



# Module 4: ADJUSTMENTS TO INCOME

*Special thanks to: Siri Belton and Monica Ruck for their contributions to this module.*

# 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



# 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 <b>adjusted gross income</b> . . . . . ▶	11	

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

# 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)

Schedule 1 (Form 1040) 2022 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 8i 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 8m	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) 2022



# Educator Expense Adjustments

Understand and Calculate the Educator Expense Adjustment

# 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 12<sup>th</sup> 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.
- Excluded Expenses include:
  - Homeschooling, Non-Athletic Supplies for courses in health or physical education

# 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 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

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

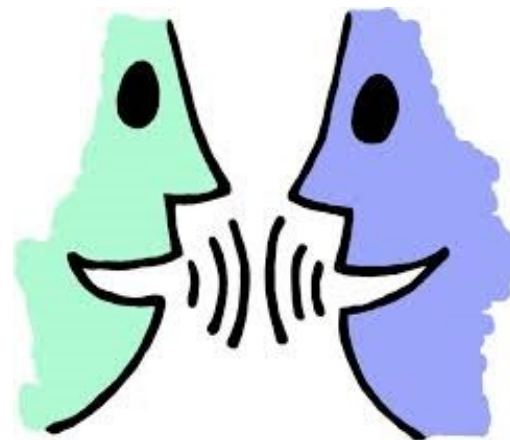
Form 1099-INT      www.irs.gov/Form1099INT      Department of the Treasury - Internal Revenue Service

# 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 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 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 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

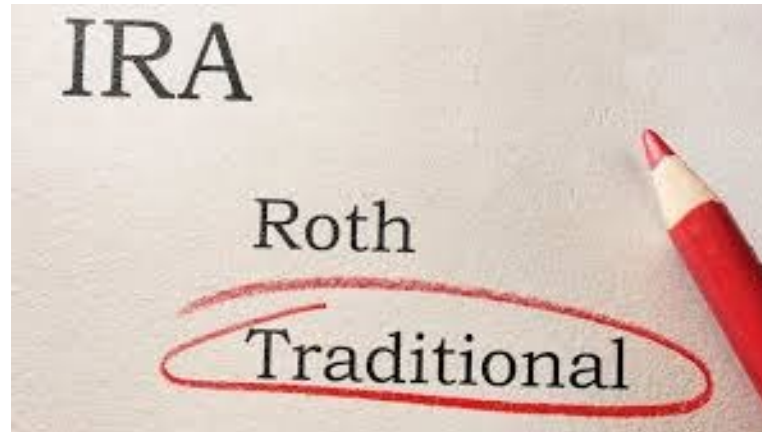
# Alimony Paid Deduction

- 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 2023, 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:
  1. Be covered by a high-deductible health plan
  2. Not be covered by other insurance
  3. Not be enrolled in Medicare
  4. 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: \$8,300 or \$9,300 for people age 55+
- Contributions can be made to an HSA up until the tax filing deadline, April 15, 2025.



# 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

- ½ 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.



# 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

**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).

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](#)
- [Publication 535](#): IRS References on Business Expenses

**Up Next...**  
**Module 5: Deductions**