



Financial Planning Tax Considerations: Business and Investment Part 1

Course #30901B

Taxes

2 Credit Hours

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FINANCIAL PLANNING TAX CONSIDERATIONS: BUSINESS AND INVESTMENT PART 1

This course explains the proper tax treatment of various types of investment income, such as interest, dividends, and capital gains. It also outlines the rules for deducting investment-related expenses and explores how the passive activity and at-risk rules affect a taxpayer's ability to claim investment losses.

LEARNING ASSIGNMENTS AND OBJECTIVES

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

SUBJECTS

**Tax Treatment of Investment Income
Deductions of Investment Expenses
Passive and At-Risk Rules**

Study the course materials

Complete the review questions at the end of each chapter

Answer the exam questions 1 to 10

Objectives:

- Recognize the proper tax treatment for various types of investment income.
- Identify limitations on the deductibility of investment expenses.
- Identify how the passive activity and at-risk rules affect the deductibility of investment losses.

NOTICE

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EXAM OUTLINE

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

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CHAPTER 1: TAX TREATMENT OF INVESTMENT INCOME

Chapter Objective

After completing this chapter, you should be able to:

- Recognize the proper tax treatment for various types of investment income.

No investment advisor or financial professional can properly recommend any particular investment or investment strategy without a thorough understanding of its tax consequences. This chapter provides information on the tax treatment of investment income. Investment income generally includes interest, dividends, capital gains, and other types of distributions.

I. INTEREST INCOME

In general, any interest that an individual receives or that is credited to an individual's account and can be withdrawn is taxable income.

A. EXCEPTIONS

1. Exempt-Interest Dividends

Form 1099-DIV, box 12, shows exempt-interest dividends from a mutual fund or other regulated investment company paid during the calendar year. Form 1099-DIV, box 13, shows exempt-interest dividends subject to the alternative minimum tax. This amount is included in box 12.

2. Interest on VA Dividends

Interest on insurance dividends that are left on deposit with the Department of Veterans Affairs (VA) is not taxable. This includes interest paid on dividends on converted United States Government Life Insurance policies and on National Service Life Insurance policies.

3. Individual Retirement Arrangements (IRAs)

Interest on a Roth IRA generally is not taxable. Interest on a traditional IRA is tax deferred. Individuals generally do not include it in their income until they make withdrawals from the IRA.

B. TAXABLE INTEREST – GENERAL

Taxable interest includes interest individuals receive from bank accounts, loans they make to others, and other sources. The following are some sources of taxable interest.

1. Dividends That Are Actually Interest

Certain distributions commonly called dividends are actually interest. Persons must report as interest so-called “dividends” on deposits or on share accounts in:

- Cooperative banks;
- Credit unions;
- Domestic building and loan associations;
- Domestic savings and loan associations;
- Federal savings and loan associations, and
- Mutual savings banks.

The “dividends” will be shown as interest income on Form 1099-INT.

2. Money Market Funds

Money market funds are offered by nonbank financial institutions, such as mutual funds and stock brokerage houses, and pay dividends. Generally, amounts received from money market funds should be reported as dividends, not as interest.

3. Certificates of Deposit and Other Deferred Interest Accounts

When one of these accounts is opened, interest may be paid at fixed intervals of 1 year or less during the term of the account. This generally must be included as interest income when it is actually received or when the individual is entitled to receive it without paying a substantial penalty. The same is true for accounts that mature in 1 year or less and pay interest in a single payment at maturity.

a. Interest Subject to Penalty for Early Withdrawal

If funds are withdrawn from a deferred interest account before maturity, the owner may have to pay a penalty. Individuals must report the total amount of interest paid or credited to their account during the year, without subtracting the penalty.

b. Money Borrowed to Invest in Certificate of Deposit

The interest paid on money borrowed from a bank or savings institution to meet the minimum deposit required for a certificate of deposit from the institution and the interest earned on the certificate are two separate items. Individuals must report the total interest earned on the certificate as income. If the individual itemizes deductions, he or she can deduct the interest paid as investment interest, up to the amount of his or her net investment income.

Example



Jane deposited \$5,000 with a bank and borrowed \$5,000 from the bank to make up the \$10,000 minimum deposit required to buy a 6-month certificate of deposit. The certificate earned \$575 at maturity in 2025, but Jane received only \$265, which represented the \$575 Jane earned minus \$310 interest charged on her \$5,000 loan. The bank gives Jane a Form 1099-INT for 2025 showing the \$575 interest earned. The bank also gives Jane a statement showing that she paid \$310 interest for 2025. Jane must include the \$575 in income. If she itemizes her deductions on Schedule A (Form 1040), she can deduct \$310, subject to the net investment income limit.

4. Interest on Insurance Dividends

Interest on insurance dividends left on deposit with an insurance company that can be withdrawn annually is taxable to the individual in the year it is credited to his or her account. However, if the individual can withdraw it only on the anniversary date of the policy (or other specified date), the interest is taxable in the year that date occurs.

5. Prepaid Insurance Premiums

Any increase in the value of prepaid insurance premiums, advance premiums, or premium deposit funds is interest if it is applied to the payment of premiums due on insurance policies or made available for an individual to withdraw.

6. U.S. Obligations

Interest on U.S. obligations, such as U.S. Treasury bills, notes, bonds, and obligations, issued by any agency or instrumentality of the United States, is taxable for federal income tax purposes.

7. Interest on Tax Refunds

Interest received on tax refunds is taxable income.

8. Installment Sale Payments

If a contract for the sale or exchange of property provides for deferred payments, it also usually provides for interest payable with the deferred payments. Generally, that interest is taxable when it is received. If little or no interest is provided for in a deferred payment contract, part of each payment may be treated as interest.

9. Interest on Annuity Contract

Accumulated interest on an annuity contract sold before its maturity date is taxable.

10. Bonds Traded Flat

If an individual buys a bond at a discount when interest has been defaulted or when the interest has accrued but has not been paid, the transaction is described as trading a bond flat. The defaulted or