PacificCPE

COURSE
34551A

Dividends, Distributions, and Other Income Taxation

Get a solid grounding in how dividends and other income types are taxed and reported. This course covers ordinary dividends, capital gain distributions, nondividend distributions, and reporting requirements, then expands into a wide range of other income sources — including canceled debts, royalties, partnership and S corporation income, bartering, unemployment benefits, and more. Ideal for tax professionals who want a comprehensive, practical refresher on income classification and reporting across both investment and non-investment income categories.

CREDIT HOURS 2 | FIELD OF STUDY TAXES | EXAM QUESTIONS 10

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Assignment

- Study the full course materials included here.
- Complete the review questions after each chapter.
- Answer 10 final exam questions.
- Final exam is scored immediately, 70% or better passes.
- Certificate of completion is available in your account.
- Failed exams can be retaken free of charge.

Course Objectives

- Recognize the proper tax treatment of dividends, capital gain distributions, and other distributions you may receive from a corporation or a mutual fund.
- Identify the taxable status of various forms of other income.

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Chapter 1: DIVIDENDS AND OTHER DISTRIBUTIONS

Chapter Objective

After completing this chapter, you should be able to:

- Recognize the proper tax treatment of dividends, capital gain distributions, and other distributions you may receive from a corporation or a mutual fund.

I. REMINDERS

Capital Gains and Dividends. Qualified dividends and long-term capital gains may escape tax entirely under the 0% rate, or be subject to capital gain rates of 15% or 20% depending on filing status, taxable income, and how much of the taxable income consists of qualified dividends and eligible long-term gains. The 20% capital gain rate taxable income thresholds for 2025 are either $600,050, $566,700, $533,400, or $300,000, depending on tax filing status. The 0%, 15%, and 20% rates do not apply to long-term gains from collectibles, which are subject to a 28% rate, or the 25% rate for unrecaptured real estate depreciation.

II. INTRODUCTION

This chapter discusses the tax treatment of:

- Ordinary dividends,
- Capital gain distributions,
- Nondividend distributions, and
- Other distributions you may receive from a corporation or a mutual fund.

This chapter also explains how to report dividend income on your tax return.

Dividends can be distributions of money, stock, or other property paid to you by a corporation or by a mutual fund. You also may receive dividends through a partnership, an estate, a trust, or an association that is taxed as a corporation. However, some amounts you receive called dividends actually are interest income.

Most distributions are paid in cash (check). However, distributions can consist of more stock, stock rights, other property, or services.

III. GENERAL INFORMATION

Children and dependents with unearned income. See the following items if you have children or dependents with unearned income.

- Form 8615, *Tax for Certain Children Who Have Unearned Income*, and Instructions for Form 8615, *Tax for Certain Children Who Have Unearned Income*.
- Form 8814, *Parent's Election to Report Child's Interest and Dividends*.

Beneficiary of an estate or trust. See the following items if you receive dividends and other distributions from an estate or trust.

- Schedule K-1 (Form 1041), *Beneficiary's Share of Income, Deductions, Credits, etc.*
- Instructions for Schedule K-1 (Form 1041) for a Beneficiary Filing Form 1040 or 1040-SR.

Backup withholding. Your dividend income is generally not subject to regular withholding. However, it may be subject to backup withholding to ensure that income tax is collected on the income. Under backup withholding, the payer of dividends must withhold, as income tax, a percentage of the amount you are paid, applying the appropriate withholding rate.

Backup withholding may also be required if the Internal Revenue Service (IRS) has determined that you underreported your interest or dividend income.

Stock certificate in two or more names. If two or more persons hold stock as joint tenants, tenants by the entirety, or tenants in common, each person's share is determined by local law.

Form 1099-DIV. Corporations may use Form 1099-DIV to show you the distributions you received from them during the year. Keep this form with your records. You do not have to attach it to your tax return. Your identifying number may be truncated on any Form 1099-DIV you receive.

Dividends not reported on Form 1099-DIV. Even if you do not receive a Form 1099-DIV, you must still report all your taxable dividend income. For example, you may receive distributive shares of dividends from partnerships or S corporations. These dividends are reported to you on Schedule K-1 (Form 1065) and Schedule K-1 (Form 1120-S).

Nominees. If someone receives distributions as a nominee for you, that person should give you a Form 1099-DIV which that will show distributions received on your behalf.

Form 1099-MISC. Certain substitute payments in lieu of dividends or tax-exempt interest received by a broker on your behalf must be reported to you on Form 1099-MISC or a similar statement.

Incorrect amount shown on a Form 1099. If you receive a Form 1099 that shows an incorrect amount (or other incorrect information), you should ask the issuer for a corrected form. The new Form 1099 you receive should be denoted "Corrected."

Dividends on stock sold. If stock is sold, exchanged, or otherwise disposed of after a dividend is declared but before it is paid, the owner of record (usually the payee shown on the dividend check) must include the dividend in income.

Dividends received in January. If a mutual fund (or other RIC) or real estate investment trust (REIT) declares a dividend (including any exempt-interest dividend or capital gain distribution) in October, November, or December, payable to shareholders of record on a date in one of those months but actually pays the dividend during January of the next calendar year, the shareholder is considered to have received the dividend on December 31 and must report the dividend in the year it was declared.

IV. ORDINARY DIVIDENDS

Ordinary dividends are the most common type of distribution from a corporation or a mutual fund. They are paid out of earnings and profits and are ordinary income to you. This means they are not capital gains. You can assume that any dividend you receive on common or preferred stock is an ordinary dividend unless the paying corporation or mutual fund tells you otherwise. Ordinary dividends will be shown on Form 1099-DIV, box 1a.

QUALIFIED DIVIDENDS

Qualified dividends are the ordinary dividends that are subject to the same 0%, 15%, or 20% maximum tax rate that applies to net capital gain.

For 2025, the maximum rate of tax on qualified dividends is the following.

- The 0% rate applies to -
  - Single filers with income up to $48,350,
  - Married filers filing separately with income up to $48,350,
  - Head of household filers with income up to $64,750,
  - Joint filers with income up to $96,700,
  - Trusts and estates with income up to $3,250;
- The 15% rate applies to -
  - Single filers with income between $48,351 and $533,400,
  - Married filers filing separately with income between $48,351 and $300,000,
  - Head of household filers with income between $64,751 and $566,700,
  - Joint filers with income between $96,701 and $600,050,
  - Trusts and estates with income between $3,251 and $15,900; and
- The 20% rate applies to -

- Single filers with income exceeding $533,400,
- Married filers filing separately with income exceeding $300,000,
- Head of household filers with income exceeding $566,700,
- Joint filers with income exceeding $600,050,
- Trusts and estates with income exceeding $15,900.

The maximum rate on qualified dividends applies only if all of the following requirements are met.

- The dividends were paid by a U.S. corporation or a qualified foreign corporation.
- The dividends are not of the type listed later under *Dividends that are not qualified dividends*.
- You meet the holding period (discussed next).

Holding period. You must have held the stock for more than 60 days during the 121-day period that begins 60 days before the ex-dividend date. The ex-dividend date is the first date following the declaration of a dividend on which the buyer of a stock is not entitled to receive the next dividend payment. When counting the number of days you held the stock, include the day you disposed of the stock, but not the day you acquired it.

Exception for preferred stock. In the case of preferred stock, you must have held the stock more than 90 days during the 181-day period that begins 90 days before the ex-dividend date if the dividends are due to periods totaling more than 366 days. If the preferred dividends are due to periods totaling less than 367 days, the holding period in the preceding paragraph applies.

Dividends that are not qualified dividends. The following dividends are not qualified dividends. They are not qualified dividends even if they are shown on Form 1099-DIV, box 1b.

- Capital gain distributions.
- Dividends paid on deposits with mutual savings banks, cooperative banks, credit unions, U.S. building and loan associations, U.S. savings and loan associations, federal savings and loan associations, and similar financial institutions. Report these amounts as interest income.
- Dividends from a corporation that is a tax-exempt organization or farmer's cooperative during the corporation's tax year in which the dividends were paid or during the corporation's previous tax year.
- Dividends paid by a corporation on employer securities held on the date of record by an employee stock ownership plan (ESOP) maintained by that corporation.
- Dividends on any share of stock to the extent you are obligated (whether under a short sale or otherwise) to make related payments for positions in substantially similar or related property.

- Payments in lieu of dividends, but only if you know or have reason to know the payments are not qualified dividends.
- Payments shown on Form 1099-DIV, box 1b, from a foreign corporation to the extent you know or have reason to know the payments are not qualified dividends.

DIVIDENDS USED TO BUY MORE STOCK

The corporation in which you own stock may have a dividend reinvestment plan. This plan lets you choose to use your dividends to buy (through an agent) more shares of stock in the corporation instead of receiving the dividends in cash. Most mutual funds also permit shareholders to automatically reinvest distributions in more shares in the fund, instead of receiving cash. If you use your dividends to buy more stock at a price equal to its fair market value, you must still report the dividends as income.

If you are a member of a dividend reinvestment plan that lets you buy more stock at a price less than its fair market value, you must report as dividend income the fair market value of the additional stock on the dividend payment date.

You also must report as dividend income any service charge subtracted from your cash dividends before the dividends are used to buy the additional stock. But you may be able to deduct the service charge.

In some dividend reinvestment plans, you can invest more cash to buy shares of stock at a price less than fair market value. If you choose to do this, you must report as dividend income the difference between the cash you invest and the fair market value of the stock you buy. When figuring this amount, use the fair market value of the stock on the dividend payment date.

MONEY MARKET FUNDS

Report amounts you receive from money market funds as dividend income. Money market funds are a type of mutual fund and should not be confused with bank money market accounts that pay interest.

V. CAPITAL GAIN DISTRIBUTIONS

Capital gain distributions (capital gain dividends) are paid to you or credited to your account by mutual funds (or other regulated investment companies) and real estate investment trusts (REITs). They will be shown in Form 1099-DIV, box 2a you receive from the mutual fund or REIT.

Report capital gain distributions as long-term capital gains, regardless of how long you owned your shares in the mutual fund or REIT.

Qualified Opportunity Fund (QOF). Code section 1400Z-2 provides a deferral of inclusion in gross income for capital gains invested in QOFs. See the Form 8949 instructions on how to report your election to defer eligible gains invested in a QOF.

Qualified Opportunity Investment. If you held a qualified investment in a qualified opportunity fund (QOF) at any time during the year, you must file your return with Form 8997. See Form 8997 instructions.

Undistributed capital gains of mutual funds and REITs. Some mutual funds and REITs keep their long-term capital gains and pay tax on them. You must treat your share of these gains as distributions, even though you did not actually receive them. However, they are not included on Form 1099-DIV. Instead, they are reported to you in Form 2439, box 1a.

Form 2439 also will show how much, if any, of the undistributed capital gains is:

- Unrecaptured section 1250 gain (box 1b),
- Gain from qualified small business stock (section 1202 gain, box 1c), or
- Collectibles (28%) gain (box 1d).

The tax paid on these gains by the mutual fund or REIT is shown in Form 2439, box 2.

Basis adjustment. Increase your basis in your mutual fund, or your interest in a REIT, by the difference between the gain you report and the credit you claim for the tax paid.

VI. NONDIVIDEND DISTRIBUTIONS

A nondividend distribution is a distribution that is not paid out of the earnings and profits of a corporation or a mutual fund. You should receive a Form 1099-DIV or other statement showing you the nondividend distribution. A nondividend distribution will be shown in Form 1099-DIV, box 3. If you do not receive such a statement, you report the distribution as an ordinary dividend.

Basis adjustment. A nondividend distribution reduces the basis of your stock. It is not taxed until your basis in the stock is fully recovered. This nontaxable portion also is called a return of capital; it is a return of your investment in the stock of the company. If you buy stock in a corporation in different lots at different times, and you cannot definitely identify the shares subject to the nondividend distribution, reduce the basis of your earliest purchases first.

When the basis of your stock has been reduced to zero, report any additional nondividend distribution you receive as a capital gain. Whether you report it as a long-term or short-term capital gain depends on how long you have held the stock.