



Module 4: ADJUSTMENTS TO INCOME

By the end of this module you will...

- Understand how Adjusted Gross Income affects any tax liability/refund on the 1040
- Understand and Calculate the Educator Expense Deduction
- Understand and Calculate the Penalty on Early Withdrawal of Savings Deduction
- Understand and Calculate the Alimony Paid Deduction
- Understand and Calculate the Student Loan Interest Deduction

In this module...

- [Adjusted Gross Income](#)
- [Educator Expense Deduction](#)
- [Penalty on Early Withdrawal of Savings Deduction](#)
- [Alimony Paid Deduction](#)
- [IRA Contributions](#)
- [Student Loan Interest Deduction](#)
- [Additional Adjustments](#)
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Adjusted Gross Income

Understand how Adjusted Gross Income affects any tax liability/refund on the 1040

Adjusted Gross Income (AGI)

- **Adjustments** are deductions that **decrease** a taxpayer's gross income.

$$\text{Total Income} - \text{Adjustments} = \text{Adjusted Gross Income (AGI)}$$

- Any increases to adjustments will ultimately lower taxable income and **reduce income tax**.
- Note that adjustments **do not lower other taxes**, such as self-employment tax.

9	Add lines 1, 2b, 3b, 4b, 5b, 6b, 7, and 8. This is your total income	9	
10	Adjustments to income from Schedule 1, line 26	10	
11	Subtract line 10 from line 9. This is your adjusted gross income	11	

- Adjustments are reported on line 10 of Form 1040, **Schedule 1, and deducted on Form 1040 or Form 1040 SR line 10.**

Adjusted Gross Income (AGI)

- Adjustments to income lowers your adjusted gross income dollar for dollar.
- Example: The taxpayer has \$20,000 in Gross Income, \$250 in educator expense deductions, \$50 in penalty on early withdrawal of savings deductions, \$2,000 in alimony paid deductions, and \$1,000 in student loan interest deductions. What is the taxpayers AGI?
- Answer:
 - Gross Income = \$20,000.
 - Total Adjustments to Income = \$3,300 (\$250 + \$50 + \$2,000 + \$1,000)
 - AGI = \$16,700 (\$20,000 - \$3,300)

Schedule 1 (Form 1040) 2021 Page 2

Part II Adjustments to Income

11	Educator expenses	11	
12	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106	12	
13	Health savings account deduction. Attach Form 8889	13	
14	Moving expenses for members of the Armed Forces. Attach Form 3903	14	
15	Deductible part of self-employment tax. Attach Schedule SE	15	
16	Self-employed SEP, SIMPLE, and qualified plans	16	
17	Self-employed health insurance deduction	17	
18	Penalty on early withdrawal of savings	18	
19a	Alimony paid	19a	
	b Recipient's SSN		
	c Date of original divorce or separation agreement (see instructions)		
20	IRA deduction	20	
21	Student loan interest deduction	21	
22	Reserved for future use	22	
23	Archer MSA deduction	23	
24	Other adjustments:		
	a Jury duty pay (see instructions)	24a	
	b Deductible expenses related to income reported on line 8k from the rental of personal property engaged in for profit	24b	
	c Nontaxable amount of the value of Olympic and Paralympic medals and USOC prize money reported on line 8l	24c	
	d Reforestation amortization and expenses	24d	
	e Repayment of supplemental unemployment benefits under the Trade Act of 1974	24e	
	f Contributions to section 501(c)(18)(D) pension plans	24f	
	g Contributions by certain chaplains to section 403(b) plans	24g	
	h Attorney fees and court costs for actions involving certain unlawful discrimination claims (see instructions)	24h	
	i Attorney fees and court costs you paid in connection with an award from the IRS for information you provided that helped the IRS detect tax law violations	24i	
	j Housing deduction from Form 2555	24j	
	k Excess deductions of section 67(e) expenses from Schedule K-1 (Form 1041)	24k	
	z Other adjustments. List type and amount	24z	
25	Total other adjustments. Add lines 24a through 24z	25	
26	Add lines 11 through 23 and 25. These are your adjustments to income. Enter here and on Form 1040 or 1040-SR, line 10, or Form 1040-NR, line 10a	26	

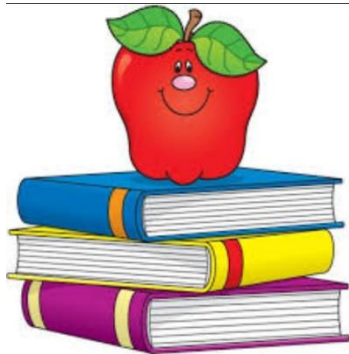
Schedule 1 (Form 1040) 2021

Educator Expense Adjustments

Understand and Calculate the Educator Expense Adjustment

Educator Expense Deductions

- An eligible educator is allowed to deduct up to \$250 (Single) or \$500 (Married Filing Joint if both spouses are eligible educators) as **Adjustments to Income**
 - An eligible educator is a kindergarten through 12th grade teacher, instructor, counselor, principal, or aide in school for at least 900 hours during the school year
- Expenses must be qualified in order to take the Adjustments to Income.
- Qualified Expenses include:
 - *Ordinary and necessary* expenses purchased, such as books, equipment, supplies, and other materials. Expenses **do not have to be required** *in order to be considered necessary*.
 - Homeschooling expenses are not considered qualified expenses



Educator Expense Deductions

- Qualified Expenses must be reduced by:
 - The interest on Series EE and I U.S. savings bonds that you exclude from income because you paid qualified higher education expenses
 - Any distribution from a qualified state tuition program that you exclude from income
 - Any tax-free withdrawals from your Coverdell education savings accounts
 - Any reimbursements you receive for expenses that aren't reported to you as wages on your W – 2

- Example: The taxpayer has \$200 worth of qualified educator expenses. Throughout the school year, \$50 was reimbursed for the art supplies the taxpayer needed to teach her class. What amount can the eligible educator include as an educator expense deduction?

- Answer: \$150 (\$200 - \$50) is deductible as an Adjustment to Income on the taxpayer's Form 1040, Schedule 1, line 10.

Adjusted
Gross
Income

23	Educator expenses	23	150	00
24	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ	24		
25	Health savings account deduction. Attach Form 8889 .	25		

Penalty on Early Withdrawal of Savings Deductions

Understand and Calculate the Penalty on Early Withdrawal of Savings Deduction

Penalty on Early Withdrawal of Savings

- The taxpayer may have paid a penalty for an early withdrawal from their savings account (usually a certificate of deposit)
 - This penalty can be identified on **Form 1099-INT Box 2** or **Form 1099 – OID Box 2**
 - The taxpayer will receive these forms from their bank
- Make sure to only deduct the amount on **Box 2** of either **Form 1099 – INT** or **Form 1099 – OID** issued by the taxpayer’s bank

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.		Payer's RTN (optional)	OMB No. 1545-0112		Interest Income
			2021		
		1 Interest income	Form 1099-INT		Copy 1
		\$			
		2 Early withdrawal penalty			For State Tax Department
		\$			
PAYER'S TIN	RECIPIENT'S TIN	3 Interest on U.S. Savings bonds and Treas. obligations			
		\$			
RECIPIENT'S name		4 Federal income tax withheld	5 Investment expenses		
		\$	\$		
Street address (including apt. no.)		6 Foreign tax paid	7 Foreign country or U.S. possession		
		\$			
City or town, state or province, country, and ZIP or foreign postal code		8 Tax-exempt interest	9 Specified private activity bond interest		
		\$	\$		
		10 Market discount	11 Bond premium		
		\$	\$		
		12 Bond premium on Treasury obligations	13 Bond premium on tax-exempt bond		
		\$	\$		
Account number (see instructions)		14 Tax-exempt and tax credit bond CUSIP no.	15 State	16 State identification no.	17 State tax withheld
					\$
					\$

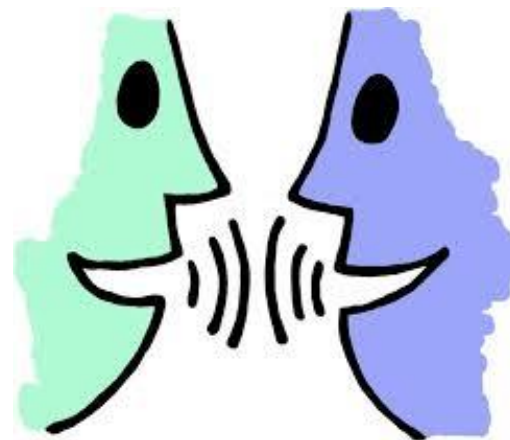
Form 1099-INT www.irs.gov/Form1099INT Department of the Treasury - Internal Revenue Service

Penalty on Early Withdrawal of Savings

- Example: The taxpayer says they have about \$100 early withdrawal penalty from their bank. After asking them if they have their Form 1099-INT, they give you their paperwork. Box 2 lists \$75. How much is **deductible as an Adjustment to Income**?
- Answer: **\$75** is deductible as a For AGI expense. Tax preparers can only utilize the amount listed in Box 2 of the taxpayer's Form 1099 – INT or 1099 – OID. This \$75 is a For AGI deduction and is written on line 30 of the taxpayer's Form 1040, Schedule 1, line 17
- Note, the information from the bank may look more like a letter than a Form 1099-INT

Whenever the taxpayer's documentation does not agree with what the taxpayer says, discuss the discrepancy with the taxpayer. Maybe he forgot to bring a second Form 1099-INT or other reasonable explanation.

When in doubt, talk to the taxpayer!





Alimony Paid Deductions

Understand and Calculate the Alimony Paid Deduction

Alimony Paid Deduction

- Alimony paid to a divorced spouse is **deductible as an Adjustment to Income that reduces AGI.**
- **A divorce before 1985 with alimony is out of scope.**
- Note: Alimony will not be deductible for any divorce decree executed or modified after 2018.
 - Alimony paid is not reported as income for the other party (divorced spouse)
- Requirements for payments to be considered alimony paid:
 - The ex-spouses do not file married filing jointly
 - The payment was in cash (includes checks and money orders)
 - The divorce does not designate the payment as “not alimony”
 - The ex-spouses were not members of the same household when the payment was made
 - The alimony payment was designated in a divorce/separation document and ordered by a judge
 - There is no liability to continue alimony payments after the death of the spouse that receives the payment
 - The payment is not treated as child support or a property settlement

Form **1040** Department of the Treasury—Internal Revenue Service (99) **2018** OMB No. 1545-0074 IRS Use Only

Filing status: Single Married filing jointly Married filing separately Head of household Qualifying widow(er)



Alimony Paid Deduction

- Alimony Paid is reported on the taxpayer's Form 1040, Schedule 1, line 18a.
- The taxpayer must also have the Social Security Number of ex-spouse they are making payments to. This is reported on the Form 1040, Schedule 1, line 18b.
- Report the date of the original divorce or separation agreement on Form 1040, Schedule 1, line 18c.
- Example: The taxpayer made alimony payments totaling \$2,500 in the past year. They also made child support payments totaling \$1,000 in the past year. How much can the taxpayer deduct as a For AGI deduction?
- Answer: **\$2,500**. Child support payments are not considered For AGI deductions.

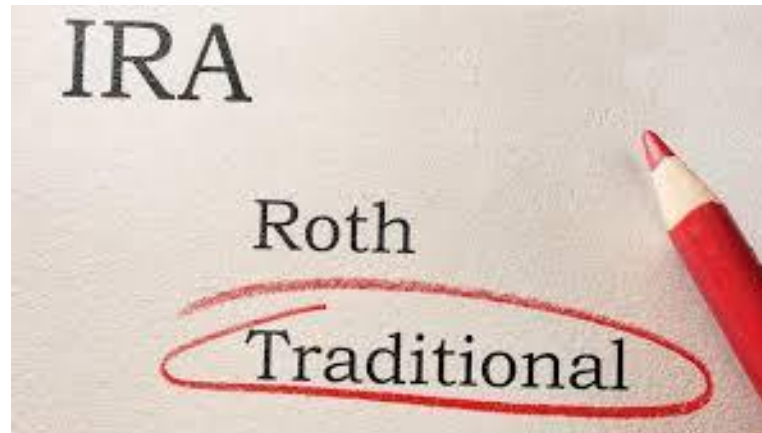
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15	Self-employed SEP, SIMPLE, and qualified plans	15	
16	Self-employed health insurance deduction	16	
17	Penalty on early withdrawal of savings	17	
18a	Alimony paid	18a	2,500
b	Recipient's SSN		
c	Date of original divorce or separation agreement (see instructions)		



IRA Calculations

IRA Calculations

- Only contributions to **traditional** IRAs are deductible
- Taxpayers may contribute and deduct up to \$6,000 (\$7,000 if age 50+)
 - Contributions cannot be more than taxpayer's yearly compensation





Student Loan Interest Deductions

Understand and Calculate the Student Loan Interest Deduction

Student Loan Interest Deduction

- Interest on qualified student loans can be deducted up to \$2,500 for the year in which the taxpayer paid interest
- A taxpayer must be legally liable for the loan.
- The taxpayer cannot be Married Filing Separate.
- Taxpayer or their Spouse cannot be claimed as dependents on someone else's return.
- Taxpayer may have a form from the lending institution or will be able to look up their account.



Additional Adjustments

Adjustments to Income

- These lines require an Advanced or other higher-level certification
 - Line 12 – certain business expenses of reservists, performance artists, and fee-basis governmental officials require Form 2016
 - Line 13 – Health Savings Account (HSA) deductions – see our Module 4 Supplement: HSA
 - Line 14 – Moving Expenses for members of the Armed Forces – use Form 3903
 - Line 15 – Self-Employment Tax
 - Line 16 – Self-employed SEP, SIMPLE, and qualified plans (**out of scope**)
 - Line 17 – self-employed health insurance deduction



Self-Employment Tax

Self-Employment Tax ([Schedule 2, Line 21](#))

- $\frac{1}{2}$ of self-employment tax can be subtracted from total income
- Automatically calculated based on [Schedule C, Line 31](#) – Net Profit (or Loss [which is out of scope]) and is calculated on [Schedule SE](#)
- For people who receive a W-2, Social Security Tax and Medicare Tax are withheld. The employer pays half and the employee pays half of these taxes which is usually figured by the employer.
- For people who are self-employed, they are both **employer** and **employee**. Schedule 1, Part II, Line 14 is the deductible part of the self-employment tax from Schedule SE.
- **The math goes like this:**
 - Self-Employed Taxpayers pay an additional 25% of self-employment tax.
 - Half of the tax is deductible
 - They may qualify for a Qualified Business Income Deduction



Self-Employed Health Insurance Deduction

Self-Employed Health Insurance Deduction

- Health insurance paid by a self-employed taxpayer can be an adjustment to income
- The cost of all out-of-pocket, not reimbursed Medicare, supplemental, private and long-term care premiums paid for the taxpayer, spouse or dependent children can be used for the deduction
- ACA Marketplace policy premiums are a qualified deduction, but they are **out-of-scope** if the taxpayer received a premium tax credit on their policy. They would have received a Form 1095-A showing the advanced premium tax credit.

Form 1095-A	Health Insurance Marketplace Statement	<input type="checkbox"/> VOID	OMB No. 1545-2232
Department of the Treasury Internal Revenue Service	▶ Do not attach to your tax return. Keep for your records. ▶ Go to www.irs.gov/Form1095A for instructions and the latest information.	<input type="checkbox"/> CORRECTED	2020

Self-Employed Health Insurance Deduction

- You can not deduct premiums for any month you were eligible for an employer subsidized health plan from your employer or your spouse's or child's employer
- You must show a net profit on schedule C
- The deduction is limited to the net profit minus the deductible part of the self-employment tax
- If the taxpayer is itemizing and meets the medical deduction threshold, do not allow any expenses entered as an adjustment to also be entered on schedule A
- Total amount paid is only entered on Schedule C-- general expense-health insurance line.
- This amount will not be used for any Schedule C calculations or appear on the Schedule C
- The software will carry the allowed amount to the adjustments section of Schedule 1 and any remainder to schedule A as a medical deduction

Knowledge Check

Additional Resources:

- [Adjusted Gross Income](#): The IRS's definition of Adjusted Gross Income
- [Educator Expense Deduction](#): IRS Topic No. 458
- [Penalty on Early Withdrawal of Savings](#): IRS and VITA Case Study
- [Alimony Paid Deduction](#): IRS Topic No. 452
- [Student Loan Interest Deduction](#): IRS Topic No. 456
- [Publication 17](#)
- [Publication 535](#): IRS References on Business Expenses

Up Next...
Module 5: Deductions