Individual Income Tax: Income Part 2

Course #3112A

Taxes

2 Credit Hours

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INDIVIDUAL INCOME TAX: INCOME PART 2

This course covers various types of income and discuses which ones are taxed and which ones are not. Types of income discussed include: rental income, retirement benefit and pensions, annuities, and others.

LEARNING ASSIGNMENTS AND OBJECTIVES

As a result of studying each assignment, you should be able to meet the objectives listed below each individual assignment.

SUBJECTS

Rental Income and Expenses
Retirement Plans,Pensions, and Annuities
Other Income

Study the course materials from pages 1 to 65

Complete the review questions at the end of each chapter

Answer the exam questions 1 to 10

Objectives:

- Recognize the proper treatment of rental property income and expenses for tax purposes.
- Identify various requirements regarding retirement plan taxation.
- Identify the taxability of various types of other income.

Program publication date **11/22/2019**

EXAM OUTLINE

- **TEST FORMAT:** The final exam for this course consists of 10 multiple-choice questions and is based specifically on the information covered in the course materials.
- **ACCESS FINAL EXAM:** Log in to your account and click Take Exam. A copy of the final exam is provided at the end of these course materials for your convenience, however you must submit your answers online to receive credit for the course.
- **LICENSE RENEWAL INFORMATION:** This course qualifies for **2** CPE hours.
- **PROCESSING:** You will receive the score for your final exam immediately after it is submitted. A score of 70% or better is required to pass.
- **CERTIFICATE OF COMPLETION:** Will be available in your account to view online or print. If you do not pass an exam, it can be retaken free of charge.

TABLE OF CONTENTS

CHAPTER 1: RENTAL INCOME AND EXPENSES

Chapter Objective

After completing this chapter, you should be able to:

- Recognize the proper treatment of rental property income and expenses for tax purposes.

I. INTRODUCTION

This chapter discusses rental income and expenses. It covers the following topics.

- Personal use of dwelling unit (including vacation home).
- Depreciation.
- Limits on rental losses.

II. RENTAL INCOME

In most cases, you must include in your gross income all amounts you receive as rent. Rental income is any payment you receive for the use or occupation of property. It is not limited to amounts you receive as normal rent payments.

When to report. Report rental income on your return for the year you actually or constructively receive it, if you are a cash basis taxpayer. You are a cash basis taxpayer if you report income in the year you receive it, regardless of when it was earned. You constructively receive income when it is made available to you, for example, by being credited to your bank account.

Advance rent. Advance rent is any amount you receive before the period that it covers. Include advance rent in your rental income in the year you receive it regardless of the period covered or the method of accounting you use.

Example

You sign a 10-year lease to rent your property. In the first year, you receive $5,000 for the first year's rent and $5,000 as rent for the last year of the lease. You must include $10,000 in your income in the first year.

Security deposits. Do not include a security deposit in your income when you receive it if you plan to return it to your tenant at the end of the lease. But if you keep part or all of the security deposit during any year because your tenant does not live up to the terms of the lease, include the amount you keep in your income for that year.

If an amount called a security deposit is to be used as a final payment of rent, it is advance rent. Include it in your income when you receive it.

Payment for canceling a lease. If your tenant pays you to cancel a lease, the amount you receive is rent. Include the payment in your income in the year you receive it regardless of your method of accounting.

Expenses paid by tenant. If your tenant pays any of your expenses, the payments are rental income. You must include them in your income. You can deduct the expenses if they are deductible rental expenses. See *Rental Expenses*, later, for more information.

Property or services. If you receive property or services, instead of money, as rent, include the fair market value of the property or services in your rental income.

If the services are provided at an agreed upon or specified price, that price is the fair market value unless there is evidence to the contrary.

Rental of property also used as a home. If you rent property that you also use as your home and you rent it fewer than 15 days during the tax year, do not include the rent you receive in your income and do not deduct rental expenses. However, you can deduct on Schedule A (Form 1040) the interest, taxes, and casualty and theft losses that are allowed for nonrental property. See *Personal Use of Dwelling Unit (Including Vacation Home)*, later.

Part interest. If you own a part interest in rental property, you must report your part of the rental income from the property.

III. RENTAL EXPENSES

This part discusses repairs and certain other expenses of renting property that you ordinarily can deduct from your rental income. It includes information on the expenses you can deduct if you rent part of your property, or if you change your property to rental use. Depreciation, which you can also deduct from your rental income, is discussed later.

When to deduct. If you are a cash-basis taxpayer, you generally deduct your rental expenses in the year you pay them.

Vacant rental property. If you hold property for rental purposes, you may be able to deduct your ordinary and necessary expenses (including depreciation) for managing, conserving, or maintaining the property while the property is vacant. However, you cannot deduct any loss of rental income for the period the property is vacant.

Pre-rental expenses. You can deduct your ordinary and necessary expenses for managing, conserving, or maintaining rental property from the time you make it available for rent.

Depreciation. You can begin to depreciate rental property when it is ready and available for rent. See *Placed-in Service Date* under *Depreciation*, later.

Vacant while listed for sale. If you sell property you held for rental purposes, you can deduct the ordinary and necessary expenses for managing, conserving, or maintaining the property until it is sold. If the property is not held out and available for rent while listed for sale, the expenses are not deductible rental expenses.

Personal use of rental property. If you sometimes use your rental property for personal purposes, you must divide your expenses between rental and personal use. Also, your rental expense deductions may be limited. See *Personal Use of Dwelling Unit (Including Vacation Home)*, later.

Part interest. If you own a part interest in rental property, you can deduct expenses that you paid according to your percentage of ownership.

Uncollected rent. If you are a cash-basis taxpayer, you do not report uncollected rent. Because you do not include it in your income, you cannot deduct it.

REPAIRS AND IMPROVEMENTS

Generally, an expense for repairing or maintaining your rental property may be deducted if you are not required to capitalize the expense.

Separate the costs of repairs and improvements, and keep accurate records. You will need to know the cost of improvements when you sell or depreciate your property.

Repairs versus improvements. Under the IRS regulations, a repair is defined as those expenses that "do not add significant value to the property or extend its life." They are reasonable in amount and are necessary to keep the property in habitable condition. Repairs are generally considered restoring an item to its previous good condition.

An improvement, on the other hand, is any type of renovation that will extend the "useful life" of the property. Improvements can be adding something that is not already there, upgrading something that is existing, or adapting an asset to a new use. Examples of improvements include replacing a roof, installing bolts to a building located in an earthquake prone area to add structural support, or making modifications to a manufacturing facility so it can be used as a showroom.

Safe Harbors under the IRS Regulations

The final regulations provide for three safe harbors related to improvements. They are a *de minimis* safe harbor, a safe harbor for small taxpayers, and a safe harbor for routine maintenance. If a safe harbor applies, a current deduction is allowed. The *de minimis* and small taxpayer safe harbors are annual elections made on a statement to be attached to the return, and not a change in accounting method.

***De minimis* safe harbor.** This safe harbor allows you to elect to apply a *de minimis* safe harbor to amounts paid to acquire or produce tangible property to the extent such amounts are deducted by you for financial accounting purposes or in keeping your books and records. If you have an applicable financial statement (AFS), you may use this safe harbor to deduct amounts paid for tangible property up to $5,000 per invoice or item (as substantiated by invoice). If you do not have an AFS, you may use the