T P L S

Tax Preparer Learning Systems, LLC

IRS Enrolled Agent Exam

Study Guide

Sample Chapter

Part 1: Individuals

July 1, 2019 to February 29, 2020 Testing

Tax Preparer Learning Systems, LLC

Introduction

This material is intended for general tax education purposes only. Refer to IRS publications for specific guidance when determining the tax obligation for any taxpayer. For advice concerning a specific taxpayer situation, consult a qualified tax professional.

Pursuant to the requirements of the Internal Revenue Service Circular 230, be advised that, to the extent any issue relating to a Federal tax issue is contained in this communication, it was not written or intended to be used for the purposes of (a) avoiding any tax related penalties that may be imposed on the organization or any other person under the Internal Revenue Code, or (b) promoting, marketing or recommending to another person any transaction or matter addressed in this communication.

Course Content

The course content is based primarily on IRS publications and information available on the IRS website. It has been edited for syntax and organizational purposes. Efforts have been made to adhere to the test specification outline, but the content does not strictly adhere to the outline for organizational reasons.

Income and Assets

Income

Wages, salaries, and other earnings

Employee Compensation

In some instances, an employer is not required to give the employee a Form W-2. The employer is not required to give the employee a Form W-2 if they perform household work in the employer's home for less than $2,000 in cash wages during the calendar year and they have no federal income taxes withheld from wages. Household work is work done in or around an employer's home.

If they provide childcare, either in the child's home or in the provider's home or other place of business, the pay they receive must be included in income. If they are not an employee, they are probably self-employed. They generally are not an employee unless they are subject to the will and control of the person who employs them as to what they are to do and how they are to do it. If they are paid to babysit, even for relatives or neighborhood children, whether on a regular basis or only periodically, the rules for childcare providers apply to them.

Tips

All tips received are income and are subject to federal income tax. Include in gross income all tips directly received, charged tips paid by the employer, and the employee's share of any tips received under a tip-splitting or tip-pooling arrangement.

The value of noncash tips, such as tickets, passes, or other items of value, is also income and subject to tax.

Reporting

Tipped employees are required to report to their employer cash, check, and debit and credit card tips you receive.

If total tips for any 1 month from any one job are less than $20, don't report the tips for that month to that employer.

If participating in a tip-splitting or tip-pooling arrangement, report only the tips received and retained. Don't report to the employer any portion of the tips received that are passed on to other employees. However, report tips received from other employees.

Don't report the value of any noncash tips, such as tickets or passes, to the employer.

Statutory employee

If workers are independent contractors under the common law rules, such workers may nevertheless be treated as employees by statute, (also known as "statutory employees") for certain employment tax purposes. This would happen if they fall within any one of the following four categories and meet the three conditions described next under *Social security and Medicare taxes*.

1. A driver who distributes beverages (other than milk) or meat, vegetable, fruit, or bakery products; or who picks up and delivers laundry or dry cleaning, if the driver is your agent or is paid on commission.
2. A full-time life insurance sales agent whose principal business activity is selling life insurance or annuity contracts, or both, primarily for one life insurance company.
3. An individual who works at home on materials or goods that you supply and that must be returned to you or to a person you name, if you also furnish specifications for the work to be done.
4. A full-time traveling or city salesperson who works on your behalf and turns in orders to you from wholesalers, retailers, contractors, or operators of hotels, restaurants, or other similar establishments. The goods sold must be merchandise for resale or supplies for use in the buyer's business operation. The work performed for you must be the salesperson's principal business activity.

Social security and Medicare taxes

Withhold social security and Medicare taxes from the wages of statutory employees if all three of the following conditions apply.

- The service contract states or implies that substantially all the services are to be performed personally by them.
- They don't have a substantial investment in the equipment and property used to perform the services (other than an investment in facilities for transportation, such as a car or truck).
- The services are performed on a continuing basis for the same payer.

Federal unemployment (FUTA) tax

For FUTA tax (the unemployment tax paid under the Federal Unemployment Tax Act), the term “employee” means the same as it does for social security and Medicare taxes, except that it doesn't include statutory employees defined in *categories 2 and 3*, earlier. Any individual who is a statutory employee described under *category 1 or 4*, earlier, is also an employee for FUTA tax purposes and subject to FUTA tax.

Income tax

Don't withhold federal income tax from the wages of statutory employees.

Reporting payments to statutory employees

Furnish Form W-2 to a statutory employee, and check “Statutory employee” in box 13. Show payments to the employee as “other compensation” in box 1. Also, show social security wages in box 3, social security tax withheld in box 4, Medicare wages in box 5, and Medicare tax withheld in box 6. The statutory employee can deduct his or her trade or business expenses from the payments shown on Form W-2. He or she reports earnings as a statutory employee on line 1 of Schedule C (Form 1040), Profit or Loss From Business, or Schedule C-EZ (Form 1040), Net Profit From Business. A statutory employee's business expenses are deductible on Schedule C (Form 1040) or C-EZ (Form 1040) and aren't subject to the reduction by 2% of his or her adjusted gross income that applies to common-law employees.

Miscellaneous Compensation

Advance commissions and other earnings.

If the employee receives advance commissions or other amounts for services to be performed in the future and they are a cash-method taxpayer, they must include these amounts in income in the year they receive them. If they repay unearned commissions or other amounts in the same year, they receive them, reduce the amount included in income by the repayment. If they repay them in a later tax year, they can deduct the repayment as an itemized deduction, or they may be able to take a credit for that year.

Reimbursements

If they received an advance, allowance, or reimbursement for expenses, how they report this amount and expenses depends on whether the employer reimbursed them under an accountable plan or a nonaccountable plan.

The employee is not reimbursed or given an allowance for the expenses if they are paid a salary or commission with the understanding that they will pay their own expenses. In this situation, they have no reimbursement or allowance arrangement, and they do not have to read this section on reimbursements.

A reimbursement or other expense allowance arrangement is a system or plan that an employer uses to pay, substantiate, and recover the expenses, advances, reimbursements, and amounts charged to the employer for employee business expenses. Arrangements include per diem and car allowances.

A per diem allowance is a fixed amount of daily reimbursement the employer gives them for the lodging, meals, and incidental expenses when they are away from home on business.

Accountable Plans

To be an accountable plan, the employer's reimbursement or allowance arrangement must include all of the following rules:

1. The expenses must have a business connection — that is, they must have paid or incurred deductible expenses while performing services as an employee of the employer.
2. The employee must adequately account to the employer for these expenses within a reasonable period of time.
3. The employee must return any excess reimbursement or allowance within a reasonable period of time.

An excess reimbursement or allowance is any amount they are paid that is more than the business-related expenses that they adequately accounted for to the employer.

The definition of reasonable period of time depends on the facts and circumstances of the situation. However, regardless of the facts and circumstances of the situation, actions that take place within the times specified in the following list will be treated as taking place within a reasonable period of time.

- The taxpayer receives an advance within 30 days of the time they have an expense.
- They adequately account for the expenses within 60 days after they were paid or incurred.
- They return any excess reimbursement within 120 days after the expense was paid or incurred.
- They are given a periodic statement (at least quarterly) that asks them to either return or adequately account for outstanding advances and they comply within 120 days of the statement.

If they meet the three rules for an accountable plan, the employer should not include any reimbursements in income in box 1 of Form W-2. If the expenses equal the reimbursements, they do not complete Form 2106. They have no deduction since the expenses and reimbursement is equal.

Even though reimbursed under an accountable plan, some of the expenses may not meet all three rules. All reimbursements that fail to meet all three rules for accountable plans are generally treated as having been reimbursed under a nonaccountable plan.

If reimbursed under an accountable plan, but the taxpayer fails to return, within a reasonable time, any amounts in excess of the substantiated amounts, the amounts paid in excess of the substantiated expenses are treated as paid under a nonaccountable plan.

An employee may be reimbursed under an employer's accountable plan for expenses related to that employer's business, some of which are deductible as employee business expenses and some of which are not deductible. The reimbursements they receive for the nondeductible expenses do not meet rule (1) for accountable plans, and they are treated as paid under a nonaccountable plan.

Example

The employer's plan reimburses them for travel expenses while away from home on business and also for meals when they work late at the office, even though they are not away from home. The part of the arrangement that reimburses them for the nondeductible meals when they work late at the office is treated as paid under a nonaccountable plan.

Nonaccountable Plans

A nonaccountable plan is a reimbursement or expense allowance arrangement that does not meet one or more of the three rules for accountable plans.

In addition, even if the employer has an accountable plan, the following payments will be treated as being paid under a nonaccountable plan:

- Excess reimbursements they fail to return to the employer, and
- Reimbursement of nondeductible expenses related to the employer's business.

An arrangement that repays the taxpayer for business expenses by reducing the amount reported as wages, salary, or other pay will be treated as a nonaccountable plan. This is because they are entitled to receive the full amount of pay whether or not they have any business expenses.

The employer will combine the amount of any reimbursement or other expense allowance paid to them under a nonaccountable plan with wages, salary, or other pay. The employer will report the total in box 1 of Form W-2.

Back pay awards

If they receive an amount in payment of a settlement or judgment for back pay, they must include the amount of the payment in income. This includes payments made to them for damages, unpaid life insurance premiums, and unpaid health insurance premiums. They should be reported to the employee by their employer on Form W-2.

Bonuses and awards

If the employee receives a bonus or award (cash, goods, services) from their employer, they must include its value in their income. However, if the employer merely promises to pay them a bonus or award at some future time, it is not taxable until they receive it or it is made available to them.

Employee achievement award

If the employee receives tangible personal property (other than cash, a gift certificate, or an equivalent item) as an award for length of service or safety achievement, they generally can exclude its value from income. The amount they can exclude is limited to the employer's cost and cannot be more than $1,600 for qualified plan awards or $400 for non-qualified plan awards for all such awards they receive during the year.

Under the Tax Cuts and Jobs Act:

1. There is now a prohibition on cash, gift cards and other non-tangible personal property as employee achievement awards.
2. Special rules allow an employee to exclude certain achievement awards from their wages if the awards are tangible personal property.
3. The new law clarifies that tangible personal property doesn’t include cash, cash equivalents, gift cards, gift coupons, certain gift certificates, tickets to theater or sporting events, vacations, meals, lodging, stocks, bonds, securities, and other similar items.

The exclusion does not apply to the following awards:

- A length-of-service award if they received it for less than 5 years of service or if they received another length-of-service award during the year or the previous 4 years.
- A safety achievement award if they are 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.

Nonqualified deferred compensation plans

An employer may report to them the total amount of deferrals for the year under a nonqualified deferred compensation plan on Form W-2, box 12, using code Y. This amount is not included in income.

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

Note received for services

If an employer gives them a secured note as payment for services, they must include the fair market value (usually the discount value) of the note in income for the year they receive it. When they later receive payments on the note, a proportionate part of each payment is the recovery of the fair market value that they previously included in income. Do not include that part again in income. Include the rest of the payment in income in the year of payment.

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

Severance pay

If an employee receives a severance payment when an employment with the employer ends or is terminated, they must include this amount in income.

Accrued leave payment

If an employee are a federal employee and receive a lump-sum payment for accrued annual leave when they retire or resign, this amount will be included as wages on Form W-2.

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

Outplacement services

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

However, they can deduct the value of these outplacement services (up to the difference between the severance pay included in income and the amount actually received) as a miscellaneous deduction (subject to the 2%-of-adjusted-gross-income (AGI) limit) on Schedule A (Form 1040).

Sick pay

Pay an employee receives from an employer while they are sick or injured is part of salary or wages. In addition, they must include in 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 the employer paid for the plan.

However, if they paid the premiums on an accident or health insurance policy themselves, the benefits they receive under the policy are not taxable.

Stock appreciation rights.

Do not include a stock appreciation right granted by an employer in income until they exercise (use) the right. When they use the right, they are generally entitled to a cash payment equal to the fair market value of the corporation's stock on the date of use minus the fair market value on the date the right was granted. They include the cash payment in income in the year they use the right.

Fringe Benefits

Fringe benefits received in connection with the performance of services are included in income as compensation unless they pay fair market value for them or they are specifically excluded by law. Abstaining 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.

Accident or Health Plan

In most cases, the value of accident or health plan coverage provided to an employee by an employer is not included in income. Benefits they receive from the plan may be taxable.

Long-term care coverage

Contributions by an employer to provide coverage for long-term care services generally are not included in income. However, contributions made through a flexible spending or similar arrangement offered by an employer must be included in income.

Archer MSA contributions

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

Health flexible spending arrangement (health FSA)

If an employer provides a health FSA that qualifies as an accident or health plan, the amount of salary reduction, and reimbursements of medical care expenses, in most cases, is not included in income.

Health FSAs are subject to a $2,500 limit on salary reduction contributions for plan years beginning after 2012. The $2,500 limit is subject to an inflation adjustment for plan years beginning after 2013.

For tax year 2018, the dollar limitation under section 125(i) on voluntary employee salary reductions for contributions to health flexible spending arrangements is $2,600.

*Health **reimbursement** arrangement (HRA)*

If an employer provides an HRA that qualifies as an accident or health plan, coverage and reimbursements of medical care expenses generally are not included in income.

Health savings accounts (HSA).

If the employee is an eligible individual, themselves and any other person, including an employer or a family member, can make contributions to an HSA. Contributions, other than employer contributions, are deductible on the return whether or not they itemize deductions. Contributions made by an employer are not included in income. Distributions from an HSA that are used to pay qualified medical expenses are not included in income. Distributions not used for qualified medical expenses are included in their income.

Adoption Assistance

An employee may be able to exclude from income amounts paid or expenses incurred by an employer for qualified adoption expenses in connection with the adoption of an eligible child.

De Minimis (Minimal) Benefits

If an employer provides an employee 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, they generally do not include its value in income. In most cases, do not include in income the value of discounts at company cafeterias, cab fares home when working overtime, and company picnics.

Holiday gifts.

If an employer gives an employee a turkey, ham, or other item of nominal value at Christmas or other holidays, do not include the value of the gift in income. However, if an employer gives them cash or a cash equivalent, they must include it in income.

Educational Assistance

An employee can exclude from income up to $5,250 of qualified employer-provided educational assistance.

Group-Term Life Insurance

In most cases, the cost of up to $50,000 of group-term life insurance coverage provided to them by an employer (or former employer) is not included in income. However, they 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 they pay toward the purchase of the insurance.

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

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.

Figuring the Cost of Group-Term Life Insurance To Include in Income

1. Enter the total amount of insurance coverage from 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 the Table. Using age on the last day of the tax year, find their age group in the left column, and enter the cost from the column on the right for 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 paid per month	9.	
10. Enter the number of months the employee paid the premiums	10.	
11. Multiply line 9 by line 10.	11.	
12. Subtract line 11 from line 8. **Include this amount in income as wages**	12.	

Cost of $1,000 of Group-Term Life Insurance for One 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

You are 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.

Figuring the Cost of Group-Term Life Insurance to Include in Income—Illustrated

1.	Enter the total amount of insurance coverage from 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 the table. Using the employee's age on the last day of the tax year, find the age group in the left column, and enter the cost from the column on the right for the 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 the employer paid per month	9.	4.15		
10.	Enter the number of months the employee 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 income as wages**			12.	33.00

Retirement Planning Services

Generally, do not include the value of qualified retirement planning services provided to an employee and the spouse by the employer's qualified retirement plan. Qualified services include retirement planning advice, information about the employer's retirement plan, and information about how the plan may fit into the overall individual retirement income plan. They cannot exclude the value of any tax preparation, accounting, legal, or brokerage services provided by the employer.

Transportation

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

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

Cash reimbursement by the 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 is not readily available for direct distribution to them.

Exclusion limit The exclusion for commuter vehicle transportation and transit pass fringe benefits cannot be more than $260 a month.

The exclusion for the qualified parking fringe benefit cannot be more than $260 a month.

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

Retirement Plan Contributions

The employer's contributions to a qualified retirement plan for them are not included in income at the time contributed. However, the cost of life insurance coverage included in the plan may have to be included.

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

Elective deferrals

If an employee is covered by certain kinds of retirement plans, they can choose to have part of the compensation contributed by the employer to a retirement fund, rather than have it paid to them. The amount they 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), is not included in wages subject to income tax at the time contributed. Rather it is subject to income tax when distributed from the plan. However, it is included in wages subject to social security and Medicare taxes at the time contributed.

Elective deferrals include elective contributions to the following retirement plans.

1. Cash or deferred arrangements (section 401(k) plans).
2. The Thrift Savings Plan for federal employees.
3. Salary reduction simplified employee pension plans (SARSEP).
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.
7. Section 457 plans.

For 2018, in most cases, an employee should not have deferred more than a total of $18,500 of contributions to the plans listed in (1) through (3) and (5) above. The limit for SIMPLE plans is $12,500.

Taxpayers may be allowed catch-up contributions (additional elective deferral) if they are age 50 or older by the end of the tax year.

Stock Options

If an employee receives a nonstatutory option to buy or sell stock or other property as payment for services, they usually will have income when they receive the option, when they exercise the option (use it to buy or sell the stock or other property), or when they sell or otherwise dispose of the option. However, if the option is a statutory stock option, they will not have any income until they sell or exchange the stock.

Restricted Property

In most cases, if an employee receives property for services, they must include its fair market value in income in the year they receive the property. However, if they receive stock or other property that has certain restrictions that affect its value, they do not include the value of the property in income until it has substantially vested. (Although they can elect to include the value of the property in income in the year it is transferred to them.)