Grace Global Alliance

An Independent Association of Christian Churches & Ministers

Personal Income Taxes
An Overview
Tax Year 2017

Prepared for:

Grace Global Alliance
Ministers & Churches

Prepared by:

John Terry
Grace Global Alliance
100 Plaza Carmona Place
Hot Springs Village AR 71909
Website: www.GraceGlobalAlliance.com

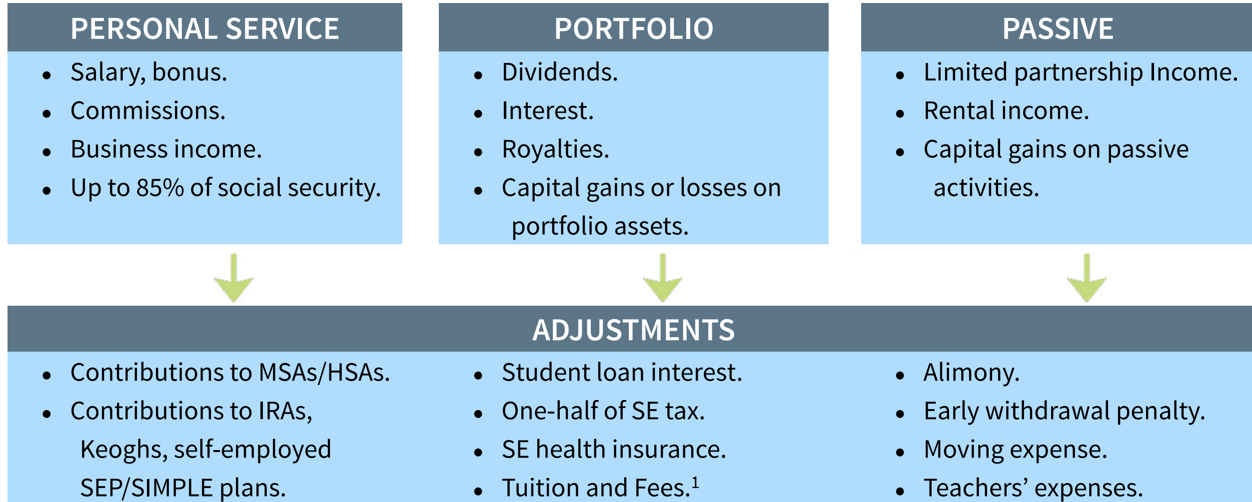
June 20, 2017

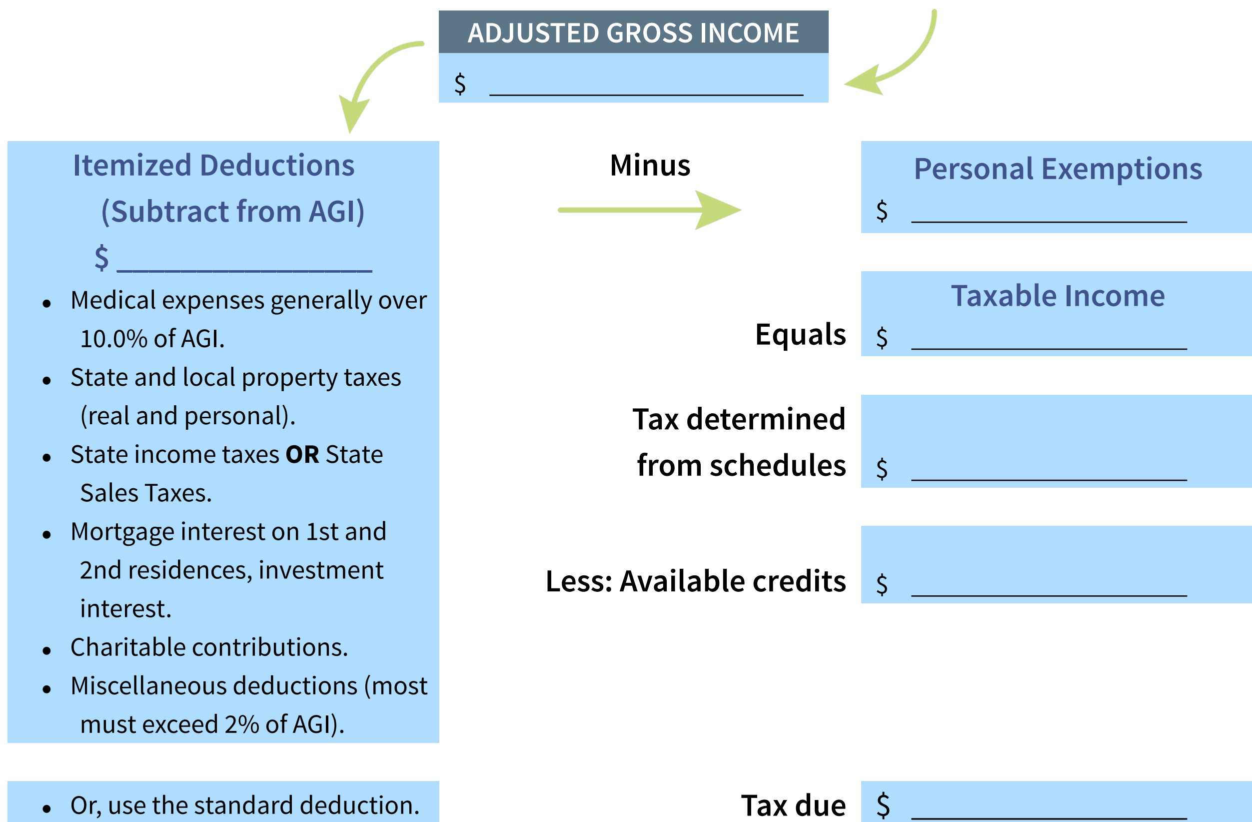
Table of Contents

Income Taxes Generally (Three Kinds of Income)........ 1
Personal Income Tax History (Top Marginal Rates 1913 to Present)........ 2
Social Security and Medicare Taxes........ 3
Federal Income Tax Tables - 2017........ 5
Capital Gains and Losses (Individuals, Estates, and Trusts)........ 8
Deductibility of Interest........ 12
Income Tax Basis........ 14
Personal Alternative Minimum Tax........ 15
Taxation of Social Security Benefits........ 18
Utilizing Passive Losses........ 19
Disclosure Notice........ 21

Income Taxes Generally

Three Kinds of Income





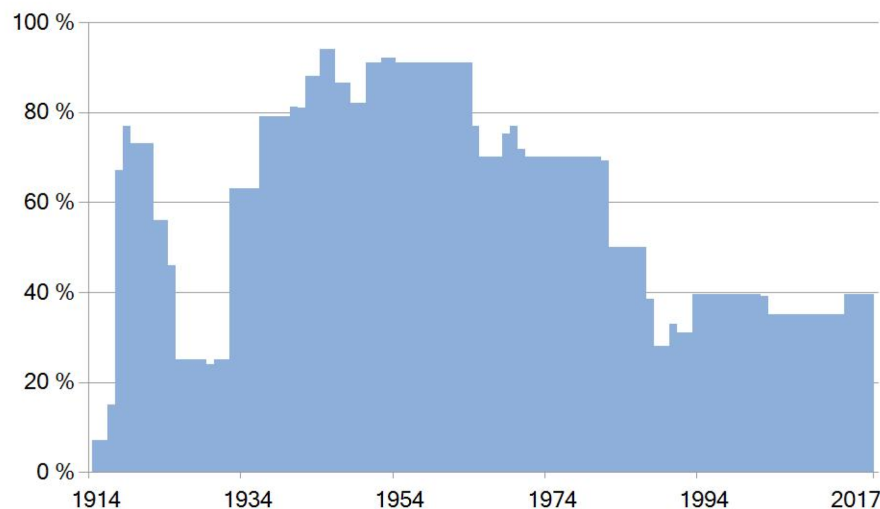
[1] Expires December 31, 2016

Personal Income Tax History

Top Marginal Rates 1913 to Present

The chart[1] traces the highest federal personal income tax rates from 1913 to today. The amount of income subject to these varying rates has also changed. In 1965-67, a rate of 70% applied to taxable incomes over $200,000, equal to approximately $1,395,501 in current dollars.

Top Federal Income Tax Rate



[1] Source: Joseph A. Pechman, "Federal Tax Policy" Fifth Edition, and IRS form 1040.

Social Security and Medicare Taxes

Federal Insurance Contributions Act (FICA) taxes are deducted from an employee's paycheck each pay period. Commonly referred to as Social Security taxes, there are actually two separate taxes: the Old-Age, Survivors and Disability Insurance (OASDI) tax and the Medicare Hospital Insurance (HI) tax. For calendar 2017, OASDI applies to the first $127,200 of wages.[1] HI is 1.45% of all wages.

Social Security Taxes for Employees				
Year	OASDI Wage Base	OASDI Rate	Maximum OASDI Tax	Hospital Insurance Rate
2014	$117,000	4.2%	$4,914	1.45%
2015	118,500	6.2%	7,347	1.45%
2016	118,500	6.2%	7,347	1.45%
2017	127,200	6.2%	7,886	1.45%

Social Security Taxes for the Self-Employed				
Year	OASDI Wage Base	OASDI Rate	Maximum OASDI Tax	Hospital Insurance Rate
2014	$117,000	10.4%	$12,168	2.90%
2015	118,500	12.4%	14,694	2.90%
2016	118,500	12.4%	14,694	2.90%
2017	127,200	12.4%	15,773	2.90%

Note: Individuals with $400 or more per year in net earnings from self-employment must file IRS schedule SE with his or her income tax return.

Calculating the Social Security Tax (2017)			
Employee Portion		Self-Employed	
Covered wages	$_________	**Covered wages**	$_________
6.2% of 1st $127,200	$_________	**12.4% of 1st $127,200**	$_________
1.45% of covered wages	$_________	**2.9% of covered income**	$_________
Total tax	$_________	**Total tax**	$_________

[1] Source: Social Security Administration. The dollar amount of wages subject to OASDI is termed the "wage base." The wage base is subject to adjustment each year for changes in the national average wage.

Patient Protection and Affordable Care Act

Beginning in 2013, the Patient Protection and Affordable Care Act imposed an additional Medicare tax on certain taxpayers:

- **0.9% health insurance tax:** Taxpayers with incomes above certain thresholds pay an additional HI tax of 0.9%. For an employee, the additional 0.9% effectively increases the HI tax from 1.45% to 2.35% on income in excess of the applicable threshold. For self-employed taxpayers, the additional tax of 0.9% effectively raises the HI tax rate to 3.8% of net self-employment income in excess of the applicable threshold. For self-employed individuals, the additional 0.9% tax is not deductible. The thresholds are $250,000 in case of a joint return (the earnings of both spouses are considered) or a surviving spouse, $125,000 in the case of a married individual filing a separate return, and $200,000 for any other taxpayer.

Federal Income Tax Tables - 2017

Filing Status	If Taxable Income Is Between			Pay	Plus Percent on Excess Over 1st Column
Single tax payers	$0	-	$9,325	$0.00	10.0%
	9,325	-	37,950	932.50	15.0%
	37,950	-	91,900	5,226.25	25.0%
	91,900	-	191,650	18,713.75	28.0%
	191,650	-	416,700	46,643.75	33.0%
	416,700	-	418,400	120,910.25	35.0%
	418,400	-	Up	121,505.25	39.6%
Married filing jointly	$0	-	$18,650	$0.00	10.0%
	18,650	-	75,900	1,865.00	15.0%
	75,900	-	153,100	10,452.50	25.0%
	153,100	-	233,350	29,752.50	28.0%
	233,350	-	416,700	52,222.50	33.0%
	416,700	-	470,700	112,728.00	35.0%
	470,700	-	Up	131,628.00	39.6%
Married filing separately	$0	-	$9,325	$0.00	10.0%
	9,325	-	37,950	932.50	15.0%
	37,950	-	76,550	5,226.25	25.0%
	76,550	-	116,675	14,876.25	28.0%
	116,675	-	208,350	26,111.25	33.0%
	208,350	-	235,350	56,364.00	35.0%
	235,350	-	Up	65,814.00	39.6%
Head of household	$0	-	$13,350	$0.00	10.0%
	13,350	-	50,800	1,335.00	15.0%
	50,800	-	131,200	6,952.50	25.0%
	131,200	-	212,500	27,052.50	28.0%
	212,500	-	416,700	49,816.50	33.0%
	416,700	-	444,550	117,202.50	35.0%
	444,550	-	Up	126,950.00	39.6%

Example

Married Filing Jointly			
Taxable income	$80,000		
Tax on the 1st	75,900	is	$10,452.50
Tax on the remaining	4,100	25.0%	1,025.00
Total Tax			**$11,477.50**

Personal and Dependent Exemptions

Year	Amount of Exemption for Each		
	Taxpayer	Spouse	Dependent Child
2014	$3,950	$3,950	$3,950
2015	4,000	4,000	4,000
2016	4,050	4,050	4,050
2017	4,050	4,050	4,050
2018	Adjusted for Inflation		

For higher-income taxpayers, the deductibility of personal exemptions and certain itemized deductions is gradually reduced as adjusted gross income (AGI) rises. For 2017, the thresholds for these phase-outs are: Single - $261,500; Married Filing Jointly - $313,800; Married Filing Separately - $156,900; and Head of Household - $287,650. These thresholds are subject to adjustment for inflation in future years.

Standard Deduction - Persons Who Do Not Itemize Deductions

Year	Amount of Deduction			
	Married Jointly	Married Separate	Heads of Household	Single
2014	$12,400	$6,200	$9,100	$6,200
2015	12,600	6,300	9,250	6,300
2016	12,600	6,300	9,300	6,300
2017	12,700	6,350	9,350	6,350
2018	Adjusted for Inflation			

Year	Additional Standard Deductions (Each Spouse)			
	65 or Older		Blind	
	Married	Single	Married	Single
2014	$1,200	$1,550	$1,200	$1,550
2015	1,250	1,550	1,250	1,550
2016	1,250	1,550	1,250	1,550
2017	1,250	1,550	1,250	1,550
2018	Adjusted for Inflation			

Children: Children with income who can be claimed as dependents on a parent's return (even if the exemption has no benefit due to the phase-out) cannot take their own personal exemption. A child's standard deduction is up to $1,050 for unearned income or up to $6,350 for earned income.

Capital Gains and Losses

Individuals, Estates, and Trusts[1]

The Internal Revenue Code[2] has long distinguished between income paid due to a person's individual effort (such as wages or self-employment earnings), and income received from the profitable sale of assets known as "capital" assets. Wages and salaries are classified as "ordinary" income. Gain from the sale of a capital asset is termed a "capital" gain. Gains from the sale of capital assets that meet certain requirements are generally accorded more favorable tax treatment than ordinary income.

Basic Terminology

There are several concepts essential to understanding capital gains and losses.

- **Capital asset:** The law defines the term "capital" asset in a negative sense by first declaring that all types of property are capital assets, and then listing certain exceptions. (See IRC Sec. 1221.) Assets such as stocks, bonds and other securities held by individuals are capital assets. In general terms, assets that are held for investment purposes are capital assets. Some assets are not capital assets by definition, but may be treated as such if used in a trade or business, and sold or exchanged at a gain.
- **Holding period:** This is the length of time an asset is owned, beginning on the day after it is acquired and ending on the day it is disposed of. The amount of time an asset has been held impacts the tax treatment of any gain or loss when the asset is sold. The law currently provides for two holding periods: short-term and long-term. Short-term assets are those held exactly 12 months or less. Long-term assets are those held more than 12 months.

Capital Losses

At the end of a tax year, a taxpayer's capital gains and losses are totaled and compared. If losses exceed gains, a taxpayer may use up to $3,000 of losses to offset other ordinary income ($1,500 if married filing separately). See IRC Sec. 1211(b). Losses that exceed the $3,000 limit may be carried to future tax years until used up. If a taxpayer dies, any un-used capital loss is gone forever; it may not be carried over to future tax years.

---

[1] Corporate taxpayers are subject to different rules regarding capital gains.

[2] The discussion here concerns federal income tax law; state or local income tax law may differ.

Capital Gains

Ordinary income such as wages and salaries can be taxed at marginal federal income tax rates as high as 39.6% Short-term capital gains are treated as ordinary income, taxable at the taxpayer's highest rate. Long-term capital gains are taxed at rates which are capped, and which may be less than a taxpayer's regular rate.

Capital Gains Tax Rates

The past few years have seen many changes in the federal income tax treatment of capital gains. The American Taxpayer Relief Act of 2012 (ATRA 2012), generally effective January 2, 2013, made permanent many of the tax code provisions in effect for 2012.

The table provides a summary of the capital gains rates under both prior law and ATRA 2012.

Item	Holding Period	Type of Gain	Tax Rate in 2012 Under Prior Law	Tax Rate Under ATRA 2012
Any capital gain property	Exactly 12 months or less	Short-term	Ordinary income, taxed at taxpayer's regular marginal rate	Ordinary income, taxed at taxpayer's regular marginal rate
Tax bracket is 10% or 15%	More than 12 months	Long-term	0%	0%
Tax bracket is 25%, 28%, 33%, or 35%	More than 12 months	Long-term	15%	15%
Tax bracket is 39.6%[1]	More than 12 months	Long-term	15%	20%
Real estate depreciation treated as capital gain[2]	More than 12 months	Long-term	25%	25%
Sale of collectibles	More than 12 months	Long-term	28%	28%

[1] In 2017, the 39.6% bracket is reached when taxable income reaches $470,700 (Married Filing Jointly); $444,550 (Head of Household); $418,400 (Single); and $235,350 (Married Filing Separately).

[2] Gain in excess of recaptured depreciation is taxed at the taxpayer's regular capital gains rate.

Special Rules for Personal Residence

Under current law, a taxpayer may exclude from income up to $250,000 of gain from the sale of a principal residence, if the taxpayer has owned and used the property as his or her principal residence for at least two years of the five-year period ending on the date of the sale or exchange. Only one such exclusion is permitted every two years.

For married couples filing a joint return, the maximum exclusion amount is increased to $500,000 if (a) either spouse meets the ownership requirement; (b) both spouses meet the use requirements, and (c) neither spouse is ineligible because of the one sale every two years rule. If a married couple does not meet the requirements for the $500,000 exclusion, the amount of gain eligible for exclusion is the sum of the amounts to which each spouse would be entitled if they had not been married.

The surviving spouse of a couple who had jointly owned and occupied a residence and who met the general requirements discussed above immediately before the deceased spouse's death, may exclude up to $500,000 of gain as long as the sale of the residence takes place within two years of the date of the deceased spouse's death.

The law also provides for a reduced maximum exclusion for taxpayers who do not meet the requirements to qualify for the full $250,000 ($500,000 if married) exclusion, and who sell or exchange a principal residence because of changes in place of employment, health, or unforeseen circumstances.

Beginning with sales or exchanges after January 1, 2009, gain from the disposition of a principal residence attributable to periods of "nonqualified use" is not excluded from gross income. Nonqualified use, generally, is a period of time (beginning on or after January 1, 2009) when the property is not used by the taxpayer or the taxpayer's spouse (or former spouse) as a principal residence. Common examples of such nonqualified use include use of the property as a rental or vacation home.

A member of the U.S. armed forces, U.S. Foreign Service, Peace Corps volunteers, or specified members of the intelligence community serving on qualified extended duty may choose to suspend the five-year period of use and ownership for up to 10 years.

An individual who acquires his or her principal residence in an IRC Sec. 1031 "like-kind-exchange" must own the property for five years before the exclusion applies.

Timing of Capital Gains Transactions

Note that a taxpayer generally controls when a capital asset will be sold and can, therefore, choose the year in which a gain or loss is to be included in his or her taxable income.

Seek Professional Guidance:

The income tax treatment of capital gains and losses is complex and often confusing. Individuals facing decisions concerning the tax implications of the sale or exchange of a capital asset are strongly advised to first consult with a CPA, IRS enrolled agent, or other competent professional.

Deductibility of Interest

Under the current income tax law, not all interest is deductible on your tax return.

Nondeductible Interest

Personal interest is not deductible and includes all interest, except those types listed below. Examples of nondeductible personal interest would include interest on credit card purchases, auto loans, unpaid income taxes and deferral of federal estate taxes made at the government's discretion for "reasonable cause" under IRC Sec. 6161.

Deductible Interest

A partial list of types of deductible interest includes:

- **Interest on loans used to purchase investment properties:** This interest is deductible to the extent there is net investment income. Interest paid on money borrowed to purchase or carry tax-exempt securities is not deductible. Any unused deduction is carried over to future years until used.[1]
- **Interest incurred in the conduct of your trade or business.**
- **Qualified residence interest:** This is one type of loan for which the interest paid is deductible without regard to the use of the borrowed funds.

  A "qualified residence" is your principal residence and one other property, such as a vacation home, a boat you live on, etc., which you use more than 14 days during the year (or 10% of the number of days it is rented, if that is larger), or any number of days if you use it as a residence but do not rent it.

There are two types of deductible qualified residence interest:

- **Acquisition indebtedness:** Mortgage debt which you incur when you purchase, build or substantially improve a qualified residence. There is a limit on acquisition indebtedness incurred after October 13, 1987 of $1,000,000 ($500,000 for married persons filing separately).[2]

---

[1] Net capital gain included in net investment income is ineligible for capital gains treatment. See IRC Sec 163(d)(4)(B)(iii).

[2] Under recent Federal income tax law (state law may differ), premiums paid for qualified mortgage insurance in connection with acquisition indebtedness on a taxpayer's qualified residence are treated as deductible mortgage interest. This provision applied only to mortgage insurance contracts issued after December 31, 2006 and only for premium amounts paid, accrued, or allocable to 2007 through 2016. The deduction phased-out for taxpayers with an AGI in excess of certain limits.

- **Home Equity indebtedness:** Loans against the equity of the home (over and above the acquisition indebtedness); for example, a second mortgage to purchase an automobile. The limit is the lesser of: (a) the fair market value (FMV) of the home less any acquisition indebtedness; or, (b) $100,000 ($50,000 for married filing separate).

- **Revenue Ruling 2010-25:** In Revenue Ruling 2010-25, the IRS determined that indebtedness incurred by a taxpayer to acquire, construct, or substantially improve a qualified residence qualified as "home equity indebtedness" (under IRC 163(h)(3)(c)) to the extent that the indebtedness exceeded $1,000,000. In effect the IRS allowed the taxpayer to deduct interest on up to $1,100,000 of debt originally incurred by the taxpayer to purchase his home. $1,000,000 of that amount was considered to be "acquisition" indebtedness, with the remaining $100,000 considered "home equity" indebtedness. There was no requirement that the home equity indebtedness be acquired in a separate transaction.

- **Interest on educational loans:** Taxpayers may deduct up to $2,500 of interest paid on "qualified" education loans. The deduction is taken as an "above-the-line adjustment," directly reducing adjusted gross income (AGI).

The deduction is phased out for taxpayers with a modified AGI in excess of certain limits.

Filing Status	2016	2017	2018
Married Filing Jointly	$130,000 - $160,000	$135,000 - $165,000	Adjusted for inflation
Single, Head of Household, Widow	$65,000 - $80,000	$65,000 - $80,000	Adjusted for inflation

Income Tax Basis

Basis is a value used to determine the amount of gain or loss on the sale of an asset and will vary, depending upon how it was acquired:

Cost Basis	=	The amount paid for an asset
Adjusted Basis	=	Cost basis plus improvements less depreciation
Capital Gain	=	Sales price is higher than adjusted basis
Capital Loss	=	Sales price is less than adjusted basis
FMV	=	Fair market value

Basic Rules as They Apply to Various Transfers

Assume owner paid $5,000 for a lot (his cost basis).

Method of Transfer	Basis in Hands of New Owner	Assume at Time of Transfer Lot Had		
		Declined in Value to $3,000	Retained Same Value of $5,000	Increased in Value to $8,000
Sale	Purchaser receives a new basis (the amount he pays for the asset).	$3,000	$5,000	$8,000
Lifetime gift	**For computing gain:** Donee takes donor's basis.	–	$5,000	$5,000[1]
	For computing loss: Donee's basis is FMV at time of gift, or the donor's basis, whichever is lower.	$3,000	–	–
Transfer at death	Beneficiary's basis is equal to value at decedent's death or six months thereafter.[2]	$3,000	$5,000	$8,000
Like kind exchange IRC Sec. 1031	Basis in newly acquired property will be the same as basis in the transferred property, plus any recognized gain and less any cash received.	$5,000	$5,000	$5,000

Note: Transfers of appreciated property to a spouse or former spouse who is a non-resident alien will trigger tax on the gain. See IRC Sec. 1041(d).

[1] This amount plus gift tax paid, if any, at time of gift attributable to the appreciation.

[2] IRC 1014(b), unless the beneficiary or his or her spouse had transferred the specific piece of property to the decedent within one year prior to his demise, in which case the beneficiary must carry over the decedent's basis. See IRC Sec. 1014(e).

Personal Alternative Minimum Tax

The alternative minimum tax (AMT) is designed to prevent taxpayers with substantial income from avoiding or deferring all tax liability through the use of deductions, exemptions and credits. The rules add substantial complexity to the tax system. (See IRC Sec. 55 and IRS Form 6251 and its instructions.)

Adjusted gross income is adjusted to reflect different treatment of certain items by the AMT rules.

Steps in Computing the AMT

1. Adjusted Gross Income (AGI)[1] $ __________
2. Plus or Minus: Certain adjustments __________
3. Plus: AMT preferences __________
4. Equals: AMT Income (AMTI) __________
5. Less: Exemptions (see last page) (_________)
6. Equals: Net AMTI __________
7. Times: Tax rate
   (26% of 1st $187,800 and 28% of amounts over $187,800.
   For married filing separate, the breakpoint is $93,900.)[2]
   ($ _________ x 0.26) + ($ _________ x 0.28) = __________
8. Tentative AMT before credits __________
9. Less: AMT foreign tax credit [3] (_________)
10. Equals: Tentative minimum tax __________
11. Less: Regular tax (_________)
12. Alternative minimum tax due[4] $ __________

---

[1] If the return includes Schedule A, use AGI less the allowable itemized deductions from Schedule A.

[2] The breakpoints values shown are for 2017. These values are subject to adjustment for inflation in future years. For 2016, the breakpoints were: $93,150 (Married Filing Separately); and $186,300 (all other taxpayers).

[3] Any part of the AMT foreign tax credit that is not used in a tax year may be carried back one year and forward 10 years.

[4] The AMT only applies to the extent it is larger than the regular tax liability. Once a taxpayer is subject to the AMT, he or she may be entitled to a credit that can reduce future tax liability. In 2012 and later years, a taxpayer's nonrefundable personal credits are allowed against both the AMT and regular tax liability.

Adjustments

Certain items are treated differently for AMT purposes than for the regular tax and must therefore be adjusted. A partial list includes the following:

- Generally, no deduction is allowed for state and local taxes or for miscellaneous itemized deductions.
- Medical expenses are deductible only to the extent that they exceed 10% of adjusted gross income.
- Accelerated depreciation under the cost-recovery rules of the AMT will more closely approximate the investment's useful life.
- Passive investments that offset taxable income generally will not reduce AMTI (alternative minimum taxable income). Therefore, deductions for passive losses may be claimed only against passive income.
- Certain interest on a home mortgage not used to build, buy, or improve a house, is not deductible for AMT purposes.
- Investment interest is deductible for AMT purposes only to the extent of net investment income.
- Incentive stock options: The excess of the fair market value of the stock at the time of exercise, over the price paid for the stock, including any amount paid for the option.

Preferences

Taxable income for AMT purposes must be increased by the following preferences:

- Tax-exempt interest from certain private purpose bonds issued by state and local governments.
- The excess of the deduction for depletion over the adjusted basis of the property at the end of the taxable year.
- Certain expensing of intangible drilling costs to the extent they exceed 65% of net oil and gas income.

Note: The untaxed appreciation on gifts of appreciated property to charities is no longer a preference item.

Exemption Amounts - 2016

Varies with filing status and is phased out for persons with high income. The exemption amounts for 2016 are:

Filing Status	Exemption Amount	Less 25% of AMTI Over	No Exemption if AMTI is Over
Married Joint/Surviving Spouse	$83,800	$159,700	$494,900
Married Filing Separately	41,900	79,850	247,450
Single or Head of Household	53,900	119,700	335,300

Exemption Amounts - 2017[1]

The AMT exemption amounts for 2017 are as follows:

Filing Status	Exemption Amount	Less 25% of AMTI Over	No Exemption if AMTI is Over
Married Joint/Surviving Spouse	$84,500	$160,900	$498,900
Married Filing Separately	42,250	80,450	249,450
Single or Head of Household	54,300	120,700	337,900

Standard Deduction

Neither the personal exemptions nor the standard deduction are deductible in this calculation.

Note: This summary is not intended to cover all of the details of the alternative minimum tax. It is a very complicated set of rules and will require careful planning to avoid or reduce its potential impact on a taxpayer's overall income tax liability.

[1] The AMT exemption amounts, as well as the breakpoints at which the exemption begins to be phased-out, are subject to adjustment for inflation.

Taxation of Social Security Benefits

A portion of Social Security benefits may be subject to income taxation. The following worksheet will assist in determining that tax.

1. Social Security benefits for the year $ ______________
2. 50% of line 1 ______________
3. Modified adjusted gross income:
   a. AGI less net Social Security benefits received ______________
   b. Tax-exempt interest and dividends received or accrued ______________
   c. Line 3a plus line 3b ______________
4. Provisional income (line 2 plus line 3c) ______________
5. Applicable "first-tier" threshold ______________
6. Line 4 less line 5 (not less than zero) ______________
7. 50% of line 6 ______________
8. Amount of benefits subject to tax (smaller of line 2 or line 7) ______________

If provisional income (line 4) does not exceed the corresponding first-tier threshold (line 5), no amount is taxable. However, if provisional income exceeds the corresponding threshold, continue with the worksheet below.

9. Applicable second-tier threshold[1] $ ______________
10. Line 4 minus line 9 (if less than zero then enter zero) ______________
11. 85% of line 10 ______________
12. Amount taxable under first-tier (from line 8, above) ______________
13. Applicable dollar amount[1] ______________
14. Smaller of line 12 or line 13 ______________
15. Line 11 plus line 14 ______________
16. 85% of line 1 ______________
17. Amount of benefits subject to tax (smaller of line 15 or line 16) ______________

Filing Status	First Tier Threshold (for line 5)	Second Tier Threshold(for line 9)	Applicable Dollar Amount (for line 13)
Married filing jointly	$32,000	$44,000	$6,000
Married filing separately (but lived together part of the year)	$0	$0	$0
All others	$25,000	$34,000	$4,500

Note: This is not an official IRS worksheet.

Caution: Any increase in income, such as from the sale of stock or a retirement plan distribution, may subject one to an unexpected tax on the Social Security benefits.

[1] See applicable column in table.

Utilizing Passive Losses

Since the Tax Reform Act of 1986, losses flowing through limited partnership investment interests to individuals are generally classified as “passive activity” losses. Federal income tax law[1] mandates that such losses cannot be used to offset or reduce earned (wages, salaries, or self-employment) income or portfolio (dividends, interest, etc.) income. Thus, persons with existing limited partnership interests, many in multiple-year funding commitments, may be unable to fully utilize these tax losses.

The Solution – Passive Income

While passive activity losses may not be used to offset earned or portfolio income, they may be used to offset income from passive sources. An investors can acquired limited partnership programs producing substantial taxable income in order to utilize existing passive losses. Typical partnerships producing high levels of taxable income include oil and gas income programs, unleveraged equipment leasing, and unleveraged rental real estate.

Passive losses in excess of passive income are not “lost.” Rather, any unused passive losses are “suspended” and are carried forward until they are either used to offset passive income or until the year the investor disposes of his or her interest in the passive activity.

Limited Exceptions to the Rule

The following are exceptions to the passive loss limitation rules.

- **Rental real estate**
  - Taxpayers considered to be real estate “professionals” are allowed to deduct their passive losses against income. Real estate professions include brokerage, construction, rental, development, management, or leasing. To qualify for this exception, a taxpayer must “materially participate” in such real estate activities, spend over 750 hours per year working in them, and devote more than one-half of his or her personal services to such businesses. The “material participation” standard requires an individual to participate on a regular, continuous, and substantial basis. Service as an employee is not considered part of a real estate profession, unless the individual is a more than 5% owner. See IRC Sec. 469(c)(7).

[1] The discussion here concerns federal income tax law; state or local law may differ

- Taxpayers who actively participate in rental real estate activities may deduct up to $25,000 from nonpassive income.[1] This exception is phased out by 50% of the amount by which their adjusted gross income exceeds $100,000 (no deduction at $150,000 of AGI or above). The "active participation" exception may be easier to qualify for than the "material participation" exception for real estate professionals. Active participation could include approving leases, tenants, capital improvements, etc. See IRC Sec. 469(i).

  However, a merely formal or nominal participation in management, without a genuine exercise of independent discretion and judgment, is insufficient.

- **Low-income and historic rehabilitation credits**

  - Credits from low-income housing or historic rehabilitation may be applied against the tax on up to $25,000 of nonpassive income even if taxpayer was not personally active[2].
  - Low-income credits range from 4% to 9% annually depending on the type of building and whether or not it is federally subsidized. IRC Sec. 42.
  - Historic rehabilitation credits are 20% for costs on certified historic structures and 10% on other pre-1936 buildings. See IRC Sec. 47(a). The rehabilitation credit is phased out by 50% of the amount by which AGI exceeds $200,000 (no deduction for AGI of $250,000 or greater). There is no phase-out for low-income housing credits on property placed in service after 1989.
  - Suspended credits are not allowed when a passive activity is disposed of.

[1] This amount is reduced to $12,500 for married persons filing separately and who lived apart for the entire year. The amount is reduced to zero for married persons not living apart.

[2] Active participation is not required for these credits.

Disclosure Notice

The information that follows is intended to serve as a basis for further discussion with your financial, legal, tax and/or accounting advisors. It is not a substitute for competent advice from these advisors. The actual application of some of these concepts may be the practice of law and is the proper responsibility of your attorney. The application of other concepts may require the guidance of a tax or accounting advisor. The company or companies listed below are not authorized to practice law or to provide legal, tax, or accounting advice.

Although great effort has been taken to provide accurate data and explanations, and while the sources are deemed reliable, the information that follows should not be relied upon for preparing tax returns or making investment decisions. This information has neither been audited by nor verified by the company, or companies, listed below and is therefore not guaranteed by them as to its accuracy.

If a numerical analysis is shown, the results are neither guarantees nor projections, and actual results may differ significantly. Any assumptions as to interest rates, rates of return, inflation, or other values are hypothetical and for illustrative purposes only. Rates of return shown are not indicative of any particular investment, and will vary over time. Any reference to past performance is not indicative of future results and should not be taken as a guaranteed projection of actual returns from any recommended investment.

John L. Terry, III - National Producer Number # 1265727   CRD # 1972803

NOTE: Grace Global Alliance is a 501(c)3 non-profit ministryfocused on clergy education, with an emphasis on retirement, taxation, law, leadership and communication. Insurance services to ministers and churches are offered through independent agents of Ministry Benefit Advisors (www.ministrybenefit.com). Investment advisory services to ministers and churches are offered by investment advisor representatives of Ministry Benefit Investments, a SEC-registered investment advisory firm (www.ministrybenefitinvestment.com). Registration as an investment advisor does not constitute an endorsement of the firm by securities regulators nor does it indicate that the advisor has attained a particular level of skill or ability.   Ministry Benefit Advisors and Ministry Benefit Investments are affiliated companies.

Disclosures: Presenter is not affiliated or employed by the federal or state government, public assistance program, Social Security Administration or any government or regulatory agency.