Note: *The draft you are looking for begins on the next page.*

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This is an early release draft of an IRS tax form, instructions, or publication, which the IRS is providing for your information. **Do not file draft forms** and do **not** rely on draft forms, instructions, and publications for filing. We do **not** release draft forms until we believe we have incorporated all changes (except when explicitly stated on this coversheet). However, unexpected issues occasionally arise, or legislation is passed—in this case, we will post a new draft of the form to alert users that changes were made to the previously posted draft. Thus, there are never any changes to the last posted draft of a form and the final revision of the form. Forms and instructions generally are subject to OMB approval before they can be officially released, so we post only drafts of them until they are approved. Drafts of instructions and publications usually have some changes before their final release.

Early release drafts are at IRS.gov/DraftForms and remain there after the final release is posted at IRS.gov/LatestForms. All information about all forms, instructions, and pubs is at IRS.gov/Forms.

Almost every form and publication has a page on IRS.gov with a friendly shortcut. For example, the Form 1040 page is at IRS.gov/Form1040; the Pub. 501 page is at IRS.gov/Pub501; the Form W-4 page is at IRS.gov/W4; and the Schedule A (Form 1040/SR) page is at IRS.gov/ScheduleA. If typing in a link above instead of clicking on it, be sure to type the link into the address bar of your browser, not a Search box.

If you wish, you can submit comments to the IRS about draft or final forms, instructions, or publications at IRS.gov/FormsComments. We cannot respond to all comments due to the high volume we receive and may not be able to consider many suggestions until the subsequent revision of the product.

If you have comments on reducing paperwork and respondent (filer) burden, with respect to draft or final forms, please respond to the relevant information collection through the Federal Register process; for more info, click here.

Department of the Treasury

Internal Revenue Service

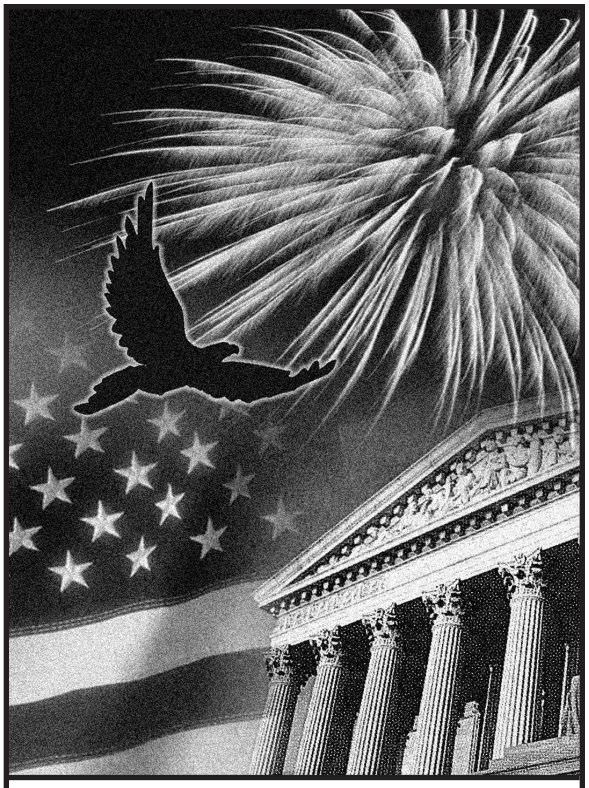
Publication 525
Cat. No. 15047D

Taxable and Nontaxable Income

DRAFT AS OF March 29, 2021

For use in preparing

2020 Returns



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Future Developments

For the latest information about developments related to Pub. 525, such as legislation enacted after it was published, go to *IRS.gov/Pub525*.

What's New

Exclusion from income tax on a portion of unemployment compensation for 2020. For individuals with adjusted gross income of less than $150,000, up to $10,200 of unemployment is excluded from gross income. In the case of a joint return, up to $10,200 received by each spouse is excluded. (See P.L. 117-2.)

Paycheck Protection Program loan forgiveness. Gross income doesn't include any amount arising from the forgiveness of a Paycheck Protection Program (PPP) loan, effective for taxable years ending after 3/27/2020. (See P.L. 116–136.) Likewise, gross income does not include any amount arising from the forgiveness of Second Draw PPP loans, effective 12/27/2020. (See P.L. 116–260.)

Families First Coronavirus Response Act (FFCRA). The FFCRA, as amended by the COVID-related Tax Relief Act of 2020, provides tax credits for self-employed individuals carrying on any trade or business within the meaning of section 1402 of the Internal Revenue Code if the self-employed individual would be entitled to receive paid leave under the FFCRA if the individual were an employee of an employer (other than him or herself). These credits are available for periods of leave taken between April 1, 2020, and March 31, 2021. The amounts of these are not included in the gross income of the eligible self-employed individual.

Emergency financial aid grants. Certain emergency financial aid grants under the CARES Act are excluded from the income of college and university students, effective for

grants made after 3/26/2020. (See P.L. 116–136 and P.L. 116–260.)

Economic impact payments. Any economic impact payments you received are not taxable for federal income tax purposes, but they reduce your recovery rebate credit.

Other loan forgiveness under the CARES Act. Gross income does not include any amount arising from the forgiveness of certain loans, emergency Economic Injury Disaster Loan (EIDL) grants, and certain loan repayment assistance, each as provided by the CARES Act, effective for tax years ending after 3/27/2020. (See P.L. 116–136 and P.L. 116–260.)

Deferred compensation contribution limit increased. If you participate in a 401(k), 403(b), or the federal government's Thrift Savings Plan (TSP), the total annual amount you can contribute is increased to $19,500 ($26,000 if age 50 or older). This also applies to most 457 plans.

Exclusion of income for volunteer firefighters and emergency medical responders. If you are a volunteer firefighter or emergency medical responder, you may be able to exclude from gross income certain rebates or reductions of state or local property or income taxes and up to $50 per month provided by a state or local government. For more information, see *Volunteer firefighters and emergency medical responders.*.

Health flexible spending arrangements (health FSAs) under cafeteria plans. For tax years beginning in 2020, the dollar limitation under section 125(i) on voluntary employee salary reductions for contributions to health FSAs is $2,750.

Reminders

Repeal of deduction for alimony payments and corresponding inclusion in gross income. Alimony received will no longer be included in your income if you entered into a divorce or separation agreement on or before December 31, 2018, and the agreement is changed after December 31, 2018, to expressly provide that alimony received isn't included in your income. Alimony received will also not be included in income if a divorce or separation agreement is entered into after December 31, 2018. For more information, see Pub. 504.

Retroactive extension from 2018 through 2020 of exclusion of debt discharged from principal residence indebtedness. The Further Consolidated Appropriations Act, 2020, Public Law 116-94 (enacted December 20, 2019) retroactively extended the exclusion from income of debt discharged from principal residence indebtedness from 2018 through 2020.

Forms 1040A and 1040EZ no longer available. Forms 1040A and 1040EZ aren't available to file your 2020 taxes. If you used one of these forms in the past, you'll now file Form 1040 or 1040-SR.

Qualified equity grants. For tax years beginning after 2017, certain qualified employees can make a new election to defer income taxation for up to 5 years for the qualified stocks received. See *Qualified Equity Grants* under *Employee Compensation*, later.

Suspension of qualified bicycle commuting reimbursement exclusion. For tax years beginning after 2017, reimbursement you receive from your employer for the purchase, repair, or storage of a bicycle you regularly use for travel between your residence and place of employment must be included in your gross income.

Unemployment compensation. If you received unemployment compensation but did not receive Form 1099-G, Certain Government Payments, through the mail, you may need to access your information through your state's website to get your electronic Form 1099-G.

Access your online account. You must authenticate your identity. To securely log in to your federal tax account, go to *IRS.gov/Account*. You can view the amount you owe, review 18 months of payment history, access online payment options, and create or modify an online payment agreement. You can also access your tax records online.

Achieving a Better Life Experience (ABLE) account. This is a type of savings account for individuals with disabilities and their families. Distributions are tax free if used to pay the beneficiary's qualified disability expenses. See Pub. 907 for more information.

Certain amounts received by wrongfully incarcerated individuals. Certain amounts you receive due to a wrongful incarceration may be excluded from gross income. See *IRS.gov/Individuals/Wrongful-Incarceration-FAQs* for more information.

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

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

Olympic and Paralympic medals and United States Olympic Committee (USOC) prize money. If you receive Olympic and Paralympic medals and USOC prize money, the value of the medals and the amount of the prize money may be nontaxable. See the Instructions for Schedule 1 (Form 1040), line 8, at *IRS.gov/Form1040* for more information.

Public safety officers. A spouse, former spouse, and child of a public safety officer killed in the line of duty can exclude from gross income survivor benefits received from a governmental section 401(a) plan attributable to the officer's service. See section 101(h).

A public safety officer that's permanently and totally disabled or killed in the line of duty and a surviving spouse or child can exclude from income death or disability benefits received from the federal Bureau of Justice Assistance or death benefits paid by a state program. See section 104(a)(6).

Qualified Medicaid waiver payments. Certain payments you receive for providing care to an eligible individual in your home under a state's Medicaid waiver program may be excluded from your income under Notice 2014-7. See also Instructions for Schedule 1 (Form 1040), line 8.

Qualified settlement income. If you're a qualified taxpayer, you can contribute all or part of your qualified settlement income, up to $100,000, to an eligible retirement plan, including an IRA. Contributions to eligible retirement plans, other than a Roth IRA or a designated Roth contribution, reduce the qualified settlement income that you must include in income. See *Exxon Valdez settlement income* under *Other Income*, later. Also, see Pub. 590-A for more information.

Taxpayer identification number (TIN). A TIN is your social security number (SSN), individual taxpayer identification number (ITIN), adoption taxpayer identification number (ATIN), or employer identification number (EIN).

Terrorist attacks. You can exclude from income certain disaster assistance, disability, and death payments received as a result of a terrorist or military action. For more information, see *Sickness and Injury Benefits*, later; Pub. 3920, Tax Relief for Victims of Terrorist Attacks; and Pub. 907, Tax Highlights for Persons With Disabilities.

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

Introduction

You can receive income in the form of money, property, or services. This publication discusses many kinds of income and explains whether they are taxable or nontaxable. It includes discussions on employee wages and fringe benefits, and income from bartering, partnerships, S corporations, and royalties. It also includes information on disability pensions, life insurance proceeds, and welfare and other public assistance benefits. Check the index for the location of a specific subject.

In most cases, an amount included in your income is taxable unless it is specifically exempted by law. Income that is taxable must be reported on your return and is subject to tax. Income that is nontaxable may have to be shown on your tax return but isn't taxable.

Constructively received income. You are generally taxed on income that is available to you, regardless of whether it is actually in your possession.

A valid check that you received or that was made available to you before the end of the tax year is considered income constructively received in that year, even if you don't cash the check or deposit it to your account until the next year. For example, if the postal service tries to deliver a check to you on the last day of the tax

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year but you aren't at home to receive it, you must include the amount in your income for that tax year. If the check was mailed so that it couldn't possibly reach you until after the end of the tax year, and you otherwise couldn't get the funds before the end of the year, you include the amount in your income for the next tax year.

Assignment of income. Income received by an agent for you is income you constructively received in the year the agent received it. If you agree by contract that a third party is to receive income for you, you must include the amount in your income when the third party receives it.

Example 1. You and your employer agree that part of your salary is to be paid directly to one of your creditors. You must include that amount in your income when your creditor receives it.

Prepaid income. In most cases, prepaid income, such as compensation for future services, is included in your income in the year you receive it. However, if you use an accrual method of accounting, you can defer prepaid income you receive for services to be performed before the end of the next tax year. In this case, you include the payment in your income as you earn it by performing the services.

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

You can send us comments through *IRS.gov/FormComments*. Or, you can write to the Internal Revenue Service, Tax Forms and Publications, 1111 Constitution Ave. NW, IR-6526, Washington, DC 20224.

Although we can't respond individually to each comment received, we do appreciate your feedback and will consider your comments and suggestions as we revise our tax forms, instructions, and publications. **Don't** send tax questions, tax returns, or payments to the above address.

Getting answers to your tax questions. If you have a tax question not answered by this publication or the How To Get Tax Help section at the end of this publication, go to the IRS Interactive Tax Assistant page at *IRS.gov/Help/ITA* where you can find topics by using the search feature or viewing the categories listed.

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Useful Items

You may want to see:

Publication

- ❑ **334** Tax Guide for Small Business
- ❑ **523** Selling Your Home
- ❑ **527** Residential Rental Property
- ❑ **541** Partnerships
- ❑ **544** Sales and Other Dispositions of Assets
- ❑ **550** Investment Income and Expenses
- ❑ **554** Tax Guide for Seniors
- ❑ **559** Survivors, Executors, and Administrators
- ❑ **575** Pension and Annuity Income
- ❑ **907** Tax Highlights for Persons With Disabilities
- ❑ **915** Social Security and Equivalent Railroad Retirement Benefits
- ❑ **970** Tax Benefits for Education
- ❑ **4681** Canceled Debts, Foreclosures, Repossessions, and Abandonments

Form (and Instructions)

- ❑ **1040** U.S. Individual Income Tax Return
- ❑ **1040-NR** U.S. Nonresident Alien Income Tax Return
- ❑ **1040-SR** U.S. Tax Return for Seniors
- ❑ **1099-R** Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.
- ❑ **W-2** Wage and Tax Statement

See How To Get Tax Help at the end of this publication for information about getting these publications.

Employee Compensation

In most cases, you must include in gross income everything you receive in payment for personal services. In addition to wages, salaries, commissions, fees, and tips, this includes other forms of compensation such as fringe benefits and stock options.

You should receive a Form W-2 from your employer or former employer showing the pay you received for your services. Include all your pay on Form 1040 or 1040-SR, line 1, even if you don't receive Form W-2, or you receive a Form W-2 that doesn't include all pay that should be included on the Form W-2.

If you performed services, other than as an independent contractor, and your employer didn't withhold social security and Medicare taxes from your pay, you must file Form 8919 with your Form 1040 or 1040-SR. These wages must be included on Form 1040 or 1040-SR, line 1. See Form 8919 for more information.

Fair market value (FMV). The FMV of an item of property is the price at which the item would change hands between a willing buyer and a willing seller, neither being required to buy or sell and both having reasonable knowledge of the relevant facts.

Childcare providers. If you provide childcare, either in the child's home or in your home or other place of business, the pay you receive must be included in your income. If you're not an employee, you're probably self-employed and must include payments for your services on Schedule C (Form 1040), Profit or Loss From Business. You generally aren't an employee unless you're subject to the will and control of the person who employs you as to what you're to do, and how you're to do it.

Babysitting. If you babysit for relatives or neighborhood children, whether on a regular basis or only periodically, the rules for childcare providers apply to you.

Self-employment tax. Whether you're an employee or self-employed person, your income could be subject to self-employment tax. See the Instructions for Schedule C (Form 1040) and the Instructions for Schedule SE (Form 1040) if you're self-employed. Also see Pub. 926 for more information.

Bankruptcy. If you filed for bankruptcy under chapter 11 of the Bankruptcy Code, you must allocate your wages and withheld income tax. Your Form W-2 will show your total wages and withheld income tax for the year. On your tax return, you report the wages and withheld income tax for the period before you filed for bankruptcy. Your bankruptcy estate reports the wages and withheld income tax for the period after you filed for bankruptcy. If you receive other information returns (such as Form 1099-DIV or Form 1099-INT) that report gross income to you, rather than to the bankruptcy estate, you must allocate that income.

The only exception is for purposes of figuring your self-employment tax if you're self-employed. For that purpose, you must take into account all your self-employment income for the year from services performed both before and after the beginning of the case.

You must file a statement with your income tax return stating you filed a chapter 11 bankruptcy case. The statement must show the allocation and describe the method used to make the allocation. For a sample of this statement and other information, see Notice 2006-83, 2006-40 I.R.B. 596, available at *IRS.gov/irb/2006-40_IRB#NOT-2006-83*.

Miscellaneous Compensation

This section discusses many types of employee compensation. The subjects are arranged in alphabetical order.

Advance commissions and other earnings. If you receive advance commissions or other amounts for services to be performed in the future and you're a cash-method taxpayer, you

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must include these amounts in your income in the year you receive them.

If you repay unearned commissions or other amounts in the same year you receive them, reduce the amount of unearned commissions included in your income by the repayment. If you repay them in a later tax year, you can deduct the repayment as an itemized deduction on your Schedule A (Form 1040), Other Itemized Deductions, line 16, or you may be able to take a credit for that year. See *Repayments*, later.

Allowances and reimbursements. If you receive travel, transportation, or other business expense allowances or reimbursements from your employer, see Pub. 463. If you're reimbursed for moving expenses, see Pub. 521.

Back pay awards. Include in income amounts you're awarded in a settlement or judgment for back pay. These include payments made to you for damages, unpaid life insurance premiums, and unpaid health insurance premiums. They should be reported to you by your employer on Form W-2.

Bonuses and awards. Bonuses or awards you receive for outstanding work are included in your income and should be shown on your Form W-2. These include prizes such as vacation trips for meeting sales goals. If the prize or award you receive is goods or services, you must include the FMV of the goods or services in your income. However, if your employer merely promises to pay you a bonus or award at some future time, it isn't taxable until you receive it or it's made available to you.

Employee achievement award. If you receive tangible personal property (other than cash, a gift certificate, or an equivalent item) as an award for length of service or safety achievement, you must generally exclude its value from your income. However, the amount you can exclude is limited to your employer's cost and can't be more than $1,600 ($400 for awards that aren't qualified plan awards) for all such awards you receive during the year. Your employer can tell you whether your award is a qualified plan award. Your employer must make the award as part of a meaningful presentation, under conditions and circumstances that don't create a significant likelihood of it being disguised pay.

However, the exclusion doesn't apply to the following awards.

- A length-of-service award if you received it for less than 5 years of service or if you received another length-of-service award during the year or the previous 4 years.
- A safety achievement award if you're a manager, administrator, clerical employee, or other professional employee or if more than 10% of eligible employees previously received safety achievement awards during the year.

Example 2. Ben Green received three employee achievement awards during the year: a nonqualified plan award of a watch valued at $250, and two qualified plan awards of a stereo valued at $1,000 and a set of golf clubs valued at $500. Assuming that the requirements for qualified plan awards are otherwise satisfied, each award by itself would be excluded from income. However, because the $1,750 total value of the awards is more than $1,600, Ben must include $150 ($1,750 – $1,600) in his income.

Differential wage payments. This is any payment made by an employer to an individual for any period during which the individual is, for a period of more than 30 days, an active duty member of the uniformed services and represents all or a portion of the wages the individual would have received from the employer for that period. These payments are treated as wages and are subject to income tax withholding, but not FICA or FUTA taxes. The payments are reported as wages on Form W-2.

Government cost-of-living allowances. Most payments received by U.S. Government civilian employees for working abroad are taxable. However, certain cost-of-living allowances are tax free. Pub. 516 explains the tax treatment of allowances, differentials, and other special pay you receive for employment abroad.

Nonqualified deferred compensation plans. Your employer will report to you the total amount of deferrals for the year under a nonqualified deferred compensation plan. This amount is shown in Form W-2, box 12, using code Y. This amount isn't included in your income.

However, if at any time during the tax year, the plan fails to meet certain requirements, or isn't operated under those requirements, all amounts deferred under the plan for the tax year and all preceding tax years are included in your income for the current year. This amount is included in your wages shown in Form W-2, box 1. It's also shown in Form W-2, box 12, using code Z.

Nonqualified deferred compensation plans of nonqualified entities. In most cases, any compensation deferred under a nonqualified deferred compensation plan of a nonqualified entity is included in gross income when there is no substantial risk of forfeiture of the rights to such compensation. For this purpose, a nonqualified entity is one of the following.

1. A foreign corporation, unless substantially all of its income is:
   a. Effectively connected with the conduct of a trade or business in the United States, or
   b. Subject to a comprehensive foreign income tax.
2. A partnership, unless substantially all of its income is allocated to persons other than:
   a. Foreign persons for whom the income isn't subject to a comprehensive foreign income tax, and
   b. Tax-exempt organizations.

Note received for services. If your employer gives you a secured note as payment for your services, you must include the FMV (usually the discount value) of the note in your income for the year you receive it. When you later receive payments on the note, a proportionate part of each payment is the recovery of the FMV that you previously included in your income. Don't include that part again in your income. Include the rest of the payment in your income in the year of payment.

If your employer gives you a nonnegotiable unsecured note as payment for your services, payments on the note that are credited toward the principal amount of the note are compensation income when you receive them.

Severance pay. You must include in income amounts you receive as severance pay and any payment for the cancellation of your employment contract.

Severance payments are subject to social security and Medicare taxes, income tax withholding, and FUTA tax. Severance payments are wages subject to social security and Medicare taxes. As noted in section 15 of Pub. 15, *Special Rules for Various Types of Service and Payments*, severance payments are also subject to income tax withholding and FUTA tax.

Accrued leave payment. If you're a federal employee and receive a lump-sum payment for accrued annual leave when you retire or resign, this amount will be included as wages on your Form W-2.

If you resign from one agency and are reemployed by another agency, you may have to repay part of your lump-sum annual leave payment to the second agency. You can reduce gross wages by the amount you repaid in the same tax year in which you received it. Attach to your tax return a copy of the receipt or statement given to you by the agency you repaid to explain the difference between the wages on your return and the wages on your Forms W-2.

Outplacement services. If you choose to accept a reduced amount of severance pay so that you can receive outplacement services (such as training in résumé writing and interview techniques), you must include the unreduced amount of the severance pay in income.

Sick pay. Pay you receive from your employer while you're sick or injured is part of your salary or wages. In addition, you must include in your income sick pay benefits received from any of the following payers.

- A welfare fund.
- A state sickness or disability fund.
- An association of employers or employees.
- An insurance company, if your employer paid for the plan.

However, if you paid the premiums on an accident or health insurance policy, the benefits you receive under the policy aren't taxable. For more information, see *Other Sickness and Injury Benefits* under *Sickness and Injury Benefits*, later.

Social security and Medicare taxes paid by employer. If you and your employer have an agreement that your employer pays your social security and Medicare taxes without deducting them from your gross wages, you must report the amount of tax paid for you as taxable wages on your tax return. The payment is also treated as wages for figuring your social security and Medicare taxes and your social security and

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Medicare benefits. However, these payments aren't treated as social security and Medicare wages if you're a household worker or a farm worker.

Stock appreciation rights. Don't include a stock appreciation right granted by your employer in income until you exercise (use) the right. When you use the right, you're entitled to a cash payment equal to the FMV of the corporation's stock on the date of use minus the FMV on the date the right was granted. You include the cash payment in income in the year you use the right.

Virtual currency. If your employer gives you virtual currency (such as Bitcoin) as payment for your services, you must include the FMV of the currency in your income. The FMV of virtual currency paid as wages is subject to federal income tax withholding, Federal Insurance Contribution Act (FICA) tax, and Federal Unemployment Tax Act (FUTA) tax and must be reported on Form W-2. Notice 2014-21, 2014-16 I.R.B. 938, describes how virtual currency is treated for federal tax purposes and is available at *IRS.gov/irb/2014-16_IRB#NOT-2014-21*. For further information, see *IRS.gov/virtualcurrency.*.

Fringe Benefits

Fringe benefits received in connection with the performance of your services are included in your income as compensation unless you pay FMV for them or they're specifically excluded by law. Refraining from the performance of services (for example, under a covenant not to compete) is treated as the performance of services for purposes of these rules.

See *Valuation of Fringe Benefits*, later in this discussion, for information on how to determine the amount to include in income.

Recipient of fringe benefit. You're the recipient of a fringe benefit if you perform the services for which the fringe benefit is provided. You're considered to be the recipient even if it's given to another person, such as a member of your family. An example is a car your employer gives to your spouse for services you perform. The car is considered to have been provided to you and not to your spouse.

You don't have to be an employee of the provider to be a recipient of a fringe benefit. If you're a partner, a director, or an independent contractor, you can also be the recipient of a fringe benefit.

Provider of benefit. Your employer or another person for whom you perform services is the provider of a fringe benefit regardless of whether that person actually provides the fringe benefit to you. The provider can be a client or customer of an independent contractor.

Accounting period. You must use the same accounting period your employer uses to report your taxable noncash fringe benefits. Your employer has the option to report taxable noncash fringe benefits by using either of the following rules.

- The general rule: benefits are reported for a full calendar year (January 1–December 31).
- The special accounting period rule: benefits provided during the last 2 months of the calendar year (or any shorter period) are treated as paid during the following calendar year. For example, each year, your employer reports the value of benefits provided during the last 2 months of the prior year and the first 10 months of the current year.

Your employer doesn't have to use the same accounting period for each fringe benefit, but must use the same period for all employees who receive a particular benefit.

You must use the same accounting period that you use to report the benefit to claim an employee business deduction (for example, use of a car).

Form W-2. Your employer must include all taxable fringe benefits in box 1 of Form W-2 as wages, tips, and other compensation, and, if applicable, in boxes 3 and 5 as social security and Medicare wages. Although not required, your employer may include the total value of fringe benefits in box 14 (or on a separate statement). However, if your employer provided you with a vehicle and included 100% of its annual lease value in your income, the employer must separately report this value to you in box 14 (or on a separate statement).

Accident or Health Plan

In most cases, the value of accident or health plan coverage provided to you by your employer isn't included in your income. Benefits you receive from the plan may be taxable, as explained under *Sickness and Injury Benefits*, later.

For information on the items covered in this section, other than *Long-term care coverage*, see Pub. 969.

Long-term care coverage. Contributions by your employer to provide coverage for long-term care services generally aren't included in your income. However, contributions made through a flexible spending or similar arrangement (such as a cafeteria plan) must be included in your income. This amount will be reported as wages in box 1 of Form W-2.

Archer MSA contributions. Contributions by your employer to your Archer MSA generally aren't included in your income. Their total will be reported in box 12 of Form W-2 with code R. You must report this amount on Form 8853, Archer MSAs and Long-Term Care Insurance Contracts. File the form with your return.

Health flexible spending arrangement (health FSA). If your employer provides a health FSA that qualifies as an accident or health plan, the amount of your salary reduction, and reimbursements of your medical care expenses, in most cases aren't included in your income.

For 2020, health FSAs are subject to a $2,750 limit on a salary reduction contribution.

Health reimbursement arrangement (HRA). If your employer provides an HRA that qualifies as an accident or health plan, coverage and reimbursements of your medical care expenses generally aren't included in your income.

Health savings account (HSA). If you're an eligible individual, you and any other person, including your employer or a family member, can make contributions to your HSA. Contributions, other than employer contributions, are deductible on your return whether or not you itemize deductions. Contributions made by your employer aren't included in your income. Distributions from your HSA that are used to pay qualified medical expenses aren't included in your income. Distributions not used for qualified medical expenses are included in your income. See Pub. 969 for the requirements of an HSA.

Contributions by a partnership to a bona fide partner's HSA aren't contributions by an employer. The contributions are treated as a distribution of money and aren't included in the partner's gross income. Contributions by a partnership to a partner's HSA for services rendered are treated as guaranteed payments that are includible in the partner's gross income. In both situations, the partner can deduct the contribution made to the partner's HSA.

Contributions by an S corporation to a 2%-shareholder-employee's HSA for services rendered are treated as guaranteed payments and are includible in the shareholder-employee's gross income. The shareholder-employee can deduct the contribution made to the shareholder-employee's HSA.

Qualified HSA funding distribution. You can make a one-time distribution from your individual retirement arrangement (IRA) to an HSA and you generally won't include any of the distribution in your income. See Pub. 590-B for the requirements for these qualified HSA funding distributions.

Adoption Assistance

You may be able to exclude from your income amounts paid or expenses incurred by your employer for qualified adoption expenses in connection with your adoption of an eligible child. See the Instructions for Form 8839 for more information.

Adoption benefits are reported by your employer in box 12 of Form W-2 with code T. They are also included as social security and Medicare wages in boxes 3 and 5. However, they aren't included as wages in box 1. To determine the taxable and nontaxable amounts, you must complete Part III of Form 8839. File the form with your return.

Athletic Facilities

If your employer provides you with the free or low-cost use of an employer-operated gym or other athletic club on your employer's premises, the value isn't included in your compensation. The gym must be used primarily by employees, their spouses, and their dependent children.

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If your employer pays for a fitness program provided to you at an off-site resort hotel or athletic club, the value of the program is included in your compensation.

De Minimis (Minimal) Benefits

If your employer provides you with a product or service and the cost of it is so small that it would be unreasonable for the employer to account for it, the value isn't included in your income. In most cases, the value of benefits such as discounts at company cafeterias, cab fares home when working overtime, occasional personal use of an employer's copying machine (where at least 85% of the use of the machine is for business), and company picnics aren't included in your income. Also, see *Employee Discounts*, later.

Holiday gifts. If your employer gives you a turkey, ham, or other item of nominal value at Christmas or other holidays, don't include the value of the gift in your income. However, if your employer gives you cash, a gift certificate, or a similar item that you can easily exchange for cash, you include the value of that gift as extra salary or wages regardless of the amount involved.

Dependent Care Benefits

If your employer provides dependent care benefits under a qualified plan, you may be able to exclude these benefits from your income. Dependent care benefits include:

- Amounts your employer pays directly to either you or your care provider for the care of your qualifying person while you work,
- The FMV of care in a daycare facility provided or sponsored by your employer, and
- Pre-tax contributions you made under a dependent care FSA.

The amount you can exclude is limited to the lesser of:

- The total amount of dependent care benefits you received during the year,
- The total amount of qualified expenses you incurred during the year,
- Your earned income,
- Your spouse's earned income, or
- $5,000 ($2,500 if married filing separately).

Your employer must show the total amount of dependent care benefits provided to you during the year under a qualified plan in box 10 of Form W-2. Your employer will also include any dependent care benefits over $5,000 in your wages shown in box 1 of Form W-2.

To claim the exclusion, you must complete Part III of Form 2441. See the Instructions for Form 2441 for more information.

Educational Assistance

You can exclude from your income up to $5,250 of qualified employer-provided educational assistance. For more information, see Pub. 970.

Employee Discounts

If your employer sells you property or services at a discount, you may be able to exclude the amount of the discount from your income. The exclusion applies to discounts on property or services offered to customers in the ordinary course of the line of business in which you work. However, it doesn't apply to discounts on real property or property commonly held for investment (such as stocks or bonds).

The exclusion is limited to the price charged nonemployee customers multiplied by the following percentage.

- For a discount on property, your employer's gross profit percentage (gross profit divided by gross sales) on all property sold during the employer's previous tax year. (Ask your employer for this percentage.)
- For a discount on services, 20% (0.20).

Financial Counseling Fees

Financial counseling fees paid for you by your employer are included in your income and must be reported as part of wages. Fees for tax or investment counseling are miscellaneous itemized deductions and are no longer deductible.

Qualified retirement planning services paid for you by your employer may be excluded from your income. For more information, see *Retirement Planning Services*, later.

Employer-Provided Group-Term Life Insurance

In most cases, the cost of up to $50,000 of group-term life insurance coverage provided to you by your employer (or former employer) isn't included in your income. However, you must include in income the cost of employer-provided insurance that is more than the cost of $50,000 of coverage reduced by any amount you pay toward the purchase of the insurance.

For exceptions to this rule, see *Entire cost excluded* and *Entire cost taxed*, later.

If your employer provided more than $50,000 of coverage, the amount included in your income is reported as part of your wages in box 1 of Form W-2. Also, it's shown separately in box 12 with code C.

Group-term life insurance. This insurance is term life insurance protection (insurance for a fixed period of time) that:

- Provides a general death benefit,
- Is provided to a group of employees,
- Is provided under a policy carried by the employer, and
- Provides an amount of insurance to each employee based on a formula that prevents individual selection.

Permanent benefits. If your group-term life insurance policy includes permanent benefits, such as a paid-up or cash surrender value, you must include in your income, as wages, the cost of the permanent benefits minus the amount you pay for them. Your employer should be able to tell you the amount to include in your income.

Accidental death benefits. Insurance that provides accidental or other death benefits but doesn't provide general death benefits (for example, travel insurance) isn't group-term life insurance.

Former employer. If your former employer provided more than $50,000 of group-term life insurance coverage during the year, the amount included in your income is reported as wages in box 1 of Form W-2. Also, it's shown separately in box 12 with code C. Box 12 will also show the amount of uncollected social security and Medicare taxes on the excess coverage, with codes M and N. You must pay these taxes with your income tax return. Include them on Schedule 2 (Form 1040), line 8. For more information, see the Instructions for Forms 1040 and 1040-SR.

Two or more employers. Your exclusion for employer-provided group-term life insurance coverage can't exceed the cost of $50,000 of coverage, whether the insurance is provided by a single employer or multiple employers. If two or more employers provide insurance coverage that totals more than $50,000, the amounts reported as wages on your Forms W-2 won't be correct. You must figure how much to include in your income. Reduce the amount you figure by any amount reported with code C in box 12 of your Forms W-2, add the result to the wages reported in box 1, and report the total on your return.

Figuring the taxable cost. Use the following worksheet to figure the amount to include in your income.

If you pay any part of the cost of the insurance, your entire payment reduces, dollar for dollar, the amount you would otherwise include in your income. However, you can't reduce the amount to include in your income by:

- Payments for coverage in a different tax year;
- Payments for coverage through a cafeteria plan, unless the payments are after-tax contributions; or
- Payments for coverage not taxed to you because of the exceptions discussed later under *Entire cost excluded*.

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Worksheet 1. **Figuring the Cost of Group-Term Life Insurance To Include in Income**
Keep for Your Records

1.	Enter the total amount of your insurance coverage from your employer(s)	**1.** _____
2.	Limit on exclusion for employer-provided group-term life insurance coverage	**2.** *50,000*
3.	Subtract line 2 from line 1	**3.** _____
4.	Divide line 3 by $1,000. Figure to the nearest tenth	**4.** _____
5.	Go to Table 1. Using your age on the last day of the tax year, find your age group in the left column, and enter the cost from the column on the right for your age group	**5.** _____
6.	Multiply line 4 by line 5	**6.** _____
7.	Enter the number of full months of coverage at this cost	**7.** _____
8.	Multiply line 6 by line 7	**8.** _____
9.	Enter the premiums you paid per month	**9.** _____
10.	Enter the number of months you paid the premiums	**10.** _____
11.	Multiply line 9 by line 10	**11.** _____
12.	Subtract line 11 from line 8. **Include this amount in your income as wages**	**12.** _____

Table 1. **Cost of $1,000 of Group-Term Life Insurance for 1 Month**

Age	Cost
Under 25	$ .05
25 through 29	.06
30 through 34	.08
35 through 39	.09
40 through 44	.10
45 through 49	.15
50 through 54	.23
55 through 59	.43
60 through 64	.66
65 through 69	1.27
70 and above	2.06

Example 3. You're 51 years old and work for employers A and B. Both employers provide group-term life insurance coverage for you for the entire year. Your coverage is $35,000 with employer A and $45,000 with employer B. You pay premiums of $4.15 a month under the employer B group plan. You figure the amount to include in your income as follows.

Worksheet 1. **Figuring the Cost of Group-Term Life Insurance To Include in Income—Illustrated**
Keep for Your Records

1.	Enter the total amount of your insurance coverage from your employer(s)	**1.** *80,000*
2.	Limit on exclusion for employer-provided group-term life insurance coverage	**2.** *50,000*
3.	Subtract line 2 from line 1	**3.** *30,000*
4.	Divide line 3 by $1,000. Figure to the nearest tenth	**4.** *30.0*
5.	Go to Table 1. Using your age on the last day of the tax year, find your age group in the left column, and enter the cost from the column on the right for your age group	**5.** *.23*
6.	Multiply line 4 by line 5	**6.** *6.90*
7.	Enter the number of full months of coverage at this cost	**7.** *12*
8.	Multiply line 6 by line 7	**8.** *82.80*
9.	Enter the premiums you paid per month	**9.** *4.15*
10.	Enter the number of months you paid the premiums	**10.** *12*
11.	Multiply line 9 by line 10	**11.** *49.80*
12.	Subtract line 11 from line 8. **Include this amount in your income as wages**	**12.** *33.00*

The total amount to include in income for the cost of excess group-term life insurance is $33. Neither employer provided over $50,000 insurance coverage, so the wages shown on your Forms W-2 don't include any part of that $33. You must add it to the wages shown on your Forms W-2 and include the total on your return.

Entire cost excluded. You aren't taxed on the cost of group-term life insurance if any of the following circumstances apply.

1. You're permanently and totally disabled and have ended your employment.
2. Your employer is the beneficiary of the policy for the entire period the insurance is in force during the tax year.
3. A charitable organization to which contributions are deductible is the only beneficiary of the policy for the entire period the insurance is in force during the tax year. (You aren't entitled to a deduction for a

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charitable contribution for naming a charitable organization as the beneficiary of your policy.)

4. The plan existed on January 1, 1984, and:
   a. You retired before January 2, 1984, and were covered by the plan when you retired; or
   b. You reached age 55 before January 2, 1984, and were employed by the employer or its predecessor in 1983.

Entire cost taxed. You're taxed on the entire cost of group-term life insurance if either of the following circumstances applies.

- The insurance is provided by your employer through a qualified employees' trust, such as a pension trust or a qualified annuity plan.
- You're a key employee and your employer's plan discriminates in favor of key employees.

Meals and Lodging

You don't include in your income the value of meals and lodging provided to you and your family by your employer at no charge if the following conditions are met.

1. The meals are:
   a. Furnished on the business premises of your employer, and
   b. Furnished for the convenience of your employer.
2. The lodging is:
   a. Furnished on the business premises of your employer,
   b. Furnished for the convenience of your employer, and
   c. A condition of your employment. (You must accept it in order to be able to properly perform your duties.)

You also don't include in your income the value of meals or meal money that qualifies as a minimal fringe benefit. See *De Minimis (Minimal) Benefits*, earlier.

Faculty lodging. If you're an employee of an educational institution or an academic health center and you're provided with lodging that doesn't meet the three conditions given earlier, you may still not have to include the value of the lodging in income. However, the lodging must be qualified campus lodging, and you must pay an *Adequate rent*.

Academic health center. This is an organization that meets the following conditions.

- Its principal purpose or function is to provide medical or hospital care or medical education or research.
- It receives payments for graduate medical education under the Social Security Act.
- One of its principal purposes or functions is to provide and teach basic and clinical medical science and research using its own faculty.

Qualified campus lodging. Qualified campus lodging is lodging furnished to you, your spouse, or any of your dependents by, or on behalf of, the institution or center for use as a home. The lodging must be located on or near a campus of the educational institution or academic health center.

Adequate rent. The amount of rent you pay for the year for qualified campus lodging is considered adequate if it's at least equal to the lesser of:

- 5% of the appraised value of the lodging, or
- The average of rentals paid by individuals (other than employees or students) for comparable lodging held for rent by the educational institution.

If the amount you pay is less than the lesser of these amounts, you must include the difference in your income.

The lodging must be appraised by an independent appraiser and the appraisal must be reviewed on an annual basis.

Example 4. Carl Johnson, a sociology professor for State University, rents a home from the university that is qualified campus lodging. The house is appraised at $200,000. The average rent paid for comparable university lodging by persons other than employees or students is $14,000 a year. Carl pays an annual rent of $11,000. Carl doesn't include in his income any rental value because the rent he pays equals at least 5% of the appraised value of the house (5% × $200,000 = $10,000). If Carl paid annual rent of only $8,000, he would have to include $2,000 in his income ($10,000 – $8,000).

Moving Expense Reimbursements

For tax years 2018 through 2025, reimbursements for certain moving expenses are no longer excluded from the gross income of nonmilitary taxpayers.

No-Additional-Cost Services

The value of services you receive from your employer for free, at cost, or for a reduced price isn't included in your income if your employer:

- Offers the same service for sale to customers in the ordinary course of the line of business in which you work, and
- Doesn't have a substantial additional cost (including any sales income given up) to provide you with the service (regardless of what you paid for the service).

In most cases, no-additional-cost services are excess capacity services, such as airline, bus, or train tickets, hotel rooms, and telephone services.

Example 5. You're employed as a flight attendant for a company that owns both an airline and a hotel chain. Your employer allows you to take personal flights (if there is an unoccupied seat) and stay in any one of their hotels (if there is an unoccupied room) at no cost to you. The value of the personal flight isn't included in your income. However, the value of the hotel room is included in your income because you don't work in the hotel business.

Retirement Planning Services

If your employer has a qualified retirement plan, qualified retirement planning services provided to you (and your spouse) by your employer aren't included in your income. Qualified services include retirement planning advice, information about your employer's retirement plan, and information about how the plan may fit into your overall individual retirement income plan. You can't exclude the value of any tax preparation, accounting, legal, or brokerage services provided by your employer. Also, see *Financial Counseling Fees*, earlier.

Transportation

If your employer provides you with a qualified transportation fringe benefit, it can be excluded from your income, up to certain limits. A qualified transportation fringe benefit is:

- Transportation in a commuter highway vehicle (such as a van) between your home and work place,
- A transit pass, or
- Qualified parking.

Cash reimbursement by your employer for these expenses under a bona fide reimbursement arrangement is also excludable. However, cash reimbursement for a transit pass is excludable only if a voucher or similar item that can be exchanged only for a transit pass isn't readily available for direct distribution to you.

Exclusion limit. The exclusion for commuter vehicle transportation and transit pass fringe benefits can't be more than $270 a month.

The exclusion for the qualified parking fringe benefit can't be more than $270 a month.

If the benefits have a value that is more than these limits, the excess must be included in your income.

Commuter highway vehicle. This is a highway vehicle that seats at least six adults (not including the driver). At least 80% of the vehicle's mileage must reasonably be expected to be:

- For transporting employees between their homes and workplace, and
- On trips during which employees occupy at least half of the vehicle's adult seating capacity (not including the driver).

Transit pass. This is any pass, token, farecard, voucher, or similar item entitling a person to ride mass transit (whether public or private) free or at a reduced rate or to ride in a commuter highway vehicle operated by a person in the business of transporting persons for compensation.

Qualified parking. This is parking provided to an employee at or near the employer's place of business. It also includes parking provided on or near a location from which the employee commutes to work by mass transit, in a commuter highway vehicle, or by car pool. It doesn't include parking at or near the employee's home.

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Tuition Reduction

You can exclude a qualified tuition reduction from your income. This is the amount of a reduction in tuition:

- For education (below graduate level) furnished by an educational institution to an employee, former employee who retired or became disabled, or his or her spouse and dependent children;
- For education furnished to a graduate student at an educational institution if the graduate student is engaged in teaching or research activities for that institution; or
- Representing payment for teaching, research, or other services if you receive the amount under the National Health Service Corps Scholarship Program or the Armed Forces Health Professions Scholarship and Financial Assistance program.

For more information, see Pub. 970.

Working Condition Benefits

If your employer provides you with a product or service and the cost of it would have been allowable as a business or depreciation deduction if you paid for it yourself, the cost isn't included in your income.

Example 6. You work as an engineer and your employer provides you with a subscription to an engineering trade magazine. The cost of the subscription isn't included in your income because the cost would have been allowable to you as a business deduction if you had paid for the subscription yourself.

Valuation of Fringe Benefits

If a fringe benefit is included in your income, the amount included is generally its value determined under the general valuation rule or under the special valuation rules. For an exception, see *Employer-Provided Group-Term Life Insurance*, earlier.

General valuation rule. You must include in your income the amount by which the FMV of the fringe benefit is more than the sum of:

1. The amount, if any, you paid for the benefit, plus
2. The amount, if any, specifically excluded from your income by law.

If you pay FMV for a fringe benefit, no amount is included in your income.

Fringe benefit FMV. The FMV of a fringe benefit is determined by all the facts and circumstances. It's the amount you would have to pay a third party to buy or lease the benefit. This is determined without regard to:

- Your perceived value of the benefit, or
- The amount your employer paid for the benefit.

Employer-provided vehicles. If your employer provides a car (or other highway motor vehicle) to you, your personal use of the car is usually a taxable noncash fringe benefit.

Under the general valuation rules, the value of an employer-provided vehicle is the amount you would have to pay a third party to lease the same or a similar vehicle on the same or comparable terms in the same geographic area where you use the vehicle. An example of a comparable lease term is the amount of time the vehicle is available for your use, such as a 1-year period. The value can't be determined by multiplying a cents-per-mile rate times the number of miles driven unless you prove the vehicle could have been leased on a cents-per-mile basis. See *Notice 2021–7* for more information on temporary relief for employers and employees using the automobile lease valuation rule to determine the value of an employer-provided vehicle in 2020 or 2021.

Flights on employer-provided aircraft. Under the general valuation rules, if your flight on an employer-provided piloted aircraft is primarily personal and you control the use of the aircraft for the flight, the value is the amount it would cost to charter the flight from a third party.

If there is more than one employee on the flight, the cost to charter the aircraft must be divided among those employees. The division must be based on all the facts, including which employee or employees control the use of the aircraft.

Special valuation rules. Generally, you can use a special valuation rule for a fringe benefit only if your employer uses the rule. If your employer uses a special valuation rule, you can't use a different special rule to value that benefit. You can always use the general valuation rule discussed earlier, based on facts and circumstances, even if your employer uses a special rule.

If you and your employer use a special valuation rule, you must include in your income the amount your employer determines under the special rule minus the sum of:

1. Any amount you repaid your employer, plus
2. Any amount specifically excluded from income by law.

The special valuation rules are the following.

- The automobile lease rule.
- The vehicle cents-per-mile rule.
- The commuting rule.
- The unsafe conditions commuting rule.
- The employer-operated eating-facility rule.

For more information on these rules, see Pub. 15-B.

For information on the noncommercial flight and commercial flight valuation rules, see sections 1.61-21(g) and 1.61-21(h) of the regulations.

Retirement Plan Contributions

Your employer's contributions to a qualified retirement plan for you aren't included in income at the time contributed. (Your employer can tell you whether your retirement plan is qualified.) However, the cost of life insurance coverage included in the plan may have to be included.

If your employer pays into a nonqualified plan for you, you must generally include the contributions in your income as wages for the tax year in which the contributions are made. However, if your interest in the plan isn't transferable or is subject to a substantial risk of forfeiture (you have a good chance of losing it) at the time of the contribution, you don't have to include the value of your interest in your income until it's transferable or is no longer subject to a substantial risk of forfeiture.

TIP *For information on distributions from retirement plans, see Pub. 575 (or Pub. 721 if you're a federal employee or retiree).*

Elective Deferrals

If you're covered by certain kinds of retirement plans, you can choose to have part of your compensation contributed by your employer to a retirement fund, rather than have it paid to you. The amount you set aside (called an elective deferral) is treated as an employer contribution to a qualified plan. An elective deferral, other than a designated Roth contribution (discussed later), isn't included in wages subject to income tax at the time contributed. However, it's included in wages subject to social security and Medicare taxes.

Elective deferrals include elective contributions to the following retirement plans.

1. Cash or deferred arrangements (section 401(k) plans).
2. The TSP for federal employees.
3. Salary reduction simplified employee pension plans (SARSEP plans).
4. Savings incentive match plans for employees (SIMPLE plans).
5. Tax-sheltered annuity plans (section 403(b) plans).
6. Section 501(c)(18)(D) plans. (But see *Reporting by employer*, later.)
7. Section 457 plans.

Qualified automatic contribution arrangements. Under a qualified automatic contribution arrangement, your employer can treat you as having elected to have a part of your compensation contributed to a section 401(k) plan. You're to receive written notice of your rights and obligations under the qualified automatic contribution arrangement. The notice must explain:

- Your rights to elect not to have elective contributions made, or to have contributions made at a different percentage; and
- How contributions made will be invested in the absence of any investment decision by you.

You must be given a reasonable period of time after receipt of the notice and before the first elective contribution is made to make an election with respect to the contributions.

Overall limit on deferrals. For 2020, you shouldn't have deferred more than a total of $19,500 of contributions to the plans listed in (1) through (3), earlier, unless you are 50 or older. The specific plan limits for the plans listed

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in (4) through (7), earlier, are discussed later. Amounts deferred under specific plan limits are part of the overall limit on deferrals.

Your employer or plan administrator should apply the proper annual limit when figuring your plan contributions. However, you're responsible for monitoring the total you defer to ensure that the deferrals aren't more than the overall limit.

Catch-up contributions. You may be allowed catch-up contributions (additional elective deferrals) if you're age 50 or older by the end of your tax year. For 2020, the catch-up limit for section 401(k) and 403(b) plans, the TSP, SARSEP plans, and governmental section 457 plans is $6,500. For SIMPLE plans, it's $3,000.

For more information about catch-up contributions to:

- Section 401(k) plans, see *Elective Deferrals* in chapter 4 of Pub. 560;
- SARSEPs, see *Salary Reduction Simplified Employee Pensions* in chapter 2 of Pub. 560;
- SIMPLE plans, see *SIMPLE Plans* in chapter 3 of Pub. 560; and
- Section 457 plans, see *Limit for deferrals under section 457 plans*, later.

Limit for deferrals under SIMPLE plans. If you're a participant in a SIMPLE plan, you generally shouldn't have deferred more than $13,500 in 2020. Amounts you defer under a SIMPLE plan count toward the overall limit ($19,500 for 2020) and may affect the amount you can defer under other elective deferral plans.

Limit for tax-sheltered annuities. If you're a participant in a tax-sheltered annuity plan (section 403(b) plan), the limit on elective deferrals for 2020 is generally $19,500. However, if you have at least 15 years of service with a public school system, a hospital, a home health service agency, a health and welfare service agency, a church, or a convention or association of churches (or associated organization), the limit on elective deferrals is increased by the least of the following amounts.

1. $3,000.
2. $15,000, reduced by the sum of:
   a. The additional pre-tax elective deferrals made in earlier years because of this rule, plus
   b. The aggregate amount of designated Roth contributions permitted for prior tax years because of this rule.
3. $5,000 times the number of your years of service for the organization, minus the total elective deferrals made by your employer on your behalf for earlier years.

If you qualify for the 15-year rule, your elective deferrals under this limit can be as high as $22,500 for 2020.

For more information, see Pub. 571.

Limit for deferral under section 501(c)(18) plans. If you're a participant in a section 501(c)(18) plan (a trust created before June 25, 1959, funded only by employee contributions), you should have deferred no more than the lesser of $7,000 or 25% of your compensation. Amounts you defer under a section 501(c)(18) plan count toward the overall limit ($19,500 in 2020) and may affect the amount you can defer under other elective deferral plans.

Limit for deferrals under section 457 plans. If you're a participant in a section 457 plan (a deferred compensation plan for employees of state or local governments or tax-exempt organizations), you should have deferred no more than the lesser of your includible compensation or $19,500 in 2020. However, if you're within 3 years of normal retirement age, you may be allowed an increased limit if the plan allows it. See *Increased limit*, later.

Includible compensation. Generally, this is your Form W-2 wages plus elective deferrals. In most cases, it includes all the following payments.

1. Wages and salaries.
2. Fees for professional services.
3. The value of any employer-provided qualified transportation fringe benefit (defined under *Transportation*, earlier) that isn't included in your income.
4. Other amounts received (cash or noncash) for personal services you performed, including, but not limited to, the following items.
   a. Commissions and tips.
   b. Fringe benefits.
   c. Bonuses.
5. Employer contributions (elective deferrals) to the following.
   a. The section 457 plan.
   b. Qualified cash or deferred arrangements (section 401(k) plans) that aren't included in your income.
   c. A SARSEP plan.
   d. A tax-sheltered annuity (section 403(b) plan).
   e. A SIMPLE plan.
   f. A section 125 cafeteria plan.

Instead of using the amounts listed earlier to determine your includible compensation, your employer can use any of the following amounts.

- Your wages as defined for income tax withholding purposes.
- Your wages as reported in box 1 of Form W-2.
- Your wages that are subject to social security withholding (including elective deferrals).

Increased limit. During any, or all, of the last 3 years ending before you reach normal retirement age under the plan, your plan may provide that your limit is the lesser of:

1. Twice the annual limit ($39,000 for 2020), or
2. The basic annual limit plus the amount of the basic limit not used in prior years (only allowed if not using age 50-or-over catch-up contributions).

Catch-up contributions. You can generally have additional elective deferrals made to your governmental section 457 plan if:

- You reached age 50 by the end of the year, and
- No other elective deferrals can be made for you to the plan for the year because of limits or restrictions.

If you qualify, your limit can be the lesser of your includible compensation or $19,500, plus $6,500. However, if you're within 3 years of retirement age and your plan provides the increased limit, discussed earlier, that limit may be higher.

Designated Roth contributions. Employers with section 401(k) plans, section 403(b) plans, and governmental section 457 plans can create qualified Roth contribution programs so that you may elect to have part or all of your elective deferrals to the plan designated as after-tax Roth contributions. Designated Roth contributions are treated as elective deferrals, except that they're included in income. Your retirement plan must maintain separate accounts and recordkeeping for the designated Roth contributions.

Qualified distributions from a Roth account aren't included in income. A distribution made before the end of the 5-tax-year period beginning with the first tax year for which you made a designated Roth contribution to the account isn't a qualified distribution.

Reporting by employer. Your employer generally shouldn't include elective deferrals in your wages in box 1 of Form W-2. Instead, your employer should mark the Retirement plan checkbox in box 13 and show the total amount deferred in box 12.

Section 501(c)(18)(D) contributions. Wages shown in box 1 of Form W-2 shouldn't have been reduced for contributions you made to a section 501(c)(18)(D) plan. The amount you contributed should be identified with code H in box 12. You may deduct the amount deferred subject to the limits that apply. Include your deduction in the total on Schedule 1 (Form 1040), line 22. Enter the amount and "501(c)(18)(D)" on the dotted line next to line 22.

Designated Roth contributions. These contributions are elective deferrals but are included in your wages in box 1 of Form W-2. Designated Roth contributions to a section 401(k) plan are reported using code AA in box 12, or, for section 403(b) plans, code BB in box 12. Designated Roth contributions to a governmental section 457 plan are reported using code EE in box 12.

Excess deferrals. If your deferrals exceed the limit, you must notify your plan by the date required by the plan. If the plan permits, the excess amount will be distributed to you. If you participate in more than one plan, you can have the excess paid out of any of the plans that permit these distributions. You must notify each plan by the date required by that plan of the amount to be paid from that particular plan. The plan must then pay you the amount of the excess, along with any income earned on that amount, by April 15 of the following year.

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You must include the excess deferral in your income for the year of the deferral. File Form 1040 or 1040-SR to add the excess deferral amount to your wages on line 1.

Excess not distributed. If you don't take out the excess amount, you can't include it in the cost of the contract even though you included it in your income. Therefore, you're taxed twice on the excess deferral left in the plan—once when you contribute it, and again when you receive it as a distribution (unless the excess deferral was a designated Roth contribution).

Excess distributed to you. If you take out the excess after the year of the deferral and you receive the corrective distribution by April 15 of the following year, don't include it in income again in the year you receive it. If you receive it later, you must include it in income in both the year of the deferral and the year you receive it (unless the excess deferral was a designated Roth contribution). Any income on the excess deferral taken out is taxable in the tax year in which you take it out. If you take out part of the excess deferral and the income on it, allocate the distribution proportionately between the excess deferral and the income.

You should receive a Form 1099-R for the year in which the excess deferral is distributed to you. Use the following rules to report a corrective distribution shown on Form 1099-R for 2020.

- If the distribution was for a 2020 excess deferral, your Form 1099-R should have code 8 in box 7. Add the excess deferral amount to your wages on your 2020 tax return.
- If the distribution was for a 2020 excess deferral to a designated Roth account, your Form 1099-R should have codes B and 8 in box 7. Don't add this amount to your wages on your 2020 return.
- If the distribution was for a 2019 excess deferral, your Form 1099-R should have code P in box 7. If you didn't add the excess deferral amount to your wages on your 2019 tax return, you must file an amended return on Form 1040-X. If you didn't receive the distribution by April 15, 2020, you must also add it to your wages on your 2020 tax return.
- If the distribution was for the income earned on an excess deferral, your Form 1099-R should have code 8 in box 7. Add the income amount to your wages on your 2020 income tax return, regardless of when the excess deferral was made.

Report a loss on a corrective distribution of an excess deferral in the year the excess amount (reduced by the loss) is distributed to you. Include the loss as a negative amount on Schedule 1 (Form 1040), line 8, and identify it as "Loss on Excess Deferral Distribution."

TIP *Even though a corrective distribution of excess deferrals is reported on Form 1099-R, it isn't otherwise treated as a distribution from the plan. It can't be rolled over into another plan, and it isn't subject to the additional tax on early distributions.*

Excess Contributions

If you're a highly compensated employee, the total of your elective deferrals made for you for any year under a section 401(k) plan or SARSEP plan may be limited by the average deferrals, as a percentage of pay, made by all eligible non-highly compensated employees.

If you contributed more to the plan than allowed, the excess contributions may be distributed to you. You must include the distribution in your income as wages on Form 1040 or 1040-SR, line 1.

If you receive a corrective distribution of excess contributions (and allocable income), it's included in your income in the year of the distribution. The allocable income is the amount of gain or loss through the end of the plan year for which the contribution was made that is allocable to the excess contributions. You should receive a Form 1099-R for the year the excess contributions are distributed to you. Add the distribution to your wages for that year.

TIP *Even though a corrective distribution of excess contributions is reported on Form 1099-R, it isn't otherwise treated as a distribution from the plan. It can't be rolled over into another plan, and it isn't subject to the additional tax on early distributions.*

Excess Annual Additions

The amount contributed in 2020 to a defined contribution plan is generally limited to the lesser of 100% of your compensation or $57,000. Under certain circumstances, contributions that exceed these limits (excess annual additions) may be corrected by a distribution of your elective deferrals or a return of your after-tax contributions and earnings from these contributions.

A corrective payment of excess annual additions consisting of elective deferrals or earnings from your after-tax contributions is fully taxable in the year paid. A corrective payment consisting of your after-tax contributions isn't taxable.

If you received a corrective payment of excess annual additions, you should receive a separate Form 1099-R for the year of the payment with code E in box 7. Report the total payment shown in box 1 of Form 1099-R on line 5a of Form 1040 or 1040-SR. Report the taxable amount shown in box 2a of Form 1099-R on line 5b of Form 1040 or 1040-SR.

TIP *Even though a corrective distribution of excess annual additions is reported on Form 1099-R, it isn't otherwise treated as a distribution from the plan. It can't be rolled over into another plan, and it isn't subject to the additional tax on early distributions.*

Stock Options

Employee stock options aren't subject to Railroad Retirement Tax. In *Wisconsin Central Ltd.* v. *United States*, 138 S. Ct. 2067, the U.S. Supreme Court ruled that "money remuneration" is "currency issued by a recognized authority as a medium of exchange," and that employee stock options aren't "money remuneration" subject to the Railroad Retirement Tax Act (RRTA). Tier 1 and Tier 2 taxes aren't withheld when employees covered by the RRTA exercise stock options. Federal income tax must still be withheld on taxable compensation from railroad employees exercising their options. If you receive an option to buy or sell stock or other property as payment for your services, you may have income when you receive the option (the grant), when you exercise the option (use it to buy or sell the stock or other property), or when you sell or otherwise dispose of the option or property acquired through exercise of the option. The timing, type, and amount of income inclusion depend on whether you receive a nonstatutory stock option or a statutory stock option. Your employer can tell you which kind of option you hold.

Nonstatutory Stock Options

Grant of option. If you're granted a nonstatutory stock option, you may have income when you receive the option. The amount of income to include and the time to include it depend on whether the FMV of the option can be readily determined. The FMV of an option can be readily determined if it's actively traded on an established market.

The FMV of an option that isn't traded on an established market can be readily determined only if all of the following conditions exist.

- You can transfer the option.
- You can exercise the option immediately in full.
- The option or the property subject to the option isn't subject to any condition or restriction (other than a condition to secure payment of the purchase price) that has a significant effect on the FMV of the option.
- The FMV of the option privilege can be readily determined.

The option privilege for an option to buy is the opportunity to benefit during the option's exercise period from any increase in the value of property subject to the option without risking any capital. For example, if during the exercise period the FMV of stock subject to an option is greater than the option's exercise price, a profit may be realized by exercising the option and immediately selling the stock at its higher value. The option privilege for an option to sell is the opportunity to benefit during the exercise period from a decrease in the value of the property subject to the option.

CAUTION *If you or a member of your family is an officer, director, or more-than-10% owner of an expatriated corporation, you may owe an excise tax on the value of nonstatutory options and other stock-based compensation from that corporation. For more information on the excise tax, see section 4985.*

Option with readily determinable value. If you receive a nonstatutory stock option that has a readily determinable FMV at the time it's granted to you, the option is treated like other property received as compensation. See *Restricted Property*, later, for rules on how much income to include and when to include it. However, the rule described in that discussion for

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choosing to include the value of property in your income for the year of the transfer doesn't apply to a nonstatutory option.

Option without readily determinable value. If the FMV of the option isn't readily determinable at the time it's granted to you (even if it's determined later), you don't have income until you exercise or transfer the option.

Exercise or transfer of option. When you exercise a nonstatutory stock option, the amount to include in your income depends on whether the option had a readily determinable value.

Option with readily determinable value. When you exercise a nonstatutory stock option that had a readily determinable value at the time the option was granted, you don't have to include any amount in income.

Option without readily determinable value. When you exercise a nonstatutory stock option that didn't have a readily determinable value at the time the option was granted, the restricted property rules apply to the property received. The amount to include in your income is the difference between the amount you pay for the property and its FMV when it becomes substantially vested. If it isn't substantially vested at the time you exercise this nonstatutory stock option (so that you may have to give the stock back), you don't have to include any amount in income. You include the difference in income when the option becomes substantially vested. For more information on restricted property, see *Restricted Property*, later.

Transfer in arm's-length transaction. If you transfer a nonstatutory stock option without a readily determinable value in an arm's-length transaction to an unrelated person, you must include in your income the money or other property you received for the transfer as if you had exercised the option.

Transfer in non-arm's-length transaction. If you transfer a nonstatutory stock option without a readily determinable value in a non-arm's-length transaction (for example, a gift), the option isn't treated as exercised or closed at that time. You must include in your income, as compensation, any money or property received. When the transferee exercises the option, you must include in your income, as compensation, the excess of the FMV of the stock acquired by the transferee over the sum of the exercise price paid and any amount you included in income at the time you transferred the option. At the time of the exercise, the transferee recognizes no income and has a basis in the stock acquired equal to the FMV of the stock.

Any transfer of this kind of option to a related person is treated as a non-arm's-length transaction. See Regulations section 1.83-7 for the definition of a related person.

Recourse note in satisfaction of the exercise price of an option. If you're an employee, and you issue a recourse note to your employer in satisfaction of the exercise price of an option to acquire your employer's stock, and your employer and you subsequently agree to reduce the stated principal amount of the note, you generally recognize compensation income at the time and in the amount of the reduction.

Tax form. If you have income from the exercise of nonstatutory stock options, your employer should report the amount to you in box 12 of Form W-2 with code V. The employer should show the spread (that is, the FMV of stock over the exercise price of options granted to you for that stock) from your exercise of the nonstatutory stock options. Your employer should include this amount in boxes 1, 3 (up to the social security wage base), and 5. Your employer should include this amount in box 14 if it's a railroad employer.

If you're a nonemployee spouse and you exercise nonstatutory stock options you received incident to a divorce, the income is reported to you in box 3 of Form 1099-MISC.

Sale of the stock. There are no special income rules for the sale of stock acquired through the exercise of a nonstatutory stock option. Report the sale as explained in the Instructions for Schedule D (Form 1040) for the year of the sale. You may receive a Form 1099-B reporting the sales proceeds.

Your basis in the property you acquire under the option is the amount you pay for it plus any amount you included in income upon grant or exercise of the option.

Your holding period begins as of the date you acquired the option, if it had a readily determinable value, or as of the date you exercised or transferred the option if it had no readily determinable value.

For options granted on or after January 1, 2014, the basis information reported to you on Form 1099-B won't reflect any amount you included in income upon grant or exercise of the option. For options granted before January 1, 2014, any basis information reported to you on Form 1099-B may or may not reflect any amount you included in income upon grant or exercise; therefore, the basis may need to be adjusted.

CAUTION *It's your responsibility to make any appropriate adjustments to the basis information reported on Form 1099-B by completing Form 8949.*

Statutory Stock Options

There are two kinds of statutory stock options.

- Incentive stock options (ISOs).
- Options granted under employee stock purchase plans.

For either kind of option, you must be an employee of the company granting the option, or a related company, at all times during the period beginning on the date the option is granted and ending 3 months before the date you exercise the option (for an ISO, 1 year before if you're disabled). Also, the option must be nontransferable except at death.

If you don't meet the employment requirements, or you receive a transferable option, your option is a nonstatutory stock option.

Grant of option. If you receive a statutory stock option, don't include any amount in your income when the option is granted.

Exercise of option. If you exercise a statutory stock option, don't include any amount in income when you exercise the option.

Alternative minimum tax (AMT). For the AMT, you must treat stock acquired through the exercise of an ISO as if no special treatment applied. This means that, when your rights in the stock are transferable or no longer subject to a substantial risk of forfeiture, you must include as an adjustment in figuring alternative minimum taxable income the amount by which the FMV of the stock exceeds the option price. Enter this adjustment on line 2i of Form 6251. Increase your AMT basis in any stock you acquire by exercising the ISO by the amount of the adjustment. However, no adjustment is required if you dispose of the stock in the same year you exercise the option.

See *Restricted Property*, later, for more information.

RECORDS Your AMT basis in stock acquired through an ISO is likely to differ from your regular tax basis. Therefore, keep adequate records for both the AMT and regular tax so that you can figure your adjusted gain or loss.

Example 7. Your employer, Elm Company, granted you an ISO on April 8, 2019, to buy 100 shares of Elm Company at $9 a share, its FMV at the time. You exercised the option on January 7, 2020, when the stock was selling on the open market for $14 a share. On January 27, 2020, when the stock was selling on the open market for $16 a share, your rights to the stock first became transferable. You include $700 ($1,600 value when your rights first became transferable minus $900 option price) as an adjustment on Form 6251, line 2i.

TIP *If you exercise an ISO during 2020, you should receive Form 3921, or a statement, from the corporation for each transfer made during 2020. The corporation must send or provide you with the form by January 31, 2021. Keep this information for your records.*

Sale of the stock. You have taxable income or a deductible loss when you sell the stock that you bought by exercising the option. Your income or loss is the difference between the amount you paid for the stock (the option price) and the amount you receive when you sell it. You generally treat this amount as capital gain or loss and report it as explained in the Instructions for Schedule D (Form 1040) for the year of the sale.

However, you may have ordinary income for the year that you sell or otherwise dispose of the stock in either of the following situations.

- You don't satisfy the holding period requirement.
- You satisfy the conditions described under *Option granted at a discount* under *Employee stock purchase plan*, later.

Your employer or former employer should report the ordinary income to you as wages in

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box 1 of Form W-2, and you must report this ordinary income amount on Form 1040 or 1040-SR, line 1. If your employer or former employer doesn't provide you with a Form W-2, or if the Form W-2 doesn't include the ordinary income in box 1, you must still report the ordinary income as wages on Form 1040 or 1040-SR, line 1, for the year of the sale or other disposition of the stock.

For options granted on or after January 1, 2014, the basis information reported to you on Form 1099-B won't reflect any amount you included in income upon grant or exercise of the option. For options granted before January 1, 2014, any basis information reported to you on Form 1099-B may or may not reflect any amount you included in income upon grant or exercise; therefore, the basis may need to be adjusted.

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CAUTION *It's your responsibility to make any appropriate adjustments to the basis information reported on Form 1099-B by completing Form 8949.*

Holding period requirement. You satisfy the holding period requirement if you don't sell the stock until the end of the later of the 1-year period after the stock was transferred to you or the 2-year period after the option was granted. However, you're considered to satisfy the holding period requirement if you sold the stock to comply with conflict-of-interest requirements.

Your holding period for the property you acquire when you exercise an option begins on the day after you exercise the option.

ISOs. If you sell stock acquired by exercising an ISO, you need to determine if you satisfied the holding period requirement.

Holding period requirement satisfied. If you sell stock acquired by exercising an ISO and satisfy the holding period requirement, your gain or loss from the sale is capital gain or loss. Report the sale as explained in the Instructions for Schedule D (Form 1040). The basis of your stock is the amount you paid for the stock.

Holding period requirement not satisfied. If you sell stock acquired by exercising an ISO, don't satisfy the holding period requirement, and have a gain from the sale, the gain is ordinary income up to the amount by which the stock's FMV when you exercised the option exceeded the option price. Any excess gain is capital gain. If you have a loss from the sale, it's a capital loss and you don't have any ordinary income.

Your employer or former employer should report the ordinary income to you as wages in box 1 of Form W-2, and you must report this ordinary income amount on Form 1040 or 1040-SR, line 1. If your employer or former employer doesn't provide you with a Form W-2, or if the Form W-2 doesn't include the ordinary income in box 1, you must still report the ordinary income as wages on Form 1040 or 1040-SR, line 1, for the year of the sale or other disposition of the stock. Report the capital gain or loss as explained in the Instructions for Schedule D (Form 1040). In determining capital gain or loss, your basis is the amount you paid when you exercised the option plus the amount reported as wages.

Example 8. Your employer, Oak Corporation, granted you an ISO on March 12, 2018, to buy 100 shares of Oak Corporation stock at $10 a share, its FMV at the time. You exercised the option on January 7, 2019, when the stock was selling on the open market for $12 a share. On January 27, 2020, you sold the stock for $15 a share. Although you held the stock for more than a year, less than 2 years had passed from the time you were granted the option. In 2020, you must report the difference between the option price ($10) and the value of the stock when you exercised the option ($12) as wages. The rest of your gain is capital gain, figured as follows.

Selling price ($15 × 100 shares)	$ 1,500
Purchase price ($10 × 100 shares)	– 1,000
Gain	$ 500
Amount reported as wages [($12 × 100 shares) – $1,000]	– 200
Amount reported as capital gain	$ 300

Employee stock purchase plan. If you sold stock acquired by exercising an option granted under an employee stock purchase plan, you need to determine if you satisfied the holding period requirement.

Holding period requirement satisfied. If you sold stock acquired by exercising an option granted under an employee stock purchase plan, and you satisfy the holding period requirement, determine your ordinary income as follows.

Your basis is equal to the option price at the time you exercised your option and acquired the stock. The timing and amount of pay period deductions don't affect your basis.

Example 9. Pine Company has an employee stock purchase plan. The option price is the lower of the stock price at the time the option is granted or at the time the option is exercised. The value of the stock when the option was granted was $25. Pine Company deducts $5 from Adrian's pay every week for 48 weeks (total = $240 ($5 × 48)). The value of the stock when the option is exercised is $20. Adrian receives 12 shares of Pine Company's stock ($240 ÷ $20). Adrian's holding period for all 12 shares begins the day after the option is exercised, even though the money used to purchase the shares was deducted from Adrian's pay on 48 separate days. Adrian's basis in each share is $20.

Option granted at a discount. If, at the time the option was granted, the option price per share was less than 100% (but not less than 85%) of the FMV of the share, and you dispose of the share after meeting the holding period requirement, or you die while owning the share, you must include in your income as compensation the lesser of:

- The excess of the FMV of the share at the time the option was granted over the option price, or
- The excess of the FMV of the share at the time of the disposition or death over the amount paid for the share under the option.

For this purpose, if the option price wasn't fixed or determinable at the time the option was granted, the option price is figured as if the option had been exercised at the time it was granted.

Any excess gain is capital gain. If you have a loss from the sale, it's a capital loss, and you don't have any ordinary income.

Example 10. Your employer, Willow Corporation, granted you an option under its employee stock purchase plan to buy 100 shares of stock of Willow Corporation for $20 a share at a time when the stock had a value of $22 a share. 18 months later, when the value of the stock was $23 a share, you exercised the option, and 14 months after that you sold your stock for $30 a share. In the year of sale, you must report as wages the difference between the option price ($20) and the value at the time the option was granted ($22). The rest of your gain ($8 per share) is capital gain, figured as follows.

Selling price ($30 × 100 shares)	$ 3,000
Purchase price (option price) ($20 × 100 shares)	– 2,000
Gain	$ 1,000
Amount reported as wages [($22 × 100 shares) – $2,000]	– 200
Amount reported as capital gain	$ 800

Holding period requirement not satisfied. If you don't satisfy the holding period requirement, your ordinary income is the amount by which the stock's FMV when you exercised the option exceeded the option price. This ordinary income isn't limited to your gain from the sale of the stock. Increase your basis in the stock by the amount of this ordinary income. The difference between your increased basis and the selling price of the stock is a capital gain or loss.

Example 11. The facts are the same as in *Example 10*, except that you sold the stock only 6 months after you exercised the option. You didn't satisfy the holding period requirement, so you must report $300 as wages and $700 as capital gain, figured as follows.

Selling price ($30 × 100 shares)	$3,000
Purchase price (option price) ($20 × 100 shares)	– 2,000
Gain	$1,000
Amount reported as wages [($23 × 100 shares) – $2,000]	– 300
Amount reported as capital gain [$3,000 – ($2,000 + $300)]	$700

TIP *If you sold stock in 2020 that you acquired by exercising an option granted at a discount under an employee stock purchase plan, you should receive Form 3922 from the corporation. The corporation must send or provide you with the form by January 31, 2021. Keep this information for your records.*

Qualified Equity Grants

P.L. 115-97 made a change in the law that allows a new election for "qualified employees" of private corporations to elect to defer income

taxation for up to 5 years from the date of vesting on "qualified stock" granted in connection with broad-based compensatory stock option and restricted stock unit (RSU) programs. This election is available for stock attributable to options exercised or RSUs settled after 2017. The corporation must have a written plan providing RSU or option to at least 80% of U.S. employees. The recipients must have the same rights and privileges under RSU or option plan.

The term "qualified employee" doesn't include:

- 1% owner of corporation (current or any point during prior 10 calendar years),
- Current or former CEO or CFO (current or any point previously),
- Family of previously mentioned individuals, or
- One of the four highest compensated officers (current or any point during prior 10 calendar years).

The term "qualified stock" means any stock in a corporation that is the employer of the employee if:

- Stock is received relating to the exercise of an option, or
- Stock is received in settlement of an RSU, and
- Option or RSU was granted by the corporation.

The term "qualified stock" can't include stock from stock-settled stock appreciation rights or restricted stock awards (restricted property). It won't include any stock if the employee may receive cash instead of stock. The election is made in a manner similar to the election described under *Choosing to include in income for year of transfer*, later, under *Restricted Property*, even though the "qualified stock" isn't restricted property. The election must be made no later than 30 days after the first date the rights of the employee in such stock are transferable or aren't subject to a substantial risk of forfeiture, whichever occurs earlier. See *Restricted Property*, later, for how to make the choice.

If an employee elects to defer income inclusion under the provision, the income must be included in the employee's income for the year that includes the earliest of (1) the first date the qualified stock becomes transferable, (2) the date the employee first becomes an excluded employee (as excluded from "qualified employee"), (3) the first date on which any stock of the employer becomes readily tradable on an established securities market, (4) the date 5 years after the first date the employee's right to the stock becomes substantially vested, or (5) the date on which the employee revokes his or her inclusion deferral election.

The employer corporation is required to provide notification of rights to employees covered under a qualified program or face penalties. There will be withholding at the highest marginal rate.

Restricted Property

In most cases, if you receive property for your services, you must include its FMV in your income in the year you receive the property. However, if you receive stock or other property that has certain restrictions that affect its value, you don't include the value of the property in your income until it has been substantially vested. (You can choose to include the value of the property in your income in the year it's transferred to you, as discussed later, rather than the year it's substantially vested.)

Until the property becomes substantially vested, it's owned by the person who makes the transfer to you, usually your employer. However, any income from the property, or the right to use the property, is included in your income as additional compensation in the year you receive the income or have the right to use the property.

When the property becomes substantially vested, you must include its FMV, minus any amount you paid for it, in your income for that year. Your holding period for this property begins when the property becomes substantially vested.

Example 12. Your employer, the Holly Corporation, sells you 100 shares of its stock at $10 a share. At the time of the sale the FMV of the stock is $100 a share. Under the terms of the sale, the stock is under a substantial risk of forfeiture (you have a good chance of losing it) for a 5-year period. Your stock isn't substantially vested when it's transferred, so you don't include any amount in your income in the year you buy it. At the end of the 5-year period, the FMV of the stock is $200 a share. You must include $19,000 in your income [100 shares × ($200 FMV – $10 you paid)]. Dividends paid by the Holly Corporation on your 100 shares of stock are taxable to you as additional compensation during the period the stock can be forfeited.

Substantially vested. Property is substantially vested when:

- It's transferable, or
- It isn't subject to a substantial risk of forfeiture. (You don't have a good chance of losing it.)

Transferable property. Property is transferable if you can sell, assign, or pledge your interest in the property to any person (other than the transferor), and if the person receiving your interest in the property isn't required to give up the property, or its value, if the substantial risk of forfeiture occurs.

Substantial risk of forfeiture. Generally, a substantial risk of forfeiture exists only if rights in property that are transferred are conditioned, directly or indirectly, on the future performance (or refraining from performance) of substantial services by any person, or on the occurrence of a condition related to a purpose of the transfer if the possibility of forfeiture is substantial.

Example 13. The Redwood Corporation transfers to you as compensation for services 100 shares of its corporate stock for $100 a share. Under the terms of the transfer, you must resell the stock to the corporation at $100 a share if you leave your job for any reason within 3 years from the date of transfer. You must perform substantial services over a period of time, and you must resell the stock to the corporation at $100 a share (regardless of its value) if you don't perform the services; so, your rights to the stock are subject to a substantial risk of forfeiture.

Choosing to include in income for year of transfer. You can choose to include the value of restricted property at the time of transfer (minus any amount you paid for the property) in your income for the year it's transferred. If you make this choice, the substantial vesting rules don't apply and, generally, any later appreciation in value isn't included in your compensation when the property becomes substantially vested. Your basis for figuring gain or loss when you sell the property is the amount you paid for it plus the amount you included in income as compensation.

CAUTION *If you make this choice, you can't revoke it without the consent of the IRS. Consent will be given only if you were under a mistake of fact as to the underlying transaction.*

If you forfeit the property after you have included its value in income, your loss is the amount you paid for the property minus any amount you realized on the forfeiture.

CAUTION *You can't make this choice for a nonstatutory stock option.*

How to make the choice. You make the choice by filing a written statement with the Internal Revenue Service Center where you file your return. You must file this statement no later than 30 days after the date the property was transferred. Mail your statement to the address listed for your state under "Are requesting a refund or aren't enclosing a check or money order..." given in *Where Do You File* in the Instructions for Forms 1040 and 1040-SR. You must give a copy of this statement to the person for whom you performed the services and, if someone other than you received the property, to that person.

You must sign the statement and indicate on it that you're making the choice under section 83(b) of the Internal Revenue Code. The statement must contain all of the following information.

- Your name, address, and TIN.
- A description of each property for which you're making the choice.
- The date or dates on which the property was transferred and the tax year for which you're making the choice.
- The nature of any restrictions on the property.
- The FMV at the time of transfer (ignoring restrictions except those that will never lapse) of each property for which you're making the choice.
- Any amount that you paid for the property.
- A statement that you have provided copies to the appropriate persons.

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You can't make this choice for a nonstatutory stock option.

Dividends received on restricted stock. Dividends you receive on restricted stock are treated as compensation and not as dividend income. Your employer should include these payments on your Form W-2. If they are also reported on a Form 1099-DIV, you should list them on Schedule B (Form 1040), with a statement that you have included them as wages. Don't include them in the total dividends received.

Stock you chose to include in your income. Dividends you receive on restricted stock you chose to include in your income in the year transferred are treated the same as any other dividends. You should receive a Form 1099-DIV showing these dividends. Don't include the dividends in your wages on your return. Report them as dividends.

Sale of property not substantially vested. These rules apply to the sale or other disposition of property that you didn't choose to include in your income in the year transferred and that isn't substantially vested.

If you sell or otherwise dispose of the property in an arm's-length transaction, include in your income as compensation for the year of sale the amount realized minus the amount you paid for the property. If you exchange the property in an arm's-length transaction for other property that isn't substantially vested, treat the new property as if it were substituted for the exchanged property.

The sale or other disposition of a nonstatutory stock option to a related person isn't considered an arm's-length transaction. See Regulations section 1.83-7 for the definition of a related person.

If you sell the property in a transaction that isn't at arm's length, include in your income as compensation for the year of sale the total of any money you received and the FMV of any substantially vested property you received on the sale. In addition, you'll have to report income when the original property becomes substantially vested, as if you still held it. Report as compensation its FMV minus the total of the amount you paid for the property and the amount included in your income from the earlier sale.

Example 14. In 2017, you paid your employer $50 for a share of stock that had an FMV of $100 and was subject to forfeiture until 2020. In 2019, you sold the stock to your spouse for $10 in a transaction not at arm's length. You had compensation of $10 from this transaction. In 2020, when the stock had an FMV of $120, it became substantially vested. For 2019, you must report additional compensation of $60, figured as follows.

FMV of stock at time of substantial vesting		$120
Minus: Amount paid for stock	$50	
Minus: Compensation previously included in income from sale to spouse	10	– 60
Additional income		$60

Inherited property not substantially vested. If you inherit property not substantially vested at the time of the decedent's death, any income you receive from the property is considered income in respect of a decedent and is taxed according to the rules for restricted property received for services. For information about income in respect of a decedent, see Pub. 559.

Special Rules for Certain Employees

This part of the publication deals with special rules for people in certain types of employment: members of the clergy, members of religious orders, people working for foreign employers, military personnel, and volunteers.

Clergy

If you're a member of the clergy, you must include in your income offerings and fees you receive for marriages, baptisms, funerals, masses, etc., in addition to your salary. If the offering is made to the religious institution, it isn't taxable to you.

If you're a member of a religious organization and you give your outside earnings to the organization, you must still include the earnings in your income. However, you may be entitled to a charitable contribution deduction for the amount paid to the organization. See Pub. 526. Also, see *Members of Religious Orders*, later.

Pension. A pension or retirement pay for a member of the clergy is usually treated as any other pension or annuity. It must be reported on lines 5a and 5b of Form 1040 or 1040-SR.

Housing

Special rules for housing apply to members of the clergy. Under these rules, you don't include in your income the rental value of a home (including utilities) or a designated housing allowance provided to you as part of your pay. However, the exclusion can't be more than the reasonable pay for your service. If you pay for the utilities, you can exclude any allowance designated for utility cost, up to your actual cost. The home or allowance must be provided as compensation for your services as an ordained, licensed, or commissioned minister. However, you must include the rental value of the home or the housing allowance as earnings from self-employment on Schedule SE (Form 1040) if you're subject to the self-employment tax. For more information, see Pub. 517.

Members of Religious Orders

If you're a member of a religious order who has taken a vow of poverty, how you treat earnings that you renounce and turn over to the order depends on whether your services are performed for the order.

Services performed for the order. If you're performing the services as an agent of the order in the exercise of duties required by the order, don't include in your income the amounts turned over to the order.

If your order directs you to perform services for another agency of the supervising church or an associated institution, you're considered to be performing the services as an agent of the order. Any wages you earn as an agent of an order that you turn over to the order aren't included in your income.

Example 15. You're a member of a church order and have taken a vow of poverty. You renounce any claims to your earnings and turn over to the order any salaries or wages you earn. You're a registered nurse, so your order assigns you to work in a hospital that is an associated institution of the church. However, you remain under the general direction and control of the order. You're considered to be an agent of the order and any wages you earn at the hospital that you turn over to your order aren't included in your income.

Services performed outside the order. If you're directed to work outside the order, your services aren't an exercise of duties required by the order unless they meet both of the following requirements.

- They're the kind of services that are ordinarily the duties of members of the order.
- They're part of the duties that you must exercise for, or on behalf of, the religious order as its agent.

If you're an employee of a third party, the services you perform for the third party won't be considered directed or required of you by the order. Amounts you receive for these services are included in your income, even if you have taken a vow of poverty.

Example 16. Ivan Brown is a member of a religious order and has taken a vow of poverty. He renounces all claims to his earnings and turns over his earnings to the order.

Ivan is a schoolteacher. He was instructed by the superiors of the order to get a job with a private tax-exempt school. Ivan became an employee of the school, and, at his request, the school made the salary payments directly to the order.

Because Ivan is an employee of the school, he's performing services for the school rather than as an agent of the order. The wages Ivan earns working for the school are included in his income.

Example 17. Alex Dennis is a member of a religious order who, as a condition of membership, has taken vows of poverty and obedience. All claims to his earnings are renounced. Alex received permission from the order to establish a private practice as a psychologist and counsels members of religious orders as well as nonmembers. Although the order reviews Alex's budget annually, Alex controls not only the details of his practice but also the means by which his work as a psychologist is accomplished.

Alex's private practice as a psychologist doesn't make him an agent of the religious order. The psychological services provided by Alex aren't the type of services that are provided by the order. The income Alex earns as a psychologist is earned in his individual capacity.

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Alex must include in his income the earnings from his private practice.

Foreign Employer

Special rules apply if you work for a foreign employer.

U.S. citizen. If you're a U.S. citizen who works in the United States for a foreign government, an international organization, a foreign embassy, or any foreign employer, you must include your salary in your income.

Social security and Medicare taxes. You're exempt from social security and Medicare employee taxes if you're employed in the United States by an international organization or a foreign government. However, you must pay self-employment tax on your earnings from services performed in the United States, even though you aren't self-employed. This rule also applies if you're an employee of a qualifying wholly owned instrumentality of a foreign government.

Employees of international organizations or foreign governments. Your compensation for official services to an international organization is exempt from federal income tax if you aren't a citizen of the United States or you're a citizen of the Philippines (whether or not you're a citizen of the United States).

Your compensation for official services to a foreign government is exempt from federal income tax if all of the following are true.

- You aren't a citizen of the United States or you're a citizen of the Philippines (whether or not you're a citizen of the United States).
- Your work is like the work done by employees of the United States in foreign countries.
- The foreign government gives an equal exemption to employees of the United States in its country.

Waiver of alien status. If you're an alien who works for a foreign government or international organization and you file a waiver under section 247(b) of the Immigration and Nationality Act to keep your immigrant status, any salary you receive after the date you file the waiver isn't exempt under this rule. However, it may be exempt under a treaty or agreement. See Pub. 519, U.S. Tax Guide for Aliens, for more information about treaties.

Nonwage income. This exemption applies only to employees' wages, salaries, and fees. Pensions and other income, such as investment income, don't qualify for this exemption.

Employment abroad. For information on the tax treatment of income earned abroad, see Pub. 54.

Military

Payments you receive as a member of a military service are generally taxed as wages except for retirement pay, which is taxed as a pension. Allowances generally aren't taxed. For more information on the tax treatment of military allowances and benefits, see Pub. 3.

Differential wage payments. Any payments made to you by an employer during the time you're performing service in the uniformed services are treated as compensation. These wages are subject to income tax withholding and are reported on Form W-2. See the discussion under *Miscellaneous Compensation*, earlier.

Military retirement pay. If your retirement pay is based on age or length of service, it's taxable and must be included in your income as a pension on lines 5a and 5b of Form 1040 or 1040-SR. Don't include in your income the amount of any reduction in retirement or retainer pay to provide a survivor annuity for your spouse or children under the Retired Serviceman's Family Protection Plan or the Survivor Benefit Plan.

For a more detailed discussion of survivor annuities, see Pub. 575.

Disability. If you're retired on disability, see *Military and Government Disability Pensions* under *Sickness and Injury Benefits*, later.

Qualified reservist distribution (QRD). If you received a QRD of all or part of the balance in your health FSA because you're a reservist and you have been ordered or called to active duty for a period of 180 days or more, the QRD is treated as wages and is reportable on Form W-2.

Veterans' benefits. Don't include in your income any veterans' benefits paid under any law, regulation, or administrative practice administered by the Department of Veterans Affairs (VA). The following amounts paid to veterans or their families aren't taxable.

- Education, training, and subsistence allowances.
- Disability compensation and pension payments for disabilities paid either to veterans or their families.
- Grants for homes designed for wheelchair living.
- Grants for motor vehicles for veterans who lost their sight or the use of their limbs.
- Veterans' insurance proceeds and dividends paid either to veterans or their beneficiaries, including the proceeds of a veteran's endowment policy paid before death.
- Interest on insurance dividends left on deposit with the VA.
- Benefits under a dependent-care assistance program.
- The death gratuity paid to a survivor of a member of the U.S. Armed Forces who died after September 10, 2001.
- Payments made under the compensated work therapy program.
- Any bonus payment by a state or political subdivision because of service in a combat zone.

Note. If, in a previous year, you received a bonus payment by a state or political subdivision because of service in a combat zone that you included in your income, you can file a claim for refund of the taxes on that income. Use Form 1040-X to file the claim. File a separate form for each tax year involved. In most cases, you must file your claim within 3 years after the date you filed your original return or within 2 years after the date you paid the tax, whichever is later. See the Instructions for Form 1040-X for information on filing that form.

Volunteers

The tax treatment of amounts you receive as a volunteer is covered in the following discussions.

Peace Corps. Living allowances you receive as a Peace Corps volunteer or volunteer leader for housing, utilities, household supplies, food, and clothing are exempt from tax.

Taxable allowances. The following allowances must be included in your income and reported as wages.

- Allowances paid to your spouse and minor children while you're a volunteer leader training in the United States.
- Living allowances designated by the Director of the Peace Corps as basic compensation. These are allowances for personal items such as domestic help, laundry and clothing maintenance, entertainment and recreation, transportation, and other miscellaneous expenses.
- Leave allowances.
- Readjustment allowances or termination payments. These are considered received by you when credited to your account.

Example 18. Gary Carpenter, a Peace Corps volunteer, gets $175 a month as a readjustment allowance during his period of service, to be paid to him in a lump sum at the end of his tour of duty. Although the allowance isn't available to him until the end of his service, Gary must include it in his income on a monthly basis as it's credited to his account.

Volunteers in Service to America (VISTA). If you're a VISTA volunteer, you must include meal and lodging allowances paid to you in your income as wages.

National Senior Service Corps programs. Don't include in your income amounts you receive for supportive services or reimbursements for out-of-pocket expenses from the following programs.

- Retired Senior Volunteer Program (RSVP).
- Foster Grandparent Program.
- Senior Companion Program.

Service Corps of Retired Executives (SCORE). If you receive amounts for supportive services or reimbursements for out-of-pocket expenses from SCORE, don't include these amounts in gross income.

Volunteer tax counseling. Don't include in your income any reimbursements you receive for transportation, meals, and other expenses you have in training for, or actually providing, volunteer federal income tax counseling for the elderly (TCE).

You can deduct as a charitable contribution your unreimbursed out-of-pocket expenses in taking part in the volunteer income tax assistance (VITA) program.

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Volunteer firefighters and emergency medical responders. If you are a volunteer firefighter or emergency medical responder, do not include in your income the following benefits you receive from a state or local government.

- Rebates or reductions of property or income taxes you receive because of services you performed as a volunteer firefighter or emergency medical responder
- Payments you receive because of services you performed as a volunteer firefighter or emergency medical responder, up to $50 for each month you provided services.

The excluded income reduces any related tax or contribution deduction.

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Business and Investment Income

This section provides information on the treatment of income from certain rents and royalties, and from interests in partnerships and S corporations.

Note. You may be subject to the Net Investment Income Tax (NIIT). The NIIT is a 3.8% tax on the lesser of net investment income or the excess of your modified adjusted gross income (MAGI) over a threshold amount. For details, see Form 8960 and its instructions.

CAUTION *Income from sales at auctions, including online auctions, may be business income. For more information, see Pub. 334.*

Rents From Personal Property

If you rent out personal property, such as equipment or vehicles, how you report your income and expenses is in most cases determined by:

- Whether or not the rental activity is a business, and
- Whether or not the rental activity is conducted for profit.

In most cases, if your primary purpose is income or profit and you're involved in the rental activity with continuity and regularity, your rental activity is a business. See Pub. 535 for details on deducting expenses for both business and not-for-profit activities.

Reporting business income and expenses. If you're in the business of renting personal property, report your income and expenses on Schedule C (Form 1040). The form instructions have information on how to complete them.

Reporting nonbusiness income. If you aren't in the business of renting personal property, report your rental income on Schedule 1 (Form 1040), line 8. List the type and amount of the income on the dotted line next to line 8.

Reporting nonbusiness expenses. If you rent personal property for profit, include your rental expenses in the total amount you enter on Schedule 1 (Form 1040), line 22. Also, enter the amount and "PPR" on the dotted line next to line 22.

If you don't rent personal property for profit, your deductions are limited and you can't report a loss to offset other income. See *Activity not for profit* under *Other Income*, later.

Royalties

Royalties from copyrights; patents; and oil, gas, and mineral properties are taxable as ordinary income.

In most cases, you report royalties on Schedule E (Form 1040). However, if you hold an operating oil, gas, or mineral interest or are in business as a self-employed writer, inventor, artist, etc., report your income and expenses on Schedule C (Form 1040).

Copyrights and patents. Royalties from copyrights on literary, musical, or artistic works, and similar property, or from patents on inventions, are amounts paid to you for the right to use your work over a specified period of time. Royalties are generally based on the number of units sold, such as the number of books, tickets to a performance, or machines sold.

Oil, gas, and minerals. Royalty income from oil, gas, and mineral properties is the amount you receive when natural resources are extracted from your property. The royalties are generally based on production or revenue and are paid to you by a person or company who leases the property from you.

Depletion. If you're the owner of an economic interest in mineral deposits or oil and gas wells, you can recover your investment through the depletion allowance. For information on this subject, see chapter 9 of Pub. 535.

Coal and iron ore. Under certain circumstances, you can treat amounts you receive from the disposal of coal and iron ore as payments from the sale of a capital asset, rather than as royalty income. For information about gain or loss from the sale of coal and iron ore, see chapter 2 of Pub. 544.

Sale of property interest. If you sell your complete interest in oil, gas, or mineral rights, the amount you receive is considered payment for the sale of section 1231 property, not royalty income. Under certain circumstances, the sale is subject to capital gain or loss treatment as explained in the Instructions for Schedule D (Form 1040). For more information on selling section 1231 property, see chapter 3 of Pub. 544.

If you retain a royalty, an overriding royalty, or a net profit interest in a mineral property for the life of the property, you have made a lease or a sublease, and any cash you receive for the assignment of other interests in the property is ordinary income subject to a depletion allowance.

Part of future production sold (carved out production payment). If you own mineral property but sell part of the future production, in most cases you treat the money you receive from the buyer at the time of the sale as a loan from the buyer. Don't include it in your income or take depletion based on it.

When production begins, you include all the proceeds in your income, deduct all the production expenses, and deduct depletion from that amount to arrive at your taxable income from the property.

Partnership Income

A partnership generally isn't a taxable entity. The income, gains, losses, deductions, and credits of a partnership are passed through to the partners based on each partner's distributive share of these items. For more information, see Pub. 541.

Partner's distributive share. Your distributive share of partnership income, gains, losses, deductions, or credits is generally based on the partnership agreement. You must report your distributive share of these items on your return whether or not they are actually distributed to you. However, your distributive share of the partnership losses is limited to the adjusted basis of your partnership interest at the end of the partnership year in which the losses took place.

Partnership agreement. The partnership agreement usually covers the distribution of profits, losses, and other items. However, if the agreement doesn't state how a specific item of gain or loss will be shared, or the allocation stated in the agreement doesn't have substantial economic effect, your distributive share is figured according to your interest in the partnership.

Partnership return. Although a partnership generally pays no tax, it must file an information return on Form 1065. This shows the result of the partnership's operations for its tax year and the items that must be passed through to the partners.

Schedule K-1 (Form 1065). You should receive from each partnership in which you're a member a copy of Schedule K-1 (Form 1065) showing your share of income, deductions, credits, and tax preference items of the partnership for the tax year. Keep Schedule K-1 for your records. Don't attach it to your Form 1040 or 1040-SR, unless you're specifically required to do so.

Partner's return. You must generally report partnership items on your individual return the same way as they're reported on the partnership return. That is, if the partnership had a capital gain, you report your share as explained in the Instructions for Schedule D (Form 1040). You report your share of partnership ordinary income on Schedule E (Form 1040).

TIP *In many cases, Schedule K-1 (Form 1065) will tell you where to report an item of income on your individual return.*

Qualified joint venture. If you and your spouse each materially participate as the only members of a jointly owned and operated business, and you file a joint return for the tax year, you can make a joint election to be treated as a qualified joint venture instead of a partnership. To make this election, you must divide all items

of income, gain, loss, deduction, and credit attributable to the business between you and your spouse in accordance with your respective interests in the venture. For further information on how to make the election and which schedule(s) to file, see the instructions for your individual tax return.

S Corporation Income

In most cases, an S corporation doesn't pay tax on its income. Instead, the income, losses, deductions, and credits of the corporation are passed through to the shareholders based on each shareholder's pro rata share. You must report your share of these items on your return. In most cases, the items passed through to you will increase or decrease the basis of your S corporation stock as appropriate.

S corporation return. An S corporation must file a return on Form 1120-S. This shows the results of the corporation's operations for its tax year and the items of income, losses, deductions, or credits that affect the shareholders' individual income tax returns.

Schedule K-1 (Form 1120-S). You should receive a copy of Schedule K-1 (Form 1120-S) from any S corporation in which you're a shareholder. Schedule K-1 (Form 1120-S) shows your share of income, losses, deductions, and credits for the tax year. Keep Schedule K-1 (Form 1120-S) for your records. Don't attach it to your Form 1040 or 1040-SR, unless you're specifically required to do so.

Shareholder's return. Your distributive share of the items of income, losses, deductions, or credits of the S corporation must be shown separately on your Form 1040 or 1040-SR. The character of these items is generally the same as if you had realized or incurred them personally.

TIP *In many cases, Schedule K-1 (Form 1120-S) will tell you where to report an item of income on your individual return.*

Distributions. In most cases, S corporation distributions are a nontaxable return of your basis in the corporation stock. However, in certain cases, part of the distributions may be taxable as a dividend, or as a long-term or short-term capital gain, or as both. The corporation's distributions may be in the form of cash or property.

More information. For more information, see the Instructions for Form 1120-S.

Sickness and Injury Benefits

In most cases, you must report as income any amount you receive for personal injury or sickness through an accident or health plan that is paid for by your employer. If both you and your employer pay for the plan, only the amount you receive that is due to your employer's payments is reported as income. However, certain payments may not be taxable to you. For information on nontaxable payments, see *Military and Government Disability Pensions* and *Other Sickness and Injury Benefits*, later in this discussion.

TIP *Don't report as income any amounts paid to reimburse you for medical expenses you incurred after the plan was established.*

Cost paid by you. If you pay the entire cost of an accident or health plan, don't include any amounts you receive from the plan for personal injury or sickness as income on your tax return. If your plan reimbursed you for medical expenses you deducted in an earlier year, you may have to include some, or all, of the reimbursement in your income. See *Recoveries* under *Miscellaneous Income*, later.

Cafeteria plans. In most cases, if you're covered by an accident or health insurance plan through a cafeteria plan, and the amount of the insurance premiums wasn't included in your income, you aren't considered to have paid the premiums and you must include any benefits you receive in your income. If the amount of the premiums was included in your income, you're considered to have paid the premiums and any benefits you receive aren't taxable.

Disability Pensions

If you retired on disability, you must include in income any disability pension you receive under a plan that is paid for by your employer. You must report your taxable disability payments as wages on line 1 of Form 1040 or 1040-SR until you reach minimum retirement age. Minimum retirement age is generally the age at which you can first receive a pension or annuity if you aren't disabled.

TIP *You may be entitled to a tax credit if you were permanently and totally disabled when you retired. For information on this credit, see Pub. 524.*

Beginning on the day after you reach minimum retirement age, payments you receive are taxable as a pension or annuity. Report the payments on lines 5a and 5b of Form 1040 or 1040-SR. For more information on pensions and annuities, see Pub. 575.

Terrorist attacks. Don't include in your income disability payments you receive for injuries incurred as a direct result of terrorist attacks directed against the United States (or its allies), whether outside or within the United States. However, you must include in your income any amounts that you received that you would have received in retirement had you not become disabled as a result of a terrorist attack. Accordingly, you must include in your income any payments you receive from a 401(k), pension, or other retirement plan to the extent that you would have received the amount at the same or later time regardless of whether you had become disabled. See Pub. 907.

TIP *Contact the company or agency making these payments if it incorrectly reports your payments as taxable income to the IRS on Form W-2, or on Form 1099-R, to request that it reissue the form to report some or all of these payments as nontaxable income in box 12 (under code J) of Form W-2 or in box 1 but not in box 2a of Form 1099-R. If income taxes are being incorrectly withheld from these payments, you may also submit Form W-4 to the company or agency to stop the withholding of income taxes from payments reported on Form W-2 or you may submit Form W-4P to stop the withholding of income taxes from payments reported on Form 1099-R.*

Disability payments you receive for injuries not incurred as a direct result of a terrorist attack or for illnesses or diseases not resulting from an injury incurred as a direct result of a terrorist attack can't be excluded from your income under this provision but may be excludable for other reasons. See Pub. 907.

Retirement and profit-sharing plans. If you receive payments from a retirement or profit-sharing plan that doesn't provide for disability retirement, don't treat the payments as a disability pension. The payments must be reported as a pension or annuity.

Accrued leave payment. If you retire on disability, any lump-sum payment you receive for accrued annual leave is a salary payment. The payment isn't a disability payment. Include it in your income in the tax year you receive it.

Military and Government Disability Pensions

Certain military and government disability pensions aren't taxable.

Service-connected disability. You may be able to exclude from income amounts you receive as a pension, annuity, or similar allowance for personal injury or sickness resulting from active service in one of the following government services.

- The armed forces of any country.
- The National Oceanic and Atmospheric Administration.
- The Public Health Service.
- The Foreign Service.

Conditions for exclusion. Don't include the disability payments in your income if any of the following conditions apply.

1. You were entitled to receive a disability payment before September 25, 1975.
2. You were a member of a listed government service or its reserve component, or were under a binding written commitment to become a member, on September 24, 1975.
3. You receive the disability payments for a combat-related injury. This is a personal injury or sickness that:
   a. Results directly from armed conflict;
   b. Takes place while you're engaged in extra-hazardous service;
   c. Takes place under conditions simulating war, including training exercises such as maneuvers; or
   d. Is caused by an instrumentality of war.

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4. You would be entitled to receive disability compensation from the VA if you filed an application for it. Your exclusion under this condition is equal to the amount you would be entitled to receive from the VA.

Pension based on years of service. If you receive a disability pension based on years of service, in most cases, you must include it in your income. However, if the pension qualifies for the exclusion for a service-connected disability (discussed earlier), don't include in income the part of your pension that you would have received if the pension had been based on a percentage of disability. You must include the rest of your pension in your income.

Retroactive VA determination. If you retire from the U.S. Armed Forces based on years of service and are later given a retroactive service-connected disability rating by the VA, your retirement pay for the retroactive period is excluded from income up to the amount of VA disability benefits you would have been entitled to receive. You can claim a refund of any tax paid on the excludable amount (subject to the statute of limitations) by filing an amended return on Form 1040-X for each previous year during the retroactive period. You must include with each Form 1040-X a copy of the official VA determination letter granting the retroactive benefit. The letter must show the amount withheld and the effective date of the benefit.

If you receive a lump-sum disability severance payment and are later awarded VA disability benefits, exclude 100% of the severance benefit from your income. However, you must include in your income any lump-sum readjustment or other nondisability severance payment you received on release from active duty, even if you're later given a retroactive disability rating by the VA.

Special statute of limitations. In most cases, under the statute of limitations a claim for credit or refund must be filed within 3 years from the time a return was filed. However, if you receive a retroactive service-connected disability rating determination, the statute of limitations is extended by a 1-year period beginning on the date of the determination. This 1-year extended period applies to claims for credit or refund filed after June 17, 2008, and doesn't apply to any tax year that began more than 5 years before the date of the determination.

Example 19. You retired in 2014 and receive a pension based on your years of service. On August 3, 2020, you receive a determination of service-connected disability retroactive to 2014. Generally, you could claim a refund for the taxes paid on your pension for 2017, 2018, and 2019. However, under the special limitation period, you can also file a claim for 2016 as long as you file the claim by August 3, 2021. You can't file a claim for 2014 and 2015 because those tax years began more than 5 years before the determination.

Terrorist attack or military action. Don't include in your income disability payments you receive for injuries resulting directly from a terrorist or military action. In the case of the September 11 attacks, injuries eligible for coverage by the September 11 Victim Compensation Fund are treated as incurred as a direct result of the attack. However, you must include in your income any amounts that you received that you would have received in retirement had you not become disabled as a result of a terrorist or military action. Accordingly, you must include in your income any payments you receive from a 401(k), pension, or other retirement plan to the extent that you would have received the amount at the same or later time regardless of whether you had become disabled. Disability payments you receive for injuries not incurred as a direct result of a terrorist or military action or for illnesses or diseases not resulting from an injury incurred as a direct result of a terrorist or military action may be excludable from income for other reasons. See Pub. 907.

A terrorist action is one that is directed against the United States or any of its allies (including a multinational force in which the United States is participating). A military action is one that involves the U.S. Armed Forces and is a result of actual or threatened violence or aggression against the United States or any of its allies, but doesn't include training exercises.

Long-Term Care Insurance Contracts

In most cases, long-term care insurance contracts are treated as accident and health insurance contracts. Amounts you receive from them (other than policyholder dividends or premium refunds) are excludable in most cases from income as amounts received for personal injury or sickness. To claim an exclusion for payments made on a per diem or other periodic basis under a long-term care insurance contract, you must file Form 8853 with your return.

A long-term care insurance contract is an insurance contract that only provides coverage for qualified long-term care services. The contract must:

- Be guaranteed renewable;
- Not provide for a cash surrender value or other money that can be paid, assigned, pledged, or borrowed;
- Provide that refunds, other than refunds on the death of the insured or complete surrender or cancellation of the contract, and dividends under the contract may be used only to reduce future premiums or increase future benefits; and
- In most cases, not pay or reimburse expenses incurred for services or items that would be reimbursed under Medicare, except where Medicare is a secondary payer or the contract makes per diem or other periodic payments without regard to expenses.

Qualified long-term care services. Qualified long-term care services are:

- Necessary diagnostic, preventive, therapeutic, curing, treating, mitigating, rehabilitative services, and maintenance and personal care services; and
- Required by a chronically ill individual and provided pursuant to a plan of care prescribed by a licensed health care practitioner.

Chronically ill individual. A chronically ill individual is one who has been certified by a licensed health care practitioner within the previous 12 months as one of the following.

- An individual who, for at least 90 days, is unable to perform at least two activities of daily living without substantial assistance due to a loss of functional capacity. Activities of daily living are eating, toileting, transferring, bathing, dressing, and continence.
- An individual who requires substantial supervision to be protected from threats to health and safety due to severe cognitive impairment.

Limit on exclusion. The exclusion for payments made on a per diem or other periodic basis under a long-term care insurance contract is subject to a limit. The limit applies to the total of these payments and any accelerated death benefits made on a per diem or other periodic basis under a life insurance contract because the insured is chronically ill. (For more information on accelerated death benefits, see *Life Insurance Proceeds* under *Miscellaneous Income*, later.)

Under this limit, the excludable amount for any period is figured by subtracting any reimbursement received (through insurance or otherwise) for the cost of qualified long-term care services during the period from the larger of the following amounts.

- The cost of qualified long-term care services during the period.
- The dollar amount for the period ($380 per day for any period in 2020).

See Section C of Form 8853 and its instructions for more information.

Workers' Compensation

Amounts you receive as workers' compensation for an occupational sickness or injury are fully exempt from tax if they're paid under a workers' compensation act or a statute in the nature of a workers' compensation act. The exemption also applies to your survivors. The exemption, however, doesn't apply to retirement plan benefits you receive based on your age, length of service, or prior contributions to the plan, even if you retired because of an occupational sickness or injury.

CAUTION *If part of your workers' compensation reduces your social security or equivalent railroad retirement benefits received, that part is considered social security (or equivalent railroad retirement) benefits and may be taxable. See Pub. 554, and Pub. 915, Social Security and Equivalent Railroad Retirement Benefits, for more information.*

Return to work. If you return to work after qualifying for workers' compensation, salary payments you receive for performing light duties are taxable as wages.

Disability pension. If your disability pension is paid under a statute that provides benefits only to employees with service-connected disabilities, part of it may be workers' compensation. That part is exempt from tax. The rest of your pension, based on years of service, is taxable as pension or annuity income. If you die, the

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part of your survivors' benefit that is a continuation of the workers' compensation is exempt from tax.

Other Sickness and Injury Benefits

In addition to disability pensions and annuities, you may receive other payments for sickness or injury.

Railroad sick pay. Payments you receive as sick pay under the Railroad Unemployment Insurance Act are taxable and you must include them in your income. However, don't include them in your income if they're for an on-the-job injury.

Black lung benefit payments. These payments are similar to workers' compensation and aren't taxable in most cases.

Federal Employees' Compensation Act (FECA). Payments received under FECA for personal injury or sickness, including payments to beneficiaries in case of death, aren't taxable. However, you're taxed on amounts you receive under FECA as continuation of pay for up to 45 days while a claim is being decided. Report this income on line 1 of Form 1040 or 1040-SR. Also, pay for sick leave while a claim is being processed is taxable and must be included in your income as wages.

CAUTION *If part of the payments you receive under FECA reduces your social security or equivalent railroad retirement benefits received, that part is considered social security (or equivalent railroad retirement) benefits and may be taxable. See Pub. 554 for more information.*

Qualified Indian health care benefit. For benefits and coverage provided after March 23, 2010, the value of any qualified Indian health care benefit isn't taxable. These benefits include any health service or benefits provided by the Indian Health Service, amounts to reimburse medical care expenses provided by an Indian tribe, coverage under accident or health insurance, and any other medical care provided by an Indian tribe.

Other compensation. Many other amounts you receive as compensation for sickness or injury aren't taxable. These include the following amounts.

- Compensatory damages you receive for physical injury or physical sickness, whether paid in a lump sum or in periodic payments. See *Court awards and damages* under *Other Income*, later.
- Benefits you receive under an accident or health insurance policy on which either you paid the premiums or your employer paid the premiums but you had to include them in your income.
- Disability benefits you receive for loss of income or earning capacity as a result of injuries under a no-fault car insurance policy.
- Compensation you receive for permanent loss or loss of use of a part or function of your body, or for your permanent disfigurement. This compensation must be based only on the injury and not on the period of your absence from work. These benefits aren't taxable even if your employer pays for the accident and health plan that provides these benefits.

Reimbursement for medical care. A reimbursement for medical care is generally not taxable. However, it may reduce your medical expense deduction. If you receive reimbursement for an expense you deducted in an earlier year, see *Recoveries*, later.

If you receive an advance reimbursement or loan for future medical expenses from your employer without regard to whether you suffered a personal injury or sickness or incurred medical expenses, that amount is included in your income, whether or not you incur uninsured medical expenses during the year.

Reimbursements received under your employer's plan for expenses incurred before the plan was established are included in income.

Amounts you receive under a reimbursement plan that provides for the payment of unused reimbursement amounts in cash or other benefits are included in your income. For details, see Pub. 969.

Miscellaneous Income

This section discusses various types of income. You may have taxable income from certain transactions even if no money changes hands. For example, you may have taxable income if you lend money at a below-market interest rate or have a debt you owe canceled.

Bartering

Bartering is an exchange of property or services. You must include in your income, at the time received, the FMV of property or services you receive in bartering. If you exchange services with another person and you both have agreed ahead of time on the value of the services, that value will be accepted as FMV unless the value can be shown to be otherwise.

Generally, you report this income on Schedule C (Form 1040). However, if the barter involves an exchange of something other than services, such as in *Example 23*, later, you may have to use another form or schedule instead.

Example 20. You're a self-employed attorney who performs legal services for a client, a small corporation. The corporation gives you shares of its stock as payment for your services. You must include the FMV of the shares in your income on Schedule C (Form 1040) in the year you receive them.

Example 21. You're a self-employed accountant. You and a house painter are members of a barter club. Members contact each other directly and bargain for the value of the services to be performed. In return for accounting services you provided, the house painter painted your home. You must report as your income on Schedule C (Form 1040) the FMV of the house painting services you received. The house painter must include in income the FMV of the accounting services you provided.

Example 22. You're self-employed and a member of a barter club. The club uses credit units as a means of exchange. It adds credit units to your account for goods or services you provide to members, which you can use to purchase goods or services offered by other members of the barter club. The club subtracts credit units from your account when you receive goods or services from other members. You must include in your income the value of the credit units that are added to your account, even though you may not actually receive goods or services from other members until a later tax year.

Example 23. You own a small apartment building. In return for 6 months rent-free use of an apartment, an artist gives you a work of art she created. You must report as rental income on Schedule E (Form 1040) the FMV of the artwork, and the artist must report as income on Schedule C (Form 1040) the fair rental value of the apartment.

Form 1099-B from barter exchange. If you exchanged property or services through a barter exchange, Form 1099-B or a similar statement from the barter exchange should be sent to you by February 16, 2021. It should show the value of cash, property, services, credits, or scrip you received from exchanges during 2020. The IRS will also receive a copy of Form 1099-B.

Backup withholding. In most cases, the income you receive from bartering isn't subject to regular income tax withholding. However, backup withholding will apply in certain circumstances to ensure that income tax is collected on this income.

Under backup withholding, the barter exchange must withhold, as income tax, 28% of the income if:

- You don't give the barter exchange your TIN, or
- The IRS notifies the barter exchange that you gave it an incorrect TIN.

If you join a barter exchange, you must certify under penalties of perjury that your TIN is correct and that you aren't subject to backup withholding. If you don't make this certification, backup withholding may begin immediately. The barter exchange will give you a Form W-9, or a similar form, for you to make this certification. The barter exchange will withhold tax only up to the amount of any cash paid to you or deposited in your account and any scrip or credit issued to you (and converted to cash).

TIP *If tax is withheld from your barter income, the barter exchange will report the amount of tax withheld on Form 1099-B or similar statement.*

Canceled Debts

In most cases, if a debt you owe is canceled or forgiven, other than as a gift or bequest, you must include the canceled amount in your income. You have no income from the canceled

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debt if it's intended as a gift to you. A debt includes any indebtedness for which you're liable or which attaches to property you hold.

If the debt is a nonbusiness debt, report the canceled amount on Schedule 1 (Form 1040), line 8. If it's a business debt, report the amount on Schedule C (Form 1040) or on Schedule F (Form 1040) if the debt is farm debt and you're a farmer.

Starting in 2014, you must include the income you elected to defer in 2009 or 2010 from a cancellation, reacquisition, or modification of a business debt. For information on this election, see Revenue Procedure 2009-37, available at *IRS.gov/irb/2009-36_IRB#RP-2009-37*.

Form 1099-C. If a federal government agency, financial institution, or credit union cancels or forgives a debt you owe of $600 or more, you may receive a Form 1099-C. Form 1099-C, box 2, shows the amount of debt either actually or deemed discharged. If you don't agree with the amount reported in box 2, contact your creditor.

Interest included in canceled debt. If any interest is forgiven and included in the amount of canceled debt in box 2, the amount of interest will also be shown in box 3. Whether or not you must include the interest portion of the canceled debt in your income depends on whether the interest would be deductible if you paid it. See *Deductible debt* under *Exceptions*, later.

If the interest would not be deductible (such as interest on a personal loan), include in your income the amount from box 2 of Form 1099-C. If the interest would be deductible (such as on a business loan), include in your income the net amount of the canceled debt (the amount shown in box 2 less the interest amount shown in box 3).

Discounted mortgage loan. If your financial institution offers a discount for the early payment of your mortgage loan, the amount of the discount is canceled debt. You must include the canceled amount in your income.

Mortgage relief upon sale or other disposition. If you're personally liable for a mortgage (recourse debt), and you're relieved of the mortgage when you dispose of the property, you may realize gain or loss up to the FMV of the property. To the extent the mortgage discharge exceeds the FMV of the property, it's income from discharge of indebtedness unless it qualifies for exclusion under *Excluded debt*, later. Report any income from discharge of indebtedness on nonbusiness debt that doesn't qualify for exclusion as other income on Schedule 1 (Form 1040), line 8.

TIP *You may be able to exclude part of the mortgage relief on your principal residence. See* Excluded debt*, later.*

If you aren't personally liable for a mortgage (nonrecourse debt), and you're relieved of the mortgage when you dispose of the property (such as through foreclosure), that relief is included in the amount you realize. You may have a taxable gain if the amount you realize exceeds your adjusted basis in the property. Report any gain on nonbusiness property as a capital gain.

See Pub. 4681 for more information.

Stockholder debt. If you're a stockholder in a corporation and the corporation cancels or forgives your debt to it, the canceled debt is a constructive distribution that is generally dividend income to you. For more information, see Pub. 542.

If you're a stockholder in a corporation and you cancel a debt owed to you by the corporation, you generally don't realize income. This is because the canceled debt is considered as a contribution to the capital of the corporation equal to the amount of debt principal that you canceled.

Repayment of canceled debt. If you included a canceled amount in your income and later pay the debt, you may be able to file a claim for refund for the year the amount was included in income. You can file a claim on Form 1040-X if the statute of limitations for filing a claim is still open. The statute of limitations generally doesn't end until 3 years after the due date of your original return.

Exceptions

There are several exceptions to the inclusion of canceled debt in income. These are explained next.

Student loans. Certain student loans contain a provision that all or part of the debt incurred to attend the qualified educational institution will be canceled if you work for a certain period of time in certain professions for any of a broad class of employers.

You don't have income if your student loan is canceled after you agreed to this provision and then performed the services required. To qualify, the loan must have been made by:

1. The federal government, a state or local government, or an instrumentality, agency, or subdivision thereof;
2. A tax-exempt public benefit corporation that has assumed control of a state, county, or municipal hospital, and whose employees are considered public employees under state law; or
3. An educational institution:
   a. Under an agreement with an entity described in (1) or (2) that provided the funds to the institution to make the loan, or
   b. As part of a program of the institution designed to encourage students to serve in occupations or areas with unmet needs and under which the services provided are for or under the direction of a governmental unit or a tax-exempt section 501(c)(3) organization (defined later).

A loan to refinance a qualified student loan will also qualify if it was made by an educational institution or a tax-exempt section 501(a) organization under its program designed as described in item 3b earlier.

An educational institution is an organization with a regular faculty and curriculum and a regularly enrolled body of students in attendance at the place where the educational activities are carried on.

A section 501(c)(3) organization is any corporation, community chest, fund, or foundation organized and operated exclusively for one or more of the following purposes.

- Charitable.
- Educational.
- Fostering national or international amateur sports competition (but only if none of the organization's activities involve providing athletic facilities or equipment).
- Literary.
- Preventing cruelty to children or animals.
- Religious.
- Scientific.
- Testing for public safety.

Exception. In most cases, the cancellation of a student loan made by an educational institution because of services you performed for that institution or another organization that provided the funds for the loan must be included in gross income on your tax return.

Education loan repayment assistance. Education loan repayments made to you by the National Health Service Corps Loan Repayment Program (NHSC Loan Repayment Program), a state education loan repayment program eligible for funds under the Public Health Service Act, or any other state loan repayment or loan forgiveness program that is intended to provide for the increased availability of health services in underserved or health professional shortage areas aren't taxable.

Deductible debt. You don't have income from the cancellation of a debt if your payment of the debt would be deductible. This exception applies only if you use the cash method of accounting. For more information, see chapter 5 of Pub. 334.

Price reduced after purchase. In most cases, if the seller reduces the amount of debt you owe for property you purchased, you don't have income from the reduction. The reduction of the debt is treated as a purchase price adjustment and reduces your basis in the property.

Excluded debt. Don’t include a canceled debt in your gross income in the following situations.

- The debt is canceled in a bankruptcy case under title 11 of the U.S. Code. See Pub. 908.
- The debt is canceled when you're insolvent. However, you can't exclude any amount of canceled debt that is more than the amount by which you're insolvent. See Pub. 908.
- The debt is qualified farm debt and is canceled by a qualified person. See chapter 3 of Pub. 225.
- The debt is qualified real property business debt. See chapter 5 of Pub. 334.
- The cancellation is intended as a gift.
- The debt is qualified principal residence indebtedness, discussed next.

Qualified principal residence indebtedness (QPRI). This is debt secured by your principal residence that you took out to buy, build, or substantially improve your principal

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residence. QPRI can't be more than the cost of your principal residence plus improvements.

You must reduce the basis of your principal residence by the amount excluded from gross income. To claim the exclusion, you must file Form 982 with your tax return.

Principal residence. Your principal residence is the home where you ordinarily live most of the time. You can have only one principal residence at any one time.

Amount eligible for exclusion. The exclusion applies only to debt discharged after 2006 and in most cases before 2026. The maximum amount you can treat as QPRI is $2 million ($1 million if married filing separately). You can't exclude debt canceled because of services performed for the lender or on account of any other factor not directly related to a decline in the value of your residence or to your financial condition.

Limitation. If only part of a loan is QPRI, the exclusion applies only to the extent the canceled amount is more than the amount of the loan immediately before the cancellation that isn't QPRI.

Example 24. Your principal residence is secured by a debt of $1 million, of which $800,000 is QPRI. Your residence is sold for $700,000 and $300,000 of debt is canceled. Only $100,000 of the canceled debt may be excluded from income (the $300,000 that was discharged minus the $200,000 of nonqualified debt).

Host or Hostess

If you host a party or event at which sales are made, any gift or gratuity you receive for giving the event is a payment for helping a direct seller make sales. You must report this item as income at its FMV.

Your out-of-pocket party expenses are subject to the 50% limit for meal expenses. For tax years beginning after 2017, no deduction is allowed for any expenses related to activities generally considered entertainment, amusement, or recreation. Taxpayers may continue to deduct 50% of the cost of business meals if the taxpayer (or an employee of the taxpayer) is present and the food or beverages aren't considered lavish or extravagant. The meals may be provided to a current or potential business customer, client, consultant, or similar business contact. Food and beverages that are provided during entertainment events won't be considered entertainment if purchased separately from the event.

For more information about the 50% limit for meal expenses, see *50% Limit* in Pub. 463.

Life Insurance Proceeds

Life insurance proceeds paid to you because of the death of the insured person aren't taxable unless the policy was turned over to you for a price. This is true even if the proceeds were paid under an accident or health insurance policy or an endowment contract. However, interest income received as a result of life insurance proceeds may be taxable.

Proceeds not received in installments. If death benefits are paid to you in a lump sum or other than at regular intervals, include in your income only the benefits that are more than the amount payable to you at the time of the insured person's death. If the benefit payable at death isn't specified, you include in your income the benefit payments that are more than the present value of the payments at the time of death.

Proceeds received in installments. If you receive life insurance proceeds in installments, you can exclude part of each installment from your income.

To determine the excluded part, divide the amount held by the insurance company (generally, the total lump sum payable at the death of the insured person) by the number of installments to be paid. Include anything over this excluded part in your income as interest.

Example 25. The face amount of the policy is $75,000 and, as beneficiary, you choose to receive 120 monthly installments of $1,000 each. The excluded part of each installment is $625 ($75,000 ÷ 120), or $7,500 for an entire year. The rest of each payment, $375 a month (or $4,500 for an entire year), is interest income to you.

Installments for life. If, as the beneficiary under an insurance contract, you're entitled to receive the proceeds in installments for the rest of your life without a refund or period-certain guarantee, you figure the excluded part of each installment by dividing the amount held by the insurance company by your life expectancy. If there is a refund or period-certain guarantee, the amount held by the insurance company for this purpose is reduced by the actuarial value of the guarantee.

Surviving spouse. If your spouse died before October 23, 1986, and insurance proceeds paid to you because of the death of your spouse are received in installments, you can exclude up to $1,000 a year of the interest included in the installments. If you remarry, you can continue to take the exclusion.

Employer-owned life insurance contract. If you're the policyholder of an employer-owned life insurance contract, you must include in income any life insurance proceeds received that are more than the premiums and any other amounts you paid on the policy. You're subject to this rule if you have a trade or business, you own a life insurance contract on the life of your employee, and you (or a related person) are a beneficiary under the contract.

However, you may exclude the full amount of the life insurance proceeds if the following apply.

1. Before the policy is issued, you provide written notice about the insurance to the employee and the employee provides written consent to be insured.
2. Either:
   a. The employee was your employee within the 12-month period before death, or, at the time the contract was issued, was a director or highly compensated employee; or
   b. The amount is paid to the family or designated beneficiary of the employee.

Interest option on insurance. If an insurance company pays you interest only on proceeds from life insurance left on deposit, the interest you've paid is taxable.

If your spouse died before October 23, 1986, and you chose to receive only the interest from your insurance proceeds, the $1,000 interest exclusion for a surviving spouse doesn't apply. If you later decide to receive the proceeds from the policy in installments, you can take the interest exclusion from the time you begin to receive the installments.

Surrender of policy for cash. If you surrender a life insurance policy for cash, you must include in income any proceeds that are more than the cost of the life insurance policy. In most cases, your cost (or investment in the contract) is the total of premiums that you paid for the life insurance policy, less any refunded premiums, rebates, dividends, or unrepaid loans that weren't included in your income.

You should receive a Form 1099-R showing the total proceeds and the taxable part. Report these amounts on lines 5a and 5b of Form 1040 or 1040-SR.

TIP *For information on when the proceeds are excluded from income, see* Accelerated Death Benefits*, later.*

Split-dollar life insurance. In most cases, a split-dollar life insurance arrangement is an arrangement between an owner and a nonowner of a life insurance contract under which either party to the arrangement pays all or part of the premiums, and one of the parties paying the premiums is entitled to recover all or part of those premiums from the proceeds of the contract. There are two mutually exclusive rules to tax split-dollar life insurance arrangements.

1. Under the economic benefit rule, the owner of the life insurance contract is treated as providing current life insurance protection and other taxable economic benefits to the nonowner of the contract.
2. Under the loan rule, the nonowner of the life insurance contract is treated as loaning premium payments to the owner of the contract.

Only one of these rules applies to any one policy. For more information, see sections 1.61-22 and 1.7872-15 of the regulations.

Endowment Contract Proceeds

An endowment contract is a policy under which you're paid a specified amount of money on a certain date unless you die before that date, in which case the money is paid to your designated beneficiary. Endowment proceeds paid in a lump sum to you at maturity are taxable only if the proceeds are more than the cost (investment in the contract) of the policy. To determine your cost, subtract any amount that you previously received under the contract and excluded

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from your income from the total premiums (or other consideration) paid for the contract. Include the part of the lump payment that is more than your cost in your income.

Endowment proceeds that you choose to receive in installments instead of a lump sum payment at the maturity of the policy are taxed as an annuity. This is explained in Pub. 575. For this treatment to apply, you must choose to receive the proceeds in installments before receiving any part of the lump sum. This election must be made within 60 days after the lump-sum payment first becomes payable to you.

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Accelerated Death Benefits

Certain amounts paid as accelerated death benefits under a life insurance contract or viatical settlement before the insured's death are excluded from income if the insured is terminally or chronically ill.

Viatical settlement. This is the sale or assignment of any part of the death benefit under a life insurance contract to a viatical settlement provider. A viatical settlement provider is a person who regularly engages in the business of buying or taking assignment of life insurance contracts on the lives of insured individuals who are terminally or chronically ill and who meets the requirements of section 101(g)(2)(B) of the Internal Revenue Code.

Exclusion for terminal illness. Accelerated death benefits are fully excludable if the insured is a terminally ill individual. This is a person who has been certified by a physician as having an illness or physical condition that can reasonably be expected to result in death within 24 months from the date of the certification.

Exclusion for chronic illness. If the insured is a chronically ill individual who isn't terminally ill, accelerated death benefits paid on the basis of costs incurred for qualified long-term care services are fully excludable. Accelerated death benefits paid on a per diem or other periodic basis are excludable up to a limit. For 2020, this limit is $380. It applies to the total of the accelerated death benefits and any periodic payments received from long-term care insurance contracts. For information on the limit and the definitions of chronically ill individual, qualified long-term care services, and long-term care insurance contracts, see *Long-Term Care Insurance Contracts* under *Sickness and Injury Benefits*, earlier.

Exception. The exclusion doesn't apply to any amount paid to a person (other than the insured) who has an insurable interest in the life of the insured because the insured:

- Is a director, officer, or employee of the person; or
- Has a financial interest in the person's business.

Form 8853. To claim an exclusion for accelerated death benefits made on a per diem or other periodic basis, you must file Form 8853 with your return. You don't have to file Form 8853 to exclude accelerated death benefits paid on the basis of actual expenses incurred.

Recoveries

A recovery is a return of an amount you deducted or took a credit for in an earlier year. The most common recoveries are refunds, reimbursements, and rebates of itemized deductions. You may also have recoveries of nonitemized deductions (such as payments on previously deducted bad debts) and recoveries of items for which you previously claimed a tax credit.

Tax benefit rule. You must include a recovery in your income in the year you receive it up to the amount by which the deduction or credit you took for the recovered amount reduced your tax in the earlier year. For this purpose, any increase to an amount carried over to the current year that resulted from the deduction or credit is considered to have reduced your tax in the earlier year.

Federal income tax refund. Refunds of federal income taxes aren't included in your income because they're never allowed as a deduction from income.

State tax refund. If you received a state or local income tax refund (or credit or offset) in 2020, you must generally include it in income if you deducted the tax in an earlier year. The payer should send Form 1099-G to you by January 31, 2021. The IRS will also receive a copy of the Form 1099-G. If you file Form 1040 or 1040-SR, use the worksheet in the 2020 Instructions for Schedule 1 (Form 1040) to figure the amount (if any) to include in your income. See *Itemized Deduction Recoveries*, later, for when you must use Worksheet 2, later in this publication.

If you could choose to deduct for a tax year either:

- State and local income taxes, or
- State and local general sales taxes, then

the maximum refund that you may have to include in income is limited to the excess of the tax you chose to deduct for that year over the tax you didn't choose to deduct for that year.

Example 26. For 2019, you can choose a $10,000 state income tax deduction or a $9,000 state general sales tax deduction. You choose to deduct the state income tax. In 2020, you receive a $2,500 state income tax refund. The maximum refund that you may have to include in income is $1,000, because you could have deducted $9,000 in state general sales tax.

Example 27. For 2019, you can choose a $9,500 state general sales tax deduction based on actual expenses or a $9,200 state income tax deduction. You choose to deduct the general sales tax deduction. In 2020, you return an item you had purchased and receive a $500 sales tax refund. In 2020, you also receive a $1,500 state income tax refund. The maximum refund that you may have to include in income is $500, because it's less than the excess of the tax deducted ($9,500) over the tax you didn't choose to deduct ($9,200 – $1,500 = $7,700). Because you didn't choose to deduct the state income tax, you don't include the state income tax refund in income.

Mortgage interest refund. If you received a refund or credit in 2020 of mortgage interest paid in an earlier year, the amount should be shown in box 4 of your Form 1098. Don't subtract the refund amount from the interest you paid in 2020. You may have to include it in your income under the rules explained in the following discussions.

Interest on recovery. Interest on any of the amounts you recover must be reported as interest income in the year received. For example, report any interest you received on state or local income tax refunds on Form 1040 or 1040-SR, line 2b, or Form 1040-NR, line 9a.

Recovery and expense in same year. If the refund or other recovery and the expense occur in the same year, the recovery reduces the deduction or credit and isn't reported as income.

Recovery for 2 or more years. If you receive a refund or other recovery that is for amounts you paid in 2 or more separate years, you must allocate, on a pro rata basis, the recovered amount between the years in which you paid it. This allocation is necessary to determine the amount of recovery from any earlier years and to determine the amount, if any, of your allowable deduction for this item for the current year.

Example 28. You paid 2019 estimated state income tax of $4,000 in four equal payments. You made your fourth payment in January 2020. You had no state income tax withheld during 2019. In 2020, you received a $400 tax refund based on your 2019 state income tax return. You claimed itemized deductions each year on Schedule A (Form 1040).

You must allocate the $400 refund between 2019 and 2020, the years in which you paid the tax on which the refund is based. You paid 75% ($3,000 ÷ $4,000) of the estimated tax in 2019, so 75% of the $400 refund, or $300, is for amounts you paid in 2019 and is a recovery item. If all of the $300 is a taxable recovery item, you'll include $300 on Schedule 1 (Form 1040), line 1, for 2020, and attach a copy of your calculation showing why that amount is less than the amount shown on the Form 1099-G you received from the state.

The balance ($100) of the $400 refund is for your January 2020 estimated tax payment. When you figure your deduction for state and local income taxes paid during 2020, you'll reduce the $1,000 paid in January by $100. Your deduction for state and local income taxes paid during 2020 will include the January net amount of $900 ($1,000 – $100), plus any estimated state income taxes paid in 2020 for 2020, and any state income tax withheld during 2020.

Joint state or local income tax return. If you filed a joint state or local income tax return in an earlier year and you aren't filing a joint Form 1040 or 1040-SR with the same person for 2020, any refund of a deduction claimed on that state or local income tax return must be allocated to the person that paid the expense. If both persons paid a portion of the expense, allocate the refund based on your individual portion. For

example, if you paid 25% of the expense, then you would use 25% of the refund to figure if you must include any portion of the refund in your income.

Registered domestic partners (RDPs) domiciled in community property states. For the rules that apply to RDPs who are domiciled in community property states, see Pub. 555 and Form 8958.

Deductions not itemized. If you didn't itemize deductions for the year for which you received the recovery of an expense that was deductible only if you itemized, don't include any of the recovery amount in your income.

Example 29. You claimed the standard deduction on your 2019 federal income tax return. In 2020, you received a refund of your 2019 state income tax. Don't report any of the refund as income because you didn't itemize deductions for 2019.

Itemized Deduction Recoveries

The following discussion explains how to determine the amount to include in your income from a recovery of an amount deducted in an earlier year as an itemized deduction. However, you generally don't need to use this discussion if you file Form 1040 or 1040-SR and the recovery is for state or local income taxes paid in 2019. Instead, use the State and Local Income Tax Refund Worksheet—Schedule 1, Line 1, in the 2020 Instructions for Schedule 1 (Form 1040) for line 1 to figure the amount (if any) to include in your income. See the Instructions for Forms 1040 and 1040-SR.

You can't use the State and Local Income Tax Refund Worksheet—Schedule 1, Line 1, and must use this discussion if you're a nonresident alien (discussed later) or any of the following statements are true.

1. You received a refund in 2020 that is for a tax year other than 2019.
2. You received a refund other than an income tax refund, such as a general sales tax or real property tax refund, in 2020 of an amount deducted or credit claimed in an earlier year.
3. The amount on your 2019 Form 1040, line 10, was more than the amount on your 2019 Form 1040, line 8b minus line 9.
4. You had taxable income on your 2019 Form 1040, line 11b, but no tax on your Form 1040, line 12a, because of the 0% tax rate on net capital gains and qualified dividends in certain situations. See *Capital gains*, later.
5. Your 2019 state and local income tax refund is more than your 2019 state and local income tax deduction minus the amount you could have deducted as your 2019 state and local general sales taxes.
6. You made your last payment of 2019 estimated state or local income tax in 2020.
7. You owed AMT in 2019.
8. You couldn't use the full amount of credits you were entitled to in 2019 because the total credits were more than the amount shown on your 2019 Form 1040, line 12b.
9. You could be claimed as a dependent by someone else in 2019.
10. You received a refund because of a jointly filed state or local income tax return, but you aren't filing a joint 2020 Form 1040 or 1040-SR with the same person.

CAUTION *If you also recovered an amount deducted as a nonitemized deduction, figure the amount of that recovery to include in your income and add it to your adjusted gross income (AGI) before applying the rules explained here. See* Nonitemized Deduction Recoveries, *later.*

Nonresident aliens. If you're a nonresident alien and file Form 1040-NR, you can't claim the standard deduction. If you recover an itemized deduction that you claimed in an earlier year, you must generally include the full amount of the recovery in your income in the year you receive it. However, if you had no taxable income in that earlier year (see *Negative taxable income*, later), you should complete Worksheet 2 to determine the amount you must include in income. If any other statement under *Total recovery included in income* isn't true, see the discussion referenced in the statement to determine the amount to include in income.

Capital gains. If you determined your tax in the earlier year by using the Schedule D Tax Worksheet, or the Qualified Dividends and Capital Gain Tax Worksheet, and you receive a refund in 2020 of a deduction claimed in that year, you'll have to refigure your tax for the earlier year to determine if the recovery must be included in your income. If inclusion of the recovery doesn't change your total tax, you don't include the recovery in income. However, if your total tax increases by any amount, you must include the recovery in your income up to the amount of the deduction that reduced your tax in the earlier year.

Total recovery included in income. If you recover any itemized deduction that you claimed in an earlier year, you must generally include the full amount of the recovery in your income in the year you receive it. This rule applies if, for the earlier year, all of the following statements are true.

1. Your itemized deductions exceeded the standard deduction by at least the amount of the recovery. (If your itemized deductions didn't exceed the standard deduction by at least the amount of the recovery, see *Standard deduction limit*, later.)
2. You had taxable income. (If you had no taxable income, see *Negative taxable income*, later.)
3. Your deduction for the item recovered equals or exceeds the amount recovered. (If your deduction was less than the amount recovered, see *Recovery limited to deduction*, later.)
4. You had no unused tax credits. (If you had unused tax credits, see *Unused tax credits*, later.)
5. You weren't subject to AMT. (If you were subject to AMT, see *Subject to AMT*, later.)

If any of the earlier statements isn't true, see *Total recovery not included in income*, later.

State tax refund. In addition to the previous six items, you must include in your income the full amount of a refund of state or local income tax or general sales tax if the excess of the tax you deducted over the tax you didn't deduct is more than the refund of the tax deducted.

If the refund is more than the excess, see *Total recovery not included in income*, later.

Where to report. Enter your state or local income tax refund on Schedule 1 (Form 1040), line 1, and the total of all other recoveries as other income on Schedule 1 (Form 1040), line 8.

Example 30. For 2019, you filed a joint return on Form 1040. Your taxable income was $60,000 and you weren't entitled to any tax credits. Your standard deduction was $24,400, and you had itemized deductions of $26,200. In 2020, you received the following recoveries for amounts deducted on your 2018 return:

Medical expenses	$200
State and local income tax refund	400
Refund of mortgage interest	325
Total recoveries	$925

None of the recoveries were more than the deductions taken for 2019. The difference between the state and local income tax you deducted and your local general sales tax you could have deducted was more than $400.

Your total recoveries are less than the amount by which your itemized deductions exceeded the standard deduction ($26,200 – $24,400 = $1,800), so you must include your total recoveries in your income for 2020. Report the state and local income tax refund of $400 on Schedule 1 (Form 1040), line 1, and the balance of your recoveries, $525, on Schedule 1 (Form 1040), line 8.

Total recovery not included in income. If one or more of the five statements listed earlier under *Total recovery included in income* isn't true, you may be able to exclude at least part of the recovery from your income. See the discussion referenced in the statement. You may be able to use Worksheet 2 to determine the part of your recovery to include in your income. You can also use Worksheet 2 to determine the part of a state tax refund (discussed earlier) to include in income.

Allocating the included part. If you aren't required to include all of your recoveries in your income, and you have both a state income tax refund and other itemized deduction recoveries, you must allocate the taxable recoveries between the state income tax refund you report on Schedule 1 (Form 1040 or 1040-NR), line 1, and the amount you report as other income on Schedule 1 (Form 1040 or 1040-NR), line 8. If

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you don't use Worksheet 2, make the allocation as follows.

1. Divide your state income tax refund by the total of all your itemized deduction recoveries.
2. Multiply the amount of taxable recoveries by the percentage in (1). This is the amount you report as a state income tax refund.
3. Subtract the result in (2) above from the amount of taxable recoveries. This is the amount you report as other income.

Example 31. In 2020, you recovered $2,500 of your 2019 itemized deductions claimed on Schedule A (Form 1040), but the recoveries you must include in your 2020 income are only $1,500. Of the $2,500 you recovered, $500 was due to your state income tax refund. Your state income tax was more than your state general sales tax by $600. The amount you report as a state tax refund on Schedule 1 (Form 1040), line 1, is $300 [($500 ÷ $2,500) × $1,500]. The balance of the taxable recoveries, $1,200, is reported as other income on Schedule 1 (Form 1040), line 8.

Standard deduction limit. You are generally allowed to claim the standard deduction if you don't itemize your deductions. Only your itemized deductions that are more than your standard deduction are subject to the recovery rule (unless you're required to itemize your deductions). If your total deductions on the earlier year return weren't more than your income for that year, include in your income this year the lesser of:

- Your recoveries, or
- The amount by which your itemized deductions exceeded the standard deduction.

Standard deduction for earlier years. To determine if amounts recovered in the current year must be included in your income, you must know the standard deduction for your filing status for the year the deduction was claimed. Look in the instructions for your tax return from prior years to locate the standard deduction for the filing status for that prior year. If you filed Form 1040-NR or 1040-NR-EZ, you couldn't claim the standard deduction.

Example 32. You filed a joint return on Form 1040 for 2019 with taxable income of $45,000. Your itemized deductions were $24,650. The standard deduction that you could have claimed was $24,400. In 2020, you recovered $2,100 of your 2019 itemized deductions. None of the recoveries were more than the actual deductions for 2019. Include $250 of the recoveries in your 2020 income. This is the smaller of your recoveries ($2,100) or the amount by which your itemized deductions were more than the standard deduction ($24,650 – $24,400 = $250).

Negative taxable income. If your taxable income for the prior year (Worksheet 2, line 10) was a negative amount, the recovery you must include in income is reduced by that amount. You have a negative taxable income for 2019 if your:

- Form 1040, the sum of lines 9 and 10, was more than line 8b;
- Form 1040-NR, line 40, was more than line 35; or
- Form 1040-NR-EZ, line 11, was more than line 10.

Example 33. The facts are the same as in *Example 32*, except line 12b was $200 more than line 11b on your 2019 Form 1040, giving you a negative taxable income of $200. You must include $50 in your 2020 income, rather than $250.

Recovery limited to deduction. You don't include in your income any amount of your recovery that is more than the amount you deducted in the earlier year. The amount you include in your income is limited to the smaller of:

- The amount deducted, or
- The amount recovered.

Example 34. For 2019, you paid $1,700 for medical expenses. Because of the limit on deducting medical expenses, you deducted only $200 as an itemized deduction. In 2020, you received a $500 reimbursement from your medical insurance for your 2019 expenses. The only amount of the $500 reimbursement that must be included in your income for 2020 is $200, the amount actually deducted.

Overall limitation on itemized deductions no longer applies. For tax years beginning after 2017, there is no limitation on itemized deductions based on your AGI.

To determine the part of the recovery you must include in income, follow the two steps below.

1. Figure the greater of:
   a. The standard deduction for the earlier year, or
   b. The amount of itemized deductions you would have been allowed for the earlier year if you had figured them using only the net amount of the recovery item. The net amount is the amount you actually paid reduced by the recovery amount.

   Note. If you were required to itemize your deductions in the earlier year, use step 1b and not step 1a.
2. Subtract the amount in step 1 from the amount of itemized deductions actually allowed in the earlier year after applying the limit on itemized deductions.

The result of step 2 is the amount of the recovery to include in your income for the year you receive the recovery. If your taxable income for the earlier year was a negative amount, reduce your recovery by the negative amount.

If you had unused tax credits in the earlier year, see *Unused tax credits*, later.

For more information on this calculation, see Revenue Ruling 93-75. This ruling is in Cumulative Bulletin 1993-2.

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Worksheet 2a. **Computations for Worksheet 2, lines 1a and 1b**

Keep for Your Records

To determine amounts to enter on lines 1a and 1b of Worksheet 2, complete the following:

1. Enter the income tax refund from Form(s) 1099–G (or similar statement) . . . . . 1. _____
2. Enter the refunds received for state and local real estate taxes and state and local personal property taxes . . . . . 2. _____
3. Total state and local refunds. Add lines 1 and 2. But don't enter more than the amount of your state and local taxes shown on your 2019 Schedule A, line 5d . . . . . 3. _____
4. Is the amount of state and local income taxes (or general sales taxes), real estate taxes, and personal property taxes paid in 2019 (generally, this is the amount reported on your 2019 Schedule A, line 5d), more than the amount on your 2019 Schedule A, line 5e?

   ☐ No. Enter the amount from line 3 on line 4 and go to line 5.

   ☐ Yes. Subtract the amount on your 2019 Schedule A, line 5e, from the amount of state and local income taxes (or general sales taxes), real estate taxes, and personal property taxes paid in 2019 (generally, this is the amount reported on your 2019 Schedule A, line 5d). Enter the result here . . . . . 4. _____
5. Is the amount on line 3 more than the amount on line 4?

   ☐ No. [STOP] None of the refunds on lines 1 or 2 is taxable.

   ☐ Yes. Subtract line 4 from line 3 and enter the result here . . . . . 5. _____
6. Add lines 1 and 2 and enter the result here . . . . . 6. _____
7. Divide line 1 by line 6. Then multiply by the amount on line 5 and enter the result here and on Worksheet 2, line 1a . . . . . 7. _____
8. Divide line 2 by line 6. Then multiply by the amount on line 5 and enter the result here and on Worksheet 2, line 1b . . . . . 8. _____

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Worksheet 2. **Recoveries of Itemized Deductions**

Keep for Your Records

To determine whether you should complete this worksheet to figure the part of a recovery amount to include in income on your 2020 tax return, see *Itemized Deduction Recoveries*. If you recovered amounts from more than 1 year, such as a state income tax refund from 2019 and a casualty loss reimbursement from 2018, complete a separate worksheet for each year. Use information from your tax return for the year the expense was deducted.

A recovery is included in income only to the extent of the deduction amount that reduced your tax in the prior year (year of the deduction). If you were subject to the AMT or your tax credits reduced your tax to zero, see *Unused tax credits* and *Subject to AMT* under *Itemized Deduction Recoveries*. If your recovery was for an itemized deduction that was limited, you should read *Itemized deductions limited* under *Itemized Deduction Recoveries*.

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NOTE: Before completing lines 1a and 1b, see Worksheet 2a, Computations for Worksheet 2, lines 1a and 1b.

1a.	State/local income tax refund or credit[1a]		1a. _____
1b.	State/local real estate and personal property taxes[1a]		1b. _____
2.	Enter the total of all other Schedule A refunds or reimbursements (excluding the amounts you entered on lines 1a and 1b)[2]		2. _____
3.	Add lines 1a, 1b, and 2		3. _____
4.	Itemized deductions for the prior year. For 2019: • Form 1040, Schedule A, line 17 • Form 1040-NR, Schedule A, line 15 • Form 1040-NR-EZ, line 11	4. _____	
5.	Enter any amount previously refunded to you (don't enter an amount from lines 1a or 1b or line 2)	5. _____	
6.	Subtract line 5 from line 4	6. _____	
7.	Standard deduction for the prior year.[3] If you filed Form 1040-NR or 1040-NR-EZ, enter -0-	7. _____	
8.	Subtract line 7 from line 6. If the result is zero or less, stop here. The amounts on lines 1a, 1b, and 2 aren't taxable		8. _____
9.	Enter the smaller of line 3 or line 8		9. _____
10.	Taxable income for prior year[4] (2019 Form 1040, line 11b; 2019 Form 1040-NR, line 41; or 2019 Form 1040-NR-EZ, line 14)	10. _____	
11.	**Amount to include in income for 2020:** • If line 10 is zero or more, enter the amount from line 9. • If line 10 is a negative amount, add lines 9 and 10 and enter the result (but not less than zero)[5]		11. _____

If line 11 equals line 3—
Enter the amount from line 1a on Schedule 1 (Form 1040), line 1.
Enter the amounts from lines 1b and 2 on Schedule 1 (Form 1040), line 8.

If line 11 is less than line 3 and either lines 1a or 1b or line 2 is zero—
If there is an amount on line 1a, enter the amount from line 11 on Schedule 1 (Form 1040), line 1.
If there is an amount on lines 1b and/or 2, enter the amount from line 11 on Schedule 1 (Form 1040), line 8.

If line 11 is less than line 3, and there are amounts on line 1a and on line 1b or 2, complete the following worksheet.

A.	Divide the amount on line 1a by the amount on line 3. Enter the percentage	A. _____
B.	Multiply the amount on line 11 by the percentage on line A. Enter the result here and on Schedule 1 (Form 1040), line 1	B. _____
C.	Subtract the amount on line B from the amount on line 11. Enter the result here and on Schedule 1 (Form 1040), line 8	C. _____

[1a] Don't enter more than the amount deducted for the prior year. Don't enter more than the excess of your state and local income tax deduction over your state and local general sales taxes you could have deducted.

[2] Don't enter more than the amount deducted for the prior year. If you deducted state and local general sales taxes and received a refund of those taxes, include the amount on line 2, but don't enter more than the excess of your sales tax deduction over your state and local income tax you could have deducted.

[3] See the instructions for prior year forms at *IRS.gov* for prior year standard deduction.

[4] If taxable income is a negative amount, enter that amount in brackets. Don't enter zero unless your taxable income is exactly zero. See *Negative taxable income*. Taxable income will have to be adjusted for any net operating loss carryover. For more information, see Pub. 536.

[5] For example, $700 + ($400) = $300.

Unused tax credits. If you recover an item deducted in an earlier year in which you had unused tax credits, you must refigure the earlier year's tax to determine if you must include the recovery in your income. To do this, add the amount of the recovery to your earlier year's taxable income and refigure the tax and the credits on the refigured amount. If the refigured tax, after application of the credits, is more than the actual tax in the earlier year, include the recovery in your income up to the amount of the deduction that reduced the tax in the earlier

year. For this purpose, any increase to a credit carried over to the current year that resulted from deducting the recovered amount in the earlier year is considered to have reduced your tax in the earlier year. If the recovery is for an itemized deduction claimed in a year in which the deductions were limited, see *Itemized deductions limited*, earlier.

If your tax, after application of the credits, doesn't change, you didn't have a tax benefit from the deduction. Don't include the recovery in your income.

Example 35. In 2019, Jean Black filed as head of household and itemized her deductions on Schedule A (Form 1040). Her taxable income was $5,260 and her tax was $528. She claimed a child care credit of $1,200. The credit reduced her tax to zero, and she had an unused tax credit of $672 ($1,200 – $528). In 2020, Jean recovered $1,000 of her itemized deductions. She reduces her 2019 itemized deductions by $1,000 and refigures that year's tax on taxable income of $6,260. However, the child care credit exceeds the refigured tax of $628. Jean's tax liability for 2019 isn't changed by reducing her deductions by the recovery. She didn't have a tax benefit from the recovered deduction and doesn't include any of the recovery in her income for 2020.

Subject to AMT. If you were subject to the AMT in the year of the deduction, you'll have to refigure your tax for the earlier year to determine if the recovery must be included in your income. This will require a refiguring of your regular tax, as shown in *Example 35*, and a refiguring of your AMT. If inclusion of the recovery doesn't change your total tax, you don't include the recovery in your income. However, if your total tax increases by any amount, you received a tax benefit from the deduction and you must include the recovery in your income up to the amount of the deduction that reduced your tax in the earlier year.

Nonitemized Deduction Recoveries

This section discusses recovery of deductions other than itemized deductions.

Total recovery included in income. If you recover an amount that you deducted in an earlier year when you were figuring your AGI, you must generally include the full amount of the recovery in your income in the year received.

Total recovery not included in income. If any part of the deduction you took for the recovered amount didn't reduce your tax, you may be able to exclude at least part of the recovery from your income. You must include the recovery in your income only up to the amount of the deduction that reduced your tax in the year of the deduction. (See *Tax benefit rule*, earlier.)

Negative taxable income. If your taxable income for the prior year was a negative amount, the recovery you must include in income is reduced by that amount. You have a negative taxable income for 2019 if your:

- Form 1040, the sum of lines 9 and 10, was more than line 8b;
- Form 1040-NR, line 40, was more than line 35; or
- Form 1040-NR-EZ, line 11, was more than line 10.

If you had a net operating loss (NOL) in a prior year, you'll have to adjust your taxable income for any NOL carryover. See Pub. 536 for more information.

Unused tax credits. If you recover an item deducted in an earlier year in which you had unused tax credits, you must refigure the earlier year's tax to determine if you must include the recovery in your income. To do this, add the amount of the recovery to your earlier year's taxable income and refigure the tax and the credits on the refigured amount. If the refigured tax, after application of the credits, is more than the actual tax in the earlier year, include the recovery in your income up to the amount of the deduction that reduced the tax in the earlier year. For this purpose, any increase to a credit carried over to the current year that resulted from deducting the recovered amount in the earlier year is considered to have reduced your tax in the earlier year.

If your tax, after application of the credits, doesn't change, you didn't have a tax benefit from the deduction. Don't include the recovery in your income.

Capital gains. If you determined your tax in the earlier year by using the Schedule D Tax Worksheet, or the Qualified Dividends and Capital Gain Tax Worksheet, and you receive a refund in 2020 of a deduction claimed in that year, you'll have to refigure your tax for the earlier year to determine if the recovery must be included in your income. If inclusion of the recovery doesn't change your total tax, you don't include the recovery in income. However, if your total tax increases by any amount, you must include the recovery in your income up to the amount of the deduction that reduced your tax in the earlier year.

Amounts Recovered for Credits

If you received a recovery in 2020 for an item for which you claimed a tax credit in an earlier year, you must increase your 2020 tax by the amount of the recovery, up to the amount by which the credit reduced your tax in the earlier year. You had a recovery if there was a downward price adjustment or similar adjustment on the item for which you claimed a credit.

This rule doesn't apply to the investment credit or the foreign tax credit. Recoveries of these credits are covered by other provisions of the law. See Pub. 514 or Form 4255 for details.

Sharing/Gig Economy

Generally, if you work in the gig economy or did gig work, you must include all income received from all jobs whether you received a Form 1099-K, Payment Card and Third-Party Network Transactions, or not. See the Instructions for Schedule C (Form 1040) and the Instructions for Schedule SE (Form 1040).

Survivor Benefits

In most cases, payments made by or for an employer because of an employee's death must be included in income. The following discussions explain the tax treatment of certain payments made to survivors. For additional information, see Pub. 559.

Lump-sum payments. Lump-sum payments you receive from a decedent's employer as the surviving spouse or beneficiary may be accrued salary payments; distributions from employee profit-sharing, pension, annuity, or stock bonus plans; or other items that should be treated separately for tax purposes. The tax treatment of these lump-sum payments depends on the type of payment.

Salary or wages. Salary or wages received after the death of the employee are usually ordinary income to you.

Qualified employee retirement plans. Lump-sum distributions from qualified employee retirement plans are subject to special tax treatment. For information on these distributions, see Pub. 575 (or Pub. 721 if you're the survivor of a federal employee or retiree).

Public safety officer killed in the line of duty. If you're a survivor of a public safety officer who was killed in the line of duty, you can exclude from income any amount received as a survivor annuity on account of the death of a public safety officer killed in the line of duty.

For this purpose, the term "public safety officer" includes law enforcement officers, firefighters, chaplains, and rescue squad and ambulance crew members. For more information, see Pub. 559.

Unemployment Benefits

The tax treatment of unemployment benefits you receive depends on the type of program paying the benefits.

Unemployment compensation. Generally, you must include in income all unemployment compensation you receive. You should receive a Form 1099-G showing in box 1 the total unemployment compensation paid to you. In most cases, you enter unemployment compensation on Schedule 1 (Form 1040), line 7.

Exclusion from income tax on a portion of unemployment compensation for 2020. For individuals with adjusted gross income of less than $150,000, up to $10,200 of unemployment compensation is excluded from gross income. In the case of a joint return, up to $10,200 received by each spouse is excluded. (See P.L. 117–2 and section 85(c).)

CAUTION *If you received unemployment compensation but didn't receive Form 1099–G, Certain Government Payments, through the mail, you may need to access your information through your state's website to get your electronic Form 1099-G.*

Types of unemployment compensation. Unemployment compensation generally includes any amount received under an

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unemployment compensation law of the United States or of a state. It includes the following benefits.

- Benefits paid by a state or the District of Columbia from the Federal Unemployment Trust Fund.
- State unemployment insurance benefits.
- Railroad unemployment compensation benefits.
- Disability payments from a government program paid as a substitute for unemployment compensation. (Amounts received as workers' compensation for injuries or illness aren't unemployment compensation. See *Workers' Compensation* under *Sickness and Injury Benefits*, earlier.)
- Trade readjustment allowances under the Trade Act of 1974.
- Unemployment assistance under the Disaster Relief and Emergency Assistance Act of 1974.
- Unemployment assistance under the Airline Deregulation Act of 1978 Program.

Governmental program. If you contribute to a governmental unemployment compensation program and your contributions aren't deductible, amounts you receive under the program aren't included as unemployment compensation until you recover your contributions. If you deducted all of your contributions to the program, the entire amount you receive under the program is included in your income.

Repayment of unemployment compensation. If you repaid in 2020 unemployment compensation you received in 2020, subtract the amount you repaid from the total amount you received and enter the difference on Schedule 1 (Form 1040), line 7. On the dotted line next to your entry, enter "Repaid" and the amount you repaid. If you repaid unemployment compensation in 2020 that you included in your income in an earlier year, you can deduct the amount repaid on Schedule A (Form 1040), line 16, if you itemize deductions and if the amount is more than $3,000. See *Repayments*, later.

Tax withholding. You can choose to have federal income tax withheld from your unemployment compensation. To make this choice, complete Form W-4V and give it to the paying office. Tax will be withheld at 10% of your payment.

CAUTION *If you don't choose to have tax withheld from your unemployment compensation, you may be liable for estimated tax. If you don't pay enough tax, either through withholding or estimated tax, or a combination of both, you may have to pay a penalty. For more information, see Pub. 505.*

Supplemental unemployment benefits. Benefits received from an employer-financed fund (to which the employees didn't contribute) aren't unemployment compensation. They're taxable as wages and are subject to withholding for income tax. They may be subject to social security and Medicare taxes. For more information, see *Supplemental Unemployment Benefits* in section 5 of Pub. 15-A. Report these payments on line 1 of Form 1040 or 1040-SR.

Repayment of benefits. You may have to repay some of your supplemental unemployment benefits to qualify for trade readjustment allowances under the Trade Act of 1974. If you repay supplemental unemployment benefits in the same year you receive them, reduce the total benefits by the amount you repay. If you repay the benefits in a later year, you must include the full amount of the benefits in your income for the year you received them.

Deduct the repayment in the later year as an adjustment to gross income on Form 1040 or 1040-SR. Include the repayment on Schedule 1 (Form 1040), line 22, and enter "Sub-Pay TRA" and the amount on the dotted line next to line 22. If the amount you repay in a later year is more than $3,000, you may be able to take a credit against your tax for the later year instead of deducting the amount repaid. For information on this, see *Repayments*, later.

Private unemployment fund. Unemployment benefit payments from a private (nonunion) fund to which you voluntarily contribute are taxable only if the amounts you receive are more than your total payments into the fund. Report the taxable amount on Schedule 1 (Form 1040), line 8.

Payments by a union. Benefits paid to you as an unemployed member of a union from regular union dues are included in your income on Schedule 1 (Form 1040), line 8. However, if you contribute to a special union fund and your payments to the fund aren't deductible, the unemployment benefits you receive from the fund are includible in your income only to the extent they're more than your contributions.

Guaranteed annual wage. Payments you receive from your employer during periods of unemployment, under a union agreement that guarantees you full pay during the year, are taxable as wages. Include them on line 1 of Form 1040 or 1040-SR.

State employees. Payments similar to a state's unemployment compensation may be made by the state to its employees who aren't covered by the state's unemployment compensation law. Although the payments are fully taxable, don't report them as unemployment compensation. Report these payments on Schedule 1 (Form 1040), line 8.

Welfare and Other Public Assistance Benefits

Don't include in your income governmental benefit payments from a public welfare fund based upon need, such as payments due to blindness. Payments from a state fund for the victims of crime shouldn't be included in the victims' incomes if they're in the nature of welfare payments. Don't deduct medical expenses that are reimbursed by such a fund. You must include in your income any welfare payments that are compensation for services or that are obtained fraudulently.

Work-training program. Payments you receive from a state welfare agency for taking part in a work-training program aren't included in your income, as long as the payments (exclusive of extra allowances for transportation or other costs) don't total more than the public welfare benefits you would have received otherwise. If the payments are more than the welfare benefits you would have received, the entire amount must be included in your income as wages.

Reemployment Trade Adjustment Assistance (RTAA) payments. Payments you receive from a state agency under the RTAA must be included in your income. The state must send you Form 1099-G to advise you of the amount you should include in income. The amount should be reported on Schedule 1 (Form 1040), line 8.

Persons with disabilities. If you have a disability, you must include in income compensation you receive for services you perform unless the compensation is otherwise excluded. However, you don't include in income the value of goods, services, and cash that you receive, not in return for your services, but for your training and rehabilitation because you have a disability. Excludable amounts include payments for transportation and attendant care, such as interpreter services for the deaf, reader services for the blind, and services to help individuals with an intellectual disability do their work.

Disaster relief grants. Don't include post-disaster grants received under the Disaster Relief and Emergency Assistance Act in your income if the grant payments are made to help you meet necessary expenses or serious needs for medical, dental, housing, personal property, transportation, or funeral expenses. Don't deduct casualty losses or medical expenses that are specifically reimbursed by these disaster relief grants. If you have deducted a casualty loss for the loss of your personal residence and you later receive a disaster relief grant for the loss of the same residence, you may have to include part or all of the grant in your taxable income. See *Recoveries*, earlier. Unemployment assistance payments under the Act are taxable unemployment compensation. See *Unemployment compensation* under *Unemployment Benefits*, earlier.

Disaster relief payments. You can exclude from income any amount you receive that is a qualified disaster relief payment. A qualified disaster relief payment is an amount paid to you:

1. To reimburse or pay reasonable and necessary personal, family, living, or funeral expenses that result from a qualified disaster;
2. To reimburse or pay reasonable and necessary expenses incurred for the repair or rehabilitation of your home or repair or replacement of its contents to the extent it's due to a qualified disaster;
3. By a person engaged in the furnishing or sale of transportation as a common carrier because of the death or personal physical injuries incurred as a result of a qualified disaster; or
4. By a federal, state, or local government, or agency or instrumentality in connection

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with a qualified disaster in order to promote the general welfare.

You can exclude this amount only to the extent any expense it pays for isn't paid for by insurance or otherwise. The exclusion doesn't apply if you were a participant or conspirator in a terrorist action or a representative of one.

A qualified disaster is:

- A disaster that results from a terrorist or military action;
- A federally declared disaster; or
- A disaster that results from an accident involving a common carrier, or from any other event, which is determined to be catastrophic by the Secretary of the Treasury or his or her delegate.

For amounts paid under item 4, a disaster is qualified if it's determined by an applicable federal, state, or local authority to warrant assistance from the federal, state, or local government, agency, or instrumentality.

Disaster mitigation payments. You can also exclude from income any amount you receive that is a qualified disaster mitigation payment. Qualified disaster mitigation payments are commonly paid to you in the period immediately following damage to property as a result of a natural disaster. However, disaster mitigation payments are used to mitigate (reduce the severity of) potential damage from future natural disasters. They're paid to you through state and local governments based on the provisions of the Robert T. Stafford Disaster Relief and Emergency Assistance Act or the National Flood Insurance Act.

You can't increase the basis or adjusted basis of your property for improvements made with nontaxable disaster mitigation payments.

Home Affordable Modification Program (HAMP). If you benefit from Pay-for-Performance Success Payments under HAMP, the payments aren't taxable.

Hardest Hit Fund and Emergency Homeowners' Loan Program. If you receive or benefit from payments made under:

- A State Housing Finance agency (State HFA) Hardest Hit Fund program in which program payments can be used to pay mortgage interest, or
- An Emergency Homeowners' Loan Program (EHLP) administered by the Department of Housing and Urban Development (HUD) or a state,

the payments aren't included in gross income and aren't taxable.

Mortgage assistance payments under section 235 of the National Housing Act. Payments made under section 235 of the National Housing Act for mortgage assistance aren't included in the homeowner's income. Interest paid for the homeowner under the mortgage assistance program can't be deducted.

Replacement housing payments. Replacement housing payments made under the Uniform Relocation Assistance and Real Property Acquisition Policies Act for Federal and Federally Assisted Programs aren't includible in gross income, but are includible in the basis of the newly acquired property.

Relocation payments and home rehabilitation grants. A relocation payment under section 105(a)(11) of the Housing and Community Development Act made by a local jurisdiction to a displaced individual moving from a flood-damaged residence to another residence isn't includible in gross income. Home rehabilitation grants received by low-income homeowners in a defined area under the same Act are also not includible in gross income.

Indian financing grants. Nonreimbursable grants under title IV of the Indian Financing Act of 1974 to Indians to expand profit-making Indian-owned economic enterprises on or near reservations aren't includible in gross income.

Indian general welfare benefit. Gross income doesn't include the value of any Indian general welfare benefit. "Indian general welfare benefit" includes any payment made or services provided to or on behalf of a member of an Indian tribe (or any spouse or dependent of that member) under an Indian tribal government program, but only if:

1. The program is administered under specified guidelines and doesn't discriminate in favor of members of the governing body of the tribe; and
2. The benefits provided under the program (a) are available to any tribal member who meets guidelines, (b) are for the promotion of general welfare, (c) aren't lavish or extravagant, and (d) aren't compensation for services.

Any items of cultural significance, reimbursement of costs, or cash honorarium for participation in cultural or ceremonial activities for the transmission of tribal culture aren't treated as compensation for services.

Note. The above exclusion was enacted by the Tribal General Welfare Exclusion Act of 2014, September 26, 2014. The exclusion applies to tax years for which the period of limitation on refund or credit under section 6511 has not expired (generally, within 3 years from the time the return was filed or 2 years from the time the tax was paid, whichever expires later). Additionally, a claim for the above exclusion will be allowed if made within 1 year of the enactment of the exclusion.

Note. The enactment of the above exclusion generally codifies the exclusion afforded under Revenue Procedure 2014-35, June 4, 2014. See Revenue Procedure 2014-35 for more details.

Medicare. Medicare benefits received under title XVIII of the Social Security Act aren't includible in the gross income of the individuals for whom they're paid. This includes basic (Part A (Hospital Insurance Benefits for the Aged)) and supplementary (Part B (Supplementary Medical Insurance Benefits for the Aged)).

Social security benefits (including lump-sum payments attributable to prior years), Supplemental Security Income (SSI) benefits, and lump-sum death benefits. The Social Security Administration (SSA) provides benefits such as old-age benefits, benefits to disabled workers, and benefits to spouses and dependents. These benefits may be subject to federal income tax depending on your filing status and other income. See Pub. 915 for more information. An individual originally denied benefits, but later approved, may receive a lump-sum payment for the period when benefits were denied (which may be prior years). See Pub. 915 for information on how to make a lump-sum election, which may reduce your tax liability. There are also other types of benefits paid by the SSA. However, SSI benefits and lump-sum death benefits (one-time payment to spouse and children of deceased) aren't subject to federal income tax. For more information on these benefits, go to *SSA.gov*.

Form SSA-1099. If you received social security benefits during the year, you'll receive Form SSA-1099, Social Security Benefit Statement. An IRS Notice 703 will be enclosed with your Form SSA-1099. This notice includes a worksheet you can use to figure whether any of your benefits are taxable.

For an explanation of the information found on your Form SSA-1099, see Pub. 915.

Form RRB-1099. If you received equivalent railroad retirement or special guaranty benefits during the year, you'll receive Form RRB-1099, Payments by the Railroad Retirement Board.

For an explanation of the information found on your Form RRB-1099, see Pub. 915.

Joint return. If you're married and file a joint return, you and your spouse must combine your incomes and your social security and equivalent railroad retirement benefits when figuring whether any of your combined benefits are taxable. Even if your spouse didn't receive any benefits, you must add your spouse's income to yours when figuring if any of your benefits are taxable.

Taxable amount. Use the worksheet in the Forms 1040 and 1040-SR instruction package to determine the amount of your benefits to include in your income. Pub. 915 also has worksheets you can use. However, you must use the worksheets in Pub. 915 if any of the following situations apply.

- You received a lump-sum benefit payment during the year that is for one or more earlier years.
- You exclude employer-provided adoption benefits or interest from qualified U.S. savings bonds.
- You take the foreign earned income exclusion, the foreign housing exclusion or deduction, the exclusion of income from American Samoa, or the exclusion of income from Puerto Rico by bona fide residents of Puerto Rico.

Benefits may affect your IRA deduction. You must use the special worksheets in Appendix B of Pub. 590-A to figure your taxable benefits and your IRA deduction if all of the following conditions apply.

- You receive social security or equivalent railroad retirement benefits.
- You have taxable compensation.

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- You contribute to your IRA.
- You or your spouse is covered by a retirement plan at work.

How to report. If any of your benefits are taxable, you must use Form 1040 or 1040-SR to report the taxable part. Report your net benefits (as shown on your Forms SSA-1099 and RRB-1099) on line 6a of Form 1040 or 1040-SR. Report the taxable part on line 6b of Form 1040 or 1040-SR.

Nutrition Program for the Elderly. Food benefits you receive under the Nutrition Program for the Elderly aren't taxable. If you prepare and serve free meals for the program, include in your income as wages the cash pay you receive, even if you're also eligible for food benefits.

Payments to reduce cost of winter energy. Payments made by a state to qualified people to reduce their cost of winter energy use aren't taxable.

Other Income

The following brief discussions are arranged in alphabetical order. Other income items briefly discussed below are referenced to publications that provide more information.

Activity not for profit. You must include on your return income from an activity from which you don't expect to make a profit. An example of this type of activity is a hobby or a farm you operate mostly for recreation and pleasure. Enter this income on Schedule 1 (Form 1040), line 8. Deductions for expenses related to the activity are limited. They can't total more than the income you report and can be taken only if you itemize deductions on Schedule A (Form 1040). See *Not-for-Profit Activities* in chapter 1 of Pub. 535 for information on whether an activity is considered carried on for a profit.

Alaska Permanent Fund dividend. If you received a payment from Alaska's mineral income fund (Alaska Permanent Fund dividend), report it as income on Schedule 1 (Form 1040), line 8. The state of Alaska sends each recipient a document that shows the amount of the payment with the check. The amount is also reported to the IRS.

Alimony. Include in your income on Schedule 1 (Form 1040), line 2a, any taxable alimony payments you receive. Amounts you receive for child support aren't income to you. For complete information, see Pub. 504 and the Instructions for Forms 1040 and 1040-SR.

CAUTION *Don't include alimony payments you receive under a divorce or separation agreement (1) executed after 2018, or (2) executed before 2019 but later modified if the modification expressly states the repeal of the deduction for alimony payments applies to the modification.*

Below-market loans. A below-market loan is a loan on which no interest is charged or on which the interest is charged at a rate below the applicable federal rate. If you make a below-market gift or demand loan, you must include the forgone interest (at the federal rate) as interest income on your return. These loans are considered a transaction in which you, the lender, are treated as having made:

- A loan to the borrower in exchange for a note that requires the payment of interest at the applicable federal rate; and
- An additional payment to the borrower, which the borrower transfers back to you as interest.

Depending on the transaction, the additional payment to the borrower is treated as a:

- Gift,
- Dividend,
- Contribution to capital,
- Payment of compensation, or
- Another type of payment.

The borrower may have to report this payment as income, depending on its classification.

For more information on below-market loans, see chapter 1 of Pub. 550.

Bribes. If you receive a bribe, include it in your income.

Campaign contributions. These contributions aren't income to a candidate unless they're diverted to his or her personal use. To be exempt from tax, the contributions must be spent for campaign purposes or kept in a fund for use in future campaigns. However, interest earned on bank deposits, dividends received on contributed securities, and net gains realized on sales of contributed securities are taxable and must be reported on Form 1120-POL. Excess campaign funds transferred to an office account must be included in the officeholder's income on Schedule 1 (Form 1040), line 8, in the year transferred.

Canceled sales contract. If you sell property (such as land or a residence) under a contract, but the contract is canceled and you return the buyer's money in the same tax year as the original sale, you have no income from the sale. If the contract is canceled and you return the buyer's money in a later tax year, you must include your gain in your income for the year of the sale. When you return the money and take back the property in the later year, you treat the transaction as a purchase that gives you a new basis in the property equal to the funds you return to the buyer.

Special rules apply to the reacquisition of real property where a secured indebtedness (mortgage) to the original seller is involved. For further information, see *Repossession* in Pub. 537.

Car pools. Don't include in your income amounts you receive from the passengers for driving a car in a car pool to and from work. These amounts are considered reimbursement for your expenses. However, this rule doesn't apply if you have developed car pool arrangements into a profit-making business of transporting workers for hire.

Cash rebates. A cash rebate you receive from a dealer or manufacturer of an item you buy isn't income, but you must reduce your basis by the amount of the rebate.

Example 36. You buy a new car for $24,000 cash and receive a $2,000 rebate check from the manufacturer. The $2,000 isn't income to you. Your basis in the car is $22,000. This is the basis on which you figure gain or loss if you sell the car, and figure depreciation if you use it for business.

Casualty insurance and other reimbursements. You generally shouldn't report these reimbursements on your return unless you're figuring gain or loss from the casualty or theft. See Pub. 547.

Charitable gift annuities. If you're the beneficiary of a charitable gift annuity, you must include the yearly annuity or fixed percentage payment in your income.

The payer will report the types of income you received on Form 1099-R. Report the gross distribution from box 1 on Form 1040 or 1040-SR, line 5a, and the part taxed as ordinary income (box 2a minus box 3) on Form 1040 or 1040-SR, line 5b. Report the portion taxed as capital gain as explained in the Instructions for Schedule D (Form 1040).

Child support payments. You shouldn't report these payments on your return. See Pub. 504 for more information.

Court awards and damages. To determine if settlement amounts you receive by compromise or judgment must be included in your income, you must consider the item that the settlement replaces. The character of the income as ordinary income or capital gain depends on the nature of the underlying claim. Include the following as ordinary income.

1. Interest on any award.
2. Compensation for lost wages or lost profits in most cases.
3. Punitive damages in most cases. It doesn't matter if they relate to a physical injury or physical sickness.
4. Amounts received in settlement of pension rights (if you didn't contribute to the plan).
5. Damages for:
   a. Patent or copyright infringement,
   b. Breach of contract, or
   c. Interference with business operations.
6. Back pay and damages for emotional distress received to satisfy a claim under title VII of the Civil Rights Act of 1964.
7. Attorney fees and costs (including contingent fees) where the underlying recovery is included in gross income.
8. Attorney fees and costs relating to whistleblower awards where the underlying recovery is included in gross income.

Don't include in your income compensatory damages for personal physical injury or physical sickness (whether received in a lump sum or installments).

Emotional distress. Emotional distress itself isn't a physical injury or physical sickness, but damages you receive for emotional distress due to a physical injury or sickness are treated

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as received for the physical injury or sickness. Don't include them in your income.

If the emotional distress is due to a personal injury that isn't due to a physical injury or sickness (for example, unlawful discrimination or injury to reputation), you must include the damages in your income, except for any damages you receive for medical care due to that emotional distress. Emotional distress includes physical symptoms that result from emotional distress, such as headaches, insomnia, and stomach disorders.

Deduction for costs involved in unlawful discrimination suits. You may be able to deduct attorney fees and court costs paid to recover a judgment or settlement for a claim of unlawful discrimination under various provisions of federal, state, and local law listed in section 62(e), a claim against the U.S. Government, or a claim under section 1862(b)(3)(A) of the Social Security Act. You can claim this deduction as an adjustment to income on Schedule 1 (Form 1040), line 22. The following rules apply.

- The attorney fees and court costs may be paid by you or on your behalf in connection with the claim for unlawful discrimination, the claim against the U.S. Government, or the claim under section 1862(b)(3)(A) of the Social Security Act.
- The deduction you're claiming can't be more than the amount of the judgment or settlement you're including in income for the tax year.
- The judgment or settlement to which your attorney fees and court costs apply must occur after October 22, 2004.

Pre-existing agreement. If you receive damages under a written binding agreement, court decree, or mediation award that was in effect (or issued on or before) September 13, 1995, don't include in income any of those damages received on account of personal injuries or sickness.

Credit card insurance. In most cases, if you receive benefits under a credit card disability or unemployment insurance plan, the benefits are taxable to you. These plans make the minimum monthly payment on your credit card account if you can't make the payment due to injury, illness, disability, or unemployment. Report on Schedule 1 (Form 1040), line 8, the amount of benefits you received during the year that is more than the amount of the premiums you paid during the year.

Down payment assistance. If you purchase a home and receive assistance from a nonprofit corporation to make the down payment, that assistance isn't included in your income. If the corporation qualifies as a tax-exempt charitable organization, the assistance is treated as a gift and is included in your basis of the house. If the corporation doesn't qualify, the assistance is treated as a rebate or reduction of the purchase price and isn't included in your basis.

Employment agency fees. If you get a job through an employment agency, and the fee is paid by your employer, the fee isn't includible in your income if you aren't liable for it. However, if you pay it and your employer reimburses you for it, it's includible in your income.

Energy conservation subsidies. You can exclude from gross income any subsidy provided, either directly or indirectly, by public utilities for the purchase or installation of an energy conservation measure for a dwelling unit.

Energy conservation measure. This includes installations or modifications that are primarily designed to reduce consumption of electricity or natural gas, or improve the management of energy demand.

Dwelling unit. This includes a house, apartment, condominium, mobile home, boat, or similar property. If a building or structure contains both dwelling and other units, any subsidy must be properly allocated.

Estate and trust income. An estate or trust, unlike a partnership, may have to pay federal income tax. If you're a beneficiary of an estate or trust, you may be taxed on your share of its income distributed or required to be distributed to you. However, there is never a double tax. Estates and trusts file their returns on Form 1041, and your share of the income is reported to you on Schedule K-1 (Form 1041).

Current income required to be distributed. If you're the beneficiary of an estate or trust that must distribute all of its current income, you must report your share of the distributable net income, whether or not you actually received it.

Current income not required to be distributed. If you're the beneficiary of an estate or trust and the fiduciary has the choice of whether to distribute all or part of the current income, you must report all income that is required to be distributed to you, whether or not it's actually distributed, plus all other amounts actually paid or credited to you, up to the amount of your share of distributable net income.

How to report. Treat each item of income the same way that the estate or trust would treat it. For example, if a trust's dividend income is distributed to you, you report the distribution as dividend income on your return. The same rule applies to distributions of tax-exempt interest and capital gains.

The fiduciary of the estate or trust must tell you the type of items making up your share of the estate or trust income and any credits you're allowed on your individual income tax return.

Losses. Losses of estates and trusts generally aren't deductible by the beneficiaries.

Grantor trust. Income earned by a grantor trust is taxable to the grantor, not the beneficiary, if the grantor keeps certain control over the trust. (The grantor is the one who transferred property to the trust.) This rule applies if the property (or income from the property) put into the trust will or may revert (be returned) to the grantor or the grantor's spouse.

Generally, a trust is a grantor trust if the grantor has a reversionary interest valued (at the date of transfer) at more than 5% of the value of the transferred property, or has certain other powers.

Expenses paid by another. If your personal expenses are paid for by another person, such as a corporation, the payment may be taxable to you depending upon your relationship with that person and the nature of the payment. But if the payment makes up for a loss caused by that person, and only restores you to the position you were in before the loss, the payment isn't includible in your income.

Exxon Valdez settlement income. Include in your income on Schedule 1 (Form 1040), line 8, any qualified settlement income you receive as a qualified taxpayer. See *Statement*, later. Qualified settlement income is any interest and punitive damage awards that are:

- Otherwise includible in taxable income, and
- Received in connection with the civil action *In re Exxon Valdez*, No. 89-095-CV (HRH) (Consolidated) (D. Alaska).

You're a qualified taxpayer if you were a plaintiff in the civil action mentioned earlier or you were a beneficiary of the estate of your spouse or a close relative who was such a plaintiff and from whom you acquired the right to receive qualified settlement income.

The income can be received as a lump sum or as periodic payments. You'll receive a Form 1099-MISC showing the gross amount of the settlement income paid to you in the tax year.

Contributions to eligible retirement plan. If you're a qualified taxpayer, you can contribute all or part of your qualified settlement income, up to $100,000, to an eligible retirement plan, including an IRA. Contributions to eligible retirement plans, other than a Roth IRA or a designated Roth account, reduce the qualified settlement income that you must include in income. See *Statement*, later. For more information on these contributions, see Pubs. 575 and 590-A.

Legal expenses. For tax years after 2017, you can no longer deduct legal expenses that were subject to the 2%-of-adjusted-gross-income floor. If the qualified settlement income was received in connection with your trade or business (other than as an employee), you can reduce the taxable amount of qualified settlement income by these expenses.

Statement. If you report on Schedule 1 (Form 1040), line 8, qualified settlement income that is less than the gross amount shown on Form 1099-MISC, you must attach a statement to your tax return. The statement must identify and show the gross amount of the qualified settlement income, the reductions for the amount contributed to an eligible retirement plan, and the net amount.

Income averaging. For purposes of the income averaging rules that apply to an individual engaged in a farming or fishing business, qualified settlement income is treated as attributable to a fishing business for the tax year in which it's received. See Schedule J (Form 1040) and its instructions for more information.

Fees for services. Include all fees for your services in your income. Examples of these fees are amounts you receive for services you perform as:

- A corporate director;
- An executor, administrator, or personal representative of an estate;

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- A manager of a trade or business you operated before declaring chapter 11 bankruptcy;
- A notary public; or
- An election precinct official.

TIP *If you aren't an employee and the fees for your services from a single payer in the course of the payer's trade or business total $600 or more for the year, the payer should send you Form 1099-MISC.*

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Corporate director. Corporate director fees are self-employment income. Report these payments on Schedule C (Form 1040).

Personal representatives. All personal representatives must include in their gross income fees paid to them from an estate. If you aren't in the trade or business of being an executor (for instance, you're the executor of a friend's or relative's estate), report these fees on Schedule 1 (Form 1040), line 8. If you're in the trade or business of being an executor, report these fees as self-employment income on Schedule C (Form 1040). The fee isn't includible in income if it's waived.

Manager of trade or business for bankruptcy estate. Include in your income all payments received from your bankruptcy estate for managing or operating a trade or business that you operated before you filed for bankruptcy. Report this income on Schedule 1 (Form 1040), line 8.

Notary public. Report payments for these services on Schedule C (Form 1040). These payments aren't subject to self-employment tax. See the separate Instructions for Schedule SE (Form 1040) for details.

Election precinct official. You should receive a Form W-2 showing payments for services performed as an election official or election worker. Report these payments on line 1 of Form 1040 or 1040-SR.

Food program payments to daycare providers. If you operate a daycare service and receive payments under the Child and Adult Care Food Program administered by the Department of Agriculture that aren't for your services, the payments aren't included in your income in most cases. However, you must include in your income any part of the payments you don't use to provide food to individuals eligible for help under the program.

Foreign currency transactions. If you have a gain on a personal foreign currency transaction because of changes in exchange rates, you don't have to include that gain in your income unless it's more than $200. If the gain is more than $200, report it as a capital gain.

Foster care providers. Generally, payment you receive from a state, political subdivision, or a qualified foster care placement agency for caring for a qualified foster individual in your home is excluded from your income. However, you must include in your income payment to the extent it's received for the care of more than 5 qualified foster individuals age 19 years or older.

A qualified foster individual is a person who:

1. Is living in a foster family home; and
2. Was placed there by:
   a. An agency of a state or one of its political subdivisions, or
   b. A qualified foster care placement agency.

Difficulty-of-care payments. These are payments that are designated by the payer as compensation for providing the additional care that is required for physically, mentally, or emotionally handicapped qualified foster individuals. A state must determine that the additional compensation is needed, and the care for which the payments are made must be provided in the foster care provider's home in which the qualified foster individual was placed.

Certain Medicaid waiver payments are treated as difficulty-of-care payments when received by an individual care provider for caring for an eligible individual (whether related or unrelated) living in the provider's home. See Notice 2014-7, available at *IRS.gov/irb/2014-4_IRB#NOT-2014-7*, and related questions and answers, available at *IRS.gov/Individuals/Certain-Medicaid-Waiver-Payments-May-Be-Excludable-From-Income*, for more information.

You must include in your income difficulty-of-care payments to the extent they're received for more than:

- 10 qualified foster individuals under age 19, or
- Five qualified foster individuals age 19 or older.

Maintaining space in home. If you're paid to maintain space in your home for emergency foster care, you must include the payment in your income.

Reporting taxable payments. If you receive payments that you must include in your income and you're in business as a foster care provider, report the payments on Schedule C (Form 1040). See Pub. 587 to help you determine the amount you can deduct for the use of your home.

Found property. If you find and keep property that doesn't belong to you that has been lost or abandoned (treasure trove), it's taxable to you at its FMV in the first year it's your undisputed possession.

Free tour. If you received a free tour from a travel agency for organizing a group of tourists, you must include its value in your income. Report the FMV of the tour on Schedule 1 (Form 1040), line 8, if you aren't in the trade or business of organizing tours. You can't deduct your expenses in serving as the voluntary leader of the group at the group's request. If you organize tours as a trade or business, report the tour's value on Schedule C (Form 1040).

Gambling winnings. You must include your gambling winnings in your income on Schedule 1 (Form 1040), line 8. If you itemize your deductions on Schedule A (Form 1040), you can deduct gambling losses you had during the year, but only up to the amount of your winnings. If you're in the trade or business of gambling, use Schedule C (Form 1040). For tax years 2018 through 2025, professional gambling losses and expenses are limited to the amount of your winnings.

Lotteries and raffles. Winnings from lotteries and raffles are gambling winnings. In addition to cash winnings, you must include in your income the FMV of bonds, cars, houses, and other noncash prizes. However, the difference between the FMV and the cost of an oil and gas lease obtained from the government through a lottery isn't includible in income.

Installment payments. Generally, if you win a state lottery prize payable in installments, you must include in your gross income the annual payments and any amounts you receive designated as interest on the unpaid installments. If you sell future lottery payments for a lump sum, you must report the amount you receive from the sale as ordinary income (on Schedule 1 (Form 1040), line 8) in the year you receive it.

Form W-2G. You may have received a Form W-2G, showing the amount of your gambling winnings and any tax taken out of them. Include the amount from box 1 on Schedule 1 (Form 1040), line 8. Include the amount shown in box 4 on Form 1040 or 1040-SR, line 25, as federal income tax withheld.

Gifts and inheritances. In most cases, property you receive as a gift, bequest, or inheritance isn't included in your income. However, if property you receive this way later produces income such as interest, dividends, or rents, that income is taxable to you. If property is given to a trust and the income from it is paid, credited, or distributed to you, that income is also taxable to you. If the gift, bequest, or inheritance is the income from the property, that income is taxable to you.

Inherited pension or IRA. If you inherited a pension or an IRA, you may have to include part of the inherited amount in your income. See *Survivors and Beneficiaries* in Pub. 575 if you inherited a pension. See *What if You Inherit an IRA?* in Pubs. 590-A and 590-B if you inherited an IRA.

Expected inheritance. If you sell an interest in an expected inheritance from a living person, include the entire amount you receive in gross income on Schedule 1 (Form 1040), line 8.

Bequest for services. If you receive cash or other property as a bequest for services you performed while the decedent was alive, the value is taxable compensation.

Gulf oil spill. If you received payments for lost wages or income, property damage, or physical injury due to the Gulf oil spill, the payment may be taxable.

Lost wages or income. Payments you received for lost wages, lost business income, or lost profits are taxable.

Property damage. Payments you received for property damage aren't taxable if the payments aren't more than your adjusted basis in the property. If the payments are more than your adjusted basis, you'll realize a gain. If the

damage was due to an involuntary conversion, you may defer the tax on the gain if you purchase qualified replacement property. See Pub. 544.

If the payments (including insurance proceeds) you received, or expect to receive, are less than your adjusted basis, you may be able to claim a casualty deduction. See Pub. 547.

Physical injury. Payments you received for personal physical injuries or physical sickness aren't taxable. This includes payments for emotional distress that is attributable to personal physical injuries or physical sickness. Payments for emotional distress that aren't attributable to personal physical injuries or physical sickness are taxable.

More information. For the most recent guidance, go to IRS.gov and enter "Gulf Oil Spill" in the search box.

Historic preservation grants. Don't include in your income any payment you receive under the National Historic Preservation Act to preserve a historically significant property.

Hobby losses. Losses from a hobby aren't deductible from other income. A hobby is an activity from which you don't expect to make a profit. See *Activity not for profit*, earlier, under *Other Income.*

CAUTION *If you collect stamps, coins, or other items as a hobby for recreation and pleasure, and you sell any of the items, your gain is taxable as a capital gain. However, if you sell items from your collection at a loss, you can't deduct the loss.*

Holocaust victims restitution. Restitution payments you receive as a Holocaust victim (or the heir of a Holocaust victim) and interest earned on the payments aren't taxable. Excludable interest is earned by escrow accounts or settlement funds established for holding funds prior to the settlement. You also don't include the restitution payments and interest the funds earned prior to disbursement in any calculation in which you ordinarily would add excludable income to your AGI, such as the calculation to determine the taxable part of social security benefits. If the payments are made in property, your basis in the property is its FMV when you receive it.

Excludable restitution payments are payments or distributions made by any country or any other entity because of persecution of an individual on the basis of race, religion, physical or mental disability, or sexual orientation by Nazi Germany, any other Axis regime, or any other Nazi-controlled or Nazi-allied country, whether the payments are made under a law or as a result of a legal action. They include compensation or reparation for property losses resulting from Nazi persecution, including proceeds under insurance policies issued before and during World War II by European insurance companies.

Illegal activities. Income from illegal activities, such as money from dealing illegal drugs, must be included in your income on Schedule 1 (Form 1040), line 8, or on Schedule C (Form 1040) if from your self-employment activity.

Indian fishing rights. If you're a member of a qualified Indian tribe that has fishing rights secured by treaty, executive order, or an Act of Congress as of March 17, 1988, don't include in your income amounts you receive from activities related to those fishing rights. The income isn't subject to income tax, self-employment tax, or employment taxes.

Indian money account litigation settlement. Amounts received by an individual Indian as a lump sum or periodic payment pursuant to the Class Action Settlement Agreement dated December 7, 2009, aren't included in gross income. This amount won't be used to figure AGI or MAGI in applying any Internal Revenue Code provision that takes into account excludable income.

Interest on frozen deposits. In general, you exclude from your income the amount of interest earned on a frozen deposit. A deposit is frozen if, at the end of the calendar year, you can't withdraw any part of the deposit because:

- The financial institution is bankrupt or insolvent, or
- The state where the institution is located has placed limits on withdrawals because other financial institutions in the state are bankrupt or insolvent.

Excludable amount. The amount of interest you exclude from income for the year is the interest that was credited on the frozen deposit for that tax year minus the sum of:

1. The net amount withdrawn from the deposit during that year, and
2. The amount that could have been withdrawn at the end of that tax year (not reduced by any penalty for premature withdrawals of a time deposit).

The excluded part of the interest is included in your income in the tax year it becomes withdrawable.

Interest on qualified savings bonds. You may be able to exclude from income the interest from qualified U.S. savings bonds you redeem if you pay qualified higher education expenses in the same year. Qualified higher education expenses are those you pay for tuition and required fees at an eligible educational institution for you, your spouse, or your dependent. A qualified U.S. savings bond is a series EE bond issued after 1989 or a series I bond. The bond must have been issued to you when you were 24 years of age or older. For more information on this exclusion, see *Education Savings Bond Program* in chapter 1 of Pub. 550 and in chapter 10 of Pub. 970.

Interest on state and local government obligations. This interest is usually exempt from federal tax. However, you must show the amount of any tax-exempt interest on your federal income tax return. For more information, see *State or Local Government Obligations* in chapter 1 of Pub. 550.

Job interview expenses. If a prospective employer asks you to appear for an interview and either pays you an allowance or reimburses you for your transportation and other travel expenses, the amount you receive isn't taxable in most cases. You include in income only the amount you receive that is more than your actual expenses.

Jury duty. Jury duty pay you receive must be included in your income on Schedule 1 (Form 1040), line 8. If you must give the pay to your employer because your employer continues to pay your salary while you serve on the jury, you can deduct the amount turned over to your employer as an adjustment to income. Enter the amount you repay your employer on Schedule 1 (Form 1040), line 22. Enter "Jury Pay" and the amount on the dotted line next to line 22.

Kickbacks. You must include kickbacks, side commissions, push money, or similar payments you receive in your income on Schedule 1 (Form 1040), line 8, or on Schedule C (Form 1040) if from your self-employment activity.

Example 37. You sell cars and help arrange car insurance for buyers. Insurance brokers pay back part of their commissions to you for referring customers to them. You must include the kickbacks in your income.

Manufacturer incentive payments. You must include as other income on Schedule 1 (Form 1040), line 8 (or Schedule C (Form 1040) if you're self-employed), incentive payments from a manufacturer that you receive as a salesperson. This is true whether you receive the payment directly from the manufacturer or through your employer.

Example 38. You sell cars for an automobile dealership and receive incentive payments from the automobile manufacturer every time you sell a particular model of car. You report the incentive payments on Schedule 1 (Form 1040), line 8.

Medical savings accounts (Archer MSAs and Medicare Advantage MSAs). In most cases, you don't include in income amounts you withdraw from your Archer MSA or Medicare Advantage MSA if you use the money to pay for qualified medical expenses. Generally, qualified medical expenses are those you can deduct on Schedule A (Form 1040). For more information about Archer MSAs or Medicare Advantage MSAs, see Pub. 969.

Moving expense reimbursements. For tax years beginning after 2017, reimbursements for certain moving expenses are no longer excluded from the gross income of nonmilitary taxpayers. See Pub. 521 for more information.

Prizes and awards. If you win a prize in a lucky number drawing, television or radio quiz program, beauty contest, or other event, you must include it in your income. For example, if you win a $50 prize in a photography contest, you must report this income on Schedule 1 (Form 1040), line 8. If you refuse to accept a prize, don't include its value in your income.

Prizes and awards in goods or services must be included in your income at their FMV.

Employee awards or bonuses. Cash awards or bonuses given to you by your employer for good work or suggestions must

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generally be included in your income as wages. However, certain noncash employee achievement awards can be excluded from income. See *Bonuses and awards* under *Miscellaneous Compensation*, earlier.

Prize points. If you're a salesperson and receive prize points redeemable for merchandise that are awarded by a distributor or manufacturer to employees of dealers, you must include their FMV in your income. The prize points are taxable in the year they're paid or made available to you, rather than in the year you redeem them for merchandise.

Pulitzer, Nobel, and similar prizes. If you were awarded a prize in recognition of accomplishments in religious, charitable, scientific, artistic, educational, literary, or civic fields, you must generally include the value of the prize in your income. However, you don't include this prize in your income if you meet all of the following requirements.

1. You were selected without any action on your part to enter the contest or proceeding.
2. You aren't required to perform substantial future services as a condition for receiving the prize or award.
3. The prize or award is transferred by the payer directly to a governmental unit or tax-exempt charitable organization as designated by you. The following conditions apply to the transfer.
   a. You can't use the prize or award before it's transferred.
   b. You should provide the designation before the prize or award is presented to prevent a disqualifying use. The designation should contain:
      i. The purpose of the designation by making a reference to section 74(b)(3);
      ii. A description of the prize or award;
      iii. The name and address of the organization to receive the prize or award;
      iv. Your name, address, and TIN; and
      v. Your signature and the date signed.
   c. In the case of an unexpected presentation, you must return the prize or award before using it (or spending, depositing, or investing it, etc., in the case of money) and then prepare the statement as described in (b) above.
   d. After the transfer, you should receive from the payer a written response stating when and to whom the designated amounts were transferred.

These rules don't apply to scholarship or fellowship awards. See *Scholarships and fellowships*, later.

Qualified opportunity fund (QOF). Effective December 22, 2017, section 1400Z-2 provides a temporary deferral of inclusion in gross income for eligible gains invested in QOFs, and a stepped-up basis to fair market value of the investment in the QOF at time of sale or exchange, if the investment is held for at least 10 years. See the Form 8949 instructions on how to report your election to defer eligible gains invested in a QOF. See Form 8997, Initial and Annual Statement of Qualified Opportunity Fund (QOF) Investments, and its instructions for reporting information. For additional information, see Opportunity Zones Frequently Asked Questions, available at *IRS.gov/Newsroom/Opportunity-Zones-Frequently-Asked-Questions*.

Qualified tuition program (QTP). A QTP (also known as a 529 program) is a program set up to allow you to either prepay or contribute to an account established for paying a student's qualified higher education expenses at an eligible educational institution. A program can be established and maintained by a state, an agency or instrumentality of a state, or an eligible educational institution.

The part of a distribution representing the amount paid or contributed to a QTP isn't included in income. This is a return of the investment in the program.

In most cases, the beneficiary doesn't include in income any earnings distributed from a QTP if the total distribution is less than or equal to adjusted qualified higher education expenses. See Pub. 970 for more information.

Railroad retirement annuities. The following types of payments are treated as pension or annuity income and are taxable under the rules explained in Pub. 575.

- Tier 1 railroad retirement benefits that are more than the social security equivalent benefit.
- Tier 2 benefits.
- Vested dual benefits.

Rewards. If you receive a reward for providing information, include it in your income.

Sale of home. You may be able to exclude from income all or part of any gain from the sale or exchange of your main home. See Pub. 523.

Sale of personal items. If you sold an item you owned for personal use, such as a car, refrigerator, furniture, stereo, jewelry, or silverware, your gain is taxable as a capital gain. Report it as explained in the Instructions for Schedule D (Form 1040). You can't deduct a loss.

However, if you sold an item you held for investment, such as gold or silver bullion, coins, or gems, any gain is taxable as a capital gain and any loss is deductible as a capital loss.

Example 39. You sold a painting on an online auction website for $100. You bought the painting for $20 at a garage sale years ago. Report your $80 gain as a capital gain as explained in the Instructions for Schedule D (Form 1040).

Scholarships and fellowships. A candidate for a degree can exclude amounts received as a qualified scholarship or fellowship. A qualified scholarship or fellowship is any amount you receive that is for:

- Tuition and fees required to enroll at or attend an eligible educational institution; or
- Course-related expenses, such as fees, books, and equipment that are required for courses at the eligible educational institution. These items must be required of all students in your course of instruction.

Amounts used for room and board don't qualify for the exclusion. See Pub. 970 for more information on qualified scholarships and fellowship grants.

Payment for services. Generally, you can't exclude from your gross income the part of any scholarship or fellowship that represents payment for teaching, research, or other services required as a condition for receiving the scholarship. This applies even if all candidates for a degree must perform the services to receive the degree.

Exceptions. You don't have to include in income the part of any scholarship or fellowship that represents payment for teaching, research, or other services if you receive the amount under:

- The National Health Services Corps Scholarship Program,
- The Armed Forces Health Professions Scholarship and Financial Assistance Program, or
- A comprehensive student work-learning-service program (as defined in section 448(e) of the Higher Education Act of 1965) operated by a work college (as defined in that section).

For information about the rules that apply to a tax-free qualified tuition reduction provided to employees and their families by an educational institution, see Pub. 970.

VA payments. Allowances paid by the VA for education, training, or subsistence under any law administered by the Department of Veterans Affairs, aren't included in your income. These allowances aren't considered scholarship or fellowship grants.

Prizes. Scholarship prizes won in a contest aren't scholarships or fellowships if you don't have to use the prizes for educational purposes. You must include these amounts in your income on Schedule 1 (Form 1040), line 8, whether or not you use the amounts for educational purposes.

Smallpox vaccine injuries. If you're an eligible individual who receives benefits under the Smallpox Emergency Personnel Protection Act of 2003 for a covered injury resulting from a covered countermeasure, you can exclude the payment from your income (to the extent it isn't allowed as a medical and dental expense deduction on Schedule A (Form 1040)). Eligible individuals include health care workers, emergency personnel, and first responders in a smallpox emergency who have received a smallpox vaccination.

Stolen property. If you steal property, you must report its FMV in your income in the year

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you steal it unless in the same year, you return it to its rightful owner.

Transporting school children. Don't include in your income a school board mileage allowance for taking children to and from school if you aren't in the business of taking children to school. You can't deduct expenses for providing this transportation.

Union benefits and dues. Amounts deducted from your pay for union dues, assessments, contributions, or other payments to a union can't be excluded from your income.

For tax years beginning after 2017, you can no longer deduct job-related expenses or other miscellaneous itemized deductions subject to the 2%-of-adjusted-gross-income floor.

Strike and lockout benefits. Benefits paid to you by a union as strike or lockout benefits, including both cash and the FMV of other property, are usually included in your income as compensation. You can exclude these benefits from your income only when the facts clearly show that the union intended them as gifts to you.

Reimbursed union convention expenses. If you're a delegate of your local union chapter and you attend the annual convention of the international union, don't include in your income amounts you receive from the international union to reimburse you for expenses of traveling away from home to attend the convention. You can't deduct the reimbursed expenses, even if you're reimbursed in a later year. If you're reimbursed for lost salary, you must include that reimbursement in your income.

Utility rebates. If you're a customer of an electric utility company and you participate in the utility's energy conservation program, you may receive on your monthly electric bill either:

- A reduction in the purchase price of electricity furnished to you (rate reduction), or
- A nonrefundable credit against the purchase price of the electricity.

The amount of the rate reduction or nonrefundable credit isn't included in your income.

Whistleblower's award. If you receive a whistleblower's award from the IRS, you must include it in your income. Any deduction allowed for attorney fees and court costs paid by you, or on your behalf, in connection with the award are deducted as an adjustment to income, but can't be more than the amount included in income for the tax year.

Repayments

If you had to repay an amount that you included in your income in an earlier year, you may be able to deduct the amount repaid from your income for the year in which you repaid it. Or, if the amount you repaid is more than $3,000, you may be able to take a credit against your tax for the year in which you repaid it. In most cases, you can claim a deduction or credit only if the repayment qualifies as an expense or loss incurred in your trade or business or in a for-profit transaction.

Type of deduction. The type of deduction you're allowed in the year of repayment depends on the type of income you included in the earlier year. In most cases, you deduct the repayment on the same form or schedule on which you previously reported it as income. For example, if you reported it as self-employment income, deduct it as a business expense on Schedule C (Form 1040) or Schedule F (Form 1040). If you reported it as a capital gain, deduct it as a capital loss as explained in the Instructions for Schedule D (Form 1040). If you reported it as wages, unemployment compensation, or other nonbusiness income, you may be able to deduct it as an other itemized deduction if the amount repaid is over $3,000.

CAUTION *For tax years beginning after 2017, you can no longer claim any miscellaneous itemized deductions; so, if the amount repaid was $3,000 or less, you aren't able to deduct it from your income in the year you repaid it.*

Repaid social security benefits. If you repaid social security or equivalent railroad retirement benefits, see Pub. 915.

Repayment over $3,000. If the amount you repaid was more than $3,000, you can deduct the repayment as an other itemized deduction on Schedule A (Form 1040), line 16, if you included the income under a claim of right. This means that at the time you included the income, it appeared that you had an unrestricted right to it. However, you can choose to take a credit for the year of repayment. Figure your tax under both methods and compare the results. Use the method (deduction or credit) that results in less tax.

CAUTION *When determining whether the amount you repaid was less than $3,000, consider the total amount being repaid on the return. Each instance of repayment isn't considered separately.*

Method 1. Figure your tax for the year of repayment claiming a deduction for the repaid amount.

Method 2. Figure your tax for the year of repayment claiming a credit for the repaid amount. Follow these steps.

1. Figure your tax for the year of repayment without deducting the repaid amount.
2. Refigure your tax from the earlier year without including in income the amount you repaid in the year of repayment.
3. Subtract the tax in (2) from the tax shown on your return for the earlier year. This is the credit.
4. Subtract the answer in (3) from the tax for the year of repayment figured without the deduction (step 1).

If method 1 results in less tax, deduct the amount repaid. If method 2 results in less tax, claim the credit figured in (3) above on Form 1040 or 1040-SR. (If the year of repayment is 2019, and you're taking the credit, enter the credit on Schedule 3 (Form 1040), line 12, and see the instructions for it.)

Example 40. For 2019, you filed a return and reported your income on the cash method. In 2020, you repaid $5,000 included in your 2019 income under a claim of right. Your filing status in 2020 and 2019 is single. Your income and tax for both years are as follows:

	2019	
	With Income	Without Income
Taxable Income	$15,000	$10,000
Tax	$1,609	$1,009

	2020	
	Without Deduction	With Deduction
Taxable Income	$49,950	$44,950
Tax	$6,785	$5,685

Your tax under method 1 is $5,685. Your tax under method 2 is $6,185, figured as follows.

Tax previously determined for 2019	$1,609
Less: Tax as refigured	– 1,009
Decrease in 2019 tax	$ 600
Regular tax liability for 2020	$6,785
Less: Decrease in 2019 tax	– 600
Refigured tax for 2020	$6,185

You pay less tax using method 1, so you should take a deduction for the repayment in 2020.

Repaid wages subject to social security and Medicare taxes. If you had to repay an amount that you included in your wages or compensation in an earlier year on which social security, Medicare, or tier 1 RRTA taxes were paid, ask your employer to refund the excess amount to you. If the employer refuses to refund the taxes, ask for a statement indicating the amount of the overcollection to support your claim. File a claim for refund using Form 843.

Repaid wages subject to Additional Medicare Tax. Employers can't make an adjustment or file a claim for refund for Additional Medicare Tax withholding when there is a repayment of wages received by an employee in a prior year because the employee determines liability for Additional Medicare Tax on the employee's income tax return for the prior year. If you had to repay an amount that you included in your wages or compensation in an earlier year, and on which Additional Medicare Tax was paid, you may be able to recover the Additional Medicare Tax paid on the amount. To recover Additional Medicare Tax on the repaid wages or compensation, you must file Form 1040-X for the prior year in which the wages or compensation were originally received. See the Instructions for Form 1040-X.

Repayment rules don't apply. This discussion doesn't apply to:

- Deductions for bad debts;
- Deductions for theft losses due to criminal fraud or embezzlement in a transaction entered into for profit;
- Deductions from sales to customers, such as returns and allowances, and similar items; or
- Deductions for legal and other expenses of contesting the repayment.

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Year of deduction (or credit). If you use the cash method, you can take the deduction (or credit, if applicable) for the tax year in which you actually make the repayment. If you use any other accounting method, you can deduct the repayment or claim a credit for it only for the tax year in which it's a proper deduction under your accounting method. For example, if you use an accrual method, you're entitled to the deduction or credit in the tax year in which the obligation for the repayment accrues.

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How To Get Tax Help

If you have questions about a tax issue, need help preparing your tax return, or want to download free publications, forms, or instructions, go to *www.IRS.gov* and find resources that can help you right away.

Preparing and filing your tax return. After receiving all your wage and earnings statements (Form W-2, W-2G, 1099-R, 1099-MISC, 1099-NEC, etc.); unemployment compensation statements (by mail or in a digital format) or other government payment statements (Form 1099-G); and interest, dividend, and retirement statements from banks and investment firms (Forms 1099), you have several options to choose from to prepare and file your tax return. You can prepare the tax return yourself, see if you qualify for free tax preparation, or hire a tax professional to prepare your return.

Free options for tax preparation. Go to *IRS.gov* to see your options for preparing and filing your return online or in your local community, if you qualify, which include the following.

- **Free File.** This program lets you prepare and file your federal individual income tax return for free using brand-name tax-preparation-and-filing software or Free File fillable forms. However, state tax preparation may not be available through Free File. Go to *IRS.gov/FreeFile* to see if you qualify for free online federal tax preparation, e-filing, and direct deposit or payment options.
- **VITA.** The Volunteer Income Tax Assistance (VITA) program offers free tax help to people with low-to-moderate incomes, persons with disabilities, and limited-English-speaking taxpayers who need help preparing their own tax returns. Go to *IRS.gov/VITA*, download the free IRS2Go app, or call 800-906-9887 for information on free tax return preparation.
- **TCE.** The Tax Counseling for the Elderly (TCE) program offers free tax help for all taxpayers, particularly those who are 60 years of age and older. TCE volunteers specialize in answering questions about pensions and retirement-related issues unique to seniors. Go to *IRS.gov/TCE*, download the free IRS2Go app, or call 888-227-7669 for information on free tax return preparation.
- **MilTax.** Members of the U.S. Armed Forces and qualified veterans may use MilTax, a free tax service offered by the Department of Defense through Military OneSource.

  Also, the IRS offers Free Fillable Forms, which can be completed online and then filed electronically regardless of income.

Using online tools to help prepare your return. Go to *IRS.gov/Tools* for the following.

- The *Earned Income Tax Credit Assistant* (*IRS.gov/EITCAssistant*) determines if you're eligible for the earned income credit (EIC).
- The *Online EIN Application* (*IRS.gov/EIN*) helps you get an employer identification number (EIN).
- The *Tax Withholding Estimator* (*IRS.gov/W4app*) makes it easier for everyone to pay the correct amount of tax during the year. The tool is a convenient, online way to check and tailor your withholding. It's more user-friendly for taxpayers, including retirees and self-employed individuals. The features include the following.
  - Easy to understand language.
  - The ability to switch between screens, correct previous entries, and skip screens that don't apply.
  - Tips and links to help you determine if you qualify for tax credits and deductions.
  - A progress tracker.
  - A self-employment tax feature.
  - Automatic calculation of taxable social security benefits.
- The *First Time Homebuyer Credit Account Look-up* (*IRS.gov/HomeBuyer*) tool provides information on your repayments and account balance.
- The *Sales Tax Deduction Calculator* (*IRS.gov/SalesTax*) figures the amount you can claim if you itemize deductions on Schedule A (Form 1040).

Getting answers to your tax questions. On IRS.gov, you can get up-to-date information on current events and changes in tax law.

- *IRS.gov/Help*: A variety of tools to help you get answers to some of the most common tax questions.
- *IRS.gov/ITA*: The Interactive Tax Assistant, a tool that will ask you questions on a number of tax law topics and provide answers.
- *IRS.gov/Forms*: Find forms, instructions, and publications. You will find details on 2020 tax changes and hundreds of interactive links to help you find answers to your questions.
- You may also be able to access tax law information in your electronic filing software.

Need someone to prepare your tax return? There are various types of tax return preparers, including tax preparers, enrolled agents, certified public accountants (CPAs), attorneys, and many others who don't have professional credentials. If you choose to have someone prepare your tax return, choose that preparer wisely. A paid tax preparer is:

- Primarily responsible for the overall substantive accuracy of your return,
- Required to sign the return, and
- Required to include their preparer tax identification number (PTIN).

Although the tax preparer always signs the return, you're ultimately responsible for providing all the information required for the preparer to accurately prepare your return. Anyone paid to prepare tax returns for others should have a thorough understanding of tax matters. For more information on how to choose a tax preparer, go to *Tips for Choosing a Tax Preparer* on IRS.gov.

Coronavirus. Go to *www.IRS.gov/Coronavirus* for links to information on the impact of the coronavirus, as well as tax relief available for individuals and families, small and large businesses, and tax-exempt organizations.

Tax reform. Tax reform legislation affects individuals, businesses, and tax-exempt and government entities. Go to *IRS.gov/TaxReform* for information and updates on how this legislation affects your taxes.

Employers can register to use Business Services Online. The Social Security Administration (SSA) offers online service at *SSA.gov/employer* for fast, free, and secure online W-2 filing options to CPAs, accountants, enrolled agents, and individuals who process Form W-2, Wage and Tax Statement, and Form W-2c, Corrected Wage and Tax Statement.

IRS social media. Go to *www.IRS.gov/SocialMedia* to see the various social media tools the IRS uses to share the latest information on tax changes, scam alerts, initiatives, products, and services. At the IRS, privacy and security are paramount. We use these tools to share public information with you. **Don't** post your SSN or other confidential information on social media sites. Always protect your identity when using any social networking site.

The following IRS YouTube channels provide short, informative videos on various tax-related topics in English, Spanish, and ASL.

- *Youtube.com/irsvideos*.
- *Youtube.com/irsvideosmultilingua*.
- *Youtube.com/irsvideosASL*.

Watching IRS videos. The IRS Video portal (*IRSVideos.gov*) contains video and audio presentations for individuals, small businesses, and tax professionals.

Online tax information in other languages. You can find information on *IRS.gov/MyLanguage* if English isn't your native language.

Free interpreter service. Multilingual assistance, provided by the IRS, is available at Taxpayer Assistance Centers (TACs) and other IRS offices. Over-the-phone interpreter service is accessible in more than 350 languages.

Getting tax forms and publications. Go to *IRS.gov/Forms* to view, download, or print all of the forms, instructions, and publications you may need. You can also download and view popular tax publications and instructions (including the Instructions for Forms 1040 and 1040-SR) on mobile devices as an eBook at *IRS.gov/eBooks*. Or you can go to *IRS.gov/OrderForms* to place an order.

Access your online account (individual taxpayers only). Go to *IRS.gov/Account* to securely access information about your federal tax account.

- View the amount you owe, pay online, or set up an online payment agreement.
- Access your tax records online.
- Review your payment history.
- Go to *IRS.gov/SecureAccess* to review the required identity authentication process.

Using direct deposit. The fastest way to receive a tax refund is to file electronically and choose direct deposit, which securely and electronically transfers your refund directly into your financial account. Direct deposit also avoids the possibility that your check could be lost, stolen, or returned undeliverable to the IRS. Eight in 10 taxpayers use direct deposit to receive their refunds. The IRS issues more than 90% of refunds in less than 21 days.

Getting a transcript of your return. The quickest way to get a copy of your tax transcript is to go to *IRS.gov/Transcripts*. Click on either "Get Transcript Online" or "Get Transcript by Mail" to order a free copy of your transcript. If you prefer, you can order your transcript by calling 800-908-9946.

Reporting and resolving your tax-related identity theft issues.

- Tax-related identity theft happens when someone steals your personal information to commit tax fraud. Your taxes can be affected if your SSN is used to file a fraudulent return or to claim a refund or credit.
- The IRS doesn't initiate contact with taxpayers by email, text messages, telephone calls, or social media channels to request personal or financial information. This includes requests for personal identification numbers (PINs), passwords, or similar information for credit cards, banks, or other financial accounts.
- Go to *IRS.gov/IdentityTheft*, the IRS Identity Theft Central webpage, for information on identity theft and data security protection for taxpayers, tax professionals, and businesses. If your SSN has been lost or stolen or you suspect you're a victim of tax-related identity theft, you can learn what steps you should take.
- Get an Identity Protection PIN (IP PIN). IP PINs are six-digit numbers assigned to eligible taxpayers to help prevent the misuse of their SSNs on fraudulent federal income tax returns. When you have an IP PIN, it prevents someone else from filing a tax return with your SSN. To learn more, go to *IRS.gov/IPPIN*.

Checking on the status of your refund.

- Go to *IRS.gov/Refunds*.
- The IRS can't issue refunds before mid-February 2021 for returns that claimed the EIC or the additional child tax credit (ACTC). This applies to the entire refund, not just the portion associated with these credits.
- Download the official IRS2Go app to your mobile device to check your refund status.
- Call the automated refund hotline at 800-829-1954.

Making a tax payment. The IRS uses the latest encryption technology to ensure your electronic payments are safe and secure. You can make electronic payments online, by phone, and from a mobile device using the IRS2Go app. Paying electronically is quick, easy, and faster than mailing in a check or money order. Go to *IRS.gov/Payments* for information on how to make a payment using any of the following options.

- *IRS Direct Pay*: Pay your individual tax bill or estimated tax payment directly from your checking or savings account at no cost to you.
- *Debit or Credit Card*: Choose an approved payment processor to pay online, by phone, or by mobile device.
- *Electronic Funds Withdrawal*: Offered only when filing your federal taxes using tax return preparation software or through a tax professional.
- *Electronic Federal Tax Payment System*: Best option for businesses. Enrollment is required.
- *Check or Money Order*: Mail your payment to the address listed on the notice or instructions.
- *Cash*: You may be able to pay your taxes with cash at a participating retail store.
- *Same-Day Wire*: You may be able to do same-day wire from your financial institution. Contact your financial institution for availability, cost, and cut-off times.

What if I can't pay now? Go to *IRS.gov/Payments* for more information about your options.

- Apply for an *online payment agreement* (*IRS.gov/OPA*) to meet your tax obligation in monthly installments if you can't pay your taxes in full today. Once you complete the online process, you will receive immediate notification of whether your agreement has been approved.
- Use the *Offer in Compromise Pre-Qualifier* to see if you can settle your tax debt for less than the full amount you owe. For more information on the Offer in Compromise program, go to *IRS.gov/OIC*.

Filing an amended return. You can now file Form 1040-X electronically with tax filing software to amend 2019 Forms 1040 and 1040-SR. To do so, you must have e-filed your original 2019 return. Amended returns for all prior years must be mailed. See *Tips for taxpayers who need to file an amended tax return* and go to *IRS.gov/Form1040X* for information and updates.

Checking the status of your amended return. Go to *IRS.gov/WMAR* to track the status of Form 1040-X amended returns. Please note that it can take up to 3 weeks from the date you filed your amended return for it to show up in our system, and processing it can take up to 16 weeks.

Understanding an IRS notice or letter you've received. Go to *IRS.gov/Notices* to find additional information about responding to an IRS notice or letter.

Contacting your local IRS office. Keep in mind, many questions can be answered on IRS.gov without visiting an IRS Taxpayer Assistance Center (TAC). Go to *IRS.gov/LetUsHelp* for the topics people ask about most. If you still need help, IRS TACs provide tax help when a tax issue can't be handled online or by phone. All TACs now provide service by appointment, so you'll know in advance that you can get the service you need without long wait times. Before you visit, go to *IRS.gov/TACLocator* to find the nearest TAC and to check hours, available services, and appointment options. Or, on the IRS2Go app, under the Stay Connected tab, choose the Contact Us option and click on "Local Offices."

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The Taxpayer Advocate Service (TAS) Is Here To Help You

What Is TAS?

TAS is an ***independent*** organization within the IRS that helps taxpayers and protects taxpayer rights. Their job is to ensure that every taxpayer is treated fairly and that you know and understand your rights under the *Taxpayer Bill of Rights*.

How Can You Learn About Your Taxpayer Rights?

The Taxpayer Bill of Rights describes 10 basic rights that all taxpayers have when dealing with the IRS. Go to *TaxpayerAdvocate.IRS.gov* to help you understand what these rights mean to you and how they apply. These are ***your*** rights. Know them. Use them.

What Can TAS Do For You?

TAS can help you resolve problems that you can't resolve with the IRS. And their service is free. If you qualify for their assistance, you will be assigned to one advocate who will work with you throughout the process and will do everything possible to resolve your issue. TAS can help you if:

- Your problem is causing financial difficulty for you, your family, or your business;
- You face (or your business is facing) an immediate threat of adverse action; or
- You've tried repeatedly to contact the IRS but no one has responded, or the IRS hasn't responded by the date promised.

How Can You Reach TAS?

TAS has offices *in every state, the District of Columbia, and Puerto Rico*. Your local advocate's number is in your local directory and at *TaxpayerAdvocate.IRS.gov/Contact-Us*. You can also call them at 877-777-4778.

How Else Does TAS Help Taxpayers?

TAS works to resolve large-scale problems that affect many taxpayers. If you know of one of these broad issues, please report it to them at *IRS.gov/SAMS*.

TAS for Tax Professionals

TAS can provide a variety of information for tax professionals, including tax law updates and guidance, TAS programs, and ways to let TAS know about systemic problems you've seen in your practice.

Low Income Taxpayer Clinics (LITCs)

LITCs are independent from the IRS. LITCs represent individuals whose income is below a certain level and need to resolve tax problems with the IRS, such as audits, appeals, and tax collection disputes. In addition, clinics can provide information about taxpayer rights and responsibilities in different languages for individuals who speak English as a second language. Services are offered for free or a small fee for eligible taxpayers. To find a clinic near you, visit *TaxpayerAdvocate.IRS.gov/about/LITC* or see IRS Pub. 4134, *Low Income Taxpayer Clinic List*.

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To help us develop a more useful index, please let us know if you have ideas for index entries. See "Comments and Suggestions" in the "Introduction" for the ways you can reach us.

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