



Individual Income Tax: Income Part 2

Course #31052B

Taxes

2 Credit Hours

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INDIVIDUAL INCOME TAX: INCOME PART 2

This course explains how to report rental income and expenses, the tax rules for different types of retirement plans, and key thresholds for taxing Social Security benefits. It also identifies how to handle other types of income on a tax return.

LEARNING ASSIGNMENTS AND OBJECTIVES

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

SUBJECTS

Rental Income and Expenses

Retirement Plans, Pensions, and Annuities

Social Security and Equivalent Railroad Retirement Benefits

Other Income

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 treatment of rental property income and expenses for tax purposes.
- Identify various requirements regarding retirement plan taxation.
- Recognize key taxation thresholds related to social security income.
- Identify the taxability of various types of other income.

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.

TABLE OF CONTENTS

Chapter 1: Rental Income and Expenses	1
I. Introduction	1
II. Rental Income	1
III. Rental Expenses	2
REPAIRS AND IMPROVEMENTS	3
OTHER EXPENSES	5
IV. Personal Use of Dwelling Unit (Including Vacation Home)	6
DWELLING UNIT USED AS HOME	6
WHAT IS A DAY OF PERSONAL USE?	7
V. Depreciation	11
DEPRECIATION METHODS	12
MACRS	13
MACRS DEPRECIATION UNDER GDS	17
USING THE OPTIONAL TABLES	19
MACRS DEPRECIATION UNDER ADS	20
OTHER RULES ABOUT DEPRECIABLE PROPERTY	21
VI. Limits on Rental Losses	21
AT-RISK RULES	22
PASSIVE ACTIVITY LIMITS	22
Chapter 1: Test Your Knowledge	24
Chapter 1: Solutions and Suggested Responses	26
Chapter 2: Retirement Plans, Pensions, and Annuities	28
I. What's New	28
SECURE Act and SECURE 2.0 ACT	28
TRADITIONAL IRA AND ROTH IRA CONTRIBUTION PHASEOUT	28
401K28	
II. Introduction	29
III. General Information	29
IV. Cost (Investment in the Contract)	31
V. Taxation of Periodic Payments	31
SIMPLIFIED METHOD	32
VI. Taxation of Nonperiodic Payments	33
LUMP-SUM DISTRIBUTIONS	34

VII. Rollovers	36
VIII. Special Additional Taxes	38
Chapter 2: Test Your Knowledge	43
Chapter 2: Solution and Suggested Responses	44
Chapter 3: Social Security and Equivalent Railroad Retirement Benefits	45
I. Introduction	45
II. Are Any of Your Benefits Taxable?	46
III. How To Report Your Benefits	47
HOW MUCH IS TAXABLE?	47
Chapter 3: Test Your Knowledge	49
Chapter 3: Solution and Suggested Responses	50
Chapter 12: Other Income	51
I. Reminder	51
II. Introduction	51
III. Canceled Debts	52
IV. Life Insurance Proceeds	53
ENDOWMENT CONTRACT PROCEEDS	54
ACCELERATED DEATH BENEFITS	54
V. Partnership Income	55
VI. S Corporation Income	55
VII. Recoveries	56
VIII. Rents from Personal Property	57
IX. Repayments	57
X. Royalties	59
XI. Unemployment Benefits	59
XII. Other Income	61
Chapter 4: Test Your Knowledge	69
Chapter 4: Solutions and Suggested Responses	70
Glossary	71
Index	86
Final Exam Copy	88

CHAPTER 1: RENTAL INCOME AND EXPENSES

Chapter Objective

After completing this chapter, you should be able to:

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

I. INTRODUCTION

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

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

II. RENTAL INCOME

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

When to report. If you are a cash basis taxpayer, report rental income on your return for the year you actually or constructively receive it, regardless of when it was earned. You constructively receive income when it is made available to you, for example, by being credited to your bank account. If you are an accrual basis taxpayer, you generally report income when you earn it, rather than when you receive it.

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

Example



You sign a 10-year lease to rent your property. In the first year, you receive \$9,600 for the first year's rent and \$9,600 as rent for the last year of the lease. You must include \$19,200 in your income in the first year.

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

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

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

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

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

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

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

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

III. RENTAL EXPENSES

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

When to deduct. If you are a cash basis taxpayer, you generally deduct your rental expenses in the year you pay them. If you are an accrual basis taxpayer, you generally deduct your expenses when you incur them, rather than when you pay them.

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

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

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

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

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

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

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

REPAIRS AND IMPROVEMENTS

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

Improvements. You must capitalize any expense you pay to improve your rental property. An expense is for an improvement if it results in a betterment to your property, restores your property, or adapts your property to a new or different use.

Betterments. Expenses that may result in a betterment to your property include expenses for fixing a pre-existing defect or condition, enlarging or expanding your property, or increasing the capacity, strength, or quality of your property.

Restoration. Expenses that may be for restoration include expenses for replacing a substantial structural part of your property, repairing damage to your property after you properly adjusted the basis of your property as a result of a casualty loss, or rebuilding your property to a like-new condition.

Adaptation. Expenses that may be for adaptation include expenses for altering your property to a use that is not consistent with the intended ordinary use of your property when you began renting the property.

Safe harbor for routine maintenance. If you determine that your cost was for an improvement to a building or equipment, you still may be able to deduct your cost under the routine maintenance safe harbor.

Note



Separate the costs of repairs and improvements, and keep accurate records. You will need to know the cost of improvements when you sell or depreciate your property. The expenses you capitalize for improving your property generally can be depreciated as if the improvement were separate property.