

# Contents Chapter by Chapter

What's New for 2013	xxv
Key Tax Numbers for 2013	xxix
Tax-Saving Opportunities	xxx

## PART 1 FILING BASICS 1

Do You Have to File a 2013 Tax Return?	3
Filing Tests for Dependents: 2013 Returns	4
Where to File	5
Filing Deadlines (on or before)	6
Choosing Which Tax Form to File	8

## Filing Status 9

1.1 Which Filing Status Should You Use?	10
1.2 Tax Rates Based on Filing Status	10
1.3 Filing Separately Instead of Jointly	12
1.4 Filing a Joint Return	13
1.5 Nonresident Alien Spouse	14
1.6 Community Property Rules	15
1.7 Innocent Spouse Rules	16
1.8 Separate Liability Relief for Former Spouses	17
1.9 Equitable Relief	20
1.10 Death of Your Spouse in 2013	21
1.11 Qualifying Widow/Widower Status If Your Spouse Died in 2012 or 2011	22
1.12 Qualifying as Head of Household	22
1.13 Filing for Your Child	24
1.14 Return for Deceased	25
1.15 Return for an Incompetent Person	26
1.16 How a Nonresident Alien Is Taxed	27
1.17 How a Resident Alien Is Taxed	27
1.18 Who Is a Resident Alien?	27
1.19 When an Alien Leaves the United States	30
1.20 Expatriation Tax	30

## PART 2 REPORTING YOUR INCOME 31

### Wages, Salary, and Other Compensation 33

2.1 Salary and Wage Income	36
2.2 Constructive Receipt of Year-End Paychecks	37
2.3 Pay Received in Property Is Taxed	37
2.4 Commissions Taxable When Credited	38
2.5 Unemployment Benefits	38

## Table of Contents

2.6	Strike Pay Benefits and Penalties	39
2.7	Nonqualified Deferred Compensation	39
2.8	Did You Return Wages Received in a Prior Year?	41
2.9	Waiver of Executor's and Trustee's Commissions	41
2.10	Life Insurance Benefits	41
2.11	Educational Benefits for Employees' Children	42
2.12	Sick Pay Is Taxable	43
2.13	Workers' Compensation Is Tax Free	43
2.14	Disability Pensions	44
2.15	Stock Appreciation Rights (SARs)	45
2.16	Stock Options	45
2.17	Restricted Stock	48

---

### **Fringe Benefits** **50**

3.1	Tax-Free Health and Accident Coverage Under Employer Plans	52
3.2	Health Savings Accounts (HSAs) and Archer MSAs	52
3.3	Reimbursements and Other Tax-Free Payments From Employer Health and Accident Plans	54
3.4	Group-Term Life Insurance Premiums	57
3.5	Dependent Care Assistance	59
3.6	Adoption Benefits	59
3.7	Education Assistance Plans	60
3.8	Company Cars, Parking, and Transit Passes	60
3.9	Working Condition Fringe Benefits	62
3.10	De Minimis Fringe Benefits	63
3.11	Employer-Provided Retirement Advice	64
3.12	Employee Achievement Awards	64
3.13	Employer-Furnished Meals or Lodging	64
3.14	Minister's Rental or Housing Allowance	67
3.15	Cafeteria Plans Provide Choice of Benefits	68
3.16	Flexible Spending Arrangements	68
3.17	Company Services Provided at No Additional Cost	70
3.18	Discounts on Company Products or Services	71

---

### **Dividend and Interest Income** **72**

4.1	Reporting Dividends and Mutual-Fund Distributions	73
4.2	Qualified Corporate Dividends Taxed at Favorable Capital Gain Rates	74
4.3	Dividends From a Partnership, S Corporation, Estate, or Trust	75
4.4	Real Estate Investment Trust (REIT) Dividends	75
4.5	Taxable Dividends of Earnings and Profits	76
4.6	Stock Dividends on Common Stock	76
4.7	Dividends Paid in Property	76
4.8	Taxable Stock Dividends	77
4.9	Who Reports the Dividends	77
4.10	Year Dividends Are Reported	78
4.11	Distribution Not Out of Earnings: Return of Capital	78

4.12	Reporting Interest on Your Tax Return	79
4.13	Interest on Frozen Accounts Not Taxed	80
4.14	Interest Income on Debts Owed to You	80
4.15	Reporting Interest on Bonds Bought or Sold	81
4.16	Forfeiture of Interest on Premature Withdrawals	82
4.17	Amortization of Bond Premium	82
4.18	Discount on Bonds	83
4.19	Reporting Original Issue Discount on Your Return	84
4.20	Reporting Income on Market Discount Bonds	85
4.21	Discount on Short-Term Obligations	86
4.22	Stripped Coupon Bonds and Stock	87
4.23	Sale or Retirement of Bonds and Notes	88
4.24	State and City Interest Generally Tax Exempt	88
4.25	Taxable State and City Interest	89
4.26	Tax-Exempt Bonds Bought at a Discount	89
4.27	Treasury Bills, Notes, and Bonds	90
4.28	Interest on United States Savings Bonds	91
4.29	Deferring United States Savings Bond Interest	92
4.30	Minimum Interest Rules	93
4.31	Interest-Free or Below-Market-Interest Loans	93
4.32	Minimum Interest on Seller-Financed Sales	95

---

## Reporting Property Sales

		<b>97</b>
5.1	General Tax Rules for Property Sales	98
5.2	How Property Sales Are Classified and Taxed	98
5.3	Capital Gains Rates and Holding Periods	99
5.4	Capital Losses and Carryovers	103
5.5	Capital Losses of Married Couples	103
5.6	Losses May Be Disallowed on Sales to Related Persons	104
5.7	Deferring or Excluding Gain on Small Business Stock Investment	105
5.8	Sample Entries of Capital Asset Sales on Form 8949 and on Schedule D	106
5.9	Counting the Months in Your Holding Period	113
5.10	Holding Period for Securities	113
5.11	Holding Period for Real Estate	114
5.12	Holding Period: Gifts, Inheritances, and Other Property	114
5.13	Calculating Gain or Loss	115
5.14	Amount Realized Is the Total Selling Price	116
5.15	Finding Your Cost	116
5.16	Unadjusted Basis of Your Property	116
5.17	Basis of Property You Inherited or Received as a Gift	118
5.18	Joint Tenancy Basis Rules for Surviving Tenants	120
5.19	Allocating Cost Among Several Assets	122
5.20	How To Find Adjusted Basis	123
5.21	Tax Advantage of Installment Sales	124
5.22	Figuring the Taxable Part of Installment Payments	125

5.23	Electing Not To Report on the Installment Method	128
5.24	Restriction on Installment Sales to Relatives	128
5.25	Contingent Payment Sales	129
5.26	Using Escrow and Other Security Arrangements	130
5.27	Minimum Interest on Deferred Payment Sales	131
5.28	Dispositions of Installment Notes	131
5.29	Repossession of Personal Property Sold on Installment	132
5.30	Boot in Like-Kind Exchange Payable in Installments	133
5.31	“Interest” Tax on Sales Over \$150,000 Plus \$5 Million Debt	134
5.32	Worthless Securities	134
5.33	Tax Consequences of Bad Debts	135
5.34	Four Rules To Prove a Bad Debt Deduction	137
5.35	Family Bad Debts	137
<hr/>		
<b>Tax-Free Exchanges of Property</b>		<b>139</b>
6.1	Trades of Like-Kind Property	140
6.2	Personal Property Held for Business or Investment	141
6.3	Receipt of Cash and Other Property—“Boot”	142
6.4	Time Limits and Security Arrangements for Deferred Exchanges	144
6.5	Qualified Exchange Accommodation Arrangements (QEAs) for Reverse Exchanges	147
6.6	Exchanges Between Related Parties	148
6.7	Property Transfers Between Spouses and Ex-Spouses	148
6.8	Tax-Free Exchanges of Stock in Same Corporation	151
6.9	Joint Ownership Interests	151
6.10	Setting up Closely Held Corporations	151
6.11	Exchanges of Coins and Bullion	152
6.12	Tax-Free Exchanges of Insurance Policies	152
<hr/>		
<b>Retirement and Annuity Income</b>		<b>154</b>
7.1	Retirement Distributions on Form 1099-R	156
7.2	Lump-Sum Distributions	158
7.3	Lump-Sum Options If You Were Born Before January 2, 1936	159
7.4	Averaging on Form 4972	159
7.5	Capital Gain Treatment for Pre-1974 Participation	161
7.6	Lump-Sum Payments Received by Beneficiary	161
7.7	Tax-Free Rollovers From Qualified Plans	162
7.8	Direct Rollover or Personal Rollover	163
7.9	Rollover of Proceeds From Sale of Property	166
7.10	Distribution of Employer Stock or Other Securities	166
7.11	Survivor Annuity for Spouse	167
7.12	Court Distributions to Former Spouse Under a QDRO	168
7.13	When Retirement Benefits Must Begin	169
7.14	Payouts to Beneficiaries	169
7.15	Penalty for Distributions Before Age 59½	170

7.16	Restrictions on Loans From Company Plans	172
7.17	Tax Benefits of 401(k) Plans	173
7.18	Limit on Salary-Reduction Deferrals	174
7.19	Withdrawals From 401(k) Plans Restricted	175
7.20	Designated Roth Contributions to 401(k) Plans	176
7.21	Annuities for Employees of Tax-Exempts and Schools (403(b) Plans)	176
7.22	Government and Exempt Organization Deferred Pay Plans	178
7.23	Figuring the Taxable Part of Your Annuity	178
7.24	Life Expectancy Tables	183
7.25	When You Convert Your Endowment Policy	184
7.26	Reporting Employee Annuities	184
7.27	Simplified Method for Calculating Taxable Employee Annuity	185
7.28	Employee's Cost in Annuity	187
7.29	Withdrawals From Employer's Qualified Retirement Plan Before Annuity Starting Date	187

---

**IRAs**
**188**

8.1	Starting a Traditional IRA	189
8.2	Traditional IRA Contributions Must Be Based on Earnings	190
8.3	Contributions to a Traditional IRA If You Are Married	191
8.4	IRA Deduction Restrictions for Active Participants in Employer Plan	193
8.5	Active Participation in Employer Plan	196
8.6	Nondeductible Contributions to Traditional IRAs	197
8.7	Penalty for Excess Contributions to Traditional IRAs	198
8.8	Taxable Distributions From Traditional IRAs	198
8.9	Partially Tax-Free Traditional IRA Distributions Allocable to Nondeductible Contributions	200
8.10	Tax-Free Rollovers and Direct Transfers to Traditional IRAs	202
8.11	Transfer of Traditional IRA to Spouse at Divorce	204
8.12	Penalty for Traditional IRA Withdrawals Before Age 59½	204
8.13	Mandatory Distributions From a Traditional IRA After Age 70½	208
8.14	Inherited Traditional IRAs	211
8.15	SEP Basics	217
8.16	Salary-Reduction SEP Set Up Before 1997	217
8.17	Who Is Eligible for a SIMPLE IRA?	218
8.18	SIMPLE IRA Contributions and Distributions	218
8.19	Roth IRA Advantages	219
8.20	Annual Contributions to a Roth IRA	220
8.21	Converting a Traditional IRA to a Roth IRA	221
8.22	Recharacterizations and Reconversions	222
8.23	Distributions From a Roth IRA	224
8.24	Distributions to Roth IRA Beneficiaries	226

<b>Income From Real Estate Rentals and Royalties</b>	<b>227</b>
9.1 Reporting Rental Real Estate Income and Expenses	228
9.2 Checklist of Rental Deductions	229
9.3 Distinguishing Between a Repair and an Improvement	230
9.4 Reporting Rents From a Multi-Unit Residence	231
9.5 Depreciation on Converting a Home to Rental Property	232
9.6 Renting a Residence to a Relative	234
9.7 Personal Use and Rental of a Residence During the Year	234
9.8 Counting Personal-Use Days and Rental Days for a Residence	235
9.9 Allocating Expenses of a Residence to Rental Days	236
9.10 Rentals Lacking Profit Motive	238
9.11 Reporting Royalty Income	240
9.12 Production Costs of Books and Creative Properties	240
9.13 Deducting the Cost of Patents or Copyrights	240
9.14 Intangible Drilling Costs	241
9.15 Depletion Deduction	241
9.16 Oil and Gas Percentage Depletion	242
<b>Loss Restrictions: Passive Activities and At-Risk Limits</b>	<b>244</b>
10.1 Rental Activities	245
10.2 Rental Real Estate Loss Allowance of up to \$25,000	247
10.3 Real Estate Professionals	250
10.4 Participation May Avoid Passive Loss Restrictions	252
10.5 Classifying Business Activities as One or Several	253
10.6 Material Participation Tests for Business	254
10.7 Tax Credits of Passive Activities Limited	256
10.8 Determining Passive or Nonpassive Income and Loss	257
10.9 Passive Income Recharacterized as Nonpassive Income	259
10.10 Working Interests in Oil and Gas Wells	261
10.11 Partners and Members of LLCs and LLPs	261
10.12 Form 8582	262
10.13 Suspended Losses Allowed on Disposition of Your Interest	263
10.14 Suspended Tax Credits	265
10.15 Personal Service and Closely Held Corporations	265
10.16 Sales of Property and of Passive Activity Interests	266
10.17 At-Risk Limits	267
10.18 What Is At Risk?	268
10.19 Amounts Not At Risk	269
10.20 At-Risk Investment in Several Activities	271
10.21 Carryover of Disallowed Losses	271
10.22 Recapture of Losses Where At Risk Is Less Than Zero	271
<b>Other Income</b>	<b>272</b>
11.1 Prizes and Awards	273
11.2 Lottery and Sweepstake Winnings	273
11.3 Gambling Winnings and Losses	273

11.4	Gifts and Inheritances	275
11.5	Refunds of State and Local Income Tax Deductions	275
11.6	Other Recovered Deductions	278
11.7	How Legal Damages Are Taxed	279
11.8	Cancellation of Debts You Owe	281
11.9	Schedule K-1	285
11.10	How Partners Report Partnership Profit and Loss	285
11.11	When a Partner Reports Income or Loss	287
11.12	Partnership Loss Limitations	287
11.13	Unified Tax Audits of Partnerships	287
11.14	Stockholder Reporting of S Corporation Income and Loss	288
11.15	How Beneficiaries Report Estate or Trust Income	289
11.16	Reporting Income in Respect of a Decedent (IRD)	289
11.17	Deduction for Estate Tax Attributable to IRD	289
11.18	How Life Insurance Proceeds Are Taxed to a Beneficiary	290
11.19	A Policy With a Family Income Rider	291
11.20	Selling or Surrendering Life Insurance Policy	291
11.21	Jury Duty Fees	292
11.22	Foster Care Payments	292

**PART 3 CLAIMING DEDUCTIONS****293****Deductions Allowed in Figuring Adjusted Gross Income 295**

12.1	Figuring Adjusted Gross Income (AGI)	296
12.2	Claiming Deductions From Gross Income	296
12.3	What Moving Costs Are Deductible?	299
12.4	The Distance Test	300
12.5	The 39-Week Test for Employees	301
12.6	The 78-Week Test for the Self-Employed and Partners	302
12.7	Claiming Deductible Moving Expenses	302
12.8	Reimbursements of Moving Expenses	303

**Claiming the Standard Deduction or Itemized Deductions 304**

13.1	Claiming the Standard Deduction	306
13.2	When To Itemize	307
13.3	Husbands and Wives Filing Separate Returns	307
13.4	Standard Deduction If 65 or Older or Blind	308
13.5	Standard Deduction for Dependents	309
13.6	Prepaying or Postponing Itemized Expenses	310
13.7	Itemized Deductions Reduced for Higher-Income Taxpayers	310

**Charitable Contribution Deductions 312**

14.1	Deductible Contributions	313
14.2	Nondeductible Contributions	314
14.3	Contributions That Provide You With Benefits	315
14.4	Unreimbursed Expenses of Volunteer Workers	317

## Table of Contents

14.5	Support of a Student in Your Home	318
14.6	What Kind of Property Are You Donating?	318
14.7	Cars, Clothing, and Other Property Valued Below Cost	322
14.8	Bargain Sales of Appreciated Property	323
14.9	Art Objects	324
14.10	Interests in Real Estate	326
14.11	Life Insurance	327
14.12	Business Inventory	328
14.13	Donations Through Trusts	328
14.14	Records Needed To Substantiate Your Contributions	329
14.15	Form 8283 and Written Appraisal Requirements for Property Donations	330
14.16	Penalty for Substantial Overvaluation of Property	332
14.17	Ceiling on Charitable Contributions	332
14.18	Carryover for Excess Donations	335
14.19	Election To Reduce Fair Market Value by Appreciation	335

---

### **Itemized Deduction for Interest Expenses** **336**

15.1	Home Mortgage Interest	337
15.2	Home Acquisition Loans	338
15.3	Home Equity Loans	340
15.4	Home Construction Loans	340
15.5	Home Improvement Loans	342
15.6	Mortgage Insurance Premiums and Other Payment Rules	342
15.7	Interest on Refinanced Loans	343
15.8	“Points”	344
15.9	Cooperative and Condominium Apartments	346
15.10	Investment Interest Limitations	346
15.11	Debts To Carry Tax-Exempt Obligations	348
15.12	Earmarking Use of Loan Proceeds For Investment or Business	348
15.13	Year To Claim an Interest Deduction	350
15.14	Prepaid Interest	351

---

### **Deductions for Taxes** **352**

16.1	Deductible Taxes	353
16.2	Nondeductible Taxes	354
16.3	State and Local Income Taxes or General Sales Taxes	354
16.4	Deducting Real Estate Taxes	355
16.5	Assessments	356
16.6	Tenants’ Payment of Taxes	356
16.7	Allocating Taxes When You Sell or Buy Realty	356
16.8	Automobile License Fees	357
16.9	Taxes Deductible as Business Expenses	358
16.10	Foreign Taxes	358

<b>Medical and Dental Expense Deductions</b>	<b>359</b>
17.1 Medical Expenses Must Exceed AGI Threshold	360
17.2 Allowable Medical Care Costs	360
17.3 Premiums for Health Insurance	364
17.4 Nondeductible Medical Expenses	365
17.5 Reimbursements Reduce Deductible Expenses	365
17.6 Expenses of Your Spouse	367
17.7 Expenses of Your Dependents	368
17.8 Decedent's Medical Expenses	369
17.9 Travel Costs May Be Medical Deductions	370
17.10 Schooling for the Mentally or Physically Disabled	371
17.11 Nursing Homes	372
17.12 Nurses' Wages	373
17.13 Home Improvements as Medical Expenses	373
17.14 Costs Deductible as Business Expenses	375
17.15 Long-Term Care Premiums and Services	375
17.16 Life Insurance Used by Chronically ill or Terminally ill Persons	376
<b>Casualty and Theft Losses and Involuntary Conversions</b>	<b>377</b>
18.1 Sudden Event Test for Casualty Losses	378
18.2 When to Deduct a Casualty Loss	380
18.3 Disaster Losses	381
18.4 Who May Deduct a Casualty Loss	383
18.5 Bank Deposit Losses	384
18.6 Damage to Trees and Shrubs	385
18.7 Deducting Damage to Your Car	386
18.8 Proving a Casualty Loss	386
18.9 Theft Losses	387
18.10 Proving a Theft Loss	388
18.11 Nondeductible Casualty and Theft Losses	388
18.12 Floors for Personal-Use Property Losses	389
18.13 Figuring Your Loss on Form 4684	390
18.14 Personal and Business Use of Property	392
18.15 Repairs May Be a "Measure of Loss"	393
18.16 Insurance Reimbursements	393
18.17 Excess Living Costs Paid by Insurance Are Not Taxable	394
18.18 Do Your Casualty or Theft Losses Exceed Your Income?	395
18.19 Defer Gain by Replacing Property	395
18.20 Involuntary Conversions Qualifying for Tax Deferral	395
18.21 How To Elect To Defer Tax	396
18.22 Time Period for Buying Replacement Property	397
18.23 Types of Qualifying Replacement Property	398
18.24 Cost of Replacement Property Determines Postponed Gain	399
18.25 Special Assessments and Severance Damages	400
18.26 Reporting Gains From Casualties	400

<b>Deducting Job Costs and Other Miscellaneous Expenses</b>	<b>401</b>
19.1 2% AGI Floor Reduces Most Miscellaneous Expenses	402
19.2 Effect of 2% AGI Floor on Deductions	403
19.3 Checklist of Job Expenses Subject to the 2% AGI Floor	403
19.4 Job Expenses Not Subject to the 2% AGI Floor	404
19.5 Dues and Subscriptions	404
19.6 Uniforms and Work Clothes	405
19.7 Expenses of Looking for a New Job	406
19.8 Local Transportation Costs	407
19.9 Unusual Job Expenses	407
19.10 Computers Bought for Work	408
19.11 Cell Phones, Calculators, Copiers and Fax Machines	409
19.12 Small Tools	409
19.13 Employee Home Office Deductions	409
19.14 Telephone Costs	410
19.15 Checklist of Deductible Investment Expenses	410
19.16 Costs of Tax Return Preparation and Audits	412
19.17 Deducting Legal Costs	413
19.18 Contingent Fees Paid Out of Taxable Awards	414
<b>Travel and Entertainment Expense Deductions</b>	<b>415</b>
20.1 Deduction Guide for Travel and Transportation Expenses	416
20.2 Contracting Expenses	416
20.3 Overnight-Sleep Test Limits Deduction of Meal Costs	417
20.4 IRS Meal Allowance	419
20.5 Business Trip Deductions	420
20.6 Local Lodging Costs	421
20.7 When Are You Away From Home?	421
20.8 Fixing a Tax Home If You Work in Different Locations	422
20.9 Tax Home of Married Couple Working in Different Cities	423
20.10 Deducting Living Costs on Temporary Assignment	423
20.11 Business-Vacation Trips Within the United States	425
20.12 Business-Vacation Trips Outside the United States	425
20.13 Deducting Expenses of Business Conventions	426
20.14 Travel Expenses of a Spouse or Dependents	428
20.15 Restrictions on Foreign Conventions and Cruises	428
20.16 50% Deduction Limit	428
20.17 The Restrictive Tests for Meals and Entertainment	429
20.18 Directly Related Dining and Entertainment	429
20.19 Goodwill Entertainment	430
20.20 Home Entertaining	430
20.21 Your Personal Share of Entertainment Costs	430
20.22 Entertainment Costs of Spouses	430
20.23 Entertainment Facilities and Club Dues	430
20.24 Restrictive Test Exception for Reimbursements	431
20.25 50% Cost Limitation on Meals and Entertainment	431
20.26 Business Gift Deductions Are Limited	433

20.27	Record-Keeping Requirements	434
20.28	Proving Travel and Entertainment Expenses	434
20.29	Reporting T&E Expenses If You Are Self-Employed	435
20.30	Employee Reporting of Unreimbursed T&E Expenses	435
20.31	Tax Treatment of Reimbursements	435
20.32	What Is an Accountable Plan?	436
20.33	<i>Per Diem</i> Travel Allowance Under Accountable Plans	437
20.34	Automobile Mileage Allowance	439
20.35	Reimbursements Under Non-Accountable Plans	440

---

## **Personal Exemptions** **441**

21.1	How Many Exemptions May You Claim?	442
21.2	Your Spouse as an Exemption	443
21.3	Qualifying Children	443
21.4	Qualifying Relatives	445
21.5	Meeting the Support Test for a Qualifying Relative	447
21.6	Multiple Support Agreements	450
21.7	Special Rule for Divorced or Separated Parents	451
21.8	The Dependent Must Meet a Citizen or Resident Test	452
21.9	The Dependent Does Not File a Joint Return	452
21.10	Spouses' Names and Social Security Numbers on Joint Return	452
21.11	Reporting Social Security Numbers of Dependents	453
21.12	Phaseout of Personal Exemptions	453

---

## **PART 4 PERSONAL TAX COMPUTATIONS** **455**

### **Figuring Your Regular Income Tax Liability** **457**

22.1	Taxable Income and Regular Income Tax Liability	458
22.2	Using the Tax Table	458
22.3	Tax Computation Worksheet	459
22.4	Tax Calculation If You Have Net Capital Gain or Qualified Dividends	459
22.5	Foreign Earned Income Tax Worksheet	459
22.6	Income Averaging for Farmers and Fishermen	459
22.7	Tax Credits	460
22.8	Additional Medicare Taxes.	460

---

### **Alternative Minimum Tax (AMT)** **461**

23.1	Computing Alternative Minimum Tax on Form 6251	462
23.2	Adjustments and Preferences for AMT	464
23.3	Tax Credits Allowed Against AMT	467
23.4	AMT Tax Credit From Regular Tax	468
23.5	Avoiding AMT	468

<b>Computing the “Kiddie Tax” on Your Child’s Investment Income</b>	<b>469</b>
24.1 Filing Your Child’s Return	470
24.2 Children Subject to “Kiddie Tax” for 2013	471
24.3 Computing “Kiddie Tax” on Child’s Return	472
24.4 Parent’s Election To Report Child’s Dividends and Interest	473
<b>Personal Tax Credits Reduce Your Tax Liability</b>	<b>475</b>
25.1 Overview of Personal Tax Credits	476
25.2 Child Tax Credit for Children Under Age 17	476
25.3 Figuring the Child Tax Credit	477
25.4 Qualifying for Child and Dependent Care Credit	478
25.5 Limits on the Dependent Care Credit	478
25.6 Earned Income Test for Dependent Care Credit	480
25.7 Credit Allowed for Care of Qualifying Persons	480
25.8 Expenses Qualifying for the Dependent Care Credit	481
25.9 Dependent Care Credit Rules for Separated Couples	482
25.10 Qualifying Tests for EIC	482
25.11 Income Tests for Earned Income Credit (EIC)	484
25.12 Look up EIC in Government Tables	485
25.13 Qualifying for the Adoption Credit	485
25.14 Claiming the Adoption Credit on Form 8839	485
25.15 Eligibility for the Saver’s Credit	486
25.16 Figuring the Saver’s Credit	487
25.17 Health Coverage Credit	487
25.18 Mortgage Interest Credit	488
25.19 Residential Energy Credits	488
25.20 Credits for Fuel Cell Vehicles and Plug-in Electric Vehicles	489
25.21 Repayment of the First-Time Homebuyer Credit	490
<b>Tax Withholdings</b>	<b>491</b>
26.1 Withholdings Should Cover Estimated Tax	492
26.2 Income Taxes Withheld on Wages	492
26.3 Low Earners May Be Exempt From Withholding	493
26.4 Are You Withholding the Right Amount?	493
26.5 Voluntary Withholding on Government Payments	494
26.6 When Tips Are Subject to Withholding	494
26.7 Withholding on Gambling Winnings	495
26.8 FICA Withholdings	495
26.9 Withholding on Retirement Distributions	496
26.10 Backup Withholding	497
<b>Estimated Tax Payments</b>	<b>498</b>
27.1 Do You Owe an Estimated Tax Penalty for 2013?	499
27.2 Planning Estimated Tax Payments for 2014	500
27.3 Dates for Paying Estimated Tax Installments for 2014	501

27.4	Estimates by Husband and Wife	502
27.5	Adjusting Your Payments During the Year	503
<b>Additional Medicare Taxes</b>		<b>504</b>
28.1	Additional Medicare Taxes Take Effect in 2013	505
28.2	Additional 0.9% Medicare Tax on Earnings	505
28.3	Additional 3.8% Medicare Tax on Net Investment Income	507
<b>PART 5 TAX PLANNING</b>		<b>511</b>
<b>Tax Savings for Residence Sales</b>		<b>513</b>
29.1	Avoiding Tax on Sale of Principal Residence	514
29.2	Meeting the Ownership and Use Tests	515
29.3	Home Sales by Married Persons	518
29.4	Reduced Maximum Exclusion	519
29.5	Figuring Gain or Loss	522
29.6	Figuring Adjusted Basis	523
29.7	Personal and Business Use of a Home	523
29.8	No Loss Allowed on Personal Residence	524
29.9	Loss on Residence Converted to Rental Property	526
29.10	Loss on Residence Acquired by Gift or Inheritance	527
<b>Tax Rules for Investors in Securities</b>		<b>528</b>
30.1	Planning Year-End Securities Transactions	529
30.2	Earmarking Stock Lots	529
30.3	Sale of Stock Dividends	530
30.4	Stock Rights	530
30.5	Short Sales of Stock	531
30.6	Wash Sales	533
30.7	Convertible Stocks and Bonds	535
30.8	Constructive Sales of Appreciated Financial Positions	535
30.9	Straddle Losses	536
30.10	Capital Gain Restricted on Conversion Transactions	539
30.11	Puts and Calls and Index Options	539
30.12	Investing in Tax-Exempts	540
30.13	Ordinary Loss for Small Business Stock (Section 1244)	541
30.14	Series EE Bonds	541
30.15	I Bonds	543
30.16	Trader, Dealer, or Investor?	543
30.17	Mark-to-Market Election for Traders	544
<b>Tax Savings for Investors in Real Estate</b>		<b>546</b>
31.1	Real Estate Ventures	547
31.2	Sales of Subdivided Land—Dealer or Investor?	548
31.3	Exchanging Real Estate Without Tax	549
31.4	Timing Your Real Property Sales	550

## Table of Contents

31.5	Cancellation of a Lease	550
31.6	Sale of an Option	551
31.7	Granting of an Easement	551
31.8	Special Tax Credits for Real Estate Investments	552
31.9	Foreclosures, Repossessions, Short Sales, and Voluntary Conveyances to Creditors	553
31.10	Restructuring Mortgage Debt	554
31.11	Abandonments	555
31.12	Seller's Repossession After Buyer's Default on Mortgage	556
31.13	Foreclosure on Mortgages Other Than Purchase Money	557
31.14	Foreclosure Sale to Third Party	558
31.15	Transferring Mortgaged Realty	558

---

### **Tax Rules for Investors in Mutual Funds** **559**

32.1	Timing of Your Investment Can Affect Your Taxes	560
32.2	Reinvestment Plans	560
32.3	Mutual-Fund Distributions Reported on Form 1099-DIV	560
32.4	Tax-Exempt Bond Funds	561
32.5	Fund Expenses	561
32.6	Tax Credits From Mutual Funds	561
32.7	How To Report Mutual Fund Distributions	563
32.8	Redemptions and Exchanges of Fund Shares	563
32.9	Basis of Redeemed Shares	563
32.10	Comparison of Basis Methods	565

---

### **Educational Tax Benefits** **567**

33.1	Scholarships and Grants	568
33.2	Tuition Reductions for College Employees	568
33.3	How Fulbright Awards Are Taxed	568
33.4	United States Savings Bond Tuition Plans	568
33.5	Contributing to a Qualified Tuition Program (Section 529 Plan)	570
33.6	Distributions From Qualified Tuition Programs (Section 529 Plans)	570
33.7	Education Tax Credits	572
33.8	American Opportunity Credit	573
33.9	Lifetime Learning Credit	574
33.10	Contributing to a Coverdell Education Savings Account (ESA)	575
33.11	Distributions From Coverdell ESAs	576
33.12	Tuition and Fees Deduction	578
33.13	Student Loan Interest Deduction	579
33.14	Types of Deductible Work-Related Costs	580
33.15	Work-Related Tests for Education Costs	581
33.16	Local Transportation and Travel Away From Home To Take Courses	583

<b>Special Tax Rules for Senior Citizens</b>	<b>585</b>
34.1 Senior Citizens Get Certain Filing Breaks	586
34.2 Social Security Benefits Subject to Tax	586
34.3 Computing Taxable Social Security Benefits	588
34.4 Election for Lump-Sum Social Security Benefit Payment	588
34.5 Retiring on Social Security Benefits	589
34.6 How Tax on Social Security Reduces Your Earnings	589
34.7 Claiming the Credit for the Elderly or the Disabled	590
34.8 Base Amount for the Elderly or Disabled Credit	591
34.9 Reduction of the Base Amount and Liability Limitation for the Credit	591
34.10 Tax Effects of Moving to a Continuing Care Facility	592
34.11 Medicare Part B and Part D Premiums for 2014	593
<b>Members of the Armed Forces</b>	<b>594</b>
35.1 Taxable Armed Forces Pay and Benefits	595
35.2 Tax Breaks for Armed Forces Members	595
35.3 Deductions for Armed Forces Personnel	597
35.4 Tax-Free Pay for Service in Combat Zone	597
35.5 Tax Deadlines Extended for Combat Zone or Contingency Operation Service	598
35.6 Tax Forgiveness for Combat Zone or Terrorist or Military Action Deaths	599
35.7 Extension To Pay Your Tax When Entering the Service	599
35.8 Tax Information for Reservists	600
<b>How To Treat Foreign Earned Income</b>	<b>601</b>
36.1 Claiming the Foreign Earned Income Exclusion	602
36.2 What Is Foreign Earned Income?	602
36.3 Qualifying for the Foreign Earned Income Exclusion	604
36.4 How To Treat Housing Costs	605
36.5 Meeting the Foreign Residence or Physical Presence Test	606
36.6 Claiming Deductions	608
36.7 Exclusion Not Established When Your Return Is Due	608
36.8 Tax-Free Meals and Lodging for Workers in Camps	609
36.9 U. S. Virgin Islands, Samoa, Guam, and Northern Marianas	609
36.10 Earnings in Puerto Rico	609
36.11 Tax Treaties With Foreign Countries	610
36.12 Exchange Rates and Blocked Currency	610
36.13 Foreign Tax Credit or Deduction	610
<b>Planning Alimony and Marital Settlements</b>	<b>612</b>
37.1 Planning Alimony Agreements	613
37.2 Decree or Agreement Required	613
37.3 Cash Payments Required	615
37.4 Payments Must Stop at Death	615

37.5	Child Support Payments Are Not Alimony	616
37.6	No Minimum Payment Period for Alimony	617
37.7	3rd Year Recapture If Alimony Drops by More Than \$15,000	617
37.8	Legal Fees of Marital Settlements	618

---

## **Household Employment Taxes (“Nanny Tax”) 619**

38.1	Who Is a Household Employee?	620
38.2	Social Security and Medicare (FICA) Taxes for Household Employees	620
38.3	Filing Schedule H To Report Household Employment Taxes	621
38.4	Federal Unemployment Taxes (FUTA) for Household Employees	623

---

## **Gift and Estate Tax Planning Basics 624**

39.1	Gifts of Appreciated Property	625
39.2	Gift Tax Basics	625
39.3	Filing a Gift Tax Return	626
39.4	Gift Tax Credit	626
39.5	Custodial Accounts for Minors	626
39.6	Trusts in Family Planning	627
39.7	What is the Estate Tax?	628
39.8	Take Inventory and Estimate the Value of Your Potential Estate	628
39.9	Estate Tax for 2013	629
39.10	Planning for a Potential Estate Tax	630

---

## **PART 6 BUSINESS TAX PLANNING 633**

### **Income or Loss From Your Business or Profession 635**

40.1	Forms of Doing Business	636
40.2	Reporting Self-Employed Income	636
40.3	Accounting Methods for Reporting Business Income	638
40.4	Tax Reporting Year for Self-Employed	640
40.5	Reporting Certain Payments and Receipts to the IRS	640
40.6	Filing Schedule C	641
40.7	Deductions for Professionals	645
40.8	Nondeductible Expense Items	646
40.9	How Authors and Artists May Write Off Expenses	647
40.10	Deducting Expenses of a Sideline Business or Hobby	647
40.11	Deducting Expenses of Looking for a New Business	648
40.12	Home Office Deduction	649
40.13	Write-Off Methods	652
40.14	Allocating Expenses to Business Use	653
40.15	Business Income May Limit Home Office Deductions	653
40.16	Home Office for Sideline Business	654
40.17	Depreciation of Office in Cooperative Apartment	656
40.18	Net Operating Losses (NOLs)	656

40.19	Your Net Operating Loss	657
40.20	How To Report a Net Operating Loss	657
40.21	How To Carry Back Your Net Operating Loss	658
40.22	Election To Carry Forward Losses	659
40.23	Overview of the Domestic Production Activities Deduction	659
40.24	Qualified Production Activities	659
40.25	Figuring the Deduction	660
40.26	Business Credits	660
40.27	Filing Schedule F	661
40.28	Farming Expenses	662

---

## **Retirement and Medical Plans for Self-Employed** **663**

41.1	Overview of Retirement and Medical Plans	664
41.2	Choosing a Keogh Plan	664
41.3	Choosing a SEP	665
41.4	Deductible Keogh or SEP Contributions	665
41.5	How To Claim the Keogh or SEP Deduction	668
41.6	How To Qualify a Keogh Plan or SEP Plan	668
41.7	Annual Keogh Plan Return	668
41.8	How Keogh Plan Distributions Are Taxed	669
41.9	SIMPLE IRA Plans	669
41.10	Health Savings Account (HSA) Basics	669
41.11	Limits on Deductible HSA Contributions	670
41.12	Distributions From HSAs	670
41.13	Archer MSAs	671
41.14	Small Business Health Tax Credit	672

---

## **Claiming Depreciation Deductions** **673**

42.1	What Property May Be Depreciated?	674
42.2	Claiming Depreciation on Your Tax Return	675
42.3	First-Year Expensing Deduction	675
42.4	MACRS Recovery Periods	677
42.5	MACRS Rates	678
42.6	Half-Year Convention for MACRS	680
42.7	Last Quarter Placements—Mid-Quarter Convention	680
42.8	150% Rate Election	681
42.9	Straight-Line Depreciation	681
42.10	Computers and Other Listed Property	682
42.11	Assets in Service Before 1987	684
42.12	MACRS for Real Estate Placed in Service After 1986	684
42.13	Demolishing a Building	686
42.14	Leasehold Improvements	686
42.15	Depreciating Real Estate Placed in Service After 1980 and Before 1987	686
42.16	When MACRS Is Not Allowed	686
42.17	Amortizing Goodwill and Other Intangibles (Section 197)	687
42.18	Deducting the Cost of Computer Software	688

42.19	Amortizing Song Rights	688
42.20	Bonus Depreciation	689

---

## **Deducting Car and Truck Expenses** **690**

43.1	Standard Mileage Rate	691
43.2	Expense Allocations	693
43.3	Depreciation Restrictions on Cars, Trucks, and Vans	693
43.4	Annual Ceilings on Depreciation	694
43.5	MACRS Rates for Cars, Trucks, and Vans	695
43.6	Straight-Line Method	699
43.7	Depreciation for Year Vehicle Is Disposed Of	700
43.8	Depreciation After Recovery Period Ends	701
43.9	Trade-in of Business Vehicle	701
43.10	Recapture of Deductions on Business Car, Truck, or Van	702
43.11	Keeping Records of Business Use	703
43.12	Leased Business Vehicles: Deductions and Income	703

---

## **Sales of Business Property** **704**

44.1	Depreciation Recaptured as Ordinary Income on Sale of Personal Property	705
44.2	Depreciation Recaptured as Ordinary Income on Sale of Real Estate	705
44.3	Recapture of First-Year Expensing	706
44.4	Gifts and Inheritances of Depreciable Property	706
44.5	Involuntary Conversions and Tax-Free Exchanges	707
44.6	Installment Sale of Depreciable Property	707
44.7	Sale of a Proprietorship	707
44.8	Property Used in a Business (Section 1231 Assets)	707
44.9	Sale of Property Used for Business and Personal Purposes	708
44.10	Should You Trade in Business Equipment?	709
44.11	Corporate Liquidation	709
44.12	Additional Medicare Taxes	710

---

## **Figuring Self-Employment Tax** **711**

45.1	What Is Self-Employment Income?	712
45.2	Partners Pay Self-Employment Tax	713
45.3	Schedule SE	714
45.4	How Wages Affect Self-Employment Tax	715
45.5	Optional Method If 2013 Was a Low-Income or Loss Year	716
45.6	Self-Employment Tax Rules for Certain Positions	717

---

## **PART 7 FILING YOUR RETURN AND WHAT HAPPENS AFTER YOU FILE** **719**

### **Filing Your Return** **721**

46.1	Keeping Tax Records	722
46.2	Getting Ready To File Your Return	722

46.3	Applying for an Extension	723
46.4	Getting Your Refund	724
46.5	Paying Taxes Due	725
46.6	Electronic Filing	726
46.7	Notify the IRS of Address Changes	726
46.8	Interest on Tax Underpayments	726
46.9	Tax Penalties for Late Filing and Late Payment	727

---

## **Filing Refund Claims, and Amended Returns** **733**

47.1	Filing An Amended Return	734
47.2	When To File a Refund Claim	734
47.3	Stating the Reasons for Refund Claim	735
47.4	Quick Refund Claims	735
47.5	Interest Paid on Refund Claims	735
47.6	Refunds Withheld To Cover Debts	736
47.7	Amended Returns Showing Additional Tax	736
47.8	Penalty for Filing Excessive Refund Claim	736

---

## **If the IRS Examines Your Return** **737**

48.1	Odds of Being Audited	738
48.2	When the IRS Can Assess Additional Taxes	739
48.3	Audit Overview	740
48.4	Preparing for the Audit	740
48.5	Handling the Audit	741
48.6	Tax Penalties for Inaccurate Returns	742
48.7	Penalties for Not Reporting Foreign Financial Accounts	744
48.8	Agreeing to the Audit Changes	745
48.9	Disputing the Audit Changes	745
48.10	Offer in Compromise	746
48.11	Recovering Costs of a Tax Dispute	747
48.12	Suing the IRS for Unauthorized Collection	748

---

## **PART 8 2013 SAMPLE TAX FORMS TAX TABLE AND EIC TABLE** **749**

Form 1040	751
Schedule A	753
Schedule B	754
Schedule C	755
Schedule D	757
Schedule SE	759
Dividend and Capital Gains Worksheet	761
2013 Tax Table	762
Tax Computation Worksheet	774
2013 EIC Table	775

**PART 9 TAX LAW AUTHORITIES****787**

Legislative Authorities	
Internal Revenue Code	789
Congressional Committee Reports	789
Administrative Authorities	
Treasury Regulations	789
Revenue Rulings	789
Other IRS Rulings and Releases	790
Judicial Authorities	
Court Decisions	790
U.S. Tax Court	790
Federal District Court	791
U.S. Court of Federal Claims	791
Court of Appeals Decisions	791
Supreme Court Decisions	792
States Within Court of Appeals Regions	792

**PART 10 CITATIONS OF AUTHORITY****793**

Key to Citations	795
Filing Basics	796
Citations to tax content for Parts 1–7	797

**PART 11 PRACTICE BEFORE THE IRS****919**

How Returns Are Examined	921
Audit Rules for Partnerships	928
The Time Limits Within Which the IRS Must Act for Additional Taxes	928
Filing Refund Claims	934
How To Arrange Closing Agreements and Compromises	938
How To Get the IRS's Opinion on a Tax Problem	939
Circular 230: Who May Practice Before the IRS	945
Tax Return Preparer Penalties	950

**GLOSSARY****955****INDEX****961**