

**RTRP Exam**  
**100 Key Points to Remember**  
**(Learning 5 a Day Will Keep a Failing Score at Bay!)**

**Filing Rules: Requirements to File & Standard Deduction**

1. **Gross Income**- Gross income is defined as gross receipts less statutory exclusions from income (but *no* deductions, other than cost of goods sold); this is the number used in dependency tests and requirements to file a return.
2. **Standard Deduction** - The standard deduction for 2011 is \$5,800 (single or married-filing separately), \$11,600 (married-filing jointly or surviving spouse), or \$8,500 (head of household); additional amounts (\$1,150 on a joint return, \$1,400 on others) are available for each instance that the taxpayer and his or her spouse (but not dependents) are either age 65 or older or legally blind.
3. **Limits on Full Standard Deduction** - There are two instances where a full standard deduction is not guaranteed: (1) a taxpayer whose spouse has already filed and itemized must also itemize his or her deductions, regardless of amount, and (2) a person eligible to be claimed as a dependent of another has a standard deduction limited to the larger of (1) \$950, the minimum standard deduction, or (2) earned income plus \$300.
4. **Proper Form to File** - Strict conditions apply for the filing of either Form 1040EZ or 1040A (both of which must have taxable income less than \$100,000 and do not allow itemized deductions): (1) Form 1040EZ is limited to salary income, interest income less than \$1,500, some scholarships, and only the earned income tax credit; (2) Form 1040A allows dividend income and a wider variety of credits.
5. **Requirements to File** - The general rule for requirements to file a tax return, based on gross income, is to add the standard deduction (including bump-ups) and exemption deductions for a taxpayer and spouse (but no dependents); exceptions are (1) married-filing separately (\$3,700 gross income requirement), (2) eligible to be a dependent of another (\$950 unearned income), and self-employed (\$400 Schedule C income, but don't forget for more general rule that gross income test does not include expenses).

**Exemption Deductions, Filing Status, and Accounting Methods**

6. **General Rules for Exemption Deductions** - Personal exemption deductions (\$3,700 each) are available for taxpayer, spouse, and any dependent meeting five tests; a full exemption is available in year of death, and anyone eligible to be claimed by another person may not take his or her own exemption deduction.
7. **Five Tests for Dependency Exemptions** - The five tests for exemption deductions, with related exceptions, are: (1) *relationship by blood test* (unless individual lives with taxpayer entire year), (2) *gross income test* (\$3,700 limit unless child under age 19 or full-time student under age 24), (3) *support test* (actual amounts spent, but scholarships are ignored, and special rules for multiple-support agreements [10%] and children of divorced parents [custody parent]), (4) *filing status test* (no

joint return by dependent unless solely for refund with no gross tax due), and (5) *citizenship test* (unless part-year resident of Canada or Mexico).

8. **Filing Status – Single & Married – Filing Jointly** - Single filing status is simply unmarried (final decree, if divorced) at end of year or an abandoned spouse (not live with spouse last six months of the year, child in home any six months of the year); married filing jointly is married at the end of the year (includes common law; if marriage is annulled, amended returns required for ALL open tax years), married-jointly election binding by due date of return (married-separately may be changed within statute of limitations).
9. **Filing Status – Surviving Spouse & Head of Household** - Surviving spouse status if for two years following year of death, with a dependent child (use married-filing jointly rates and standard deductions); for head of household, must (1) be unmarried or an abandoned spouse, (2) provide over 50% of the household expenses, and (3) qualifying dependent lives with you the entire year (exceptions for parents living elsewhere, unmarried child need not be a dependent).
10. **Tax Year, Accounting Method, and Exceptions** - Taxpayers may use calendar or fiscal year (most use calendar year) and may elect cash or accrual basis (most cash basis); concepts overriding basis election include (1) *cash equivalent* (use FMV of goods or services received as income), (2) *constructive receipt* (income as soon as it can be reduced to taxpayer's possession, i.e., savings account interest), (3) *claim of right* doctrine (income at latest when received, even if in error (adjust later with deduction), and (4) *assignment of income* (income from services taxed to person performing the services, income from property taxed to legal owner of property).

## **Wages, Salary Income, and Fringe Benefits**

11. **Property, Services and Tip Income** - Property or services income recognized under cash equivalent doctrine, FMV becomes basis of property; cancellation of debt produces income (unless a gift), as does bargain purchase from employer (cost below employer's cost); tips of \$20 or more must be reported to employer (but all tips are taxable income).
12. **Statutory (Code-Sanctioned) Fringe Benefit Exclusions** - Unemployment compensation is fully taxable, but worker's compensation is not; other statutory exclusions from income include (1) employer provided health insurance premiums and benefits under the policy (unless disability pay for lost income), (2) first \$5,000 of child care payments, (3) first \$5,250 of educational assistance benefits, (4) first \$50,000 coverage of group-term life insurance coverage, (5) meals and lodging (if on business premises, for convenience of employer, and required to live there for lodging), (6) other miscellaneous exclusions (free tuition, service/safety awards to \$400 average, welfare and assistance plan payments).
13. **Code Sec. 132 Guidance for Other Fringe Benefits** - Code guidance for other non-statutory fringe benefits include (1) *no additional cost services* (flights, hotel rooms), (2) *courtesy discounts* (limited to employer gross profit on goods, 20% for services), (3) *working conditions benefits* (otherwise deductible, such as dues payments), (4) *de minimis benefits* (too small to count for, e.g., ham), (5) *transportation* (\$230 limit for parking or commuting, and \$230 limit for transit passes), (6) *company-offered athletic facilities* (on business premises), and (7) *company eating facilities* (if revenues cover costs).

## Interest & Dividend Income

14. **Interest Income in General** - Most interest, other than state or local obligation interest, is taxable, including property received for opening an account exceeding \$10, and some dividends are actually interest (e.g., co-ops, credit unions, mutual banks); interest may be imputed on below-market loans exceeding \$10,000 (or \$100,000 for certain family loans not reinvested).
15. **Interest on Joint Accounts & Frozen Accounts** - Interest on joint accounts taxed to the owner and interest on co-owned accounts taxed to purchaser, and interest on UGMA gifts to minors taxed to minor unless used for child's support; interest on state frozen deposits not taxable unless withdrawn.
16. **Interest on U.S. Savings Bonds** - U.S. Savings bond interest (discount) taxed as earned to accrual-basis taxpayer and only when cashed in, sold, or redeemed by electing cash-basis taxpayer (EEs may also be converted to HH to further postponed prior accrued interest, but not future interest on new bonds); a pro rata share of interest income on redemption is excludable if used based on percent of proceeds spent on qualifying educational expenses ((\$75,100-\$86,100 (S) or \$106,650-\$136,650 (MJ) phase-outs).
17. **Dividend Income in General** - Dividend distributions taxable (15% or 0% rate for "qualified") to extent of corporate earnings and profits, then tax-free recovery of basis, then capital gains; for property dividends, FMV of property is dividend income and becomes basis of property.
18. **Stock Dividends, Stock Rights and DRIPs** - Proportionate stock dividends and stock rights nontaxable (allocate portion of old basis and holding period to new); DRIP (dividend reinvestment plan) dividends taxable regardless of whether stock or cash is received, use FMV of stock to measure dividend, and this becomes basis of shares.

## Rental Income

19. **Rental Income – Taxability** - Prepaid rental income taxable when received (including "last month's rent"), as are lease cancellation payments and third-party payments by tenants, but deposits are not taxed until forfeited; leasehold improvements reverting to owner at end of lease are not taxable (unless in lieu of rent), and have a \$0 basis (unless taxed as rent).
20. **Vacation Rental Homes** - A vacation (second) home is taxed under one of three classifications: (1) *de minimis rule* (if rented less than 15 days, leave off return), (2) *insignificant personal usage* (< greater of 14 days or 10% of days rented) allows rental loss, subject to passive loss rules, or (3) *significant personal usage* (> larger of 14 days or 10% of days rented), allocated deductions limited to income, with interest/taxes/ casualty & theft losses deducted first, then non-depreciation expenses, then depreciation).
21. **At-Risk Rules and Passive Activity Rules** - The at-risk rules limit losses from an activity to the amount "at risk" (contributions of cash and property not financed with non-recourse loans, plus undistributed prior profits); if deductible, then loss must clear passive activity loss (PAL) rule hurdle, with three baskets of income (active, passive, and portfolio), with passive losses (usually rents) only offsetting passive incomes in same basket.

22. **Suspended PAL Losses & Material Participation** – Nondeductible passive losses are suspended until years with passive incomes or year in which activity is disposed; one of seven methods of *material participation (MP)* will put an activity in the active basket (>500 hrs., substantially all, >100 hrs. and more than anyone else, aggregate significant activities (>100) total > 500 hrs., MP present in 5 of 10 prior years of the activity, MP in any 3 prior years for personal services, facts & circumstances).
23. **Residential Real Estate \$25,000 Exception to PAL Rules** - A special residential rental property exception allows an “active participant” (> 10% unlimited interest, participate in major decisions involving the property) to deduct first \$25,000 losses against any type of income (\$25,000 amount phases out \$.50 per \$1.00 of AGI exceeding \$100,000); certain real estate professionals avoid passive treatment if more than ½ hours worked are in real estate and total real estate activity participation > 750 hours.

### Miscellaneous Sources of Income

24. **Mutual Fund Income & Distributions** - Any dividends declared by a mutual fund in the last three months of the year are taxable on Form 1099-DIV, regardless of whether amount was received or not, and capital gains are taxable immediately (even if not received) and are *always* reported as long-term gain; report on Schedule D (or directly on 1040 if no other gains/losses), and a credit is allowed for any taxes paid by the mutual fund.
25. **Taxation of Annuities** - The portion of annuity payments that is taxable is determined by an *exclusion ratio* (investment in contract/total expected return), with the expected return determined by mortality tables if based on a life expectancy; if the taxpayer lives longer than life expectancy, all future payments are full taxable, and if the taxpayer dies early, the unrecovered cost is deducted as an itemized deduction on the final tax return.
26. **Taxation of Social Security** - Generally, 50% of social security (from Form SSA-1099) is taxable for only for taxpayers with “provisional income (PI)” (AGI + ½ SS + tax-exempt interest received) exceeds \$25,000 (S) or \$32,000 (MJ); taxable portion increases to 85% when PI exceeds \$34,000 (S) or \$44,000 (MJ); formula may tax less, using 50% or 85% of excess of PI over base amounts shown above (85% formula must add \$4,500 (S) or \$6,000 (MJ) to computed amount).

### Miscellaneous Exclusions From Income

27. **Miscellaneous Exclusions – I** - Miscellaneous exclusion rules include (1) *clergy* (exclude housing and utility allowances, but still take interest/tax deductions), (2) *prizes and awards* (taxable, unless certain scientific/charitable/ educational awards donated to charity, and certain service/safety awards averaging < \$400), and (3) *scholarships* (exclude only if candidate for a degree and no significant benefit to grantor, exclusion only for books, tuition and fees, as does not cover room and board, and compensation for services always taxable),
28. **Miscellaneous Exclusions – II** - Other exclusion rules include (1) *forgiveness of debt* (exclude if family gift, bankrupt, insolvent, certain nonbusiness real estate loan renegotiations, farming, \$2 million of forgiveness on personal residence, and student loan forgiveness for teaching, service, etc.), (2) *life insurance proceeds* (exclude if paid by reason of death), (3) *lawsuit damages* (exclude only for

physical injury), *gifts and inheritances* (exclude unless compensation), (4) *foreign earned income* (\$92,900 maximum exclusion prorated over year, if qualified), and (5) *tax benefit rule* (exclude reimbursement if no benefit received in prior year, e.g., state tax refund, no itemized in prior year).

## **Deductions FOR AGI: Rents, Royalties, Alimony & Moving Expenses**

29. **Sec. 212 Deductions** – Sec. 212 allows three types of deductions that do not rise to the level of a trade or business under Sec. 162: (1) expenses associated with *income-producing activities* (i.e., depreciation on a rental property), (2) expenses to *conserve income-producing property* (i.e., safety deposit box rental for storing securities), and (3) expenses incurred in *determining and litigating a tax liability* (i.e., tax prep fees and representation fees before the IRS); of the income-producing expenses, only those associated with rents and royalties qualify as deductions FOR AGI (deductions related to stock & bond investments are FROM AGI).
30. **Basic Concepts Related to Rental Property Deductions** – If part of a residence, allocate costs to rental/personal portions by floor space, unless entire cost relates to rental; Sec. 179 expensing is NOT allowed on rental personalty; and repairs are for ordinary maintenance (i.e. painting), while capital expenditures add to value, extend useful life, or create a different use (i.e., a new roof).
31. **Tax Treatment of Alimony** – Alimony (deduction FOR AGI to payor, income to payee) is deductible only if 4 conditions are met: (1) cash payments pursuant to a written instrument (payments to a third party may still qualify), (2) no payments designated as not alimony, (3) spouses are not members of same household, and (4) no liability for payment after death of either spouse; child care payments are NOT alimony, and if less than total required payments are made during the year, payments are first considered to be child care.
32. **Property Settlements and Front-Loaded Payments** – Are never treated as alimony, the transfer is non-taxable, and the recipient spouse's tax basis is a carryover of the other spouse's basis; "front-loaded" alimony payments in the first two years may be recaptured in third year as income by payer and deduction by payee, if payments drop more than \$15,000 a year.
33. **Moving Expenses** – The two tests for moving expenses are (1) *distance test* (commute to work would have increased at least 50 miles if taxpayer did not move), and (2) *time test* (work 38 weeks in new location in the next year, 76 weeks in two years if self-employed); deductible expenses include those of moving family and moving furnishings (optional mileage method of \$.19/\$.235 *per mile* for 6-month periods of 2011, lodging in route is deductible but meals are not, reduce deductions by reimbursement).

## **Deductions for AGI: Individual Retirement Accounts**

34. **IRAs – Basic Qualifications** – Total contribution/deduction limited to "earned income" (*total* earned income of both spouses, if married); contributions allowed up to due date of return; no investments in savings bonds or collectibles (U.S. gold/silver coins OK); rollovers allowed in 60 days, including rolling over account of deceased spouse
35. **IRAs – Earned Compensation** – Earned compensation *includes* wages/salary/commissions, self-employed (S/E) income with adjustments (less ½ S/E tax and other retirement contributions, not

required to net against salary), taxable alimony/separate maintenance payments, general partner income share & guaranteed payments; earned compensation *does NOT include* unearned income (i.e., interest, dividends, etc.), deferred compensation, limited partner's income share.

36. **IRAs – Prohibited Transactions & Penalties** – Prohibited transactions subject to tax (example: using IRA as collateral for a loan) include any transfers or other acts between IRA owner and a “disqualified person” (fiduciary, entities administering plan, and employees or family members of these groups); IRA penalties include (1) 6% nondeductible penalty for failure to withdraw excess contributions by due date (with extensions), (2) 10% penalty on distributions before age 59½ (unless death, disability, age 55 and qualified retirement annuity, domestic relations order, medical, higher education expenses, IRS levy, or \$10,000 first-time home-buyer expenses), (3) 50% tax on failure to meet minimum distribution requirements beginning on April 1<sup>st</sup> of year AFTER taxpayer turns age 70½.
37. **IRAs – Contributions and Deductions** – Maximum *contribution* ALWAYS \$5,000 (\$6,000 age 50 or older), limited to the earned income *total* of both spouses, whereas maximum *deduction* depends on coverage by another qualified pension plan (QPP) and filing status: (1) if neither spouse covered by QPP, \$5,000/\$6,000 limits apply; (2) for taxpayer covered by QPP, phase-out covered individual's deduction between \$56,000/\$66,000 (S) or \$90,000/\$110,000 (MJ), (3) for covered taxpayer's spouse who is *not* covered by QPP, phase-out deduction between \$169,000/\$179,000 (but always allow \$200 minimum deduction if any phase-out provides smaller deduction).
38. **Roth IRAs & Education (Coverdale) IRAs** – Roth IRA contributions (\$5,000/\$6,000 less any other IRA contributions) are not deductible, distributions are tax-free after 5 years (if age 59½, disabled or first-time homebuyer; otherwise, 10% penalty), no age limit on contributions, contributions phase out between \$107,000-\$122,000 (S) and \$169,000-\$179,000 (MJ), and regular IRAs may be converted to Roths; Coverdale (Education) IRAs are limited to \$2,000 nondeductible contributions per recipient in total, phase out beginning at \$95,000/\$190,000, excludable if spent on qualifying education expenses (10% penalty if not for education), must be withdrawn by age 30.

## Other Deductions for AGI

39. **Self-Employment (S/E) Tax, S/E Health Insurance Premiums, and Health Savings Accounts (HSAs)** – Deductions for AGI include (1) ½ of S/E tax (actually, 57.51% in 2011), (2) 100% of health insurance premiums for S/E person and family (unless spouse eligible for employer plan), and (3) first \$3,050 (S) or \$6,150 (families) for contributions (add \$900 if age 55 or older) to *high-deductible health insurance plans* (\$1,200 (S)/\$2,400 (F)) with maximum out-of-pocket expenses of \$1,050; exclude distributions for medical expenses (10% penalty if not for medical).
40. **Other Deductions for AGI** – Other deductions for AGI include (1) *student loan interest* (\$2,500 maximum per year, phaseouts begin at \$50,000/\$100,000), (2) *post-secondary tuition* (\$4,000 maximum, drops to \$2,000 at \$65,000/\$130,000 AGI, then to \$0 at \$80,000/\$160,000 AGI), and (3) *penalties paid for premature withdrawals of interest* (since full interest must be reported as income); other common for AGI deductions are capital losses, Keogh plan contributions, jury pay surrendered, and qualified adoption expenses (if credit is not taken).

## Itemized Deductions: Medical, Taxes, Interest, Charitable, Casualties & Thefts

41. **Medical Expenses** – Medical expenses may be deducted for taxpayer, spouse or a dependent (gross income and filing status tests waived for these purposes, either of divorced parents may claim, and only claimant for multiple support may deduct); qualifying expenses must be for specific disease or illness (birth control, obesity, stop smoking, but NOT over-the-counter drugs, cosmetic surgery, health club dues, meals); deductible amounts include travel (\$.19/\$.235 each 6 months of 2011) and capital expenditures (to extent not increasing value of property); reduce total expenditures by any insurance received (or expected) and 7.5% of AGI.
42. **State, Local and Foreign Taxes** – Deduction allowed (if the taxpayer's obligation) for state/local/foreign real estate taxes, and state & local personal property taxes if based on value; if realty changes hands during year, deduction allowed only for portion of year property is owned (regardless of who pays the tax); estate or gift taxes, tobacco taxes, gas taxes, utility taxes, or assessments for value received in return are not deductible; state & local income taxes deductible (or state sales taxes, if elected); foreign income taxes deductible if no credit is taken.
43. **Interest Expense** – Interest is deductible if it is the taxpayer's own obligation, but not for loans producing tax-exempt income or personal consumer interest; investment interest expense is limited to net investment income, excess can be carried forward; deductions also allowed for two types of residential home mortgage interest (on up to TWO homes): (1) *acquisition indebtedness* (interest on first \$1,000,000 of loans secured by the home, and proceeds spent on the home), and (2) *home equity indebtedness* (up to \$100,000 of loans secured by the home but NOT spent on the home); points paid on original home are deductible, but on refinancing are amortized over the loan period.
44. **Charitable Contributions – General Rules** – Deduction allowed for contributions of cash, property, and credit card charges (but NOT services) to a qualified listed charity; out-of-pocket expenses deductible, including \$.14 per mile for auto; raffle tickets deductible only in excess of value received; \$50 per month for charity-sponsored student living with taxpayer; and only 80% of donations made for rights to purchase athletic tickets are deductible;
45. **Charitable Contributions – Substantiation Requirements** – In substantiating charitable deductions, a taxpayer must furnish one of the following: (1) a written statement from charity (cash/property < \$75), (2) checks & receipts (cash < \$250), written acknowledgement (cash > \$250), (3) written statement from charity (property < \$250), (4) written acknowledgement (property < \$500), or (5) qualified appraisal on Form 8283 (property > \$5,000).
46. **Charitable Contributions – AGI Limitations** – Cash deductions are limited to 50% for contributions to public charities (i.e., churches, universities, Girl Scouts, Heart Fund, etc.), 30% to private charities & foundations (more exclusive purposes, such as supporting oil industry), and 50% overall for both combined in any one year (deduct public first); as for property contributions, if property generates *ordinary income* if sold (i.e., inventory or short-term capital assets), deduction reduced by gain that would be recognized if sold at FMV; if property generates *capital gains* if sold (i.e., long-term capital assets), gain limited to 30% of AGI unless elect to apply the ordinary income rule and raise AGI limit to 50% (must use this method for tangible personalty not used in tax-exempt function, and for any contributions of property to private charities; otherwise, a 20% of AGI limit for private charities).
47. **Casualty & Theft Losses** – The deduction for a personal casualty and theft (C&T) loss is the *lesser* of adjusted cost basis of the property or the decrease in fair market value of the property at the date of destruction, reduced by insurance; each C&T loss is reduced by a \$100 floor per C&T, and a final total

C&T loss is reduced by 10% of AGI; a casualty must be due to sudden destruction (not termites or rust damage), and a theft must not be merely lost property; available insurance *must* reduce the loss, even if taxpayer declines to file a claim; losses in Presidentially-declared federal disaster areas may be deducted on the prior-year return, at the election of the taxpayer.

## Miscellaneous Itemized Deductions

48. **Two Tiers of Miscellaneous Itemized Deductions** – Miscellaneous itemized deductions are those items other than medical, interest, taxes, contributions, and casualty & theft losses; these deductions are either (1) *NOT subject to the 2% of AGI floor* (impairment-related work expenses, unrecovered cost of an annuity at death, and gambling losses to extent of winnings), or (2) *ARE subject to the 2% of AGI floor* (tax prep and litigation fees, unreimbursed employee expenses, and expenses related to stock and bond investments—remember: rent & royalty expenses are FOR AGI); items that are NEVER deductible are political contributions, lobbying expenses, fines, penalties, and costs of attending stockholder meetings (not a business).
49. **Deductible Unreimbursed Employee Expenses** – These include (1) 50% of any meals & entertainment (must occur during (“direct”) or immediately preceding or following (“associated with”) a substantial business discussion, but NOT country club dues, and only face value for tickets, (2) gifts (\$25 limit per donee per year), (3) commuting costs (from job to job or job to client or customer, but not between home and job, allocated actual costs or optional mileage allowance of \$.51 (through 6/30) or \$.555 (post-6/30) for cars, add parking & tolls to both), (4) travel costs (meals, lodging, and incidentals while temporarily (< 1 year) away from tax home on business, and (5) job-hunting expenses (if currently in business), specialized work clothes, dues and subscriptions
50. **Employee Reimbursement** – Any reimbursement received reduces the deduction; if an “accountable plan” exists (employee documents expenses to employer, returns excess reimbursement), employee omits expense and reimbursement from return; if “nonaccountable plan”, excess reimbursement reported as income, and excess expenses deducted on Form 2106 (net of reimbursement) and transferred to Schedule A as an itemized deduction (subject to the 2% of AGI floor).
51. **Education Expenses as Employee Deductions** – Such expenses deductible (subject to 2% floor) if (1) improve skills on present job (i.e., CPE course) or (2) required by employer or government to retain current job (college course for teaching certificate); NOT deductible are any expenses that meet minimum educational requirements for a job or qualify taxpayer for a new job/promotion; deduction reduced for any employer education assistance payments received; qualified expenses are limited to books, tuition, fees, transportation, and 50% of meals.

## Capital Gains & Losses – Definitions and Special Rules

52. **Capital Assets Definition** – Capital assets may be defined simply as purely personal properties and investment properties; the definition NEVER includes inventory, copyrights & artistic compositions, and properties used in a trade or business; capital assets held one year or less are short-term, while those held LONGER than one year are long-term, and in some cases holding periods “tack” (use the holding period of a prior property or owner if the basis of the property also carries over); recall that capital gains distributions from mutual funds are ALWAYS treated as long-term.

53. **Special Rules - Related Party Losses and Nonbusiness Bad Debts** – Losses on transactions between related parties (i.e., family members and/or controlled entities, directly or indirectly) are NOT allowed, but the disallowed loss may offset any gain on a later sale by the related party (but may not create or add to a loss); as to nonbusiness bad debts, the Code automatically categorizes these as short-term capital losses (as long as terms are those of an independent loan), and loans from shareholders to corporations are treated as nonbusiness (unless protecting the livelihood of the shareholder, i.e., job).
54. **Determining the Amount Realized** – The amount realized (“sales price”) for tax purposes is the total cash, fair market value of property, and fair market value (FMV) of services received, as well as any liabilities assumed by the purchaser (symmetry, since these amounts were originally included in the basis of the property); selling expenses, commissions and fees reduce the amount realized.

### **Capital Gains & Losses – Determining Adjusted Basis**

55. **Determining Adjusted Basis – Purchased Property, Securities, & Converted Property** - The adjusted basis of purchased property is the total cost plus installation charges, capital improvements, unpaid taxes, and closing costs, and less capital recoveries (e.g., depreciation); liabilities are always initially included in basis; as for securities, unless specific identification is used, apply FIFO, stock dividends are not taxable (spread basis between old and new, as well as holding period), same rules for stock rights (allocation required only if value of rights > 15% of value of stock); if personal property is converted to a rental or business use, the adjusted basis for loss (and depreciation) is the lesser of cost or FMV at date of conversion.
56. **Determining Adjusted Basis – Gift Property** – The general rule for gift property is that the basis for *gain* is ALWAYS donor’s cost, while basis for *loss* is lesser of donor’s cost or FMV at date of gift (tack holding periods only if donor’s basis is used); property sold between the two bases results in \$0 gain/loss per Code (KEY POINT to remember—dual basis possible *only* when FMV at gift is *less* than donor’s basis); donor’s basis may be increased by portion of any federal gift taxes paid related to appreciation in value (i.e., appreciation/FMV of gift x gift taxes paid by donor).
57. **Determining Adjusted Basis – Inherited Property** – The adjusted basis of inherited property is FMV on the date of death of the decedent (use state tax value if no federal tax applies), unless the estate elects the alternative valuation date, which is exactly 6 months after death, but to do so the value of the gross estate and the estate tax must decrease; use FMV at distribution date if alternate valuation is elected and property is distributed before this date; if property is inherited by an individual who gifted the property to the decedent within one year of death, the donor ends up with his or her original cost basis (no step-up in basis is permitted).

### **Capital Gain & Loss Netting and Sale of a Personal Residence**

58. **Capital Gain & Loss Netting for Individuals** – Three steps: (1) net all short-term (ST) gains/losses to determine net ST result, (2) net all long-term (LT) gains/losses to determine net LT result, and (3) combine the two results if ST and LT results are same sign (+/-), or enter into income separately if ST and LT results have different signs (+/-); net results enter income under *four basic rules*: (a) ST gains fully taxable, (2) ST losses offset maximum of \$3,000 ordinary income, (3) LT gains qualify for lower 15% or 0% rate (if in 10%/15% ordinary income bracket), and (4) LT losses offset maximum of \$3,000

ordinary income (only one \$3,000 offset for ST & LT losses combined, ST first); any excess capital losses are carried forward indefinitely and retain their character; finally, certain LT gains are taxed at either a 25% rate (“unrecaptured Sec. 1250 gain” on realty) or a 28% rate (collectibles and Sec. 1202 small business stock held for more than 5 years); in netting all, capital losses always offset the highest tax-rate gains first (and ANY capital loss carryovers offset 28%-rate gain first).

59. **Sale of a Personal Residence** – Losses on sale of a personal residence are NEVER deductible, while gains may be offset by a Sec. 121 exclusion of \$250,000 (S) or \$500,000 (MJ) if (1) the property was owned and used as a personal residence for at least two of five preceding years (use does not have to be continuous), and (2) taxpayer (and spouse, if married) did not use election in past two years; for married couples, only one spouse need meet the ownership test, but both spouses must meet the usage test; a partial exclusion ( $x/24$ , where “x” is number of months the two tests are met) is available for early move due to employer-mandated moves or health reasons; any qualifying exclusion must be reduced by any post 5/6/97 depreciation due to rental/business use, and also reduced proportionately for any post-2009 non-residential use.

### **Tax Credits: Dependent & Child Care, Child, Elderly, and Education Credits**

60. **Child & Dependent Care Credit** – The child & dependent care credit is for expenses of caring for either (1) a child under age 13 or (2) a mentally or physically disabled spouse or dependent (waiving the gross income test for the latter, and custody parent need not claim dependency exemption for former); care providers may be a relative (but not a dependent); the credit allowed (limited to tax liability) is a “*qualifying amount*” (smallest of (a) actual expenses, (b) \$3,000 (1)/\$6,000 (2+), or (c) earned income of lesser earning spouse, imputing \$250/\$500 month if disabled or full-time student), times a “*qualifying percentage*” (35% if AGI  $\leq$  \$15,000, reduce 1% for each additional \$2,000 AGI, until rate levels at minimum level of 20% at \$43,000 AGI); any employer excludable assistance reduces qualifying amount.
61. **Child Credit** – The child credit is \$1,000 for each qualifying child under age 17, and is limited to tax liability; a “*qualifying child*” can be a natural child, step child, foster child, brother or sister (including step relationships), and a direct descendant of any of these categories; the credit is phased out at the rate of \$50 for each \$1,000 (or portion thereof) of AGI exceeding \$75,000 (S or HH), \$110,000 (MJ), or \$55,000 (MS; limited amounts may be refundable, regardless of tax liability (15% of taxpayer’s AGI > \$3,000, larger amounts for 3+ children).
62. **Tax Credit for the Elderly** – The tax credit for the elderly is determined by a formula: start with an initial amount (\$5,000 for one taxpayer age 65 or older, \$7,500 if both spouses are age 65 or older, and \$3,750 if married filing separately); subtract (1) any social security or railroad retirement benefits received and (2) any AGI exceeding \$5,000 (S), \$10,000 (MJ), or \$5,000 (MA); credit is 15% of any remaining amount and is limited to tax liability; permanently disabled taxpayers also qualify, substituting disability pay if this is smaller than the initial amounts as determined above; REMEMBER—a taxpayer is presumed to reach 65 years of age on the day *before* his or her birthday, so watch for January 1<sup>st</sup> birthdays.
63. **Education Credits** – Two education-related credits are available for tuition, books and fees (but NOT room & board) for a taxpayer, spouse or dependent (credit claimed by person taking the dependency exemption), and both credits are limited to tax liability: (1) the *American Opportunity*

*Tax Credit* (AOTC, formerly Hope Credit) is for up to \$2,500 of qualifying expenses (100% of first \$2,000, 25% of next \$2,000) per student for any of the four years of post-secondary education, phases out between \$80,000/\$90,000 (S) or \$160,000/\$180,000 (MJ), and up to 40% may be refundable; (2) the *Lifelong Learning Credit* is 20% of first \$10,000 of expenses (\$2,000 maximum credit) for all books, tuition, and fees not qualifying for the AOTC Credit (such as CPE courses), total is per taxpayer and not student, and credit phases out between \$51,000/\$61,000 (S) and \$102,000/\$122,000 (MJ).

## Earned Income Credit (EIC)

64. **EIC – General Qualifications** – EIC is REFUNDABLE (even if no gross tax liability) to claimant, who must be a U.S. citizen or resident who cannot have investment income (e.g., interest, dividends, etc.) exceeding \$3,150; married taxpayers must file a joint return, only custody parent can claim credit, and claimant may not be a “qualifying child” of another taxpayer (such as a parent); larger credits are available for a “qualifying child,” defined as a natural, step, foster, or adopted child who is either under age 19 or a full-time student under age 24 who lived with the taxpayer more than half the year.
65. **EIC – Earned Income Defined** – Income qualifying for the EIC is all earned income (e.g., salary, wages, commissions, tips, strike benefits, Schedule C income (after reduction for one-half of self-employment taxes) and includes deferred salary, meals & lodging, excludable combat pay (if elected) and excluded fringe benefits; earned income does NOT include interest and dividends, taxable annuities, taxable scholarships not reported on Form W-2, alimony, prisoner wages, workers’ comp or unemployment comp, welfare benefits, veteran benefits, or social security.
66. **EIC – Computations and Phaseouts** - Maximum credit is a percentage of earned income, and credit is phased out by a percentage of the *larger* of AGI or earned income exceeding a base amount; maximum credits are \$5,751 with 3 or more children, \$5,112 with two, \$3,094 with one, and \$464 with no qualifying children; credit completely phases out as low as \$13,660 AGI for single with no qualifying children to \$49,078 AGI for a married couple with 3 or more children; in using IRS table, locate credit by children, marital status, and *larger* of AGI or earned income (larger of the two is used in the table for phase-out computations).
67. **EIC – Paid Tax Return Preparer Responsibilities** – Sec. 6695(g) of the Internal Revenue Code requires tax return preparers to exercise due diligence in determining a taxpayer’s eligibility for the credit and computing the credit; failure to do so can result in a \$100 penalty per return (\$500 in 2012); tax return preparer MUST retain *Form 8867, Paid Preparer’s Earned Income Credit Checklist*, for each EIC return; form must be retained (paper copy or electronically) for three years following 6/30 of the year in which the return was prepared.

## Other Tax Credits for Individuals

68. **Other Nonrefundable Credits** – These include (1) *Foreign Tax Credit* (lesser of actual foreign taxes paid or average U.S. tax paid on foreign income, deduction may be taken in lieu of credit, no credit on excluded foreign earned income, normally reported on Form 1116 but may be reported directly on Form 1040 if only foreign passive income and maximum taxes were \$300 (S) or \$600 (MJ)); (2) *Qualified Retirement Savings Contributions Credit* (non-student taxpayers 18 years or older who claim

their own exemptions and contribute to a traditional, Roth, SEP, or SIMPLE IRA, or a Sec. 401(k) or 403(b) plan qualify for a credit of up to \$1,000 (50% of up to \$2,000 maximum qualifying retirement contributions), but credit is phased out (and credit rate is reduced) beginning \$34,000 (MJ), \$17,000 (S or MS) or \$22,500 (HH); (3) *Residential Energy Credit* (\$500 maximum credit, \$200 for windows, for certain energy-saving expenditures made to personal residence (house, houseboat, trailer, etc.).

69. **Other Refundable Credits** – These include (1) *Excess FICA Taxes Paid Credit* (taxpayers working for more than one employer and paying the 6.2% social security tax on more than \$106,800 total wages may take a credit on Form 1040 for excess taxes paid); (2) *Federal Tax Paid on Fuels Credit* (a credit for federal taxes paid on fuel, currently \$.183 per gallon, used for non-highway purposes, such as farming (but NOT personal use or business use on public roads); (3) *Adoption Credit* (with detailed documentation, taxpayers may claim a credit of up to \$13,360 in 2011 for unreimbursed expenses directly related to a legal adoption (e.g., adoption fees, attorney fees, court costs, and travel expenses); credit phases out over \$40,000 AGI exceeding \$185,210 for a married couple; full \$13,360 credit may be taken for adoption of a special needs child, even if amount spent was less); (4) *Health Coverage Tax Credit* (a special credit for eligible Trade Adjustment Assistance recipients or Pension Board Guaranty Corporation recipients age 55 or older; credit is based on the amount paid for monthly coverage, and varies by month, e.g., 80% for January/February of 2011, 72.5% rest of year).

## Other Taxes & Special Filing Issues

70. **Estimated Taxes** – Four quarterly payments of estimated tax (4/15, 6/15, 9/15, and 1/15) are required if tax liability after withholdings and prepayments is expected to exceed \$1,000 (1/15 date can be delayed to 1/31 if tax is paid by then); penalty applies to underpayment (nondeductible interest charge) unless estimated tax payments for the year (applied on a quarterly basis) are at least (1) 90% of current-year tax liability (66 2/3's if farming or fishing income is 2/3's of gross income), or (2) 100% of prior year's tax liability (110% if current-year AGI exceeds \$150,000); penalty does NOT apply to qualified farming or fishing income if one estimated tax payment is made by 1/15 or return is filed and tax is paid by 3/1).
71. **Refund Claims & Extensions to File** – A refund claim may be filed by the LATER of (1) three years after the normal due date of the return or (2) two years from the date the tax was paid, and interest is paid on the claim if not paid within 45 days of filing; as for extensions, filing Form 4868 by the due date of the return will grant taxpayers (including returns of decedents) an automatic 6-month extension to file a return (but NOT pay the tax); extension is 4 months if taxpayer is out of the country; automatic 2-month extensions (without a request) are available for taxpayers living outside the U.S. or Puerto Rico, as well as non-residence aliens with no withholdings; soldiers in combat zones are given 180 days following their last day of combat (or last hospital stay) to file a return.
72. **Self-Employment Tax Issues for Individuals** - Taxpayers with self-employment income (Schedule C) exceeding \$400 are subject to the self-employment (SE) tax; taxpayer must carry on a business for profit or be an independent contractor (and not an employee following orders); also subject to the S/E tax are partners with no limited liability (taxes on income share and guaranteed payments), board of director fees, clergy (including housing allowance), real estate agents, and owners of rental property who provide significant serviced (e.g., maid service); SE tax is composed of a social security portion (normally 12.4% of first \$106,800 of SE income less any FICA wages received, but only 10.4% in 2011) and a Medicare portion (2.9% of SE income x .9235).

73. **Household Employees Tax Issues for Individuals** - Regular FICA taxes (shared with employees and employer) must be paid (by filing Schedule H) on any household employees paid more than \$1,700 a year, and FUTA taxes if paid more than \$1,000 per year; exceptions to FICA are taxpayer's spouse, children under age 18 (21 if taxpayer's child), and parents providing less than 4 continuous weeks of care in a quarter.
74. **Special Computations: Kiddie Tax & Income Averaging** – A taxpayer's child under age 18 (24 if a full-time student) who has unearned income exceeding \$1,900 will have such excess taxed at the parents' marginal tax rate; tax is either computed on child's return or the excess may be added to the parents' gross income (plus add \$95 tax for first \$950 otherwise taxed at the child's rate); if parents are divorced, the higher AGI is used in the computations; if there are several children covered by the tax, the total additional tax is computed and then allocated to each child based on each child's unearned income exceeding \$1,900; as for income averaging, farmers may elect to file Schedule J, which involves dividing current-year farm income by 3, add that 1/3 amount to each of the two prior year returns, compute the marginal tax due, and add those two tax amounts to the current tax liability (which also includes 1/3 of current-year income).

### **Alternative Minimum Tax (AMT)**

75. **AMT – General Format** – Start with taxable income per the return, add or subtract certain adjustments specified in the Code, add certain preference items specified in the Code to determine alternative minimum taxable income (AMTI) before exemption, subtract an AMT exemption [\$74,750 (MJ) less 25% of AMTI > \$150,000, or \$32,225 (S) less 25% of AMTI > \$112,500], and the resulting AMTI is subject to a three-tier tax rate structure: 26% of the first \$175,000 of AMTI, 28% on any excess, and a 15% on any long-term capital gain (i.e., same as regular tax); if the resulting tentative minimum tax (TMT) exceeds the taxpayer's regular tax (RT) liability, the excess is the AMT, which is added back to the RT on page 2 of Form 1040 as an additional tax (in other words, the taxpayer actually owes and pays the TMT).
76. **AMT – Common Adjustments & Preferences for Individuals** – The most common adjustments for non-business taxpayers are gain at exercise of an incentive stock option (FMV of shares – option price actually paid), standard deduction (none allowed), personal exemptions (none allowed), medical expenses (10% of AGI floor for AMT), state & local tax expenses (none allowed), home equity interest (none allowed, but acquisition debt interest IS allowed), miscellaneous itemized deductions (none allowed), state income tax refund (negative adjustment, since no state & local taxes are deductible for AMT); the most common preferences are private activity bond interest income (not taxed for regular tax), 7% of any gain on sale of Sec. 1202 small business stock held longer than 5 years, and any percentage depletion deducted in excess of total cost recovery.
77. **AMT Credit** – All AMT adjustments and preference items can be classified as either *deferral (timing) differences*, those that will “turn around” later in the regular tax such as when incentive stock option stock is later sold, or as *exclusion (permanent) differences*, those that will never reverse and are therefore permanently different such as state and local taxes that are never deductible for the AMT; any of the current AMT that can be attributed to deferral (timing) differences can be carried forward indefinitely to future years and used as an AMT credit to reduce each year's regular tax liability (but not below that year's TMT).

## Circular 230: Practice Before the IRS

78. **Who May Practice Before the IRS** – Practice before the IRS covers all matters related to representations for clients before the IRS, including communications, representing the client at IRS hearings, preparing and filing documents for the client, but NOT simply preparing the return or furnishing information to the IRS; *automatic representation* privileges are granted to attorneys, CPAs, enrolled agents, enrolled actuaries, and enrolled retirement plan agents (but NOT registered tax return preparers [RTRPs]); the preparer of a return may represent that taxpayer only before the IRS (this includes RTRPs), but may NOT receive refund checks or sign claims, consents, closing agreements, or waivers of assessment; certain individuals qualify to represent a taxpayer due to their special relationship to the taxpayer (these categories include self-representation, family members, officer of a company, partner, alien, employee, or trustee guardian); categories that may NEVER represent a taxpayer include individuals with criminal convictions, disbarred or suspended individuals, and individuals denied application to practice.
79. **RTRPs – General Requirements** – An RTRP must be at least 18 years of age, pass the RTRP exam, have a valid preparer ID number, and pass possible IRS tax compliance and suitability checks; “practice” for an RTRP is limited to preparing and signing all or substantially all of a tax return or claim for refund, and RTRP may represent the taxpayer whose return he or she prepared before revenue agents, customer service representatives, and employees of the IRS (including the Taxpayer Advocacy Service), but NOT Appeals Officers, Counsel, or similar offices; any advice given to taxpayer is strictly limited to whatever is necessary to prepare the return, claim, or information request; complaints may be filed against RTRPs with the Office of Professional Responsibility, and the RTRP generally has 15 days to respond to such complaints; disciplinary action may be initiated for disreputable conduct, such as providing false information, bribery, failure to pay tax, unlawful solicitation, receiving aid from a suspended practitioner, or embezzlement.
80. **RTRPs – Enrollment & CPE Requirements** – The general enrollment period for an RTRP is set at three years, and begins on April 1<sup>st</sup> of the appropriate year (details to be released later); as for CPE requirements, RTRPs must complete a minimum of 15 hours of CPE each year, with a minimum of 10 hours on federal tax law topics, 3 hours of federal tax updates, and 2 hours of ethics and professional conduct. A contact “hour” is defined as 50 minutes, college courses can qualify (15 hours for one semester hour, 10 hours for one quarter hour), and an RTRP can qualify by (1) attending a formal program, (2) completing a correspondence, taped, or independent study course, or (3) serving as a discussion leader or lecturer of a qualified program (one hour teaching and two hours prep allowed per contact hour, but maximum of only 4 hours permitted each year); RTRP must certify that CPE requirements are met each enrollment year, keep detailed records (with provider number, program number, and certificate of completion) for a minimum of *four* years following date of renewal. Failure to comply may lead to 60-day IRS request for records, then 30-day period to protest determination, and if not corrected RTRP is placed in inactive status for up to 3 years, then terminated.
81. **Tax Preparer Responsibilities** - The only permitted description of RTRP status is “*designated as a registered tax return preparer by the IRS*” (never use the term “certified”); uninvited unethical or illegal solicitations are not allowed, source for targeted direct mail must be disclosed, copies of radio or TV ads must be retained for 36 months after last airing; Unconscionable fees are not allowed, contingent fees only allowed for original returns, amended returns, or claims for refund involving IRS

review or judicial proceedings (but NEVER for the original preparation of a return); fixed fees, hourly rates, and initial consultation fees may be advertised, but must remain at the advertised level for at least 30 days; a tax preparer may represent conflicting interests if signed permissions are received from all parties within 30 days (such written permissions should be retained for 36 months).

82. **Due Diligence, Confidentiality, and Burden of Proof** - Due diligence is always required when preparing and assisting with a return, a frivolous return should never be signed, and reasonable inquiries should be made for questionable items; if noncompliance by the taxpayer client is discovered, the client should be notified immediately; a client request for his or her records should be honored unless state law provides otherwise; an RTRP must comply with an IRS request for records unless the RTRP believes the request violates confidentiality or is of doubtful legality; an RTRP does not enjoy the same confidentiality protection of attorneys and CPAs, since this protection relates to advice outside of normal tax return preparation (which the RTRP may not give); the burden of proof in a tax matter is generally on the taxpayer, but may be shifted to the IRS with certain substantiation and cooperation; however, the burden in a fraud case is ALWAYS on the IRS.
83. **Best Practices for Tax Advisers** – Tax preparers should always exercise due diligence in client matters; these best practices include (1) communicating terms of an engagement, (2) establishing pertinent facts, (3) relating primary tax authority (law) to the facts, (4) drawing conclusions supported by the facts, and (5) communicating the importance of the conclusions to the client (including any information on possible penalties); a position taken on a return should be supported by “substantial authority” or “reasonable basis of success” (discussed below at 87); covered opinions (those with substantial or significant tax avoidance motives) require enhanced due diligence, documentation, and presentations; preparer MUST remind taxpayer that signature is under penalty of perjury.

## **Powers of Attorney, TIAs, and CAFS**

84. **Powers of Attorney (POA)** – A POA is a legal written authorization to act on someone else’s behalf on tax matters, and is required to represent a taxpayer at conference or to file a written response to the IRS; rights under a POA include representing the taxpayer, recording an interview with the IRS, signing waivers, consents, and closing agreements, receiving (but NOT endorsing) refund checks, and signing a return for the taxpayer if allowed under the Code and authorized by the taxpayer; Form 2848 used for POA, and must be specific as to tax years and matters represented; to *update* a POA, notify the IRS where original was filed or simply file a new POA (a new POA revokes a prior POA); to *revoke* a POA, either (1) send a copy of original Form 2848 to IRS with word “REVOKE” written clearly across the top center of the form, or (2) file and sign a revocation statement to the original IRS office.
85. **TIAs & CAFs** – A *Taxpayer Information Authorization* (TIA, Form 8821) is simply a request by a taxpayer to authorize an individual (or individuals) to receive confidential tax information; the authorized individual does NOT have to be licensed to practice before the IRS, and the form is NOT an authorization to practice before the IRS; A *Central Authorization File* (CAF) is simply an automated file that retains a list (maximum of 3) of those taxpayer representatives authorized by the taxpayer under a POA or TIA; the CAF is used by the IRS to determine who may receive confidential information or other notices related to the taxpayer for a specified time period, but does NOT authorize a person to practice before the IRS.

## Tax Preparer Penalties

86. **Tax Preparer Defined** – A tax preparer is defined in Circular 230 as “*anyone who prepares or hires someone to prepare for compensation an income, excise, employment, estate & gift, generation-skipping, or exempt organization tax return, substantial part of a return, or refund claim*”; a preparer can include an employer, employee, self-employed person, but normally NOT a fiduciary (note—both preparer and supervisory adviser may be subject to preparer penalties); a “substantial portion” of a return does not include amounts < \$2,000 or < \$100,000 & 20% of gross income.
87. **Sec. 6694(a) & (b) Penalties** – *Sec. 6694(a)* provides a penalty (larger of \$1,000 or 50% of return fee) for each occurrence of any tax understatement due to a lack of “substantial authority” (defined as primary tax authority justifying estimated odds of success upon audit or judicial review of at least 40%); penalty may be waived if preparer provides a “reasonable basis” of support (20-25%?) for a non-frivolous position *and* discloses the position on the return; otherwise, preparer must simply refuse to prepare the return if the position is frivolous (*note*—odds of success must be estimated at greater than 50%, i.e., “more likely than not” if the position involves a tax shelter); *Sec. 6694(b)* provides a penalty (larger of \$5,000 or 50% of return fee) for preparing return with reckless disregard of rules or willful understatement of tax (imposed on actual preparer, not employer); if both 6694(a) and (b) penalties apply, the larger (b) penalty is reduced by the (a) penalty.
88. **Preparer Penalties – Unauthorized Disclosure & EIC Due Diligence** – Both a civil penalty (\$250 per use) and a criminal penalty (\$1,000 fine and/or 1-year prison term) can apply to any unauthorized disclosure of taxpayer information (doesn’t apply to disclosures that are required by the Code, given with the client’s permission, or court-ordered—not just a subpoena); A penalty (\$100 per failure) also applies for lack of due diligence in determining eligibility and computing the earned income credit (EIC), which can apply in addition to willfulness or unreasonable position penalties; preparer must retain eligibility checklist worksheet and other info for each client claiming the credit.
89. **Preparer Penalties – Signature Requirements** – The “primary tax return preparer” (the one with primary responsibility for overall accuracy, not just math) must sign the return before giving return to taxpayer (copy OK if signed by taxpayer), sign by hand or electronically but no facsimiles; signing preparer may represent taxpayer before IRS (e.g., RTRP), and in some cases a reviewing supervisor may be signer if performing final review and taxpayer may change the return; a substitute may sign the return after a thorough review, but ONLY if original preparer is not available for an extended period of time; \$50 penalty applies for failure to sign return.
90. **Preparer Penalties – Reporting Requirements** – Penalties related to reporting (unless reasonable cause exists) include: (1) failure to furnish copy of return to taxpayer no later than when presented for signature (\$50 per failure, \$25,000 max); (2) failure to retain a copy of the return, or *alternatively* a list of name, ID#, and type of return for each taxpayer, for 3 years unless reasonable cause (\$50 per failure, \$25,000 max); (3) failure to keep a list of all persons employed by the taxpayer (name, ID#, and place of work) to prepare returns or claims for 3 years following 7/1 of the filing year (\$50 per failure, \$25,000 max).
91. **Preparer Penalties – Refund Obligations & Preparer Rights** - A \$500 penalty per instance applies to any tax return preparer who endorses or otherwise cashes a taxpayer’s refund check (a preparer can NEVER be authorized to do this); a POA may authorize a preparer to *receive* the refund check, and

the penalty also does not apply to a deposit of the full amount in the taxpayer's bank account; any check-cashing business owned by taxpayer must be *totally separate* from tax return preparation business.

## Electronic Filing (EF)

92. **EF – Registration Requirements** – Electronic filing (EF) is required for (1) partnerships with > 100 partners, (2) corps/S corps/tax-exempts with assets > \$10 million and filing > 250 returns, or (3) tax preparers filing > 100 returns in 2011 (> 10 in 2012); Form 8633 is used to request an eFile ID number (EFIN); registration should be by principal or responsible individual, denied applicants have 30 days to appeal, and preparer will be removed from the eFile list if no returns are filed electronically for two years (60-day notice to reactivate); authorized eFile providers include the following designations: Electronic Return Originators (EROs), Intermediate Service Providers (ISPs), Transmitters, Software Developers, and Reporting Agents.
93. **EF – Paying the Tax** – The following options are available for paying the tax on an eFile return: (1) *electronic funds withdrawal (EFW)*, (2) *credit or debit card*, (3) *Electronic Federal Tax Payment System (EFTPS)*, either direct or same day payments through a financial institution), (4) *check* (with a Form 1040-V attached), or (5) an *installment agreement* (if amount < \$25,000, request online by filing Form 9465).
94. **EF – Basic Filing Responsibilities** – All eFile providers other than software developers are “preparers” and must follow Circular 230 rules; returns are signed electronically by either by (1) self-select PIN method (must be 16 or older, and requires date of birth and AGI) or (2) practitioner PIN methods (Form 8879); any required paper documents (e.g., POAs, change of accounting methods, non-cash charitable contributions, Sch. D continuation sheet) are attached to a Form 8453; altered W-2's must be flagged with a nonstandard form Code; the ERO must provide the taxpayer with a paper copy of the return and Form 8453, mail original Form 8453 within 3 days of IRS acknowledgement of filing, retain copies (including acknowledgement) until the end of the filing year, and inform taxpayer if direct deposit is rescinded.
95. **EF – Special Return Issues** – Returns INELIGIBLE for EF include prior-year returns, fiscal-year returns, amended returns, M/S returns in community property states, and certain rare or non-processible forms, and TINs 900-999; if EF is rejected, the taxpayer must be notified within 24 hours and told the reject codes (found in Publication 1346); changes are normally corrected and transmitted, new Form 8453 required only if a substantial change, and the taxpayer's signature is not required if the correction involves either < \$50 income or < \$14 difference.
96. **EF – Advertising, Fees & RALs** – General Circular 230 advertising restrictions also apply to eFile, but copies of broadcast commercials must be retained only until end of calendar year following broadcast (*recall* - 3 years for non-eFile ads), only acceptable self-description is “*Authorized IRS e-file provider*”, and cooperative advertising must list all parties; fees may not be based on percentage of refund or amounts on return, NO separate fee should be charged for Direct Deposit, refunds may not be direct deposited to credit card accounts, and taxpayer should be alerted that some institutions do not permit joint refunds to individual accounts.

97. **EF - Refund Anticipation Loans (RALs)** – An RAL is a loan to the taxpayer from a lender based on the anticipated refund, and the IRS is NOT involved in any manner; the Electronic Return Originator (ERO) must explain the RAL in detail (e.g., interest charges), include all RAL indicators on the return, and may disclose taxpayer information only with consent; the ERO and the lending institution must NOT be related, and the ERO may charge only a flat fee for assisting with the RAL, the fee must be the same for all, and there can be NO sharing of fees with the lender other than the flat fees lenders charge clients for RALs; 2012 is the last filing season for big banks.
98. **EF – Levels of Sanctions** - Violations of eFile rules are subject first warnings and then possibly sanctions (sanctions are generally effective 30 days after the warning); there are three levels of sanctions: (1) *Level 1* (little impact, letter warning), (2) *Level 2* (adverse impact, may be restricted or suspended, or (3) *Level 3* (significantly adverse, may be suspended current and next two years, then expelled).

### **Records, Collection, and Installment Agreements**

99. **Record-Keeping Requirements** – Generally, tax records must be kept until the statute of limitations expires, i.e., the *later* of (1) *three years after the due date of the return* (7 for worthless securities) or (2) *two years from the date the tax was paid*. Exceptions are for tax years with more than 25% of gross receipts omitted (6 year statute) and there is NO statute of limitations for fraud cases, non-filed returns, basis records (for cost of assets sold) or changes of accounting methods; software is NOT a substitute for good records, travel & entertainment records must disclose all details, although documentation is NOT needed for reimbursements under an accountable plan if de minimis (< \$75 for lodging, < \$25 for transportation).
100. **Collection of Tax & Installment Agreements** – IRS generally has 10 years from due date of return to collect the tax, but IRS and taxpayer (or representative with a POA) may agree to extend statute by filing Form 872-A (scope may be limited by agreement); *Installment payment plan agreements* for payment of tax may be requested by taxpayer by filing Form 9465 (can be done electronically) and paying a user fee of \$52 by direct debit, \$105 for others, or \$43 for low-income individuals; interest & penalties continue to accrue, the IRS may or may not file a lien on the property, and a 30-day notice of cessation of the agreement is sent to taxpayer if payments are late.