



Module 4

ADJUSTMENTS TO INCOME

*Special thanks to: Marshall Hunt and Cara Cardotti
for their contributions to this module.*



Objectives

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
- Understand the Self Employment Health Insurance Deduction
- Understand the HSA Deduction

Overview

Topics 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
- Health Savings Accounts
- Health Savings Account Deductions
- Self-Employment Tax
- Self-Employment Health Insurance Deduction

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.
- Most adjustments are reported on Schedule 1, Part II and carried to Form 1040, Line 10.



SCHEDULE 1
(Form 1040)

Department of the Treasury
Internal Revenue Service

Additional Income and Adjustments to Income
Attach to Form 1040, 1040-SR, or 1040-NR.
Go to www.irs.gov/Form1040 for instructions and the latest information.

OMB No. 1545-0074
2024
Attachment
Sequence No. 01

Name(s) shown on Form 1040, 1040-SR, or 1040-NR _____ Your social security number _____

For 2024, enter the amount reported to you on Form(s) 1099-K that was included in error or for personal items sold at a loss _____

Note: The remaining amounts reported to you on Form(s) 1099-K should be reported elsewhere on your return depending on the nature of the transaction. See www.irs.gov/1099k.

Part I Additional Income

1	Taxable refunds, credits, or offsets of state and local income taxes	1	
2a	Alimony received	2a	
b	Date of original divorce or separation agreement (see instructions):		
3	Business income or (loss). Attach Schedule C	3	
4	Other gains or (losses). Attach Form 4797	4	
5	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E	5	
6	Farm income or (loss). Attach Schedule F	6	
7	Unemployment compensation	7	
8	Other income:		
a	Not operating loss	8a	()
b	Gambling	8b	
c	Cancellation of debt	8c	
d	Foreign earned income exclusion from Form 2555	8d	()
e	Income from Form 8853	8e	
f	Income from Form 8889	8f	
g	Alaska Permanent Fund dividends	8g	
h	Jury duty pay	8h	
i	Prizes and awards	8i	
j	Activity not engaged in for profit income	8j	
k	Stock options	8k	
l	Income from the rental of personal property if you engaged in the rental for profit but were not in the business of renting such property	8l	
m	Olympic and Paralympic medals and USOC prize money (see instructions)	8m	
n	Section 951(a) inclusion (see instructions)	8n	
o	Section 951A(a) inclusion (see instructions)	8o	
p	Section 461(f) excess business loss adjustment	8p	
q	Taxable distributions from an ABL account (see instructions)	8q	
r	Scholarship and fellowship grants not reported on Form W-2	8r	
s	Nontaxable amount of Medicaid waiver payments included on Form 1040, line 1a or 1d	8s	()
t	Pension or annuity from a nonqualified deferred compensation plan or a nongovernmental section 457 plan	8t	
u	Wages earned while incarcerated	8u	
v	Digital assets received as ordinary income not reported elsewhere. See instructions	8v	
z	Other income. List type and amount:	8z	
9	Total other income. Add lines 8a through 8z	9	
10	Combine lines 1 through 7 and 9. This is your additional income . Enter here and on Form 1040, 1040-SR, or 1040-NR, line 8	10	

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 71479F Schedule 1 (Form 1040) 2024

Note: The three new adjustments added by the One, Big, Beautiful, Bill (to be discussed later) are reported on Schedule 1-A and carried to Form 1040, Line 13b.

Adjusted Gross Income (AGI)

- Adjustments to income lower your adjusted gross income dollar for dollar.
- Example:** The taxpayer has **\$20,000** in Gross Income, **\$300** 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 = \$3,350 (\$300 + \$50 + \$2,000 + \$1,000)
 - AGI = \$16,650** (\$20,000 - \$3,350)

TREASURY/IRS AND OMB USE ONLY DRAFT

Schedule 1 (Form 1040-SS) Page 2

Part 8 Adjustments to Income

11	Educator expenses	11
12	Certain business expenses of reservists, performing artists, and fee-based 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. If claiming only storage fees, see instructions, check here <input type="checkbox"/>	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
19b	Recipient's SSN	
20	Date of original divorce or separation agreement (see instructions)	
21	IRA deduction. If you are married filing separately and lived apart from your spouse for the entire year, see instructions, check here <input type="checkbox"/>	21
22	Student loan interest deduction	22
23	Reserved for future use	23
24	Other adjustments	24
25	Other adjustments. See instructions	25
26	Deductible expenses related to income reported on line 8 from the rental of personal property engaged in for profit	26
27	Nonexcludable amount of the value of options and foreign tax credits and U.S. prize money reported on line 10	27
28	Postretirement amortization and expenses	28
29	Payment of supplemental unemployment benefits under the Trade Act of 1974	29
30	Contributions to section 501(c)(6) pension plans	30
31	Contributions by certain churches to section 501(c)(3) plans	31
32	Attorney fees and court costs for actions involving certain unlawful discrimination claims (see instructions)	32
33	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	33
34	Moving deduction from Form 3903	34
35	Business deductions of section 67(j) expenses from Schedule E (Form 1041)	35
36	Other adjustments. List type and amount	36
37	Total other adjustments. Add lines 24a through 36a	37
38	Add lines 11 through 37 and 25. These are your adjustments to income. Enter here and on Form 1040, 1040-SS, or 1040-SE, line 10	38

Schedule 1 (Form 1040-SS)

DRAFT - DO NOT FILE

New Adjustments for 2025

The One, Big, Beautiful Bill added four new additional adjustments, the No Tax on Tips, No Tax on Overtime, No Tax on Car Loan Interest, and the Enhanced Deduction for Seniors.

For a detailed discussion of these adjustments see Module 10, “What’s New for 2025” that includes a Supplemental Lesson on New Tax Law Provisions for 2025.

<https://is.gd/vitaob3>

Educator Expense Deductions

Understand and Calculate the Educator Expense Deductions

Educator Expense Deductions

- An eligible educator is allowed to deduct up to \$300 (Single) or \$600 (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.*
 - Amounts paid or incurred for personal protective equipment, disinfectant, and other supplies used for the prevention of the spread of coronavirus. Additionally, professional development expenses are allowed unless reimbursement is offered by the school but not accepted. Professional development expenses include courses related to the curriculum in which the educator provides instruction.

Note: For 2026 returns there will be an itemized deduction available in addition to the adjustment currently allowed

Educator Expense Deductions

- Excluded Expenses include:
 - Homeschooling, Non-Athletic Supplies for courses in health or physical education
- 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 11.

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

9292 ☐ VOID ☐ CORRECTED

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 Form 1099-INT (Interest Income)	
		1 Interest income	For calendar year	
		\$		
		2 Early withdrawal penalty		
		\$		
PAYER'S TIN	RECIPIENT'S TIN	3 Interest on U.S. Savings Bonds and Treasury 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. territory	
		\$		
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)	2nd TIN not	14 Tax-exempt and tax credit bond CUSIP no.	15 State	16 State identification no.
	<input type="checkbox"/>			
				17 State tax withheld
				\$
				\$

Form **1099-INT** (Rev. 1-2024) Cat. No. 14410K www.irs.gov/Form1099INT Department of the Treasury - Internal Revenue Service

Do Not Cut or Separate Forms on This Page — Do Not Cut or Separate Forms on This Page

**Interest
Income**

Copy A

**For
Internal Revenue
Service Center**

File with Form 1096.

**For Privacy Act
and Paperwork
Reduction Act
Notice, see the
current General
Instructions for
Certain
Information
Returns.**

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 an adjustment to income. Tax Preparers can only utilize the amount listed in Box 2 of Form 1099-INT or 1099-OID. The deduction is listed on Schedule 1, line 18.
- 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 the taxpayer 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 may be **deductible as an Adjustment to Income that reduces AGI and included in the recipient spouse's income.**
- **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 is not reported as income for the other party after December 31, 2018
- 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

Alimony Paid Deduction

- Alimony Paid is reported on the taxpayer's Schedule 1, line 19a.
- The taxpayer must also have the Social Security Number of ex-spouse they are making payments to. This is reported on the Schedule 1, line 19b.
- Report the date of the original divorce or separation agreement on Schedule 1, line 19c.
- 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.

IRA Calculations

IRA Deduction

- Only contributions to traditional IRAs are deductible
- For 2025, the maximum combined traditional IRA deduction or Roth contribution is \$7,000 (\$8,000 if age 50 or older)
- Contributions cannot be more than taxpayer's yearly compensation
- The IRA deduction is listed on Schedule 1, line 20.

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.
- The Student Loan Deduction is listed on Schedule 1, line 21.

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 2106
- Line 13 – Health Savings Account (HSA) deductions – use Form 8889.
- Line 14 – Moving Expenses for members of the Armed Forces – use Form 3903 – requires military certification.
- Line 15 – Self-Employment Tax
- Line 16 – Self-employed SEP, SIMPLE, and qualified plans **(out of scope)**
- Line 17 – self-employed health insurance deduction

Health Savings Accounts

Health Savings Account (HSA)

- An HSA is a medical savings account designed to pay for qualified medical expenses and save for future expenses on a tax-free basis.
- To be eligible to have an HSA, individuals must meet the following requirements:
 - Be covered by a high-deductible health plan
 - Not be covered by other insurance
 - Not be enrolled in Medicare
 - Not be eligible to be claimed as a dependent on another return
- A taxpayer has a family plan if their insurance covers themselves and a spouse or claimed dependent. A self-only plan covers only the taxpayer.
- Contributions to an HSA have an annual limit based on the type of plan.
 - Self only plans: \$4,150 or \$5,150 for people age 55+
 - Family plans: \$8,550 or \$9,550 for people age 55+
- Contributions can be made to an HSA up until the tax filing deadline, April 15, 2026.

HSA Contribution Deduction

HSA Contribution Deduction

- Taxpayers with an HSA may qualify for an adjustment to income for contributions to the account.
- Contributions made through a payroll deduction plan or by the taxpayer's employer do not qualify for the adjustment.
 - These contributions will be shown on Form W-2 in box 12 with code W.
 - Many taxpayers do not make contributions beyond payroll deductions or employer contributions and will not qualify for the adjustment.
- Use Form 8889 to collect information about a taxpayer's HSA contributions and figure the adjustment.
 - Form 8889 also collects information about a taxpayer's HSA distributions. Distributions used for non-qualified medical expenses are taxable and subject to an additional 20% tax.

Self-Employment Tax

Self Employment Tax Deduction

- Half of self-employment tax can be deducted from income.
- Self-Employment tax is based on income reported on Schedule C and figured on Schedule SE.
 - SE tax covers the Social Security and Medicare Tax for self-employed taxpayers.
 - W-2 employees have half of their Social Security and Medicare Tax taken out of their paychecks automatically and the employer pays the other half.
- The self-employment Tax Deduction is listed on Schedule 1, line 15.

Self-Employed Health Insurance Deduction

Self-Employed Health Insurance Deduction

- Health insurance premiums paid by a self-employed taxpayer can be an adjustment to income
- The cost of all out-of-pocket, unreimbursed Medicare, supplemental, private and long-term care premiums paid for the taxpayer, spouse or dependent children can be used for the deduction
- If the taxpayer purchased a Marketplace plan and qualifies for the Premium Tax Credit the return is **out of scope**.
- 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

Adjustments Knowledge Check

Knowledge Check - scenario

- Pat and Chris are married and wish to file a joint return.
- Pat and Chris are each 27 years old. They have no children.
- Pat teaches third grade at a private elementary school and spent 1,400 hours in the classroom during the tax year.
- Chris is a social service case manager for a nonprofit.
- Their combined income from work was \$60,000, and they had \$2,000 investment income from a certificate of deposit, which they cashed in six months early to pay for a new air conditioner for their home.

Pat and Chris bring you the following expenses, which they hope to deduct:

- \$600 classroom expenses for Pat.
- \$2,300 student loan interest for Pat.
- \$1,700 student loan interest for Chris.
- Chris is covered by a high deductible health plan (HDHP) at work all year. Chris' W-2 shows \$1,200 in Box 12 with code W.
- Pat contributed \$1,000 to a Roth IRA.
- \$200 early withdrawal penalty for cashing in their certificate of deposit before its maturity date (they provide Form 1099-INT with \$200 in Box 2).

Knowledge Check - question

Question: What is the total amount of adjustments that Pat and Chris can report on their tax return?

- a. \$2,500
- b. \$3,000
- c. \$4,200
- d. \$7,000

Answer on the next slide.

Knowledge Check - answer

Answer: B. \$3,000

What they can claim:

- Pat is allowed to claim \$300 in classroom expenses as an educator. Chris is not an educator, so \$300 is the maximum educator expense deduction allowed.
- Pat and Chris can claim \$2,500 student loan interest combined--not per person.
- Pat and Chris can claim the \$200 early withdrawal penalty on their certificate of deposit.

What they cannot claim:

- The excess classroom expenses and student loan interest amounts are not allowed.
- Code W in Box 12 of Form W-2 represents nondeductible HSA contributions, so the \$1,200 HSA contribution is not allowed.
- Only traditional IRA contributions are eligible for the IRA deduction, so Pat's \$1,000 contribution to a Roth IRA is not allowed.

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](#)

Thank you for completing the training!

End of Module

