

# 2022 NATIONAL INCOME TAX WORKBOOK

CHAPTER 9: INDIVIDUAL INCOME  
TAX ISSUES, P.323



## CHAPTER 9 ISSUES

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## LEARNING OBJECTIVES

P. 323

After completing this session, participants will be able to perform the following:

- ✓ Explain deductions that are available to a taxpayer who does not itemize
- ✓ Understand who is eligible for the child tax credit
- ✓ Know how to claim deductions and credits for care expenses
- ✓ Understand the special tax rules that apply to caregivers
- ✓ Discuss tax issues for divorced spouses
- ✓ Know when a taxpayer is eligible for an education tax credit
- ✓ Understand the deduction for contributions to a health savings account
- ✓ Explain who is eligible to make health savings account contributions

## ISSUE 1: STANDARD OR ITEMIZED DEDUCTIONS

P. 324

The Tax Cuts and Jobs Act increased the standard deduction. The 2022 amounts are:

- \$25,900 MFJ
- \$19,400 HoH
- \$12,950 Single and MFS

Determine which option, standard or itemized deductions

Planning Pointer: Bunch medical and charitable and itemize every few years

## MEDICAL AND DENTAL EXPENSES

P. 324

Deduct medical and dental expenses that exceed 7.5% of the taxpayer's AGI

- If the taxpayer does not itemize certain amounts may be deducted using a health savings account (HSA) or excluded using a flexible spending arrangement (FSA)

## HEALTH SAVINGS ACCOUNTS

PP. 324 - 325

2022 contribution limits

- \$3,650 for self-only coverage
- \$7,300 for family coverage
- \$1,000 additional if taxpayer is over 55 years old (spouse, if >55 also \$1,000)

Any unused amounts in the account may be carried forward

Current deduction allowed even if there is no use of funds

Distributions for qualified medical expenses

*More discussion later*

## FLEXIBLE SPENDING ARRANGEMENTS

P. 325

FSA is an employer-sponsored benefit plan allows employees to pay for medical costs and childcare with pre-tax dollars.

- 2022 medical FSA limit is \$2,850 (for employee, spouse, and dependents)
- Up to \$570 can be carried over to the subsequent year if unused
- For dependent care FSAs, the maximum limit is \$5,000 MFJ, or \$2,500 other filers

## HEALTH REIMBURSEMENT ARRANGEMENTS

P. 325

Under IRC105 of the Code, employers can contribute to an HRA for employees; not subject to any limits

Contribution excluded from income

Distributions paid to reimburse the employee for qualifying medical expenses for the employee, spouse, or dependents

Unused amounts may be carried over to subsequent year

Practitioner Note: **Self-employed persons not eligible for FSA or HRA**



## TAXES PAID BY TAXPAYER

P. 325

SALT cap applied at \$10,000 (\$5,000 MFS)

- Effective tax years beginning after Dec 31, 2017, and before Jan 1, 2026
- Practitioner Note: The Supreme Court declined to review 2<sup>nd</sup> Circuit's decision

## TAXES PAID BY TAXPAYER

P. 326

- **State Business-Level Tax**
- 27 states enacted laws to facilitate a SALT work-around
- IRS Notice 2020-75 announces the IRS plans to issue proposed regulations that SALT paid by S corp. or partnership are not included in calculating the limit

### State Tax Credit

- **Ex. 9.1 Payment to a Nonprofit: subject to SALT limitation**

### Capitalizing Real Estate Taxes

- IRC 266 allows for taxpayers to elect to capitalize (add to basis) certain property taxes and carrying charges instead of currently deducting them.
- Election is made by attaching a statement to the tax return by the due date (including extensions). This election can be made annually

## INTEREST YOU PAID

P. 327

### Home Mortgage Interest

- \$750,000 debt limit (\$375,000 MFS) on qualifying residence debt
- Buy, build or substantially improve primary or second homes

### **Practitioner Note: Limit on Deducting Home Equity Debt**

### Mortgage Insurance Premiums

- Phased out between \$100,000 and \$109,000 of taxpayer's AGI – not yet extended

## INTEREST YOU PAID

P. 327

### Investment Interest

- Limited to net investment income
- Interest, dividends, annuities, or royalties not derived in the ordinary course of business
- Can carry forward excess amounts

## GIFTS TO CHARITY

P. 328

TCJA increased the cash contributions limit from 50% to 60% of AGI to sunset January 1, 2026. Any excess amounts can be carried forward 5 years

2022 - \$600 (MFJ) above-the-line deduction for cash contributions.  
(Not extended for 2023)

## GIFTS TO CHARITY

PP. 328-329

### Qualified Charitable Distributions from IRAS

Age 70 ½ can contribute up to \$100,000

- See list of 6 benefits (pg 328)

### Gifting of Commodities

- See list of 6 steps to be met (pg 328-329)

### **Planning Pointer: Donor Advised Funds**

## OTHER DEDUCTIONS

P. 329

### Casualty and Theft Losses

- TCJA disallows personal losses for 2017 – 2025 unless attributed to a federally declared disaster
- \$100-per-casualty and 10% AGI limitations apply
- **Practitioner Note: Qualified Disaster Loss**

### Miscellaneous Itemized Deductions

- List of 12 items which are suspended under TCJA
- Deduct expenses reimbursed under an accountable plan



## OTHER ITEMIZED DEDUCTIONS

P. 332

### Deductions for Estates and Trusts

- Costs paid in connection w/ administration – would not be paid if not a trust or estate
- Deductions allowed under §§ 642(b), 651, and 661

### Section 67(b) Deductions

- A list of 12 items specifically defined NOT TO BE itemized deductions

## ISSUE 2: CHILD TAX CREDIT

P. 333

In 2021 the CTC was increased to \$3,000 (\$3,600 < 6 years old)

Cross-Reference: Due Diligence Requirements-Form 8867

Qualifying Child

- Relationship, residence, age, and support tests

**Ex. 9.2 Age Test** – Matthew turned age 17 on 3/30/22 – doesn't qualify

## CHILD TAX CREDIT CONTINUED

P. 334

Child must have SSN

Phaseout Thresholds

- Begins to phase out above \$400,000 MFJ, \$200,000 for all other filers
- Reduction is \$50 for each \$1,000 above the threshold
- Fully phased out at \$480,000 MFJ

**Ex. 9.3 CTC Income Limit** Mike and Melissa have \$400,001 MAGI, lose \$50 of the CTC

## 2021 EXPANDED CTC: A REVIEW

PP. 334-335

Increased Amounts: \$3,000 per child (\$3,600 under 6yrs) Fully refundable

Increased Age: Included children who were 17 years old

Different phaseouts for the expanded credit

Advanced Payments of up to 50% began in July 2021

### **Reconcile Advance Payments**

- Repay excess – unless eligible for repayment protection

## CTC: QUALIFYING CHILD OF MORE THAN ONE

PP. 335-336

Tiebreaker rules for qualifying children of more than one TP

Release of the CTC

- 4 requirements
- Use Form 8332, Part I for current year, Part II for future tax years
- Noncustodial parent must attach a copy of IRS Form 8332

## CTC: QUALIFYING CHILD OF MORE THAN ONE

P. 336

### Revocation of Release

- Form 8332, Part III to revoke a previous release

Practitioner Note – releases other claims

- CTC
- Dependency Exemption
- Education Credit

## 2022 REFUNDABLE PART OF THE CTC

P. 336

In 2022 the CTC reverts to \$2,000 and limited to tax due

Refundable portion is \$1,500 per qualifying child

- 1 or 2 qualifying children is 15% of earned income
- Earned income must exceed \$2,500
- Must have \$12,500 of earned income to qualify for the full CTC

## 2022 REFUNDABLE PART OF THE CTC

PP. 336-337

- **Ex. 9.4 Refundable Credit Not Allowed**
- **Ex. 9.5 Refundable Credit Partially Allowed**
- Calculation for 3 or more qualifying children
  - Alternate formula – SS Taxes > EIC

Attach Sch 8812



## ISSUE 3: CAREGIVER TAXES

P. 338

- Medical care deductions for long-term care services and institution costs in assisted living facilities
- Deduction for long-term care insurance
- Child and dependent care credit is explained
- Special tax rules applicable to caregivers
  - In-home services for elderly or disabled

## MEDICAL AND DENTAL EXPENSES

P. 338

Medical expenses paid are deductible under IRC § 213

- Medicine and drugs
- Medical care for taxpayer, spouse, or dependent of taxpayer
- Medical expenses are an itemized deduction and allowable above 7.5% of AGI

## MEDICAL AND DENTAL EXPENSES

P. 338

### Medical Care for a Dependent

- Regardless if dependent has gross income of \$4,400 (2022)
- Status is determined at the point when services are rendered, or expenses paid
- If two or more persons pay, the medical expenses are deductible by designee in the multiple support agreement
- Divorced parents, both parents can claim

## DEFINITION OF MEDICAL CARE

P. 338

Diagnosis, cure, mitigation, treatment, or prevention of disease

Transportation primarily for and essential to medical care

Qualified long-term care services

Medical Insurance (including Medicare Part B premiums), qualified long-term care insurance

Amounts paid for certain lodging to receive medical care away from home

## SUBSTANTIATION OF DEDUCTIONS

P. 339

Name and address of person to whom payment for medical expenses was made

The amount and date of expense

What was the purpose of the payment?

Was payment made in kind?

IRS can request additional substantiation

## LONG-TERM CARE

P. 339

Medical care is defined to include qualified long-term care services as defined in IRC § 7702B(c). This includes long-term care insurance premiums

Qualified long-term care services are provided for a chronically ill individual pursuant to a plan of care by licensed health care practitioner

## CHRONICALLY ILL INDIVIDUAL

P. 339

Is certified by a licensed health practitioner to:

- Not be able to perform at least 2 activities of daily living for at least 90 days
- Has a level of disability like the disability described in the bullet above
- Requires substantial supervision to protect from threats to health and safety due to cognitive impairment

## CHRONICALLY ILL INDIVIDUAL

P. 339

Qualified expenses include maintenance and personal care primarily provided to assist with the TP's disabilities

Housekeeping expenses are non-deductible personal expenses even if medically necessary

**Ex. 9.6** Verna hired cook/cleaner to help with mental health, but not deductible



## INSTITUTION EXPENSES

P. 340

Cost of in-patient hospital care is an expenditure for medical care

Incidental meal and lodging costs are part of that care

If the principal reason for institution is not for medical care, only the part of the care attributable to medical care is deductible

**Ex. 9.7** Patricia went to assisted living so she doesn't have to mow the lawn and shovel snow. Not deductible

*Baker v Commissioner*, 122 T.C. 143; the court applied a percentage method

## EDUCATION EXPENSES

P. 340

The cost of attending special school to alleviate mental or physical disabilities is deductible if the principal purpose is medical care

Includes incidental meals and lodging

## AT-HOME CARE EXPENSES

PP. 340-341

Generally, personal and family living expenses are not deductible. If at-home expenses are medical care, these expenses may be deductible.

- *Estate of Marantz v. Commissioner*, 39 T.C.M. 515 (1979) 40% of the expenditures were medical care costs

## AT-HOME CARE EXPENSES

P. 341

- **Practitioner Note:** FICA paid on medical expense also deductible
- Rev. Rul. 76-106, “nursing-type” services were medical care costs
  - Allocable Wages to household & personal services nondeductible
  - Allocable cost of meals also medical expense
- **Practitioner Note:** Payment to relatives not qualified expense

## LONG-TERM CARE PREMIUMS

PP. 341-342

Medical care includes qualified long-term care premiums

Limitations on deductible premiums

**Maximum Deductible Long-Term Care Premiums**

	2020	2021	2022
40 or less	\$430	\$450	\$450
More than 40, less than 51	\$810	\$850	\$850
More than 50, less than 61	\$1,630	\$1,690	\$1,690
More than 60, less than 71	\$4,350	\$4,520	\$4,510
More than 70	\$5,430	\$5,640	\$5,640
Maximum excludable long-term care per diem	\$380	\$400	\$390

## CHILD AND DEPENDENT CARE CREDIT

P. 342

Nonrefundable credit

To claim:

- Pay for care of a qualifying person
- Have earned income during the year
- Pay the care expenses so TP and spouse can work
- Pay care expenses to a qualifying provider
- Not be filing MFS – unless exception
- Identify the provider on the TP's tax return

## QUALIFYING PERSON

P. 343

**Practitioner Note:** Payments to relatives or dependents don't qualify

The TP's qualifying child who is a dependent and under age 13

The TP's spouse who is physically or mentally unable to care for self and lived with the TP for more than half the year

A person who is physically or mentally unable to care for self and lived with the TP for more than one-half the year and was the TP's dependent or would have been a dependent if certain requirements waived

## QUALIFYING PERSON

P. 343

**Ex. 9.8:** Harry pays nurse for disabled spouse, can claim credit.  
Cannot also claim medical expense deduction

**Practitioner Note:** Caregiver child, for a parent, may be able to claim dependent deduction and HoH status



## AMOUNT OF THE CREDIT

PP. 343-344

Percentage of employment-related expenses.

- Expenses for household services
- Expenses for care of qualifying individual in the household
- Expenses for service provided outside of the household.

## AMOUNT OF THE CREDIT

P. 344

Amount of expenses included is limited

- \$3,000 for one qualifying individual
- \$6,000 for two or more qualifying individuals

### **Figure 9.3**

- AGI up to \$15,000: 35% credit
- AGI \$15,001 to \$43,000: 34% to 21% credit
- AGI over \$43,000: 20% credit

## TAX RULES FOR HOUSEHOLD CAREGIVERS

PP. 344-345

Usually, an employee

- Employer not required to withhold income tax
- FICA taxes (with exceptions) on \$2,400 or more of cash wages paid to a household employee
- **Ex. 9.9 Household Caregiver** Elena paid 60K, must withhold SS and Medicare

## TAX RULES FOR HOUSEHOLD CAREGIVERS

P. 345

- Not Subject to FICA taxes
  - Taxpayer's spouse
  - Child < 21
  - Parent (with limited exception)
- Parent's wages subject to FICA tax for providing care to grandchild in limited circumstances

## TAX RULES CONTINUED

P. 347

Employee under 18 is exempt from FICA taxes

- **Unless** provides care as his/her principal occupation

### **FUTA**

- If wages total \$1,000 or more in any calendar quarter of 2021 or 2022
  - Exception for spouse, under 21 child, parent
- Report FICA, Fed W/H, & FUTA on Schedule H

## CAREGIVER SE TAX

P. 346

If the family member providing caregiving services is not an employee, then he or she is self-employed and must pay SE tax if in T or B of providing care

- **Ex. 9.11: No Trade or Business – No SE Tax**

- Melissa cares for husband only – no T or B – no SE tax

- **Ex. 9.12: Trade or Business – Pay SE Tax**

- Debbie has adult day care business for many clients – SE tax

## ISSUE 4: TAX ISSUES FOR DIVORCED SPOUSES

P. 347

The TCJA of 2017 alimony is not deductible by the payer and not taxable by the recipient

- Personal exemption deductions are also suspended during this period

**Cross-Reference:** Conflict of interest may occur if represent both spouses

## FILING STATUS

PP. 347-349

Marital status on December 31 of the tax year

- MFJ if still married on 12/31
  - Once a joint return is filed, it cannot be amended to be an MFS return past the original due date
  - If MFS, 3 years from due date to file amended & claim MFJ
- MFS
  - May increase tax owed
  - EITC is available if conditions are met



## FILING STATUS

PP. 348-349

Marital status on December 31 of the tax year

- HOH
  - Considered unmarried – 4 requirements
  - Does not file joint return
  - Lived apart last 6 months of the tax year
  - Paid  $> \frac{1}{2}$  cost of taxpayers's home
  - Provided principal residence  $> \frac{1}{2}$  the year
- **Ex. 9.13 Divorcing Spouses** – Regina lived separately and paid all costs, considered unmarried

## ALLOCATION OF TAX ITEMS

P. 349

MFS must allocate deductions, losses, and credits between them.  
Also allocate estimated tax payments and tax refunds

Itemized deductions – generally both must itemize or claim the standard deduction unless files as HoH

- Medical Expenses – both can deduct amounts paid
- **Ex. 9.14 Medical Expenses** – Dean and Diana divorced, and each can deduct medical expenses for child

## ALLOCATION OF TAX ITEMS

PP. 349-350

- Home Mortgage Interest – each claims one or one can claim two
- **Ex. 9.15 Deductible Mortgage Interest** – Separated but Stan is paying mortgage, can deduct
- Charitable Contribution Carryovers – divided based on MFS ratio
- **Ex. 9.16 Charitable Contribution Carryover** – Allocate as if filed MFS

## ALLOCATION OF TAX ITEMS CONTINUED

PP. 350-351

Losses – allocated to spouse who generated

**Ex. 9.17 Capital Loss Carryforward** – Loss from Sophia's stock allocated to Sophia

### **Cross-Reference: Allocation of Tax Benefits**

Estimated Tax Payments – joint payments divided as agreed

**Ex. 9.18 Allocation of Estimated Tax Payments** – If can't agree allocate based on proportionate share of tax liability

## ALLOCATION OF TAX ITEMS CONTINUED

PP. 351-352

Tax Refund – allocate as agreed or proportionately to amount of overpayment

- **Cross-Reference:** See Chapter 6 “IRS Issues”
- If IRS issued only one refund check
  - Return the check with copy of divorce decree dictating allocation

## CHILD SUPPORT

P. 352

Child support is not deductible when paid, not included in income when received

Payments are treated as child support if the payment is contingent upon an event relative to the child, e.g., turning an age

- Rebuttable presumption if either the 6-month rule or a multiple reduction rule applies
- **Ex. 9.19 Deemed Child Support** – payments reduced w/in 6 months of 18<sup>th</sup> birthday, rebuttable presumption that it's child support

# ALIMONY

PP. 352-353

Executed after 12/31/2018 -2025 not deductible or income

- Decrees executed before Jan 1, 2018, allow that alimony may be deducted by payer, thus included in income by payee

## Qualifying Payments

- Must be made in cash pursuant to divorce or separation decree
- Can't be designated as not alimony
- Payer and payee must reside in separate households (with exceptions)
- Payer and payee cannot file a joint income tax return
- Must terminate upon death of the payee spouse

## ALIMONY CONTINUED

P. 353

Cash Payment – not services, property, or use of property

Divorce or Separation Instrument – legally enforceable and written

**Ex. 9.20 Voluntary Payment not Alimony**



## ALIMONY CONTINUED

PP. 353-354

### Designated as NOT ALIMONY

- Stated as such in divorce decree
- Stipulation
- If alimony and child support are ordered, payments apply to child support first
- **Example 9.21 Child Support Deemed to be Paid First** – Nadia ordered to pay \$12K child support and \$6K alimony, paid only \$15K, considered \$12K child support/\$3K alimony

## ALIMONY CONTINUED

P. 354

Separate Households required, two exceptions

- One spouse is preparing to leave and leaves no later than 1 month after the date of the first payment
- Couple is not legally separated but payments are made under a written separation agreement, or similar order

## ALIMONY CONTINUED

PP. 354-355

### Ending at Payee's Death

- Qualifying alimony payments must stop upon death of the recipient spouse
- **Ex. 9.22 Subsequent Payments to Estate** - \$20K not deductible b/c will end at death (2016 Divorce)
- **Ex. 9.23 Subsequent Payments to Trust** – \$10,000 payments to trust for kids not alimony (2018 Divorce)

## ALIMONY CONTINUED

PP. 355-356

### Payment to Third Parties

- OK if made per the terms of the divorce or separation document
- Payments are deemed to be received by the payee spouse, but paid to a 3<sup>rd</sup> party
- **Ex. 9.25 Medical and Dental Expenses** – Manny ordered to pay Davina's medical - alimony
- **Ex. 9.26 Housing Costs Paid by Nonresident Spouse** – Angela lives rent-free in ex's house, use of house is not alimony, except utilities

**Practitioner Note: Child Support** – payment designated as child support is not alimony

## PROPERTY SETTLEMENTS

P. 356

### No gain or loss on transfers incident to divorce

- Within 1 year of end of marriage or
- Transfer is related to the end of a marriage and is made under a divorce or separation agreement within 6 years after marriage ends
- **Practitioner Note: Related to End of Marriage** – 6-year period is rebuttable presumption
- Rules apply to real, personal, tangible, intangible, separate, and community property
- Third party transfers are generally a two-step transaction
- Basis and holding period carry over to recipient spouse

## RETIREMENT BENEFITS

PP. 356-357

A qualified domestic relations order (QDRO) may establish alternate payee – no 10% early distribution penalty

- Benefits can be for: child support, alimony, marital property rights
- Payments from retirement account are taxable to recipient spouse
- Payments to child or dependent, taxable to plan participant.

## INDIVIDUAL RETIREMENT ACCOUNTS

P. 357

Transfer from one spouse to another is income tax free if required by divorce decree or other such document

There is **NO QDRO** exception for the early withdrawal penalty for IRAs.

- Distributions Taxable to the Owner – if funds distributed to owner and owner gives to spouse
- Contributions and Deductions – no contributions are deductible if made to a former spouse's traditional IRA if final decree of divorce by 12/31

## ISSUE 5: EDUCATION TAX CREDITS

P. 358

American opportunity tax credit and the lifetime learning credit

Taxpayers use IRS Form 8863, Education Credits, to calculate allowable credit amounts.

Impact on tax-free I.R.C. § 529 plan distributions



## GENERAL ELIGIBILITY REQUIREMENTS

PP. 358-359

### Eligible Educational Institutions

- College, university, etc., eligible to participate in US Dept. of Ed. aid

### Filing Status

- A TP cannot claim credit if claimed on another person's tax return or if the TP is considered married and no joint return

### Identification Requirements

- Name and TIN of the student and the filer. For AOTC issued on or before return due date and include the TIN of the educational institution

## GENERAL ELIGIBILITY REQUIREMENTS

P. 359

Income Limits

MAGI phaseout range

Lifetime Learning Credit phaseout increased to match MAGI limitations of AOTC beginning in 2021

**Ex. 9.27 Lifetime Learning Credit MAGI Phaseout** – Leon and Lexie's credit limited to \$750 b/c of \$170K MAGI

## QUALIFIED EDUCATION EXPENSES

P. 359

Amounts paid for tuition and fees required for enrollment in the tax year (reduced by tax-free scholarships or other educational assistance)

Nonacademic fees paid as a condition of enrollment in the eligible institution, e.g., student activity fees

Cost of books, supplies, and equipment

### **Observation: Books, Supplies, and Equipment**

- For lifetime learning credit, these cost must be paid to the educational institution as a condition of enrollment or attendance

## QUALIFIED EDUCATION EXPENSES CONTINUED

P. 360

Not included in qualified education expenses:

- Personal expenses (room and board), transportation, living expenses
- Student activity fees, athletic fees, and insurance expenses that are unrelated to the student's course of study

## QUALIFIED EDUCATION EXPENSES CONTINUED

P. 360

Not included in qualified education expenses:

- Courses involving sports, games, or hobbies, or any noncredit course, unless the course is required as part of the student's degree program or, for lifetime learning credit, the course helps the student to acquire or improve job skills

## SCHOLARSHIPS

P. 360

Qualified educational expenses to calculate the credit must be reduced by excludable qualified scholarship

### **Ex. 9.28 Partial Scholarship**

- Angie's qualified educational expenses were \$7,500 for tuition and fees, \$900 for books
- She received a \$4,500 scholarship
- Angie's qualified expenses were \$3,900 ( $\$7,500 - \$4,500 + \$900$ )

# SCHOLARSHIPS

Not in Book

## **Publication 970** – Tax Benefits for Education

Coordinate Pell Grants and other scholarships

- Consider including some or all of the scholarship or fellowship grant in student's income
- May increase AOTC
- Treat as paying nonqualified education expenses

## AMOUNTS PAID BY A DEPENDENT

P. 360

A taxpayer who can be claimed as a dependent on another's tax return cannot claim the educational credits

Payments made for qualified educational expenses by the dependent are deemed paid by the taxpayer claiming the dependent

### **Ex. 9.29 Tuition Paid by Student**

- Libby files as HoH claiming her son, Dan, who is a student at State University
- Dan paid \$9,000 for tuition and fees plus \$1,200 for textbooks
- Libby can claim the credit as if she had paid these expenses



## AMERICAN OPPORTUNITY TAX CREDIT

P. 360

Maximum credit of \$2,500 per eligible student

For first 4 years of higher education

Up to 40% (up to \$1,000) may be refundable

## AMERICAN OPPORTUNITY TAX CREDIT

PP. 360-361

Eligibility for the AOTC requires:

- Enrolled in a program leading to a degree, certificate or other post secondary credential
- Enrolled at least one-half time for one academic period
- Has not finished first 4 years of post secondary education at the start of the tax year
- Has not claimed the AOTC or former Hope credit for more than 4 years
- No felony drug conviction before the end of the tax year

## LIFETIME LEARNING CREDIT

P. 361

Not limited to the first 4 years of higher education

TP, TP's spouse, and TP's dependents qualify

Credit is equal to 25% of qualified tuition and related costs up to a maximum of \$10,000, therefore, the maximum credit is \$2,000

## COORDINATION WITH § 529 PLAN DISTRIBUTIONS PP. 361-362

Distributions from a 529 plan are not included in income of the beneficiary, can include:

- K-12 tuition, limited to \$10,000 per year after 2017

Higher education expenses also include, in part:

- Special needs services required for enrollment or attendance
- Room and board for students enrolled at least ½ time
- Principal and interest on qualified student loans up to \$10,000
- Certain expenses for elementary and secondary schools (in addition to tuition)

## EXPENSES USED TO CLAIM AN EDUCATION CREDIT PP. 362-363

TP must deduct higher education expense for AOTC and LLC to arrive at 529 plan qualified education expenses

### Tax on Distribution

- If total 529 distribution exceeds total qualified expenses, allocation to determine the taxable portion
- May be subject to 10% additional tax

## EXPENSES USED TO CLAIM AN EDUCATION CREDIT PP. 362-363

- **Ex. 9.30 Section 529 Plan Distribution and the AOTC**
- Brady had \$1,200 of qualified education expenses under the 529 plan (See Figure 9.4)
- Tax free earnings of \$216
- Thus, Brady reports \$738 on Line 8z of Schedule 1, Form 1040

## ADDITIONAL TAX ON 529 PLANS

P. 363

10% additional tax on nonqualified distributions

The 10% additional tax does not apply if the distribution

- Made to a beneficiary on or after the death of the designated beneficiary
- Attributable to the designated beneficiary's disability
- Made because a scholarship, allowance, or payment received by the beneficiary to the extent the amount of the 529 distribution did not exceed the amount of the scholarship, allowance, or payment

## ADDITIONAL TAX ON 529 PLANS

P. 363

The 10% additional tax does not apply if the distribution

- Made because of the attendance of the designated beneficiary at an academy listed in I.R.C. § 530(d)(4)(B)(iv) that does not exceed certain costs of advanced education to such attendance
- Includible in income solely because the qualified education expenses were considered in determining education credits.



## COMPARISON OF CREDITS

P. 364

Figure 9.6 provides a quick reference chart to compare the American opportunity tax credit and the lifetime learning credit

## ISSUE 6: HEALTH SAVINGS ACCOUNTS

P. 365

The HSA is a tax-advantaged account established to pay or reimburse medical expenses that are not covered by health insurance

HSAs are not health insurance, even though qualified distributions are made for medical expenses

Subject to certain limits, contributions to HSAs are tax deductible

Employer contributions are excluded from an employee's income

## ISSUE 6: HEALTH SAVINGS ACCOUNTS

P. 365

HSA contributions can grow, tax-free.

Distributions are excluded from taxable income if used for a beneficiary's qualified medical expenses

HSAs are portable

Funds remain available after retirement or job change

## HSA ELIGIBILITY REQUIREMENTS

P. 365

- Enrolled in a qualified high-deductible health plan (HDHP) on the first of the month
- No other health plan that is not an HDHP
- Not enrolled in Medicare
- No individual can claim the TP as a dependent

## HSA ELIGIBILITY REQUIREMENTS

P. 365

Eligibility is generally determined on the first day of each month

- Example: Enrolls in HDHP on October 20, then eligible November 1
- Last Month Rule – If eligible on the first day of the last month (Dec 1), eligible for the entire year. Must remain eligible for all of the following year
- Contributions made during ineligible period are included in gross income
- Subject to 10% additional tax
- **Ex. 9.31 Last Month Rule** – Brenton enrolled 11/1/21, employer coverage began 7/5/22. Not eligible during 13-month test period and qualified for 2 months coverage.

## QUALIFIED HDHP

P. 366

HDHP must meet the following:

- \$1,400 (self-only) or \$2,800 (family) minimum deductible amount
- \$7,050 (self-only) or \$14,100 (family) maximum out-of-pocket limit
- Covers only preventive care and some telehealth services before the individual or family meets the deductible
- Plan coverage cannot be restricted to limited benefits, e.g., vision or dental

## MINIMUM DEDUCTIBLE

P. 366

The HDHP minimum deductible is inflation adjusted annually. If the plan uses a network of providers, the limit does not apply to deductibles for out-of-network services

The HDHP may cover preventive care without a deductible or with a reduced deductible. See list pg 366

Telehealth and remote care type services for plans beginning in Q2, Q3, Q4 2022, subject to limits

## OUT-OF-POCKET LIMITS

P. 366

Out-of-pocket limits are adjusted annually for inflation

Out-of-pocket limits generally include cost share for In-network services, such as deductibles, coinsurance, and copayments

Out-of-pocket limits do not include

- Payments to providers for out-of-network services exceeding an applicable limit
- Payments to providers for noncovered services
- Premiums for insurance coverage, including the HDHP plan



## DISQUALIFYING COVERAGE

P. 367

Common types of disqualifying coverage include:

- Flexible spending accounts (FSAs)
- Standard health reimbursement arrangements (HRAs)
- Coverage under a spouse's or parent's health plan
- Medicare or TRICARE

## HSA MAY ALLOW LIMITED BENEFIT PLANS

P. 367

Limited purpose HRAs covering specific benefits

Hospital care or medical services from the Veteran's Health Admin.

Benefits received from employee wellness, disease mgmt.,  
employee assistance programs not significant in medical care

## HSA MAY ALLOW LIMITED BENEFIT PLANS

P. 367

Insurance that covers liabilities under worker's compensation laws, tort liability, or other similar cases

Insurance providing benefits for a specific illness or disease.

Insurance that pays only a fixed amount per day of hospital care

**Ex. 9.32 Disqualifying Coverage** – Meghan covered by her husband's HRA - disqualified

## CONTRIBUTIONS

P. 367

No joint HSAs

Annual limits are inflation adjusted, if 55 or older \$1,000 additional

If either spouse has family HDHP coverage, both spouses are eligible. Spouses share the \$7,300 limit (\$9,300 if both > 54)

Limits reduced by tax-free employer contributions

## CONTRIBUTIONS

P. 368

Coverage less than 1 year is prorated

Reduced by amount contributed to taxpayer's Archer MSA

### HSA Contribution Limits

	2022	2023
Self-only	\$3,650	\$3,850
Family	\$7,300	\$7,750
Catch-up contributions	\$1,000	\$1,000

## EXCESS CONTRIBUTIONS

P. 368

6% excise tax on excess contributions, unless

- Withdraw the excess contribution by the tax filing deadline, including extensions and
- Withdraw income earned on the withdrawn contributions and include in earnings
- Applies each year the excess contribution remains in the account.

**Observation: No Income Restrictions** – no income limit for the deduction

## EXCESS CONTRIBUTIONS

P. 368

### Contributors

- Individual
- Family member or friend
- Employers directly or through a cafeteria plan

Regardless of who contributes, don't exceed the maximum contribution limit

## ADDITIONAL HSA ISSUES

PP. 368-369

Qualified HSA Funding Distributions – contribute to HSA from IRA

- Must be HSA trustee to IRA trustee
- Cannot exceed taxpayer's contribution limit for the year
- Once during taxpayer's lifetime

Rollovers – HSA to another HSA

Distributions – Tax-free if for qualified medical expenses (see list)



## ADDITIONAL HSA ISSUES

PP. 369-370

**Planning Pointer: Distribution Timing** – make distributions even though not qualified to contribute

Nonqualified Expenses - Included in taxable income and subject to 20% additional tax

- No additional tax if died, disabled, or 65 and older

No joint HSAs, but one spouse's HSA can be used to pay qualified medical expenses of either spouse.

## SPOUSES AND DEPENDENTS

PP. 370-371

Under the Affordable Care Act nondependent adult children can remain on their parents' health insurance until they turn 26

**Ex. 9.33 Adult Child under 26** – Bud can deduct contributions for family coverage

**Practitioner Note: Adult Child with Other Coverage** – not eligible if covered by parent's non-HDHP plan

## TAXPAYERS AGE 65 AND OLDER

P. 371

When the TP enrolls in Medicare, he or she is no longer eligible to contribute to an HSA. Can still take distributions.

Nonqualifying distributions not subject to 20% penalty if taxpayer aged 65 or older

### **Ex. 9.43 Medicare is Disqualifying Coverage**

- Once enrolled in Medicare, Izzy and her employer cannot make contributions to HAS

### **Ex. 9.35 Nonqualified Distribution**

- Roland, age 67, withdrew \$5,700 for personal living expenses, the distribution is subject to income tax, but not the 20% additional tax

## TAXPAYERS AGE 65 AND OLDER CONTINUED

PP. 371-372

- If the TP does not enroll in Medicare, continue to make HSA contributions
- If the TP delays Medicare enrollment, coverage will be retroactively effective by 6 months or to the day the TP turned 65, whichever is shorter
- Retroactive Medicare disqualifies HSA contributions, if a contribution is made, it is subject to the 6% additional tax

## TAXPAYERS AGE 65 AND OLDER CONTINUED

P. 372

- If one spouse is covered by Medicare, and the other not, only the Medicare enrollee is ineligible for an HSA.
- The HSA may cover the medical expenses of both spouses.
- **Example 9.36 Spouses and Medicare** – Ginger is enrolled in Medicare, Gerald is not, Gerald and Ginger can both contribute to Gerald's HSA

## DEATH OF HSA HOLDER

P. 372

If the HSA account holder (owner) names a beneficiary that is the spouse, the surviving spouse is treated as the HSA owner

If the HSA holder names a beneficiary that is not a spouse, the value of the account is included in the beneficiary's income

- Beneficiary can reduce the tax liability by the amount of any qualified medical expenses paid on behalf of the decedent within 1 year of the date of death

If the HSA holder's estate is the beneficiary, the value of the HSA is included in the account holder's final income tax return

## TAX REPORTING

P. 372

Contributions to an HSA are adjustments to gross income

Employer contributions excluded not deducted

Form 8889, Health Savings Accounts

- Separate 8889 for each HSA
- The 20% additional tax for unqualified distributions are calculated on Form 8889
- The 10% additional tax for failing to be an eligible individual is calculated on Form 8889
- The 6% additional tax for excess contributions is calculated on Form 5329, Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-favored Accounts

Questions?