

Individual Taxation: Part 1

Module

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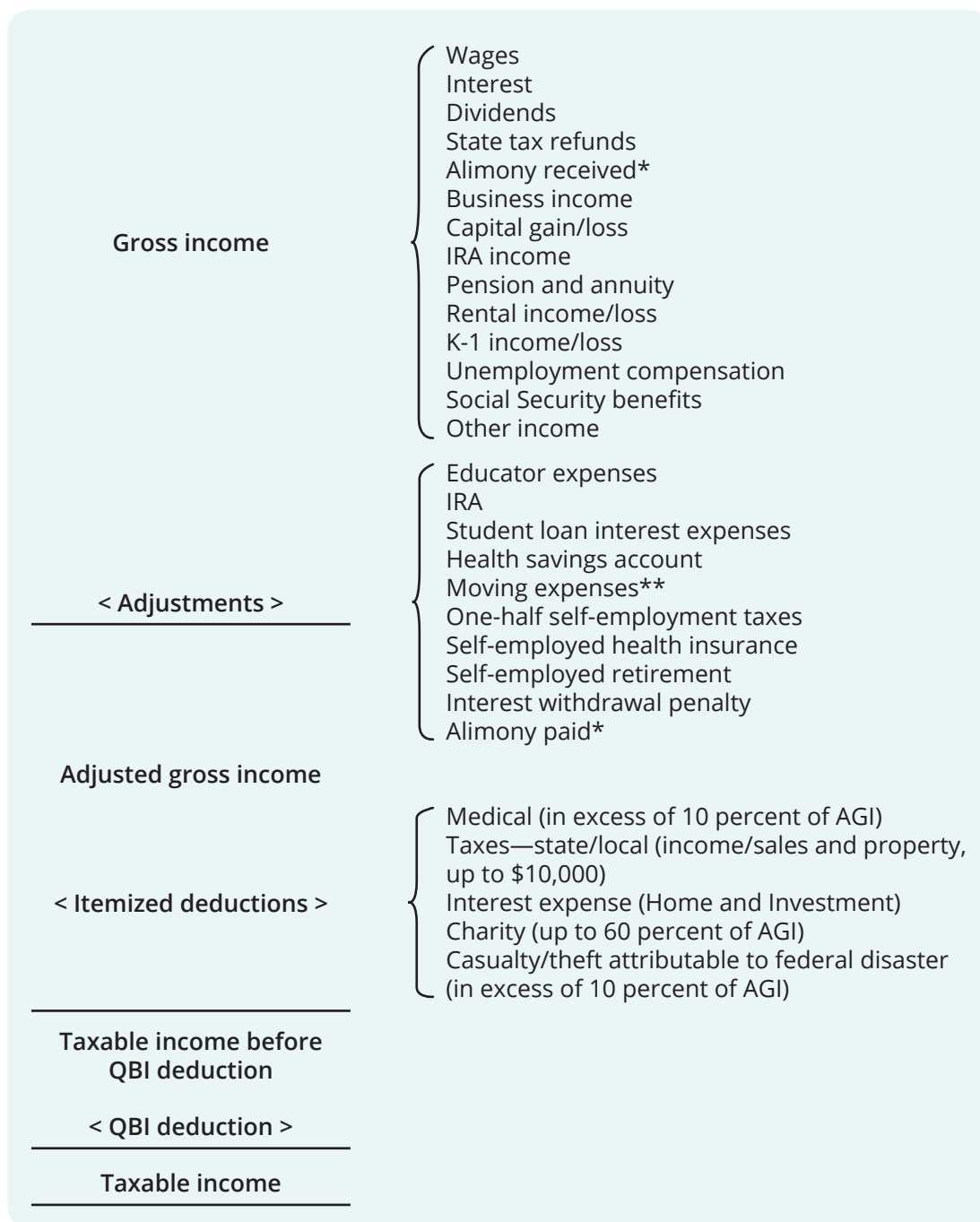
1 Individual Income Tax Formula

This module begins the discussion of individual income tax. The formula below provides a summary of the calculation of taxable income and federal income tax liability or refund for individuals. Ultimately, these items are reported on the individual income tax return, Form 1040.

$$\begin{array}{r}
 \text{Gross income} \\
 \text{< Adjustments >} \\
 \hline
 \text{Adjusted gross income} \\
 \left. \begin{array}{l} \text{< Standard deduction >} \\ \text{Or} \\ \text{< Itemized deductions >} \end{array} \right\} \\
 \hline
 \text{Taxable income before QBI deduction} \\
 \text{< QBI deduction >} \\
 \hline
 \text{Taxable income} \\
 \hline\hline
 \\
 \text{Federal income tax} \\
 \text{< Tax credits >} \\
 \text{Other taxes} \\
 \text{< Payments >} \\
 \hline
 \text{Tax due Or Refund} \\
 \hline\hline
 \end{array}$$

2 Taxable Income Formula for Individuals

Taxable income is the base for the individual income tax. The formula below demonstrates the calculation of taxable income for individual taxpayers.



*Under the Tax Cuts and Jobs Act (TCJA) for all divorce or separation agreements executed after 12/31/18, alimony received will not be included in gross income and alimony paid cannot be deducted.

**Only for members of the armed forces moving pursuant to military order.

3 Filing Requirements for Individuals

3.1 Who Must File?

The first consideration when thinking about individual taxation is who must file a tax return. Generally, a taxpayer must file a return if his or her income is equal to or greater than the sum of:

1. the regular standard deduction (except for married filing separately), plus
2. the additional standard deduction amount for taxpayers age 65 or older or blind (except for married persons filing separately).

3.2 When to File

3.2.1 Due Date—April 15

Individual taxpayers must file on or before the 15th day of the fourth month following the close of the taxpayer's taxable year, which is April 15.

3.2.2 Extension

- **Automatic Six-Month Extension to October 15:** An automatic six-month extension (until October 15) is available for those taxpayers who are unable to file by the April 15 due date. The automatic six-month extension is not an extension for the payment of any taxes owed. Although granted automatically, the six-month extension must be requested by the taxpayer by filing Form 4868 by April 15.
- **Payment of Tax:** Even with an extension, the due date for payment of taxes remains April 15.

4 Filing Status

4.1 Single (Use the End-of-Year Test)

You are considered unmarried for the whole year if, on the last day of your tax year, you are either: unmarried or legally separated.

4.2 Joint Returns (Use the End-of-Year Test)

In order to file a joint return, the parties must be married at the end of the year, living together in a legally recognized common law marriage, or married and living apart (but not legally separated or divorced).

- If married during the year, a joint return may be filed, provided the parties are married at year-end. This includes same-sex couples legally married under state law (as a result of the Supreme Court case *Obergefell v. Hodges* (2015), same-sex couples have the right to marry in all states).
- If divorced during the year, a joint return may not be filed.
- If one spouse dies during the year, a joint return may be filed.

4.3 Married Filing Separately

A married taxpayer may file a separate return even if only one spouse has income for the year. In a separate property state, spouses who elect to file using the married filing separately status must separately report their own income, credits, and deductions on their own individual income tax returns. In a community property state, most of the income, deductions, credits, etc., are split 50/50.

4.4 Qualifying Widow(er) With Dependent Child

- **Two Years After Spouse's Death:** A qualifying widow(er) is a taxpayer who may use the joint tax return standard deduction and rates for each of two taxable years following the year of death of his or her spouse, unless he or she remarries. In the event of a remarriage, the surviving spouse will file a tax return (joint or separate) with the new spouse.
- **Principal Residence for Dependent Child:** The surviving spouse must pay over half the cost of maintaining a household where a dependent child lives for the whole taxable year. The dependent child must be a child (including an adopted child but not a foster child) or stepchild of the surviving spouse.

4.5 Head of Household

Head of household status entitles certain taxpayers to pay lower taxes. The lower tax results from a larger standard deduction and "wider" tax brackets.

To qualify, the following conditions must be met:

1. The individual is unmarried, legally separated, or married and has lived apart from his or her spouse for the last six months of the year as of the close of the taxable year.
2. The individual is not a "qualifying widow(er)."
3. The individual is not a nonresident alien.
4. The individual maintains as his or her home a household that, for more than half the taxable year, is the principal residence of a qualifying person, including a dependent child, parent, or relative (as discussed below).

4.5.1 A Qualifying Child

Child, stepchild, legally adopted child, foster child, brother or sister, or a descendant of one of these who meets the definition of a dependent under the qualifying children rules.

4.5.2 Father or Mother (Not Required to Live With Taxpayer)

A dependent parent is not required to live with the taxpayer, provided the taxpayer maintains a home that was the principal residence of the parent for the entire year. Maintaining a home means contributing over half the cost of upkeep. This means rent, mortgage interest, property taxes, insurance, utility charges, repairs, and food consumed in the home.

4.5.3 Dependent Relatives (Must Live With Taxpayer)

Grandparents, brothers, sisters, aunts, uncles, nephews, and nieces (as well as stepparents, parents-in-law, sisters-in-law, or brothers-in-law) qualify as relatives. A dependent relative (other than a father or mother) must live with the taxpayer. Note that cousins, foster parents, and unrelated dependents do not qualify.

4.5.4 Summary of Who Meets Head-of-Household Qualifying Person Requirement

	Qualifying Dependent	Lives With Taxpayer
Child or descendant	Yes	Yes
Parents	Yes	No
Relative	Yes	Yes



Pass Key

In order to avoid confusing the required time period for different filing statuses, just remember:

- **Widow/widower** = Must be principal residence for dependent child for **whole** year.
- **Head of household** = Must be principal residence for qualifying person for more than **half** a year.

5 Dependency Definitions

Certain tax benefits, such as an advantageous filing status or certain tax credits, require either a qualifying child or qualifying relative. Each category has requirements:

Qualifying Child	Or	Qualifying Relative
Close relative		Support test
Age limit		Under a specific amount of (taxable) gross income test
Residency and filing requirements		Precludes dependent filing a joint tax return test
Eliminate gross income test		Only citizens (residents of US/Canada or Mexico) test
Support test		Relative test
		Or
		Taxpayer lives with individual for whole year test

Taxpayers must obtain a Social Security number for any dependent who has attained the age of one as of the close of the tax year.



Pass Key

A taxpayer will be entitled to a family tax credit for anyone whom a taxpayer "**CARES**" for, or whom they "**SUPPORT**," even if the dependent:

- was born during the year; or
- died during the year.

5.1 Qualifying Child

If the parents of a child are able to claim the child but do not, no one else may claim the child unless that taxpayer's AGI is higher than the AGI of the highest parent.

In general, a child is a qualifying child of the taxpayer if the child satisfies the following:

- 1. Close Relative**

Under the close relationship test, to be a qualifying child of a taxpayer, the child must be the taxpayer's son, daughter, stepson, stepdaughter, brother, sister, stepbrother, stepsister, or a descendant of any of these. An individual legally adopted by the taxpayer, or an individual who is lawfully placed with the taxpayer for legal adoption by the taxpayer, is treated as a child of the taxpayer. A foster child who is placed with the taxpayer by an authorized placement agency or by judgment, decree, or other order of any court of competent jurisdiction also is treated as the taxpayer's child.
- 2. Age Limit**

The age limit test varies depending on the benefit. In general, a child must be younger than the taxpayer, and under age 19 (or age 24 in the case of a full-time student) to be a qualifying child (although no age limit applies with respect to individuals who are totally and permanently disabled at any time during the tax year). A "full-time" student is a student who attends an educational institution for at least part of each of five months during the taxable year. An "educational institution" is one that maintains full-time faculty and a daytime program. School attendance only at night does not qualify.
- 3. Residency and Filing Requirements**

Under the residency and filing requirement tests, a child must have the same principal place of abode as the taxpayer for more than one half of the tax year. The child also must be a citizen of the United States or a resident of the United States, Canada, or Mexico. Furthermore, the child cannot file a joint tax return for the year (unless it was filed only for a refund claim).
- 4. Eliminate Gross Income Test**

The gross income test (see **SUPPORT**) does not apply to a qualifying child.
- 5. Support Test**

The qualifying child must not have contributed more than half of his or her own support. Support means the actual expenses incurred by or on behalf of the dependent. Scholarships received by a dependent student child or stepchild are not included in determining the student's total support. However, Social Security and state welfare payments are included in the dependent's total support, but only to the extent that such amounts are actually expended for support purposes.

5.2 Qualifying Relative

Taxpayers can apply the **SUPPORT** rules to determine whether an individual meets the qualifying relative rules. In general, an individual is a qualifying relative of the taxpayer if the individual satisfies the following:

1. **Support Test**

The taxpayer must have supplied more than one half (greater than 50 percent) of the support of a person in order to claim him or her as a qualifying relative. The same definition of support as related to a qualifying child applies.
2. **Under Gross Income Limitation**

A person may not be claimed as a qualifying relative unless the qualifying relative's gross income is less than \$4,200 (for 2019).

 - **Definition of Taxable Income:** Only income that is taxable is included for the purpose of the gross income limitation.
 - **Nontaxable Income**
 - Social Security (at low income levels)
 - Tax-exempt interest income (state and municipal interest income)
 - Tax-exempt scholarships
3. **Precludes Dependent Filing a Joint Return**

A taxpayer does not meet the definition of qualifying relative if the taxpayer is a married dependent who files a joint return, unless there is no tax liability on the couple's joint return and there would not have been any tax liability on either spouse's tax return if they had filed separately.
4. **Only Citizens of the United States or Residents of the United States, Mexico, or Canada**

The qualifying relative must be either a citizen of the United States or a resident of the United States, Mexico, or Canada.
5. **Relative**

Children, grandchildren, parents, grandparents, brothers, sisters, aunts and uncles, nieces and nephews (as well as stepchildren, stepparents, stepbrothers or stepsisters, in-laws) can meet the definition of qualifying relative. Children include legally adopted children, foster children, and stepchildren. Foster parents and cousins must live with the taxpayer the entire year.

Remember: A child born at any time during the year will qualify as a relative for qualifying-child or qualifying-relative purposes.

Or:
6. **Taxpayer Lives With the Individual (if Non-relative) for the Whole Year**

A non-relative member of a household (i.e., a person living in the taxpayer's home for the entire year) may be considered a qualifying relative provided the taxpayer's relationship with that person does not violate local law. Foster parents and cousins must live with the taxpayer the entire year because they are not regarded as relatives.

5.3 Multiple Support Agreements

Where two or more taxpayers together contribute more than 50 percent to the support of a person but none of them individually contributes more than 50 percent, the contributing taxpayers, all of whom must be qualifying relatives of (or lived the entire year with) the individual, may agree among themselves which contributor may claim the individual as a dependent for tax benefits.

- A contributor must have contributed more than 10 percent of the person's support in addition to meeting the other dependency tests in order to be able to claim him or her as a dependent.
- The joint contributors are required to file a multiple support declaration, Form 2120.

Example 1 **Multiple Support Agreement**

Facts: Peter, who is single and lives alone in Idaho, has no income of his own and is supported in full by the following people:

	Amount of Support	Percent of Total
Tim (an unrelated friend)	\$2,400	48
Angie (Peter's sister)	2,150	43
Mike (Peter's son)	<u>450</u>	<u>9</u>
	<u>\$5,000</u>	<u>100%</u>

Required: Under a multiple support agreement, Peter is considered a dependent of which of the following:

- a. No one
- b. Tim
- c. Angie
- d. Mike

Solution: Peter only meets dependency definition requirements for Angie.

	Tim	Angie	Mike
Support test	Yes	Yes	No
Under gross income	Yes	Yes	
Preclude joint filing	Yes	Yes	
Only U.S. citizens	Yes	Yes	
Relative, or	No	Yes	
Taxpayer lived with	No	N/A	

5.4 Children of Divorced Parents

- **General Rule (Custodial Parents):** Generally, the parent who has custody of the child for the greater part of the year qualifies to use the child as a dependent for tax benefit purposes (determined by a "time" test, not the divorce decree). It does not matter whether that parent actually provided more than one-half of the child's support. If the parents have equal custody during the year, the parent with the higher adjusted gross income will claim the tax benefits related to the dependent.

Question 1**MCQ-01404**

Which of the following is (are) among the requirements to enable a taxpayer to be classified as a "qualifying widow(er)"?

- I. A dependent has lived with the taxpayer for six months.
 - II. The taxpayer has maintained the cost of the principal residence for six months.
- a. I only.
 - b. II only.
 - c. Both I and II.
 - d. Neither I nor II.

Question 2**MCQ-06433**

Mark and Molly met at a New Year's Eve party held December 31, Year 1. They instantly bonded, fell madly in love, and were married at 11:38 p.m. that night. Identify Mark's filing status for Year 1.

- a. Single
- b. Married filing jointly
- c. Head of household
- d. Surviving spouse

NOTES
