Publication 4491

VITA/TCE **Training Guide**

Volunteer Income Tax Assistance (VITA) / Tax Counseling for the Elderly (TCE)

Volume 6 of 16

2023 RETURNS

Take your VITA/TCE training online at: **apps.irs.gov/app/vita/** (keyword: Link & Learn Taxes). Link to the Practice Lab to gain experience using tax software and take the certification test online, with immediate scoring and feedback.

Publication 4491 (Rev. 10-2023) Catalog Number 74182D
Department of the Treasury **Internal Revenue Service** www.irs.gov

Visit the Accessibility Page on IRS.gov

This page is intentionally left blank

Lenny bought 500 shares of XYZ Corporation stock for $1,500, including his broker's commission. Five years later, XYZ distributed a 2% nontaxable stock dividend (10 shares). Three days after the stock dividend was distributed, Lenny sold all his XYZ stock for $2,030.

Although Lenny owned the 10 shares for only three days, all the stock has a long-term holding period. Stock acquired as a nontaxable stock dividend has the same holding period as the original stock owned. Because he bought the stock for $1,500 and then sold it for $2,030 more than a year later, Lenny has a long-term capital gain of $530 on the sale of his 510 shares.

If taxpayers do not have the purchase documents or other records showing the date of purchase and cost, refer them to their stockbroker or financial planner.

For additional information on the holding period and other tax consequences of selling or trading investment property, refer to Publication 550.

Although brokers and mutual fund companies are not required to report basis information for noncovered securities, most brokers and mutual fund companies provide supplemental basis information that can be used if the taxpayer concurs with the information.

Mutual Funds

A mutual fund is a regulated investment company generally created by “pooling” funds of investors providing the advantage of a diversity of investments and professional management.

Owners of mutual funds may receive both Form 1099-DIV and Form 1099-B. Form 1099-DIV reports capital gain distributions from sales of stock held by the mutual fund.

Profits of these sales are reported to the shareholders of the fund as capital gain distributions. If taxpayers (owners) decide to sell any of their shares in the mutual fund itself, Form 1099-B will be issued. The taxable gain or loss from the sale or exchange of the taxpayer's shares in a mutual fund is reported on Schedule D as a capital gain or loss.

If mutual fund dividends and capital gain distributions are reinvested in new shares, the holding period of each new share begins the day after that share was purchased. Therefore, if both the new shares and the original shares are sold, there may be both short-term and long-term gains and losses.

To figure the gain or loss on the disposition of mutual fund shares, determine which shares were sold and the basis of those shares. If the shares in a mutual fund were acquired all on the same day and for the same price, figuring their basis is not difficult. However, shares are generally acquired at various times, in various quantities, and at various prices, making it more difficult to figure the basis. Taxpayers can choose to use either a cost basis or an average basis to figure the gain or loss. For more information on how to report the sale or exchange of mutual fund shares, refer to Publication 550.

Stock

Some taxpayers may own shares of stock they bought on different dates or for different prices. This means they own more than one “block” of stock. Each block may differ from the others in its basis (the amount paid for the stock), its holding period (long-term or short-term), or both.

In directing a broker to sell stock, the taxpayer may specify which block, or part of a block, to sell. This is called “specific identification.” To be valid, the specification must be made before or at the time of sale,

not after the sale. If the taxpayer does not do this, the shares are sold from the earliest block purchased (FIFO method – or First In, First Out).

Marie bought 100 shares of Antrim Corporation stock for $2,000. A year later, she bought another 100 shares of Antrim for $2,300. Five years later, she sold 100 shares of Antrim for $3,000 but she did not identify the specific block at the time of sale.

Because Marie purchased the earliest block of 100 shares at $2,000, the adjusted basis of the shares she sold was $2,000. The sales price of the 100 shares sold was $3,000. Marie had a long-term capital gain of $1,000.

However, if she had told her broker to sell the 100 shares from the second block of stock she bought, the adjusted basis would have been $2,300, giving Marie a long-term capital gain of $700.

What information do I need from Form 1099-B?

Sale of stock is reported to the taxpayer on Form 1099-B, Proceeds From Broker and Barter Exchange Transactions. Form 1099-B is prepared by the broker who handled the sale of the stock. Refer the taxpayer to a professional tax preparer if any of the following boxes has an entry:

- Accrued market discount
- Profit or (loss) realized on closed contracts
- Unrealized profit (loss) on open contracts – prior year
- Unrealized profit (loss) on open contracts – current year
- Aggregate profit (loss) on contracts
- Proceeds are from collectibles
- Bartering
- If there is a FATCA filing requirement

These boxes provide information about transactions that are out of scope for the VITA/TCE programs.

Most brokers report using a substitute Form 1099-B, not the IRS form. All the same information is included, but the order of the information may vary. Carefully review the broker statement during the interview to confirm that all transactions are in scope.

On a brokerage statement, margin interest is investment interest. If the taxpayer is itemizing deductions, the return is out of scope.

Form 1099-B includes these boxes for reporting sales of securities:

- Description of property
- Date acquired
- Date sold or disposed
- Proceeds

- Cost or other basis
- Wash sale loss disallowed
- Type of gain (short-term or long-term)
- Federal or state income tax withheld
- Whether the basis was reported to the IRS or if it is a noncovered security
- Whether the amount reported is gross proceeds or net proceeds

When the FATCA box is checked, the taxpayer may have additional reporting responsibilities with respect to their foreign accounts or assets. These topics are beyond the scope for the VITA/TCE programs and affected taxpayers should be referred to a professional tax preparer.

Brokers must complete boxes on the Date of sale or exchange; Date of acquisition; Type of gain or loss; Cost or other basis; and Wash sales when reporting sales of securities unless the box for Noncovered security is checked.

Date of Sale or Exchange

The stockbroker reports the date the stock was sold on Form 1099-B. If the securities sold were noncovered securities, use this date, along with the purchase date provided by the taxpayer to determine the holding period. If the securities sold were covered securities, the stockbroker reports the date the stock was acquired and whether the gain was short-term or long-term.

Sales Price

The stockbroker must reduce the gross proceeds for any commissions or transfer taxes related to the sale:

- If sales price (gross proceeds) is checked, ask the taxpayer for the amount of commissions/fees paid and enter an adjustment on the capital gains worksheet

- If sales price less commissions and option premiums (net proceeds) is checked, the broker subtracted the commissions and fees from the proceeds

Richard sold stock for $2,300. He paid his broker a commission of $35 on the sale and received net proceeds of $2,265. Richard's broker has reported:

- *Proceeds on Form 1099-B of $2,265*
- *The box next to net proceeds is checked*

EXERCISES

Answers are after the lesson summary.

Question 1: Kevin paid his broker a $75 fee on the sale of his stock. His Form 1099-B shows $925, and the box next to net proceeds is checked. What is the amount Kevin reports as his sales price?

a. $925

b. $1,000

c. $850

d. $75

Other Information

If the securities sold were noncovered securities, Form 1099-B would not report the date the stock was originally purchased, the original purchase price, or any adjustments to the basis. Some brokers report this information on a tax reporting supplement. If not, the taxpayer must provide this information.

If the tax statement includes items other than those that are in scope (interest, dividends, sales of securities), such as “miscellaneous income,” it may represent items that are out of scope. Review the entire tax statement during the interview to identify if the return is out of scope.

How do I enter data on Form 8949 and Schedule D?

Generally, transactions are not reported directly on Schedule D. Instead, they are detailed on various Forms 8949. A separate Form 8949, page 1, is required for each of the three types of short-term transactions. The three types of long-term transactions are recorded on a separate Form 8949, page 2. The subtotals from Forms 8949 are carried over to Schedule D, where aggregate gain or loss is calculated.

A check box on Form 8949 identifies the type of transaction reported; a taxpayer with more than one type of transaction must file a separate form for each type.

Some taxpayers may be able to enter capital gains transactions directly on Schedule D. See the Volunteer Resource Guide, Tab D, Income, for the current information on Schedule D and Form 8949.

All entries are made on the Capital Gains Transactions screen. The software determines the holding period and enters the information on Form 8949, pages 1 and/or 2, provided correct transaction codes are properly entered in both the Capital Gains Transactions screen and Form(s) 8949. Use the Volunteer Resource Guide, Tab D, Income, to review software information.

How do I report capital gain distributions?

Capital gain distributions are reported to the taxpayer on Form 1099-DIV. If there is no sale or disposition of capital assets to report, the Form 1099-DIV amount is reported directly on Form 1040 with a checkmark in the box to indicate a Schedule D is not required.

If a taxpayer has both Form 1099-DIV *and* Form 1099-B, then capital gain distributions are added to Schedule D, Part II, line 13.

Question 2: Which of the following taxpayers is required to file Form 1040 and Schedule D?

a. Marriah, who received one Form 1099-B and no Forms 1099-DIV

b. Lorraine, who received Forms 1099-DIV for capital gain distributions from three different mutual funds

c. Both of the above

If the source documents (Forms 1099-DIV and 1099-B) are recorded properly in the tax preparation program, then the numbers will be reported in the proper places. The amount from Form 1099-DIV, Box 2a, will be entered on the Dividend entry screen (along with the other information) and will automatically carry over to the capital gain distributions line (line 13) in Schedule D, Part II.

Eldridge received a Form 1099-DIV. Box 2a shows he received a total capital gain distribution of $170.

Eldridge also received a Form 1099-B that shows net proceeds of $1,200 on the sale of 600 shares of ABC Group, Inc. He held the stock for over 6 years. His basis in ABC, including commission, is $1,455.

Eldridge must use Schedule D to report his capital gain distribution because he sold stock that must be reported on Schedule D.

How do I complete reporting of capital gain or loss?

Form 8949 contains most capital gain and loss transactions. The subtotals from Form 8949 are carried over to Schedule D, where gain or loss is calculated in the aggregate.

Combining all the amounts in the gain or (loss) column on Schedule D, Part I, results in a net short-term capital gain or loss. Combining all the amounts in the gain or (loss) column on Schedule D, Part II, results in a net long-term capital gain or loss.

The combination of the net short-term and net long-term capital gains or losses impacts the tax liability. If there is a combined net capital loss in excess of $3,000 (or if Married Filing Separately, in excess of $1,500), then the excess is carried to the next tax year and carried forward until exhausted. Carryover losses retain their original holding period.

Bill bought 1,000 shares of stock for $15,000 (including commission). One year later he sold 600 shares of the stock for $7,800 in net proceeds. Bill had a net loss of $1,200 as shown below:

Basis = ($15,000 ÷ 1,000) x 600 = $9,000

Sales Price = $7,800

Gain or Loss = Sales Price – Basis = $7,800 – $9,000 = –$1,200 Bill had a short-term loss of $1,200.

Margo bought stock for $1,500 plus a $25 commission; 18 months later she sold all the stock for

$2,000 and paid a $25 commission. Her Form 1099-B shows the net proceeds of $1,975 as the sales price.

Basis = ($1,500 + $25) = $1,525

Sales Price = $1,975

Gain or Loss = Sales Price – Basis : $1,975 – $1,525 = $450 Margo had a long-term gain of $450.

The Volunteer Reference Guide, Tab D, Income, contains a list of adjustment codes that can be used when completing Forms 8949. When reporting transactions on a grouped basis, use code M. If another code is needed for the grouped transactions, enter both codes in the software.

In the rare event that the net proceeds on Form 1099-B are not correct, do not change the sales price amount. Instead, use the adjustment column on Form 8949 with the proper code.

How do I calculate and report a carryover of a capital loss?

Taxpayers can deduct capital losses up to the amount of their capital gains plus $3,000 ($1,500 if married filing separately). A loss carryover can occur when losses exceed gains or when there is not enough taxable income to absorb the net loss deduction. The prior year's short-term and long-term carryover losses are combined with the capital gains and losses in the current year. Unused capital losses can be carried over to later years until they are completely used up.

Capital Loss Carryover Worksheet

Check the Intake sheet and the prior year's return for a capital loss deduction on Form 1040. If there appears to be a capital loss carryover, look for the capital loss worksheet in the prior year's return. Note that the software may have already brought the carryover amount into the current year's return.

If needed, use the Capital Loss Carryover Worksheet from the Schedule D instructions to compute the amount of capital loss carryover from the previous year. To complete the worksheet, you will need information from the prior year return.

If the taxpayer's current year capital loss exceeds the deduction limit and the remainder must be carried forward to the next tax year, remind the taxpayer to bring a copy of the current year's return to assist in preparing next year's return. Make a note on the outside of the taxpayer's tax return record envelope to alert next year's preparer. Next year, whoever assists the taxpayer will use this information to figure how much capital loss the taxpayer can carry over from the prior tax year to the current tax year.

For additional information on Schedule D, capital gains and losses, and carryovers, refer to the instructions to Form 1040, Schedule D, and Reporting Gains and Losses in Publication 550.

Tax software automatically calculates the taxpayer's capital loss. If the loss is over the limit, the tax software reports the maximum allowable deduction. The tax software also completes the capital loss carryover worksheet showing the amount of loss that can be carried over to future tax years.

Taxpayer Interview and Tax Law Application

Taxpayers Jeremy and Janice Smith checked the “Yes” box for income from the sale of stock on the intake and interview sheet. The volunteer asks for details.

Sample Interview

Volunteer Says...	Jeremy Responds...
Previously we discussed your dividends from the Pembroke Fund, reported on Form 1099-DIV. Did you have any other income from the sale of stock, securities, or other investments?	Yes, I sold some stock this year.

Do you have a Form 1099 for that?	Yes, I have this Form 1099-B and this stockbroker’s statement.
We already discussed the capital gain distribution from the mutual fund when we entered the dividends. We’ll examine the stock sale information now. I see the broker’s statement has the sale details I need, but do you know when you purchased the Purdue stock?	I bought the Purdue stock back on July 13, 2000.
I see the sale date was March 10, 2021. That means the	What is that?

holding period for the stock was more than one year. They call that long-term, and it determines both where the information is reported and the tax rate for any gain. Now, do you know the basis for the stock?	
That's what it cost you, including any broker fees or commissions.	Yes, it cost $10,053, plus I had to pay $35 in fees.
Have you had any other costs, stock dividends, or stock splits related to the stock since then, such as additional fees?	No, that's it. Wait, when I sold it, I had to pay $35 more.

That means that the basis for the stock is $10,088. The Form 1099-B shows that you received net proceeds of $8,859 when you sold the stock so the $35 you paid on the sale is already taken into account. We'll put all these numbers into the tax software. After I enter these other transactions from the broker's statement, we'll get a final net gain or loss on Schedule D. This will determine the amount that will be	

reported on Form 1040. [Indicate Jeremy’s responses to these questions on the intake and interview sheet.]	

Sale of Home

The intake and interview sheet lists income from the sale of real estate. Ask taxpayers if they sold any real estate, such as their principal residence or “main home” during the tax year. The taxpayer may be eligible to exclude all or part of the gain from their taxable income. The sale of real estate other than a home used as a residence is out of scope of the VITA/TCE programs.

Who must report the sale of a home on Form 8949 and Schedule D?

To determine if the sale of the taxpayer's residence must be reported on Form 8949 and Schedule D, identify whether the home was the taxpayer's main home, if the taxpayer meets the ownership and use tests, and if the gain, if any, is more than the allowed exclusion amount. Taxpayers must report the sale of a home if ANY of the following is true:

- The taxpayer does not meet the ownership test
- The taxpayer does not meet the use test
- During the two-year period ending on the date of the sale, the taxpayer has excluded the gain from the sale of another home
- The taxpayer has a gain and does not qualify to exclude all of it

- The taxpayer has a gain and chooses not to exclude it
- The taxpayer received Form 1099-S

For additional guidance in making this determination, refer to Publication 523, Selling Your Home.

Exclusion Amount

Taxpayers who sold their main home may be able to exclude gain up to a maximum of $250,000 ($500,000 for married taxpayers who file a joint return or for certain surviving spouses).

Generally, if the taxpayer can exclude all of the gain, it is not necessary to report the sale. If the taxpayer has gain that cannot be excluded, it is taxable and reported on the return.

A loss on the sale cannot be deducted, however, the taxpayer may be required to report it.

What is considered a “main” home?

Only gain from the sale of a taxpayer’s main home may be excluded from the taxpayer’s income; gain from the sale of a home that is *not* the taxpayer’s main home will generally have to be reported as income.

A taxpayer’s “main” home is where they live most of the time. It does not have to be a traditional house; for example, it may be a houseboat, mobile home, cooperative apartment, or condominium, but it must have cooking, sleeping, and bathroom facilities. The taxpayer’s main home may also be a rented house or apartment. Taxpayers with more than one home cannot choose which home to designate as their main home.

Lucille owns a home in a Colorado ski area (the ski home). She stays at the ski home most weekends and *spends the entire months of December, January, and February there. When she is not at the ski home, she lives in a four-room apartment that she rents in Denver. Even though she does not own it, Lucille's main home is her rental apartment in Denver, because she lives there most of the time.*

What are the ownership and use tests?

To claim the exclusion on the gain from the sale of a home, the taxpayer must meet the ownership and use tests. This means that during the five-year period ending on the date of the sale, taxpayers must have:

- Owned the home for at least two years (the ownership test), and
- Lived in the home as their main home for at least two years (the use test)

There are special rules for members of the Armed Forces, intelligence personnel and

Peace Corps volunteers in the application of the five-year period. See "Five-year Test Period Suspension" later in this lesson.

The required two years of ownership/use do not have to be continuous. Taxpayers meet the tests if they can show that they owned and lived in the property as their main home for either a total of 24 full months or 730 days (365 x 2) during the five-year period ending on the date of sale. Short, temporary absences are counted as periods of use even if the property is rented during those absences. Also, if the taxpayer becomes physically or mentally unable to care for themselves, and used the residence as their principal residence for 12 months in the 5 years preceding the sale or exchange, any time spent living in a care facility (such as a nursing home) counts toward the 2-year residence requirement, so long as the facility has a license from a state or other political entity to care for people with the taxpayer's condition.

Ownership and use tests can be met during different two-year periods. However, a taxpayer must meet both tests during the five-year period ending on the date of the sale.

Helen lived in a rented apartment in 2008. The apartment building was later changed to a condominium, and she bought her apartment on December 1, 2014. In 2016, Helen became ill and on April 14 of that year she moved into her daughter's home. On July 10, 2018, while still living in her daughter's home, she sold her apartment.

For the 2018 tax year, Helen can exclude all the gain on the sale of her apartment because she met the ownership and use tests. Her five-year period is from July 11, 2013, to July 10, 2018, the date she sold the apartment. She owned her *apartment from December 1, 2014, to July 10, 2018 (over two years). She lived in the apartment from July 11, 2013 (the beginning of the five-year period) to April 14, 2016 (over two years).*

Question 3: Emily, who is single, bought a home in 2000. She lived in the home until January 1, 2009, when she accepted a temporary job assignment in Venezuela and left the house vacant. Emily returned to her home on December 31, 2010 and lived there until she sold the house on January 10, 2014. Does Emily meet the ownership and use test?

a. Yes

b. No

Reduced Exclusion

Taxpayers who owned and used a home for less than two years (do not meet the ownership and use test) may be able to claim a reduced exclusion under certain conditions. These include selling the home due to a change in place of employment (beyond a certain distance), health, or unforeseen circumstances. If any apply, refer the taxpayer to a professional tax preparer. Reduced exclusion computations/determinations are beyond the scope of the VITA/TCE programs.

Prior Exclusions

In addition, during the two-year period ending on the date of the sale, the taxpayer must not have claimed an exclusion on a gain from the sale of another home.

Married Homeowners

The ownership and use tests are applied somewhat differently to married homeowners. Married homeowners can exclude up to $500,000 if they meet *all* of these conditions:

- They file a joint return
- Either spouse meets the ownership test
- Both individuals meet the use test

- Neither one excluded gain in the two years before the sale of the current home

If either spouse does not satisfy all these requirements, they cannot claim the maximum exclusion ($500,000). The most they can claim is the total of the maximum exclusions each would qualify for if not married and the amounts were figured separately. For this purpose, each spouse is treated as owning the property during the period that either spouse owned the property. This calculation is outside the scope of the VITA/TCE programs.

Sale of Main Home by Surviving Spouse

Beginning with main home sales after 2007, the maximum exclusion ($500,000) by an unmarried surviving spouse is allowed if the sale occurs no later than two years after the date of the spouse’s death, and all other requirements are met.

Upon the death of the first spouse, some or all of the property may have a new basis based on the fair market value on the date of death. This may substantially reduce the amount of gain.

How do I figure the gain (or loss) from the sale of a home?

After determining that a taxpayer is eligible for the exclusion, figure the gain (or loss) on the sale based on the selling price, amount realized, basis, and adjusted basis. If the selling price of the taxpayer's home is less than the allowable exclusion of up to $250,000 ($500,000 if Married Filing Jointly), it is not necessary to calculate the gain; none of it will be taxable. Loss on the sale of a residence is not deductible. For more information, see Publication 523.

If the taxpayer used the home for business purposes or as rental property, or if the taxpayer did not use it as their residence, refer them to a professional tax preparer.

Selling Price

The selling price is the total amount taxpayers (the seller) received for their main home. It includes money, all notes, mortgages, or other debts taken over by the buyer as part of the sale, and the fair market value of any other property or services that the seller received.

If the taxpayer received Form 1099-S, Proceeds from Real Estate Transactions, use it to report the selling price. Box 1 shows the date of sale (closing) and Box 2 shows the gross proceeds received from the sale of the home. For taxpayers who did not receive a Form 1099-S, use sale documents and other records.

Use the gross selling price on Form 8949. Selling expenses are discussed below.

If the taxpayer can exclude the entire gain from the sale of a main home, the person responsible for closing the sale (i.e., a real estate broker or settlement agent) generally will not issue Form 1099-S. If Form 1099-S is issued and you determine that the gain is excludable, the sale should be reported on Form 8949 and Schedule D to notify the IRS of the exclusion.

If the taxpayer has a loss on the sale of a main home for which Form 1099-S was received, the taxpayer must report the loss on Form 8949 and Schedule D even though it is not deductible. Enter an adjustment to zero out the loss (nondeductible loss that will show as code L on Form 8949).

Basis

The basis in a home is determined by how the taxpayer obtained the home. If a taxpayer bought or built a home, the basis is what it cost the taxpayer to buy or build that home. If the taxpayer inherited the home, the basis is generally its fair market value on the date of the decedent's death, or on the later alternate valuation date chosen by the representative for the estate.

Alternative valuation issues and determining the adjusted basis of property received as a gift can be very complex and are outside the scope of this training. Advise taxpayers to seek assistance from a professional tax preparer if they do not know the basis and the correct holding period.

Determining the basis of property inherited in 2010 is complex and outside the scope of the VITA/ TCE *programs. Taxpayers who sold such property should be referred to a professional tax preparer if they do not know the basis and the correct holding period.*

Adjusted Basis

The adjusted basis is the taxpayer's basis in a home increased or decreased by certain amounts.

Increases include additions or improvements to the home such as building a recreation room or adding a bathroom. In order to be considered an increase, the improvement must have a useful life of more than one year. Repairs that maintain the home in good condition are not considered improvements and should not be added to the basis of the property.

Decreases to basis include deductible casualty losses and gains a taxpayer postponed from the sale of a previous home before May 7, 1997. Decreases can also include depreciation during the time the home was used for business purposes or as rental property. If any of these decreases apply, the taxpayer should be referred to a professional tax preparer.

Decreases will also include the cost of items removed from the property. An example would be a new furnace that is later replaced with a second new furnace. The cost of the first furnace is removed and only the cost of the second furnace will increase basis.

Adjusted basis = Basis + Increases Decreases

To determine basis adjustments, taxpayers can use Worksheet 2, How to Figure Your Gain or Loss, in Publication 523. While volunteers may provide assistance, the taxpayer has ultimate responsibility for all items on their return.

Selling Expenses

Selling expenses reduce the gain or increase the loss. Selling expense may include commissions, advertising fees, legal fees, mortgage points or other loan charges paid by the seller that would normally have been the buyer's responsibility, such as transfer taxes, courier fees, and many other expenses. Selling expenses would not include items such as proration of homeowner fees, property taxes, interest on the loan to the date of sale, among others. Some items may be claimed as itemized deductions (property taxes and qualified home mortgage interest). Others are never deductible because they are personal expenses.

Report the total selling expenses as an adjustment (code E). Do not reduce the gross proceeds. Use the gain after the selling expense adjustment to determine the amount of exclusion available, if any.

How much of the gain from a home sale can a taxpayer exclude?

Once you've determined the gain or loss on the sale of a taxpayer's main home, next figure the exclusion and any taxable gain from the sale.

If all the requirements are met, an individual taxpayer may exclude up to $250,000 of the gain from taxable income; taxpayers who use the Married Filing Jointly filing status and some surviving spouses may exclude up to $500,000.

Publication 523 contains Worksheet 3, Determine If You Have Taxable Gain, which may be used to figure the gain or loss, the exclusion, and the taxable gain from a sale.

Taxpayers who claimed the first-time homebuyer credit may be required to repay the credit in the year of sale. The repayment is limited to the *amount of gain on the sale. This situation is out of scope for the VITA/TCE programs. Refer taxpayers to the instructions for Form 5405, Repayment of the First-Time Homebuyer Credit, or to a professional tax preparer for more information on how to adjust the basis of the home and exceptions to the repayment rule.*

Gain from the sale or exchange of a main home is not excludable from income if allocable to periods of nonqualified use. Generally, nonqualified use means any period in 2009 or later where neither the taxpayer nor spouse (or former spouse) used the property as a main home (with certain exceptions). A list of exceptions to a period of nonqualified use can be found in Publication 523. To figure the portion of nonqualified use, multiply the gain by the following fraction:

$$\frac{\text{Total nonqualified use during period of ownership in 2009 or later}}{\text{Total period of ownership}}$$

This issue can be complex. Refer taxpayers with nonqualified use issues to a professional tax preparer.

Where do I report any taxable gain from the sale of a home?

The disposition of a home is reported on the tax return if any part of the gain is taxable or if Form 1099-S was received. If taxpayers have more than one home, they can exclude gain only from the sale of their main home. They must pay tax on the gain from selling any other home.

When completing Form 8949 and Schedule D use adjustment code H to claim the allowable exclusion. Enter both code E (for selling expenses) and code H (for the excluded gain) and the aggregate amount of both as an adjustment. If the home was used for business purposes or as rental property, the gain would be reported on Form 4797, Sales of Business Property, and the taxpayer should be referred to a professional tax preparer.

If the amount realized is less than the adjusted basis, the difference is a loss, which cannot be deducted. However, taxpayers who received Form 1099-S for a loss on the sale of a main home must report the loss on Form 8949 and Schedule D even though it is not deductible. Reporting the transaction should prevent the taxpayer from receiving a notice from the IRS.

To review information related to the software, go to the Volunteer Resource Guide, Tab D, Income, for software entries on the Sale of a Home.

How do I report a nondeductible loss if taxpayer received Form 1099-S on the sale of a main home?

If the taxpayer has a loss on the sale of a main home for which Form 1099-S was received, the transaction must be reported on Form 8949 and Schedule D even though the loss is not deductible. Adjustment code L is for a nondeductible personal loss. Enter both code E (for selling expenses) and code L (for the nondeductible loss) and the net amount of both as an adjustment to zero out the loss.

Taxpayer Interview and Tax Law Application

Jeremy and Janice Smith checked the “Yes” box for selling some real estate on the intake and interview sheet. The volunteer asks for details.

Sample Interview

Volunteer Says…	Jeremy Responds…
Did you sell a home during this tax year?	Yes, I was going to mention that to you because I should get a tax break on that.
Well, you may be able to exclude all or part of your gain from that sale, but to find out, I have to ask you a few questions. First, how long did you own the home?	Three and a half years.
And was it the main place you lived for at least two years of that time?	Yes, we lived there the whole time.

Great, you meet the ownership and use tests. During the two years before you sold the house did you claim an exclusion on a gain from another house?	No, this is my only house.
Did you receive Form 1099-S?	No, but I do have my paperwork from the sale. My real estate broker said I wouldn't need that form because I was within the limits.
Your paperwork shows a selling price of $360,000. Do you have anything that lists the basis in the	Yes, I bought it for $280,000 and put in $20,000 of improvements –

home, that is, the cost of the home at the time you bought it?	mostly new bathrooms.
With a basis of \$300,000, your gain from the sale is \$60,000. As a married couple who meets the ownership and use tests, you can exclude up to \$500,000 from the sale, so you don’t have to report the sale on your return. [Indicate Jeremy’s responses to these questions on the intake and interview sheet.]	

What is the Five-Year Test Period Suspension?

Taxpayers can choose to have the five-year test period for ownership and use suspended during any period the homeowner (either spouse if married) served on “qualified official extended duty” as a member of the uniformed services or Foreign Service of the United States, as an employee of the intelligence community, or as an employee or volunteer of the Peace Corps. This means that the taxpayer may be able to meet the two-year use test even if the taxpayer and/or spouse did not actually live in the home during the normal five-year period required of other taxpayers.

Taxpayers are on qualified official extended duty if they serve at a duty station at least 50 miles from their main home or live in government quarters under government order. Taxpayers are considered to be on extended duty when they are called to active duty for more than 90 days or an indefinite period.

Period of Suspension

The period of suspension cannot last more than ten years. Together, the ten-year suspension period and the five-year test period can be as long as fifteen years. The suspension can be used on only one property at a time.

For more information about the suspension of the five-year test period, see Service, Intelligence, and Peace Corps personnel, in Publication 523.

This extension of time can apply to taxpayers who have recently left the military.

For the 2014 tax year: Peter bought a home in 2004 and lived in it for 2½ years. Beginning in 2007, he was on qualified official extended duty *in the U.S. Army. He sold his home in 2014 and had a $12,000 gain. Peter would normally not meet the use test in the five-year period before the sale (2009-2014). Because of the suspension, Peter's test period is the five years before he went on qualified official extended duty.*

Question 4: In this exercise, John purchased a home in 2003. Through your interview process, you discover that he sold his main home in 2018. John had not lived in the home for six years. Which of the following conditions would allow John to exclude his gain?

a. John went on sabbatical for four years and backpacked through Europe.

b. John lived with a co-worker for four years and let his brother occupy his home.

c. John was deployed to Europe on official extended military duty for five years.

d. John married and his bride had her own home. The couple chose to live in the wife's home and rent out John's home, until it was sold.

Summary

This lesson covered how to report the sale of capital assets and the sale of a principal residence. In most cases, a taxpayer must use Form 8949 and Schedule D to report capital gains and losses on the sale of assets. You learned how to identify the asset's holding period, adjusted basis, net short-term and long-term capital gains or losses, the taxable gain or deductible loss, and the amount of capital loss carryover.

Qualified taxpayers may be able to exclude a portion of the gain on the sale of their main home if they meet the ownership and use tests. Taxpayers can choose to have the five-year test period for ownership and use suspended during any period the homeowner (either spouse if married) served on qualified official extended duty as a member of the uniformed services or foreign service of the United States, as an employee of the intelligence community, or as an employee or volunteer of the Peace Corps. A loss on the sale of a principal residence is not deductible but must be reported if the taxpayer received Form 1099-S.

The worksheets in Publication 523 help you figure the taxable gain from the sale of a home using the selling price, amount realized, basis and adjusted basis, along with the maximum allowed exclusion.

What situations are out of scope for the VITA/TCE programs?

The following are out of scope for this lesson. While this list may not be all inclusive, it is provided for your awareness only.

- Taxpayers who have sold any assets other than stock, mutual funds, or a personal residence
- Taxpayers who trade in options, futures, or other commodities, whether or not they disposed of any during the year
- Taxpayers who must answer "Yes" to the digital asset (virtual currency) question on Form 1040.
- Determination of basis issues:
    - Basis of any asset acquired other than by purchase or inheritance, such as a gift or employee stock option, unless the taxpayer provides the basis and holding period

  - Basis of inherited property determined by a method other than the FMV of the property on the date of the decedent's death, unless the taxpayer provides the basis and holding period

- Like-kind exchanges and worthless securities

- Form 1099-B, boxes with entries for any of the following: Bartering; Profit or (loss) realized on closed contracts; Unrealized profit (loss) on open contracts – prior year; Unrealized profit or (loss) on open contracts – current year; or Aggregate profit (loss) on contracts; Proceeds from collectibles; or FATCA filing requirement

- Reduced exclusion computations/determinations for the sale of a home

- Married homeowners who do not meet all requirements to claim the maximum exclusion on the sale of a home

- Decreases to basis, including:
  - Deductible casualty losses and gains a taxpayer postponed from the sale of a previous home before May 7, 1997
  - Depreciation during the time the home was used for business purposes or as rental property
- Taxpayers with nonqualified use issues
- Sale of a home used for business purposes or as rental property

To gain a better understanding of the tax law, complete the practice return(s) for your course of study using the Practice Lab on L&LT.

You may not be able to complete the entire exercise if some of the technical issues in the exercise are not covered until later lessons in the training. In these instances, complete as much of the exercise as you can. Come back later to finish the exercise after you cover all the technical topics.

EXERCISE Answers

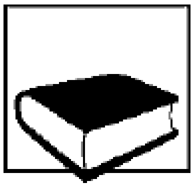
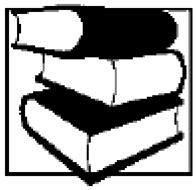
Answer 1: a. Never change the sales price.

Answer 2: a. Only Marriah sold stock and received Form 1099-B.

Answer 3: a, Yes. Emily meets the ownership and use test because she owned and lived in the home for at least two years of the five-year period ending on the date of the sale.

Answer 4: c. The only circumstance that will allow John to exclude the gain is if he can extend the five-year period due to official extended military duty.

Income – Retirement Income

Introduction

This lesson will help you identify and report the taxable portion of retirement income received by the taxpayer. To do this, you must understand the types of retirement income and the forms used to report them. You should also be able to recognize when taxpayers should adjust their withholding and determine which form to use.

For more information on the topics discussed in this lesson, see Publication 575, Pension and Annuity Income; Publication 590-B, Distributions from Individual Retirement Arrangements (IRAs); Publication 721, Tax Guide to U.S. Civil Service Retirement Benefits; and Publication 939, General Rule for Pensions and Annuities.

Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Identify how retirement income is reported to the taxpayer using Form 1099-R series
- Calculate the taxable portion of different types of retirement income
- Determine how to report retirement income on the tax return
- Determine when an adjustment to withholding should be made

What do I need?

- Form 13614-C
- Publication 4012
- Publication 575

Optional:

- Publication 590-B
- Publication 721
- Publication 939
- Form 1040 Instructions
- Form 1040-ES
- Form 1099-R
- Form 5329
- Form 8606
- Form W-2
- Form W-4P
- Form W-4V
- Simplified Method Worksheet

What is retirement income?

Retirement income can include Social Security benefits as well as benefits from annuities, retirement or profit sharing plans, insurance contracts, IRAs, etc. Retirement income may be fully or partially taxable. For information about Social Security benefits and tier 1 Railroad Retirement benefits, see the Social Security benefits lesson.

Where can I get information about a taxpayer's retirement income?

To determine if the taxpayer must report retirement income, review the taxpayer's completed intake and interview sheet, particularly the Income section. If the taxpayer had retirement income, you may need to ask additional questions to clarify the type of plan, whether the taxpayer's contributions to the plan were before-tax or after-tax dollars, etc. This is explained later in this lesson.

Be considerate when probing for the information you need to complete the return. When taxpayers cannot provide the required information (and have not retained the packet of “retirement papers” they received when they retired), suggest that they contact their former employer or annuity administrator. You may even give the taxpayer a written list of questions that need to be resolved.

Which forms are used to report retirement income?

Retirement income can be reported on one of the forms in the Form 1099-R Series:

- Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.,
- Form CSA 1099-R, Statement of Annuity Paid (civil service retirement payments),
- Form CSF 1099-R, Statement of Survivor Annuity Paid, and
- Form RRB 1099-R, Annuities or Pensions by the Railroad Retirement Board

- If Form 1099-R is for a traditional IRA distribution, it will be indicated in Box 7.

Examples of these forms can be found at IRS.gov. These forms indicate such information as the amount received, the taxable portion, and the taxpayer's cost (investment) in the plan.

If the taxable amount is indicated and does not need to be adjusted, volunteers with Basic certification can complete the return. In general, if the taxable amount is not indicated, volunteers with Advanced certification must calculate the taxable portion using the Simplified Method covered later in this lesson.

Qualified disability income reported on Form 1099-R with a Distribution Code 3 in Box 7, is reported as earned income wages on Form 1040 until the minimum retirement age is met. Review the software entries in the Volunteer Resource

Guide, Tab D, Form 1099-R Rollovers and Disability Under Minimum Retirement Age.

What if the taxable portion is already calculated?

In many instances, the payer will compute the taxable portion of the distribution and report the taxable amount on Form 1099-R. Taxpayers with Form RRB-1099-R are in scope only for Advanced certified volunteers because the taxable portion is not shown on the form.

Refer to the Volunteer Resource Guide, Tab D, Income, Form 1099-R Pension and Annuity Income.

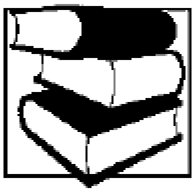
Amounts from Form 1099-R are reported as follows:

- The gross amount (Box 1 of Forms 1099-R, CSA- and CSF-1099-R) should be shown on Form 1040 on the IRA distributions or Pensions and annuities line

- The taxable amount (Box 2a of Forms 1099-R, CSA- and CSF-1099-R) should be shown on Form 1040 on the IRA distributions or Pensions and annuities line in the taxable amount section

The IRA/SEP/SIMPLE box is ***not*** *checked for Roth IRAs. Instead, Roth IRAs are identified on Form 1099-R (Box 7) with a distribution code Q, J, H, or T. Only codes H and Q are in scope for the VITA/ TCE programs. In-scope Roth IRA distributions are reported on Form 1040 on the IRA distributions line.*

Any amount of federal income tax withheld on Forms 1099-R, CSA- and CSF-1099-R should appear in the Federal income tax withheld from Form(s) 1099 line of the tax return.



What if the taxable portion is not calculated?

If the payer did not include the taxable amount on Form 1099-R, CSA- or CSF-1099-R, or if taxpayers have Form RRB 1099-R, you will need to compute the taxable portion of the distribution. The following will help you determine the additional information needed to calculate the taxable portion of distributions from IRAs, pensions, or annuities.

What do I need to know about retirement income distributions?

Retirement plans are funded by either before-tax or after-tax contributions. "Before-tax" simply means that the employee did not pay taxes on the money at the time it was contributed, i.e., the taxpayer has no cost basis in the plan. "After-tax" means the employee paid taxes on the money when it was contributed, i.e., the taxpayer has a cost basis in the plan.

If the taxpayer made all contributions to a plan with before-tax dollars, the entire distribution will be fully taxable. The funds are taxed at the time of the distribution because neither the contributions nor the earnings/investment gains were previously taxed. This is common in 401(k) and Thrift Savings Plans.

If the taxpayer did not contribute to the retirement plan, all the distributions are fully taxable.

If the taxpayer made contributions to a plan with after-tax dollars, then the distributions will be partially taxable. The portion of the distribution that is considered a return of the after-tax dollars will not be taxed again. It is considered a return of the taxpayer's cost basis (an amount for which taxes have already been paid). The portion of the distribution that represents the earnings/investment gains is taxable since it has not been previously taxed. This is common in employer retirement plans. Qualified distributions from an employer plan designated Roth account are wholly nontaxable, similar to a Roth IRA.

Employee Contributions	**Contributions**		**Taxability of Distributions**		
	Before-Tax	**After-Tax**	**Fully**	**Partially**	**Nontaxable**
No	n/a	n/a	Yes	—	—
Yes	Yes	—	Yes	—	—
Yes	—	Yes	—	Yes	—
Yes, Roth	—	Yes	—	—	Yes

Mark retired after working 30 years for a construction company. Each week, he contributed to the Carpenter's Pension Plan. Every year, Mark paid tax on the gross amount of his salary, *including his pension contribution. This means his pension contributions were made with dollars that had already been taxed. Now that he is receiving payments from the pension, he will not be taxed on the portion that represents his contribution; he will be taxed on the portion that represents earnings.*

Taxpayers may not always understand why they must pay taxes on their retirement income. When this is the case, take the time to clearly explain what retirement funds are taxed and why. It is usually a good idea to question taxpayers about the nature of their contributions to ensure that they will not be taxed twice on the same funds.

How do I find the taxable portion of IRA income?

Individual Retirement Arrangements

IRA distributions are reported on Form 1099-R. Earnings and investment gains in a taxpayer’s IRA generally accumulate tax free or tax deferred until they are withdrawn as fully or partially taxable distributions. There are four kinds of IRAs, each with different tax implications:

- Traditional IRA
- Roth IRA
- Savings Incentive Match Plans for Employees (SIMPLE) IRA
- Simplified Employee Pension (SEP) IRA

Traditional IRA

Distributions from traditional IRAs are fully taxable unless nondeductible contributions have been made. See the Adjustments to Income lesson for additional information. Form 8606, Nondeductible IRAs, is used to keep track of nondeductible contributions. Taxpayers who made nondeductible contributions should be referred to a professional tax preparer.

When you learn about IRA accounts in the Adjustments to Income lesson, be sure to note the difference between "contributions" and "deductions." Simply put, contributions are the amounts deposited into an IRA account, and deductions are the portion of the contribution that is deducted on the tax return. The deductible portion may be less than the amount allowed as a contribution.

Richard contributed $500 a year to a traditional IRA. Each year, he deducted these contributions from his income. This year he received his first distribution from the traditional IRA. It is fully taxable: Richard will pay income tax on the distributions he receives, which represent the contributions he made and deducted, as well as the earnings on these contributions over the years.

Roth IRA

Qualified distributions from a Roth IRA are tax free and may be excluded from income. The IRA trustee will indicate the distribution is qualified by using Code Q in Box 7 if the following requirements are met:

- The distribution is made after the 5-year period beginning with the first day of the first taxable year for which a contribution was made to a Roth IRA set up for the taxpayer's benefit, *and*
- The distribution is:
    - Made on or after age 59½, or
    - Made because the taxpayer was disabled, or
    - Made to a beneficiary or to an estate, or
    - To pay certain qualified first-time homebuyer amounts (up to a $10,000 lifetime limit)

The 5-year rule applies to each Roth conversion and rollover for purposes of the addition to tax on early distributions. A distribution that is not qualified may be subject to tax and penalty and is not in scope for the VITA/TCE programs See Publication 590-B.

You can identify Roth IRAs from the distribution code used on Form 1099-R. Distribution codes Q, J, H, and T are specific to Roth IRAs. Only codes H and Q are in scope in scope for the VITA/TCE programs.

Nonqualified Distributions

If the above requirements are not met, the distribution is nonqualified and additional taxes may apply. Taxpayers who received nonqualified Roth IRA distributions should be referred to a professional tax preparer.

Savings Incentive Match Plans for Employees (SIMPLE) IRA

Some employers offer their employees (including self-employed individuals) the chance to contribute part of their pay to an IRA as part of a SIMPLE plan. The employer is also generally required to make contributions on behalf of eligible employees. Generally, SIMPLE IRA contributions are not included in an employee’s income when paid into an IRA, and the distributions are fully taxable when the employee receives them in later years.

Simplified Employee Pension (SEP) IRA

Some employers offer their employees (including self-employed individuals) the chance to contribute part of their pay to an IRA as part of a SEP plan. Generally, SEP IRA contributions are not included in an employee’s income when paid into the IRA. Because of this, distributions are generally fully taxable when the employee receives them in later years.

EXERCISES

Answers follow the lesson summary.

Question 1: Distributions from all IRAs discussed in this topic are fully taxable with the exception of the Roth IRA.

a. True

b. False

Question 2: Mary opened a Roth IRA 3 years ago. This year, she took the full amount of her Roth IRA as a distribution to help her purchase her first home. The entire distribution is excluded from her taxable income.

a. True

b. False

Question 3: Amy contributed to a Roth IRA for 5 years. In year 6 (at age 60), she took a distribution from her IRA. The entire distribution is excluded from her taxable income.

a. True

b. False

How are IRA distributions reported?

Traditional IRA

If IRA/SEP/SIMPLE is checked on Form 1099-R and to determine whether there is any basis in the IRA, ask the taxpayer “Were the contributions to your traditional IRAs deducted from income in the year they were made?”

If so, the entire distribution is taxable. If the traditional IRA is a rollover from an employer plan, all the distributions will be taxable. Report the distributions on Form 1040. If not, the distribution is partially taxable and Form

8606 is required. In that case, the return is out of scope.

An early distribution (Form 1099-R, Box 7 code 1) from a traditional IRA may be subject to a 10% additional tax. Refer to the Other Taxes lesson for more information.

Converting part or all of a traditional IRA to a Roth IRA requires Form 8606, which is beyond the scope of the VITA/TCE Programs.

SIMPLE and SEP IRAs

Distributions from SIMPLE and SEP IRAs are in scope for VITA/TCE, because they are taxable and are generally reported on the return just like taxable traditional IRA distributions.

Exception: Funds distributed from a SIMPLE IRA in the first two years are subject to a 25% early distribution penalty. If this is applicable, Form 1099-R will be issued with distribution code S. If an exception to the penalty applies, complete Form 5329, Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts, as you would do with traditional IRA distributions.

Roth IRA

Distributions from a Roth IRA are not taxable as long as they meet all the criteria discussed previously. If the distribution does not meet the criteria, then all or part of the funds **may** be taxable; refer the taxpayer to a professional tax preparer.

How are rollovers handled?

Generally, a rollover is a tax-free distribution to the taxpayer from one retirement account (traditional IRA or employer's pension plan) that rolls over into another qualified retirement account within 60 days.

Form 1099-R will be issued to the taxpayer by the financial institution. If the distribution was a direct rollover by the institution to another institution, it will show distribution code G. If there is also a taxable amount in Box 2 of the 1099-R, the distribution may be partially or fully taxable.

If the taxpayer indicates that a rollover occurred but the distribution code is NOT G, then the taxpayer must have re-deposited the full amount into an appropriate account within 60 days. If this was not done, the distribution may be partially or fully taxable; refer the taxpayer to a professional tax preparer unless the self-certification procedure described later applies.

Distributions from SIMPLE IRAs in the first two years (distribution code S) can only be rolled over tax-free into other SIMPLE IRAs. Taxable SIMPLE IRA rollovers are out of scope for VITA/TCE.

There is a limit of one IRA rollover per twelve months. This does not affect the ability of an IRA owner to transfer funds from one IRA trustee directly to another because such a transfer is not a rollover.

What about a rollover from a Roth IRA?

Most of the rules for rollovers to traditional IRAs apply to Roth IRAs. Generally, a withdrawal of all or part of the assets from one Roth IRA and a contribution to another Roth IRA within 60 days is tax free. A rollover from a Roth IRA to an employer retirement plan is not allowed.

If there is a direct rollover of a designated Roth account distribution to a Roth IRA, the distribution code for Form 1099-R will be code H. Although not taxable, the rollover distribution must be reported on the tax return.

A conversion of a traditional IRA to a Roth IRA or a rollover from any other eligible retirement plan to a Roth IRA cannot be recharacterized as having been made to a traditional IRA.

Additional information must be entered for retirement account rollovers. Refer to the Volunteer Resource Guide, Tab D, Income, Form 1099-R.

A qualified plan loan offset distribution (Code M in Form 1099-R, Box 7) is due to plan termination or severance from employment. Instead of the usual 60-day rollover period, the taxpayer has until the due date, including extensions, for filing the Federal income tax return for the taxable year in which the offset occurs to complete the rollover.

Question 4: Andrew changed jobs and received Form 1099-R from his previous employer. The gross distribution amount in Box 1 is $11,200. Andrew deposited the entire

$11,200 into his IRA within 30 days of receiving the check (rollover).

Which of the following statements is true?

a. The entire distribution is includible as income

b. The entire distribution is excludable from income

c. The distribution is eligible for the ten-year tax option

d. The distribution is eligible to be taxed at a special rate

What is the IRA self-certification procedure?

Procedure Helps People Making Retirement Plan Rollovers

Revenue Procedure 2016-47 explains a self-certification procedure designed to help recipients of retirement plan distributions who inadvertently miss the 60-day time limit for properly rolling these amounts into another retirement plan or individual retirement arrangement (IRA). Eligible taxpayers can qualify for a waiver of the 60-day time limit and avoid possible taxes and penalties on early distributions, if they meet certain circumstances. Taxpayers who missed the time limit will ordinarily qualify for a waiver if one or more of 11 circumstances, listed in the revenue procedure, apply:

- An error was committed by the financial institution making the distribution or receiving the contribution.
- The distribution was in the form of a check and the check was misplaced and never cashed.
- The distribution was deposited into and remained in an account that the taxpayer mistakenly thought was a retirement plan or IRA.

- Taxpayer’s principal residence was severely damaged.
- One of the taxpayer’s family members died.
- Taxpayer or a family member was seriously ill.
- Taxpayer was incarcerated.
- Restrictions were imposed by a foreign country.
- A postal error occurred.
- The distribution was made on account of an IRS levy and the proceeds of the levy have been returned.
- The party making the distribution delayed providing information that the receiving plan or IRA required to complete the rollover despite reasonable efforts to obtain the information.

- The distribution was made to a state unclaimed property fund **(Revenue Procedure 2020-46)**

Ordinarily, the IRS, plan administrators, and trustees will honor a taxpayer's truthful self-certification that they qualify for a waiver under these circumstances. Even if a taxpayer does not self-certify, the IRS now has the authority to grant a waiver during a subsequent examination. Other requirements, along with a copy of a sample self-certification letter, can be found in the revenue procedure.

The IRS encourages eligible taxpayers wishing to transfer retirement plan or IRA distributions to another retirement plan or IRA to consider requesting that the administrator or trustee make a direct trustee-to-trustee transfer, rather than doing a rollover. Doing so can avoid some of the delays and restrictions that often arise during the rollover process.

For more information, refer to Publication 590-A, Contributions to Individual Retirement Arrangements (IRAs).

Qualified Charitable Distributions

A qualified charitable distribution (QCD) is generally a nontaxable distribution made directly from a traditional IRA to an organization eligible to receive tax-deductible contributions. The taxpayer must be at least age 70½ when the distribution is made. The amount in Box 2a of the 1099-R will reflect all the distributions for the year and must be reduced by the nontaxable QCD. In accordance to Setting Every Community Up for Retirement Enhancement (SECURE) Act, the long-standing 70½ age limit for making contributions to traditional IRAs was eliminated for tax years beginning after 2019. In addition, the excludable portion of a QCD distribution may need to be reduced by IRA deductions once the taxpayer attains age 70½. Beginning in tax years after December 31, 2019, the amount of QCDs that a taxpayer can exclude from income is reduced by the excess of the aggregate amount of IRA contributions the taxpayer deducted for the taxable year and any prior year that the taxpayer was age 70½ or older over the amount of such IRA contributions that were used to reduce the excludable amount of QCDs. Starting with tax year 2020, taxpayers should calculate the excludable amount of their QCD using the Qualified Charitable Deduction (QCD) Worksheet in Publication 590-B. Each spouse must complete a separate worksheet if married filing jointly.

The taxpayer must have the same type of acknowledgement of the contribution that is needed to claim a deduction for a charitable contribution. Typically, a QCD counts towards the taxpayer’s required minimum distribution (RMD).

The maximum annual exclusion for QCDs is $100,000. Any QCD in excess of the $100,000 exclusion limit is included in income as any other distribution. On a joint return, the spouse can also have a QCD and exclude up to $100,000.

If a QCD is reduced by an IRA contribution, the taxpayer will show that amount as a taxable distribution. Additionally, the taxpayer may claim a charitable contribution deduction for the donation.

How do I find the taxable portion of pensions and annuities?

Fully Taxable Pensions and Annuities

Pension and annuity income is reported on Form 1099-R, Form CSA 1099-R, and Form RRB 1099-R. In general, pension or annuity payments are fully taxable, if any of the following is true:

- Taxpayers did not pay any part of the cost of their pensions or annuities
- Employers did not withhold part of the cost from the taxpayers' pay while they worked
- Employers withheld part of the cost from the taxpayer's before-tax pay while they worked

Social Security benefits are not reported on the pension line of the tax return. Social Security income is covered in a later lesson.

Sue worked for a software development company for 20 years. She retired and began receiving pension income the same year. Sue never contributed to the pension plan while she was *working; her employer made all of the contributions. Her pension is fully taxable.*

Partially Taxable Pensions and Annuities

If a taxpayer made after-tax contributions toward their retirement plan, they have basis in that plan and can recover that basis a bit at a time as they get distributions from the plan. Two methods used to figure the taxable portion of each pension or annuity payment are the General Rule and the Simplified Method.

Unless an exception applies, retirees must use the Simplified Method for annuity payments from a qualified plan. A qualified plan is established by an employer to provide retirement benefits for employees and their beneficiaries. Employees typically do not pay taxes on plan assets until the assets are distributed; furthermore, earnings on qualified plans are tax deferred. If a taxpayer tells you they have been using the General Rule to figure the taxable portion for past years, refer them to a professional tax preparer.

If the taxpayer’s annuity starting date is before July 2, 1986, the General Rule has to be used unless the Three-Year Rule was used.

The Simplified Method is used to calculate the tax-free portion of each pension or annuity payment. The Simplified Method Worksheet calculates the taxpayer’s cost basis for each monthly payment. The number of monthly payments is based on the taxpayer’s age (and the spouse’s age if a joint/survivor annuity is selected by the taxpayer) on the annuity start date. This calculation is not changed for subsequent events, such as divorce, marriage or death.

Taxpayer’s cost basis ÷ Number of monthly payments = Monthly Tax-Free Portion

Joe elected a joint/survivor annuity when he retired and started receiving his pension on July 1, 2015. Joe was born March 5, 1950 and his wife, Mary, was born on July 23, 1953. Here is how they compute their combined ages for the Simplified Method.

	Joe	**Mary**	**Combined**
Date born	3/5/1950	7/23/1953	
Date annuity started	7/1/2015	7/1/2015	
Age when annuity started	65	61	126

Note that Mary had not reached her 62nd birthdate by the day the annuity started.

To ensure the taxable portion of the pension is calculated correctly, the age of the taxpayer(s) at the annuity start date, not their age for the tax year, must be used when determining the total number of expected monthly payments.

Refer to the Volunteer Resource Guide, Tab D, Income, Form 1099-R for more information on calculating the taxable portion using the Simplified Method.

Be sure to include any amount of federal income tax withheld on Form 1099-R in the Federal income tax withheld from Forms W-2 or 1099 line of the tax return.

To calculate the taxable portion of a pension or annuity using the Simplified Method, you will need certain information:

- The cost in the plan (total employee contribution on Form 1099-R)

- The taxpayer's age on the date the annuity began (and the spouse's age if joint/survivor annuity was selected). In computing the taxpayer's age, notice whether the annuity starting date is before or after the taxpayer's birthday for that year
- Total of tax-free amounts from previous years, available from the taxpayer's prior year worksheet

If the taxpayer has more than one Form 1099-R that is not fully taxable, calculate the tax-free portion for each form separately.

Melvin retired from a manufacturing plant. While he was working at the plant, his employer withheld money from each paycheck and sent it to the Engineer's Pension Fund. Melvin will receive a monthly pension payment for the rest of his life. Melvin will use the Simplified

Method Worksheet to determine the tax-free part of monthly payments.

Question 5: Dotty worked for the local tire plant for 32 years. She retired in June and receives a monthly pension of $1,679. (She received six payments for July through December.) Dotty never contributed to the pension plan; her employer made all of the contributions. How much of her pension is taxable?

a. $12,074

b. $11,074

c. $10,074

d. $1,679

Disability Pension Income

Generally, taxpayers who retire on disability must include all of their disability payments in income. **Disability payments are taxed as wages until the taxpayer reaches the minimum retirement age – t*this age is set***

by the employer**.** After the taxpayer reaches the minimum retirement age, disability payments are treated as pension income to determine taxability.

Taxpayers are considered disabled if they cannot engage in any substantial gainful activity because of any medically determinable physical or mental condition that can be expected to result in death or to be of long-continued and indefinite duration.

Minimum retirement age is generally the earliest age at which taxpayers may receive a pension, whether or not they are disabled.

Employers may report disability income on one of the following forms:

- Form W-2, if the taxpayer has not reached the minimum retirement age set by the employer
- Form 1099-R, with code 3 if the taxpayer has not reached the minimum retirement

age for the plan, or with code 7 if the taxpayer has reached the minimum retirement age

Some employers report qualified disability income on Form 1099-R with Distribution Code 3 in Box 7 regardless of the taxpayer's age. You must confirm the employers' minimum retirement age. If the taxpayer is under the retirement age, the volunteer must take steps in the software to ensure the income is properly reflected as wages on Form 1040. When disability pay is treated as wages, it might affect the earned income credit and the taxpayer's ability to make an IRA contribution.

If Form 1099-R, Box 7, indicates a distribution code 3, and the taxpayer is on disability but under retirement age, check the box so the tax software will place the amount on Form 1040 as wages, rather than on the *pension line. Refer to the Volunteer Resource Guide, Tab D, Income, Form 1099R for more information on how to report disability pay to ensure it is reported on the correct line of Form 1040.*

Question 6: Annie Jo is 47 years old and has retired on disability from her job. While loading cargo for a tractor-trailer company, a large box fell on her and left her paralyzed. She receives a monthly payment from her former employer's pension plan to which Annie Jo had not contributed. She has not reached the minimum retirement age set by her company's pension plan. How should she report her disability income on her Form 1040?

a. Estimated tax payments and amount applied from return

b. Pensions and annuities

c. Taxable pensions and annuities

d. Wages

Retired Public Safety Officers

Eligible public safety officers can elect to exclude from income distributions of up to $3,000 used to pay the premiums for accident, health, or long-term care insurance. A public safety officer includes a law enforcement officer, firefighter, chaplain, or member of a rescue squad or ambulance crew. See Insurance Premiums for Retired Public Safety Officers in Publication 575, Pension and Annuity Income, for more information.

If the taxpayer is eligible for the exclusion, refer to the Volunteer Resource Guide, Tab D, Income, Form 1099-R.