 further enhanced this deduction by allowing "professional development expenses" to qualify.

Professional development expenses cover courses related to the curriculum in which the educator provides instruction. This enhancement applies to tax years that began after 2015.

Expenses exceeding $250 and nonclassroom supplies may be deducted as an employment-related miscellaneous deduction subject to the 2% floor by eligible taxpayers who itemize. (See Chapter 5.)

[65] IRC § 71(f)(6).
[66] IRC § 62(a)(2)(D).
[67] IRC § 62(d)(1).

EXAMPLE 4-10

William and Lakeisha are married and will file a joint tax return. Both are eligible educators. William spent $420 on eligible expenses for his 4th grade class, and he received a $190 reimbursement from his school. Lakeisha spent $360 pertaining to her 11th grade science class and received no reimbursement. In total, the couple spent $780 and received reimbursement of $190, for a net expense of $590. However, William deduction is limited to his net expenses of $230 ($420 − $190), and Lakeisha's is limited to a maximum of $250. Thus the total deduction on their joint tax return is $480.

From Shoebox to Software Comprehensive Examples

In this section, we will add information to the tax returns of two taxpayers introduced in Chapter 3.

YIMING CHOW

Open the tax return file of Yiming Chow that you saved from Chapter 3. You are now going to add some information pertaining to the two *for* AGI deductions.

Moving Expense

Mr. Chow moved from Somewhere, Colorado, to Mytown, Georgia, on February 3, 2017, as a direct result of changing jobs. The distance between those two towns is 1,844 miles, and the distance from his old house to his old workplace was 27 miles. Beta Tech has continuously employed him in Mytown since his move. He paid the moving company $1,106 to move his belongings, including his auto, and spent another $319 in air travel and lodging expenses and $71 in meals pertaining to his move. His employer reimbursed him $842 for the move.

To properly report Mr. Chow's moving expense deduction, you need to perform the following steps:

Modify the W-2 information previously entered for Mr. Chow to reflect the newly created employer reimbursement. To do this, open his W-2. Go to box 12. Click on the code area of box 12 and highlight the P code. Then enter $842 in the amount box.

Go to the worksheets area and open the federal Form 3903 Distance and Time worksheet. You might first want to enter the information in the distance worksheet at the bottom of the form and then, if applicable, continue entering the remainder of the information.

Student Loan Interest Deduction

Mr. Chow also incurred $622 of interest expense pertaining to a federal student loan incurred while he was a student at State University in Colorado.

You must perform the following steps to report the student loan interest.

Open Mr. Chow's Form 1040.

Click on line 33. Then click on the yellow folder to open the supporting form. Alternatively, you could have opened the Student Loan Interest Deduction worksheet in the worksheet section.

On line 1 enter the $622 interest payment beside Mr. Chow's name.

Line 16 of the worksheet should now read $622. If you reopen Mr. Chow's Form 1040, the $622 deduction should be reflected on line 33.

After you have entered the moving expense and student loan interest data, Mr. Chow's AGI is $40,483 and his taxable income is $30,183. His total tax liability is $4,040. Because his total tax withholdings were $4,670, he should now receive a refund of $630 (rather than having a refund of $450 as determined in Chapter 3).

As mentioned, Mr. Chow now reports on Form 1040 rather than the 1040A that he was able to use in Chapter 3. This is so because Form 1040A does not accommodate a moving expense deduction. The tax software automatically chose the proper reporting form.

When you have finished, remember to save Mr. Chow's tax return for use in later chapters.

JOSE AND MARIA RAMIREZ

Open the tax return file of Mr. and Mrs. Ramirez that you saved from Chapter 3. You will now add some information pertaining to alimony. Remember that for now we are assuming the standard deduction for the Ramirezes.

Mr. Ramirez pays alimony of $150 per month to his former wife (her SSN is 412-34-5666). He paid 12 payments during the year. To record the alimony payments in the tax software, perform the following steps:

Open the Ramirezes' tax return and then open their Form 1040.

Go to the form's worksheet tab and bring up the Alimony Paid Adjustment worksheet.

On the worksheet, enter $6,000 as the amount of alimony paid by Jose and enter his ex-wife's SSN.

Open the Ramirezes' Form 1040. The $1,800 alimony payment is on line 31a and the ex-wife's SSN is on the adjacent dotted line.

After you have entered the alimony information, the AGI of the Ramirezes is $110,048. Their taxable income is $77,098, and their total tax liability is $10,373. After the child tax credit of $3,000, and income tax withheld of $9,418, they will receive a refund of $2,045.

When you have finished, make sure you save the Ramirezes' tax return for use in later chapters.

CONCEPT CHECK 4-8—
LO 4-8

Please fill in the blanks with the best answer(s).

1. To be eligible for the deduction, an educator must work at least ____________ hours in the job.
2. The maximum deduction for a couple who are both eligible educators and married filing jointly is ____________.
3. Expenses for ____________ and ____________ do not qualify for this deduction.

Summary

LO 4-1: Describe the tax rules for student loan interest.

- Only interest on a *qualified* student loan is potentially deductible.
- A *qualified* loan is one used solely to pay for qualified education expenses.
- The deduction for student loan expense may be limited based on the modified AGI of the taxpayer.

LO 4-2: Be able to determine eligibility requirements and applicable dollar limits related to the Health Savings Account deduction.

- A Health Savings Account (HSA) is a tax-exempt savings account used to pay for qualified medical expenses.
- To be eligible for an HSA, the taxpayer must be self-employed, an employee (or spouse) of an employer with a high-deductible health plan, or an uninsured employee who has purchased a high-deductible policy on his or her own.
- Distributions from an HSA are tax-free as long as they are used to pay for qualified medical expenses.

LO 4-3: Determine the deduction for moving expenses.

- If a taxpayer moves due to a change in employment location, certain expenses related to moving may be deducted.
- The costs of moving goods and people from the old residence to the new residence are considered suitable expenses.
- The deductibility of moving expenses is subject to employment, time, and distance tests.

LO 4-4: Explain the deduction for half of self-employment taxes.

- Self-employed individuals pay both halves of the FICA tax. For 2017 self-employed individuals will pay self-employment tax of 15.3%, unless their income is above the threshold for their filing status that requires them to pay the additional 0.9% Medicare tax on their earnings, effectively raising their Medicare tax on earnings from 1.45% to 2.35%.
- The amount related to the employer's portion of the self-employment tax that is a *for* AGI (above-the-line deduction) deduction remains at 7.65% of self-employment income for 2017.
- The tax is based on the *net* earnings from self-employment.

LO 4-5: Discuss the self-employed health insurance deduction.

- Self-employed individuals may be able to deduct 100% of self-employed health insurance premiums.
- The amount of the deduction may be limited by two factors:
  - Self-employed individuals cannot take a deduction in excess of the *net* earnings from self-employment.
  - The amount is a function of the availability of other health insurance coverage.

LO 4-6: Explain the penalty on early withdrawal of savings.

- A taxpayer who withdraws funds early from a time deposit account may be subject to an early withdrawal penalty.
- The amount of the penalty is reported on a Form 1099-INT issued by the financial institution.

LO 4-7: Be able to calculate the deduction for alimony paid.	• Alimony is one of three potential payments that can exist in a divorce or legal separation. • Of the three, only alimony has a tax consequence. • If payments properly qualify as alimony, they are deductible by the payer as a *for* AGI (above-the-line) deduction. • The recipient (the payee) of the payments must include these payments as income on his or her tax return. • When dealing with the character of payments in a divorce, it is important to use the "substance over form" rule.
LO 4-8: Determine the deduction for educator expenses.	• Educators may be able to deduct up to $250 of qualified out-of-pocket expenses paid in 2017. • If both spouses are eligible educators and file a joint return, each may deduct up to $250. • Qualified educators who work at least 900 hours during the school year are eligible to take the deduction. • Qualifying expenditures include classroom supplies such as paper, pens, glue, scissors, books, and computers as well as professional development expenses cover courses related to the curriculum in which the educator provides instruction.

Discussion Questions

All applicable Discussion Questions are available with ***Connect***©

EA LO 4-1 1. What is a qualified education loan for purposes of the student loan interest deduction?

EA LO 4-1 2. What are qualified education expenses for purposes of the student loan interest deduction?

EA LO 4-1 3. For purposes of the student loan interest deduction, what is modified AGI, and how is it determined?

EA LO 4-1 4. For purposes of the student loan interest deduction, what is an eligible educational institution?

EA LO 4-1 5. Explain the limitations associated with the deductibility of student loan interest.

EA LO 4-1 6. In 2013 Chara incurred a loan to pay for qualified higher education expenses for her 20-year-old grand daughter, who was a dependent. In 2017 her grand daughter graduated from college, moved away to start a new job, and ceased to be a dependent on Chara's tax return. Chara started making payments on the loan in 2017. Without regard to any modified AGI limitations, is Chara permitted to deduct interest on the loan?

EA LO 4-2 7. Explain the purpose of a Health Savings Account (HSA).

EA LO 4-2 8. What are the qualifications to be eligible for a Health Savings Account (HSA) deduction?

EA LO 4-2 9. What are the consequences of an *employer* contribution to an employee's HSA?

EA LO 4-3 10. Explain the three tests associated with deductibility of moving expenses.

EA LO 4-3 11. Describe the types of expenses that can be deducted for moving expenses.

EA LO 4-3 12. A taxpayer incurs moving expenses in conjunction with a job-related move that meets the distance test. At the end of the year, the taxpayer has not yet met the time test. Under what circumstances can the taxpayer deduct the moving expenses?

EA LO 4-3 13. Rica quit her job in Austin, TX, and moved to Seattle, WA, incurring $1,500 of moving expenses. Upon arriving in Seattle, she sought employment and found a position three weeks later. Without regard to the time test, what amount, if any, of her moving expenses can Rica deduct?

EA LO 4-3 14. In January 2017 Tran incurred $1,200 of moving expenses when he moved from Des Moines, IA, to Detroit, MI. When he moved, he had no job but found one a week after moving. He stayed on that job for two months, changed to another job for four months, and changed again to a long-term position that he held for the remainder of the year. What is the amount of moving expense deduction Tran can report in 2017, if any?

EA LO 4-4 15. Explain why self-employed taxpayers generally pay double the amount of FICA taxes that regular wage earners do.

EA LO 4-4 16. Refer to Question 15. How does the tax code attempt to remedy this seeming inequity?

EA LO 4-5 17. Explain the two limitations associated with the deduction for health insurance by self-employed individuals.

EA LO 4-6 18. What is meant by a *penalty on early withdrawal of savings,* and under what circumstances is it deductible?

EA LO 4-7 19. Define *alimony, child support,* and *property settlement.*

EA LO 4-7 20. Why is it important to distinguish between a property settlement and alimony?

EA LO 4-8 21. Who is eligible to take an above-the-line AGI deduction for educator expenses, and what is the maximum amount of the permitted deduction?

EA LO 4-8 22. What expenses qualify as deductible educator expenses?

EA LO 4-8 23. In the case of a joint return, what is the treatment of educator expenses?

Multiple-Choice Questions connect

All applicable multiple-choice questions are available with ***Connect***©

EA 24. (Introduction) *For* AGI, or above-the-line, deductions

a. Are determined by the taxpayer.
b. Are set by statute.
c. Increase tax liability.
d. Are reported in Schedule A.

EA 25. (Introduction) *For* AGI, or above-the-line, deductions

a. Increase AGI.
b. Reduce tax credits.
c. Are available only for married filing jointly.
d. Can reduce overall tax liability.

EA LO 4-1 26. Student loan interest is reported on Form

a. 1098-SA.
b. 1098-E.
c. 1099-S.
d. 1098-GA.

EA LO 4-1 27. Taxpayers eligible to take the student loan interest deduction do *not* include

a. A student who is claimed as a dependent on another's return.
b. A self-supporting student.
c. The parents of a dependent student who took out the loan on their child's behalf.
d. A married student filing jointly.

EA LO 4-1 28. In 2013 through 2016, Korey, who is single, borrowed a total of $25,000 for higher education expenses on qualified education loans. In 2017, while still living at home and being claimed by his parents as a dependent, he began making payments on the loan. The first year's interest on the loan was reported as $550, and his AGI for the year was less than $65,000. The amount that Korey can claim on his tax return is

a. $0.
b. $225.
c. $340.
d. $550.

EA LO 4-2 29. For 2017 the maximum aggregate annual contribution that a taxpayer, under age 55, can make to an HSA for *family coverage* is

a. $1,300.
b. $3,350.
c. $6,750.
d. $13,100.

EA LO 4-2 30. To be eligible to fund a Health Savings Account (HSA), a taxpayer must meet which of the following criteria:

a. An employee (or spouse) who works for an employer with a high-deductible health plan.
b. An uninsured employee who has purchased a high-deductible health plan on his or her own.
c. A self-employed individual.
d. Any of the above.

EA LO 4-3 31. To be eligible to deduct moving expenses, a taxpayer

a. Must meet the time test.
b. Must meet the distance test.
c. Must meet one of the change of job location, time, or distance tests.
d. Must meet all three of the change of job location, time, and distance tests.

EA LO 4-3 32. Deductible expenses for moving do *not* include

a. The cost of transporting household goods.
b. Hotel costs while moving to the new location.
c. Meals incurred during the move.
d. Storage of household goods for a limited time upon arrival at the new location.

EA LO 4-3 33. To meet the distance test, the new job location must be

a. 100 miles from the old job location.
b. At least 50 miles farther than the old residence was from the old job location.
c. At least 50 miles farther than the new residence from the old job location.
d. 100 miles from the old residence.

EA LO 4-4 34. The deduction for half of the self-employment tax is

a. Based on a total of 7.65% of FICA taxes.
b. Based on the gross earnings of the business.
c. Based on filing status.
d. Based on the net earnings of the business.

EA LO 4-5 35. As a *for* AGI deduction, self-employed health insurance premiums are deductible at

a. 50%.
b. 70%.
c. 80%.
d. 100%.

EA LO 4-5 36. Shana is a self-employed carpenter who had net earnings from self-employment of $3,500. She paid $325 per month for health insurance over the last year. Shana is entitled to a *for* AGI deduction for health insurance of

a. $0.
b. $325.
c. $3,500.
d. $3,900.

EA LO 4-6 37. Penalties for the early withdrawal of savings are reported by the financial institution on
- *a.* Box 2 of Form 1099-INT.
- *b.* Form EWIP.
- *c.* A letter of notification.
- *d.* None of the above.

EA LO 4-7 38. Mia is required under a 2016 divorce decree to pay $600 of alimony and $300 of child support per month for 12 years. In addition, Mia makes a voluntary payment of $100 per month. How much of each total monthly payment can Mia deduct in 2017?
- *a.* $100.
- *b.* $300.
- *c.* $600.
- *d.* $700.

EA LO 4-7 39. The Renfros were granted a decree of divorce in 2016. In accordance with the decree, Josh Renfro is to pay his ex-wife $24,000 a year until their only child, Evelyn, now 10, turns 18, and then the payments will decrease to $14,000 per year. For 2017, how much can Josh deduct as alimony in total?
- *a.* $10,000.
- *b.* $14,000.
- *c.* $24,000.
- *d.* None of the above.

EA LO 4-7 40. At the beginning of June 2017, Julia left her husband and is currently living in an apartment. The couple has no children. At the end of the current year, no formal proceedings have occurred in relation to the separation or potential divorce. Julia has been making a $2,000 a month maintenance payment since moving out. How much can Julia deduct in total as alimony for 2017?
- *a.* 0.
- *b.* $2,000.
- *c.* $12,000.
- *d.* $24,000.

EA LO 4-8 41. Which of the following items does not qualify as an educator expense item deduction?
- *a.* Books.
- *b.* Home schooling expenses.
- *c.* Computers and software.
- *d.* Professional development expenses related to the curriculum.

EA LO 4-8 42. Under current tax law, the deductible amount for expenses under the educator expense deduction is limited per taxpayer to:
- *a.* $100.
- *b.* $150.
- *c.* $200.
- *d.* $250.

Problems connect

All applicable problems are available with ***Connect***©

EA LO 4-1 43. What are some of the limitations concerning deductibility of student loan interest? Be specific and comprehensive.

EA LO 4-1 44. Discuss the characteristics of an *eligible educational institution* as it relates to the deductibility of student loan interest.

EA LO 4-1 45. Zach attended Champion University during 2012–2016. He lived at home and was claimed by his parents as a deduction during his entire education. He incurred education expenses of $10,000 during college of which $2,000 was paid for by scholarships. To finance his education, he borrowed $7,000 through a federal student loan program and borrowed another $3,000 from a local lending institution for educational purposes. After graduation, he married and moved with his spouse to a distant city. In 2017 he incurred $700 of interest on the federal loans and $300 on the lending institution loan. He filed a joint return with his spouse showing modified AGI of $128,000. What amount of student loan interest can Zach and his spouse deduct in 2017, if any?

EA LO 4-2 46. If an employer contributes to an HSA on behalf of an employee,

a. Is the contribution deductible by the employee?

b. Is the payment considered income to the employee?

EA LO 4-3 47. Fabian, a single account executive, was employed and resided in New Mexico. On July 1, 2017, his company transferred him to Florida. Fabian worked full time for the entire year. During 2017 he incurred and paid the following expenses related to the move:

Pre-move house-hunting costs	$1,500
Lodging and travel expenses (not meals) while moving	1,800
Cost of moving furniture and personal belongings	2,700

He did not receive reimbursement for any of these expenses from his employer; his AGI for the year was $85,500. What amount can Fabian deduct as moving expenses on his 2017 return?

EA LO 4-3

48. In May 2017 Regina graduated from USC with a degree in accounting and moved to Portland, OR, to look for work. Shortly after arriving in Portland, she obtained work as a staff accountant in a local CPA firm. In her move to Portland, Regina incurred the following costs:

    $275 in gasoline.
    $250 for renting a truck from UPAYME rentals.
    $100 for a tow trailer for his car.
    $85 in food.
    $25 in double espressos from Starbucks.
    $300 for motel lodging on the way to Portland.
    $405 for a previous plane trip to Portland to look for an apartment.
    $175 in temporary storage costs for her collection of crystal figurines.

    How much, if any, may Regina take as a moving expense deduction on her 2017 tax return? Is that deduction subject to any conditions that could change its deductibility in the future?

EA LO 4-3

49. Are the moving expenses of other people besides the taxpayer deductible? If so, what are the requirements for deductibility?

EA LO 4-4, 4-5

50. Juan, who is single, is a self-employed carpenter as well as an employee of Frame It, Inc. His self-employment net income is $35,000, and he received a W-2 from Frame It for wages of $25,000. He is covered by his employer's pension plan, but his employer does not offer a health plan in which he could participate.

    a. Up to how much of his self-employed health insurance premiums could he deduct for this year, if any? Why?

    b. How much of Juan's self-employment taxes would be deductible?

EA LO 4-6

51. Chantel has received a 1099-INT from her financial institution showing $75 in box 2 of the form. How should she handle this on her 2017 tax return and why?

EA LO 4-7

52. Three types of payments are associated with a decree of separation or a divorce.

    a. What are those three payments?

b. Which one has a tax consequence?

c. What is the timing rule regarding the recapture period of those payments?

EA LO 4-7 53. Under the terms of a divorce decree executed May 1, 2017, Ahmed transferred a house worth $650,000 to his ex-wife, Farah, and was to make alimony payments of $3,000 per month. The property has a tax basis to Ahmed of $300,000.

a. How much of this must be reported on Farah's tax return?

b. Of that amount, how much is taxable gain or loss that Farah must recognize related to the transfer of the house?

EA LO 4-7 54. Under the alimony recapture rules, what amounts are designated for recapture reclassification, and what are the tax consequences?

EA LO 4-1–4-7 55. Indicate whether each of the following items is considered a *for* AGI (above-the-line) deduction for the 2017 tax year:

a. Student loan interest.
b. Gambling losses.
c. Early withdrawal penalty.
d. Child support payments.
e. Charitable contributions.
f. One-half of self-employment taxes.
g. Alimony.
h. Scholarships for tuition and books.
i. Moving expenses.
j. Property taxes.
k. Self-employed health insurance premiums.

Tax Return Problems

All applicable tax return problems are available with ***Connect***©

Use your tax software to complete the following problems. If you are manually preparing the tax returns, you will need a Form 1040 and associated schedules for each problem.

Tax Return Problem 1

Jason Ready attended the University of San Diego during 2013–2017. He incurred education expenses of $10,000 in total for his education, and $1,500 of that amount was incurred in 2017 for his last semester. To finance his education, he borrowed $7,000 through a federal student loan program and borrowed another $3,000 from SoCal Credit Union for educational purposes. After graduation, he accepted a position with the Portland office of KPMG and moved there in May 2017. He lives at 4560 Ranch Drive, Portland, OR 97035. His social security number is 412-34-5670 (date of birth 7/10/1995). Jason had qualifying health care coverage at all times during the tax year.

His W-2 contained the following information:

Wages (box 1) =	$67,533.05
Federal W/H (box 2) =	$ 8,994.95
Social security wages (box 3) =	$67,533.05
Social security W/H (box 4) =	$ 4,187.05
Medicare wages (box 5) =	$67,533.05
Medicare W/H (box 6) =	$ 979.23

In moving to Portland, he incurred the following moving expenses:

$495 in gasoline.

$295 for renting a truck from IGOTYA rentals.

$125 in food.

$465 for motel lodging on the way to Portland.

He also received two Forms 1098-E. One was from the federal student loan program, which showed $450 of student loan interest; the other was from SoCal Credit Union and showed $150.75 of student loan interest.

Prepare a Form 1040, a Form 3903, and a Form 8917. If manually preparing the return, the Student Loan Interest Deduction worksheet can be found in IRS Publication 970, Tax Benefits for Education.

Tax Return Problem 2

In June 2017 Phillip and Barbara Jones and their two dependent children, who are both over 17, moved from Chicago to Albuquerque, New Mexico, a distance of 1,327 miles, which they drove in their own car. The children's names are Roger and Gwen and both will be attending the University of New Mexico in the fall, Roger as a freshman and Gwen as a junior. The move was a result of a job transfer for Phillip. The distance from their old home to Phillip's old office was 30 miles. Barbara quit her job in Chicago and decided to perform volunteer work for a year before seeking further employment. Phillip and Barbara incurred expenses of $4,550 to the moving company (which included $320 for temporary furniture storage), hotel charges of $550, and meals of $712 en route from Chicago to Albuquerque. Their new home is located at 7432 Desert Springs Way, Albuquerque, NM 87101. Phillip, but not Barbara, was employed in the new location throughout the year. Phillip's social security number is 412-34-5670 (date of birth 6/12/1975), Barbara's is 412-34-5671 (date of birth 8/12/1977), Roger's is 412-34-5672 (date of birth 2/17/2000), and Gwen's is 412-34-5673 (date of birth 9/14/1998). The Joneses had qualifying health care coverage at all times during the tax year.

Phillip is a civil engineer for a national firm; his W-2 contained the following information:

Wages (box 1) = $110,220.45
Federal W/H (box 2) = $ 11,015.42
Social security wages (box 3) = $110,220.45
Social security W/H (box 4) = $ 6,833.67
Medicare wages (box 5) = $110,220.45
Medicare W/H (box 6) = $ 1,598.20

Employer moving expense reimbursement

(box 12, Code P) = $ 5,000.00

In addition, both he and Barbara received Forms 1098-E from the federal student loan program. Phillip had student loan interest of $1,050, and Barbara had student loan interest of $750.

Prepare a Form 1040 for Phillip and Barbara as well as Form 3903. If manually preparing the return, the Student Loan Interest Deduction worksheet can be found in IRS Publication 970, Tax Benefits for Education.

Tax Return Problem 3

Kathy and Rob Wright obtained a divorce effective May 1, 2017. In accordance with the divorce decree, Rob was required to pay $2,250 per month until their only child turns 18; then the payments would be reduced to $1,500 per month. Kathy has full custody of the child and appropriately takes the dependent deduction and child credit. Furthermore, Rob was to transfer title of their house, which had a cost of $150,000 and a fair value of $200,000 on the date of transfer, to Kathy and was to continue making the monthly mortgage payments of $1,235 on behalf of Kathy. Rob works for a large oil distributor in Santa Fe, NM, and after the divorce lives at 1132 Northgate Avenue, Santa Fe, NM 87501. Rob's social security number is 412-34-5671 (date of birth 11/4/1983), and Rob's social security number is 412-34-5670 (date of birth 8/14/1980). Rob had qualifying health care coverage at all times during the tax year.

His W-2 contained the following information:

Wages (box 1) = $85,100.25
Federal W/H (box 2) = $ 7,325.24
Social security wages (box 3) = $85,100.25
Social security W/H (box 4) = $ 5,276.22
Medicare wages (box 5) = $85,100.25
Medicare W/H (box 6) = $ 1,233.95

He also received a Form 1099-INT from First New Mexico Bank with $336 of interest income in box 1. In addition, Rob made a timely $2,500 contribution to his new HSA account.

Prepare a Form 1040 and a Form 8889 for Rob.

We have provided selected filled-in source documents that are available in the *Connect Library.*