



# 4491

## VITA/TCE Training Guide

Volunteer Income Tax Assistance (VITA) / Tax Counseling for the Elderly (TCE)

2017 RETURNS



Take your VITA/TCE training online at [www.irs.gov](http://www.irs.gov) (keyword: Link & Learn Taxes). Link to the Practice Lab to gain experience using tax software and take the certification test online, with immediate scoring and feedback.



## How to Get Technical Updates?

Updates to the volunteer training materials will be contained in Publication 4491X, VITA/TCE Training Supplement. The most recent version can be downloaded at: <https://www.irs.gov/pub/irs-pdf/p4491x.pdf>

### Volunteer Standards of Conduct

#### VITA/TCE Programs

The mission of the VITA/TCE return preparation programs is to assist eligible taxpayers in satisfying their tax responsibilities by providing **free** tax return preparation. To establish the greatest degree of public trust, volunteers are required to maintain the highest standards of ethical conduct and provide quality service.

All VITA/TCE volunteers (whether paid or unpaid workers) must complete the *Volunteer Standards of Conduct (VSC)* certification and agree to adhere to the VSC by signing Form 13615, *Volunteer Standards of Conduct Agreement*, prior to working at a VITA/TCE site. In addition, return preparers, quality reviewers, and VITA/TCE tax law instructors must certify in tax law prior to signing this form. This form is not valid until the site coordinator, sponsoring partner, instructor, or IRS contact confirms the volunteer's identity and signs and dates the form.

As a volunteer in the VITA/TCE Programs, you must:

1. Follow the Quality Site Requirements (QSR).
2. Not accept payment, solicit donations, or accept refund payments for federal or state tax return preparation.
3. Not solicit business from taxpayers you assist or use the knowledge you gained (their information) about them for any direct or indirect personal benefit for you or any other specific individual.
4. Not knowingly prepare false returns.
5. Not engage in criminal, infamous, dishonest, notoriously disgraceful conduct, or any other conduct deemed to have a negative effect on the VITA/TCE Programs.
6. Treat all taxpayers in a professional, courteous, and respectful manner.

Failure to comply with these standards could result in, but is not limited to, the following:

- Your removal from all VITA/TCE Programs;
- Inclusion in the IRS Volunteer Registry to bar future VITA/TCE activity indefinitely;
- Deactivation of your sponsoring partner's site VITA/TCE EFIN (electronic filing ID number);
- Removal of all IRS products, supplies, loaned equipment, and taxpayer information from your site;
- Termination of your sponsoring organization's partnership with the IRS;
- Termination of grant funds from the IRS to your sponsoring partner; and
- Referral of your conduct for potential TIGTA and criminal investigations.

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#### Confidentiality Statement:

All tax information you receive from taxpayers in your volunteer capacity is strictly confidential and should not, under any circumstances, be disclosed to unauthorized individuals.










# Table of Contents

















## Part 1: Getting Started

 	Important Changes for 2017 . . . . .	iii
 	Course Introduction . . . . .	1-1
 	Legislative Extenders . . . . .	2-1
 	Affordable Care Act . . . . .	3-1
 	Filing Basics . . . . .	4-1

## Part 2: Determining Filing Status and Exemptions

 	Filing Status . . . . .	5-1
 	Personal Exemptions . . . . .	6-1
 	Dependency Exemptions . . . . .	7-1
 	Unique Filing Status and Exemption Situations . . . . .	8-1
















## Part 3: Determining Taxable Income

 	Income – Wages, Interest, Etc.; Form 1040, Lines 7–11 . . . . .	9-1
	Income – Business; Form 1040, Line 12 . . . . .	10-1
	Income – Capital Gain or Loss; Form 1040, Line 13 . . . . .	11-1
 	Income – Retirement Income; Form 1040, Lines 15-16 . . . . .	12-1
 	Income – Schedules K-1 and Rental . . . . .	13-1
 	Income – Unemployment Compensation; Form 1040, Line 19 . . . . .	14-1
 	Income – Social Security Benefits; Form 1040, Line 20a . . . . .	15-1
  	Income – Other Income; Form 1040, Line 21 . . . . .	16-1
	Military Income . . . . .	17-1

## Part 4: Determining Adjusted Gross Income (AGI)

 	Adjustments to Income . . . . .	18-1
	Military Moving Expenses . . . . .	19-1







## Part 5: Computing the Tax and Credits

 	Standard Deduction and Tax Computation. . . . .	20-1
 	Itemized Deductions. . . . .	21-1
	Military Employee Business Expenses. . . . .	22-1
 	Credit for Child and Dependent Care Expenses . . . . .	23-1
 	Education Credits. . . . .	24-1
 	Foreign Tax Credit . . . . .	25-1
 	Child Tax Credit . . . . .	26-1
 	Miscellaneous Credits . . . . .	27-1



## Part 6: Computing Other Taxes and Total Tax

 	Other Taxes . . . . .	28-1
---	-----------------------	------

## Part 7: Applying Refundable Credits and Computing Payments/Refund

 	Payments . . . . .	29-1
 	Earned Income Credit (EIC). . . . .	30-1
 	Refund and Amount of Tax Owed. . . . .	31-1



## Part 8: Completing and Filing the Return

 	Completing the Return . . . . .	32-1
	Military Finishing and Filing the Return . . . . .	33-1

## Part 9: Amending and Filing Returns

 	Amended and Prior Year Returns. . . . .	34-1
---	---	------

## Appendix

 	Appendix: Affordable Care Act (ACA) Exercises . . . . .	A-1
---	---	-----

<b>Index</b> . . . . .	I-1
------------------------	-----



## Important Changes for 2017



### **Due Date of Return**

The due date for filing a 2017 return is Tuesday, April 17, 2018. This is because April 15, 2018 is a Sunday and Emancipation Day, a legal holiday in the District of Columbia, is observed on Monday, April 16, 2018.

### **Standard Deduction Increases**

The standard deduction for taxpayers who do not itemize deductions on Schedule A (Form 1040) has increased. The standard deduction amounts for 2017 are:

- \$12,700 – Married Filing Jointly or Qualifying Widow(er) (increase of \$100)
- \$9,350 – Head of Household (increase of \$50)
- \$6,350 – Single or Married Filing Separately (increase of \$50)

### ***Taxpayers who are 65 and Older or are Blind***

For 2017, the additional standard deduction for taxpayers who are 65 and older or blind is:

- \$1,550 – Single or Head of Household (no change)
- \$1,250 for married taxpayers or Qualifying Widow(er) (no change)

### **Personal Exemption Amount**

The amount a taxpayer can deduct for each exemption increased to \$4,050 for 2017 (no change).

### **Retirement Savings Contribution Credit Income Limits Increased**

To claim this credit, the taxpayer's modified adjusted gross income (MAGI) must not be more than \$31,000 for Single, Married Filing Separately, or Qualifying Widower (increase of \$250). MAGI must not be more than \$46,500 (increase of \$375) for Head of Household, and \$62,000 (increase of \$500) for Married Filing Jointly.

### **Earned Income Credit (EIC)**

For 2017, the maximum credit increased to:

- \$6,318 with three or more children
- \$5,616 with two children
- \$3,400 with one child
- \$510 with no children

### ***Earned Income Amount Increased***

To be eligible for a full or partial credit, the taxpayer must have earned income of at least \$1 but less than:

- \$48,340 (\$53,930 if Married Filing Jointly) with three or more qualifying children
- \$45,007 (\$50,597 if Married Filing Jointly) with two qualifying children
- \$39,617 (\$45,207 if Married Filing Jointly) with one qualifying child
- \$15,010 (\$20,600 if Married Filing Jointly) with no qualifying child

### ***Investment Income***

Taxpayers whose investment income is more than \$3,450 cannot claim the EIC.

## Standard Mileage Rate

For 2017, the following rates are in effect:

- 53.5 cents per mile for business miles driven
- 17 cents per mile driven for medical or moving purposes
- 14 cents per mile driven in service of charitable organizations (no change)

## Itemized Deductions

**Medical** – The 7.5% threshold for taxpayers who are age 65 or older has expired. All taxpayers are now subject to a 10% AGI threshold.

## Education Benefits

**American opportunity credit** for 2017 is gradually reduced (phased out) if taxpayers' MAGI is between \$80,000 and \$90,000 (\$160,000 and \$180,000 if Married Filing Jointly). Taxpayers cannot claim a credit if their MAGI is \$90,000 or more (\$180,000 or more if Married Filing Jointly). There is no change.

To claim the American opportunity credit, taxpayers must provide the educational institution's employer identification number (EIN) on Form 8863. Taxpayers should be able to obtain this information from Form 1098-T or the educational institution.

**Lifetime learning credit** for 2017 is gradually reduced (phased out) if taxpayers' MAGI is between \$56,000 and \$66,000 (\$112,000 and \$132,000 if Married Filing Jointly). Taxpayers cannot claim a credit if their MAGI is \$66,000 or more (\$132,000 or more if Married Filing Jointly).

**Student loan interest deduction** begins to phase out for taxpayers with MAGI in excess of \$65,000 (\$135,000 for joint returns) and is completely phased out for taxpayers with MAGI of \$80,000 or more (\$165,000 or more for joint returns).

## Eligible Long-Term Care Premium Limits Increased

For 2017, the maximum amount of qualified long-term care premiums includible as medical expenses has increased. Qualified long-term care premiums up to the amounts shown below can be included as medical expenses on Schedule A (Form 1040) Itemized Deductions.

\$410: age 40 or under

\$770: age 41 to 50

\$1,530: age 51 to 60

\$4,090: age 61 to 70

\$5,110: age 71 and over



The limit on premiums is for each person.

## Foreign Earned Income Exclusion

For 2017, the maximum foreign earned income exclusion will be \$102,100, up from \$101,300 for 2016.

## Link & Learn Taxes – Optional Courses

### **Health Savings Account (HSA) Deduction**

The annual contribution limits on deductions for HSAs for individuals with self-only coverage is \$3,400 (increase of \$50) and \$6,750 for family coverage (no change). There is an additional contribution amount for taxpayers who are age 55 or older.



## Deduction Amount and Modified AGI Limit for Traditional IRA Contributions Increased

For 2017, the maximum IRA deduction remains at \$5,500 (\$6,500 if age 50 or older). For taxpayers who are covered by a retirement plan at work, the deduction for contributions to a traditional IRA is reduced (phased out) if the modified AGI is:

- More than \$99,000 but less than \$119,000 for a married couple filing a joint return or a qualifying widow(er) if both spouses are covered by a retirement plan,
- More than \$62,000 but less than \$72,000 for a single individual or head of household, or
- Less than \$10,000 for a married individual filing a separate return

For an IRA contributor who is **not** covered by a workplace retirement plan and is married to someone who is covered, the deduction is phased out if the couple's income is between \$186,000 and \$196,000.



## Extended and Expired Legislation

As a reminder, the Protecting Americans from Tax Hikes Act of 2015 (PATH Act) made the following tax provisions permanent:

- Adjustments for up to \$250 for educator classroom expenses. This provision was modified to include certain expenses related to professional development courses the taxpayer takes related to the curriculum they teach or to their students. The deduction amount will be indexed for inflation for future years.
- Qualified Charitable Distribution (QCD).
- State and local general sales tax deduction.

The PATH Act extended the following provisions only through December 31, 2016. They are expired for 2017.

- Exclusion from gross income of qualified principal residence indebtedness
- Mortgage insurance premiums deductible as qualified residence interest
- Deduction for qualified tuition & fees
- Credit for nonbusiness energy property (residential energy credit)

Under the Protecting Americans from Tax Hikes (PATH) Act, ITINs that have not been used on a federal tax return at least once in the last three consecutive years will expire Dec. 31, 2017, and ITINs with middle digits 70, 71, 72 or 80 will also expire at the end of the year. Affected taxpayers who expect to file a tax return in 2018 must submit a renewal application.



Congress may enact additional legislation that will affect taxpayers after this publication goes to print. Any changes will be reflected in Publication 4491-X, VITA/TCE Training Supplement, available in mid-January on [www.irs.gov](http://www.irs.gov).

## **Affordable Care Act: Qualified Small Employer Health Reimbursement Arrangement (QSEHRA)**

New rules enacted under the 21st Century Cures Act of 2016 allow eligible employers to offer a qualified small employer health reimbursement arrangement (QSEHRA) to their eligible employees. Under a QSEHRA, an eligible employer can reimburse eligible employees for health care costs, including premiums for Marketplace health insurance. If taxpayers were covered under a QSEHRA, their employer should have reported the annual permitted benefit in box 12 of Form W-2 with code FF. If the QSEHRA is affordable for a month, no PTC is allowed for the month. If the QSEHRA is unaffordable for a month, taxpayers must reduce the monthly PTC (but not below -0-) by the monthly permitted benefit amount.

### ***W-2 Verification Code***

This initiative is one in a series of steps to combat tax-related identity theft and refund fraud. The objective is to verify Form W-2 data submitted by taxpayers on e-filed individual tax returns.

Form W-2 will include these instructions to taxpayer and tax preparers: If you are e-filing and if there is a code in Box 9, enter it when prompted by your software. This code assists the IRS in validating the W-2 data submitted with your return. The code is not entered on paper-filed returns.

### ***Proposed Regulations***

Certain changes were made to Publications 4491 and 4012 due to proposed regulations published by the IRS on January 19, 2017. These regulations are proposed to apply to taxable years beginning after the date the regulations are published as final regulations in the Federal Register. However, pending the issuance of the final regulations, taxpayers may choose to apply these proposed regulations in any open taxable years. Since most of these provisions are advantageous to taxpayers, we have included them in the training publications:

- An individual is not a qualifying child of a person if that person is not required to file an income tax return, and either does not file an income tax return or files an income tax return solely to claim a refund of estimated or withheld taxes.
- A taxpayer may treat a home's fair market rental value as a cost of maintaining a household (instead of the sum of payments for mortgage interest, property taxes, and insurance).
- The annual cost of maintaining a household when a qualifying child or dependent resides in the household for less than the entire taxable year, in certain circumstances, may be prorated on a monthly basis.
- The proposed regulations also, in certain circumstances, recognize the creation of a new household during a year and treat shared living quarters as separate households.
- If an individual meets the definition of a qualifying child for more than one taxpayer and the individual is not treated as the qualifying child of one of those taxpayers under the tiebreaker rules, then the individual will not prevent that taxpayer from claiming the childless EIC if he or she meets the other requirements of that section.
- Governmental payments (such as TANF) made to a recipient that is used, in part, to support others are treated as support of the others provided by the recipient, whereas any part of such a payment used for the support of the recipient would constitute support of the recipient by a third party. For example, if a mother receives TANF and uses the TANF payments to support her children, the proposed regulations treat the mother as having provided that support.



- A nonpermanent failure to occupy a home by reason of illness, education, business, vacation, military service, institutionalized care for a child who is permanently and totally disabled, or incarceration may be treated as a temporary absence due to special circumstances. This definition of temporary absence applies to the residency test for a qualifying child, to the relationship test for a qualifying relative who does not have a listed relationship to the taxpayer, and to the requirements to maintain a household for surviving spouse and Head of Household.
- The qualifying child of a Qualifying Widow(er) is a child, stepchild, or adopted child who qualifies as the taxpayer's dependent for the year or would qualify as the taxpayer's dependent except that he or she does not meet the gross income test, or does not meet the joint return test, or except that the taxpayer may be claimed as a dependent by another taxpayer.
- A taxpayer other than the adopting "individual" may be eligible to claim an exemption for an adopted child. For example, the parent of the adopting parent may claim a dependency exemption for the legally adopted child of the taxpayer's son or daughter (just as biological grandparents may claim an exemption for a grandchild) if all other requirements are met.
- An authorized placement agency also may be an Indian Tribal Government (ITG), or an agency or organization authorized by, or a political subdivision of, an ITG that places children in foster care or for adoption.

### **Changes to Order of Pub 4012**

- Tabs B, K, and N have been reconfigured.
- Tab B is now called "Starting a Return/Filing Status" and contains all the information about the intake sheet, starting a return in TaxSlayer, determining the filing status and entering it in TaxSlayer.
- Tab K has been renamed "Finishing the Return" and now contains information from the prior year's Tabs K and N about completing the e-File section, performing the quality review and printing the return.
- Tab N contains information about moving around in TaxSlayer. It also contains the list of navigation hints that used to be in Tab D.
- ACA information has been moved to Tab H, which is now called "Other Taxes, Payments, and ACA."





## Course Introduction



### Welcome

We're glad you decided to take advantage of this challenging, yet rewarding experience as an important player in the tax administration process. This training material will introduce you to the major components of the Volunteer Income Tax Assistance and Tax Counseling for the Elderly (VITA/TCE) return preparation process.

Your course instructor will provide all the available technical publications and forms required for this course. If any of the suggested forms and publications are not available in the classroom or at the site, they can be viewed or downloaded at [www.irs.gov](http://www.irs.gov).

### Objectives

At the end of this lesson you will be able to describe:

- The various course levels and certification process
- The responsibilities of a VITA/TCE volunteer, including due diligence
- The critical components involved in the return preparation process
- The resources available to assist you
- The procedures for helping a taxpayer with identity theft

### What will I learn?

To successfully assist taxpayers in satisfying their tax responsibilities, you must understand tax law and the tools available to assist you in preparing and filing accurate tax returns – Forms 1040EZ, 1040A, and 1040. A tax return is accurate when tax law is applied correctly and it is free from error based on your interview of the taxpayer, the taxpayer's supporting documentation, and a completed Form 13614-C, Intake/Interview & Quality Review Sheet.

The VITA/TCE return preparation process consists of several critical components that will be taught in your training class or taken through Link & Learn Taxes:

- VITA/TCE Volunteer Standards of Conduct – Ethics Training
- Tax law training – understanding and applying tax law
- Research skills – using references, resources, and tools including return preparation software
- Intake/Interview and Quality Review Training
- Tax return preparation (screening and interviewing taxpayers)



Volunteer Standards of Conduct training and test are located in Publication 4961, VITA/TCE Volunteer Standards of Conduct – Ethics Training, and on Link & Learn Taxes. The Intake/Interview and Quality Review Training (Publication 5101) can be found on VITA/TCE Central. Form 6744, VITA/TCE Volunteer Assistor's Test/Retest, contains both the Volunteer Standards of Conduct and Intake/Interview and Quality Review tests.

### What do I need?

- Form 13614-C
- Publication 4012
- Publication 17
- Publication 4491
- Publication 4491-W
- Publication 5101
- Form 6744
- Form 13614-C Job Aid in Publication 4012
- Form 13615

#### **Optional:**

- Publication 3
- Publication 596
- Publication 972
- Publication 4299
- Publication 4403
- Publication 4575
- Internet Access (optional but highly recommended)

Unlike most classes, there is no need to memorize a lot of information. You can use information from [irs.gov](http://irs.gov), your course materials, and other print and electronic sources to gain the knowledge and insights you need to serve the taxpayers you assist.

At the completion of your course of study, you will fully understand how to apply critical aspects of each component of the process and complete an accurate return for each taxpayer you assist.

Thank you for your interest in helping the IRS achieve its mission of providing America's taxpayers with top quality service by helping them understand their tax responsibilities and by applying the tax law with integrity and fairness to all.

Let's get started!

## How is the course structured?

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Due to the production schedule for this training guide, draft forms may be used in illustrations. The draft forms should never be used for actual tax preparation. Final forms are available on [www.irs.gov](http://www.irs.gov), in the tax preparation software, in the instruction booklet (e.g., Form 1040 Instructions), or in other publications.

There are two tax law certification paths and two optional specialty courses presented in this publication, each representing a level of certification. The first six lessons apply to all levels of certification. Beginning with the Income lessons, the course levels for the subject being covered will be indicated by the following icons:



Basic covers the completion of wage earner type returns.



Advanced covers the completion of the full scope of VITA/TCE returns.



Military covers topics applicable to members of the Armed Forces, Reserve, and National Guard.



International covers topics applicable to military and non-military taxpayers living outside the United States.

Volunteers wishing to certify in Military or International must follow the Advanced certification path and should also review the applicable specialty course.

Health Savings Accounts (HSA) is an optional specialty course available electronically. Volunteers wishing to certify can follow the Basic or higher certification path.



The Affordable Care Act (ACA), or health care law, contains health insurance coverage and financial assistance options for individuals and families. The IRS administers the tax provisions included in the law. Refer to the Affordable Care Act (ACA) lesson presented in this publication for information on the advanced premium tax credit, the premium tax credit, and the individual shared responsibility payment.

At the beginning of each lesson, icons are displayed after the lesson title. If a section of a lesson is associated with only one certification level, the corresponding icon is displayed at the beginning of that section. If no icons are displayed in a section, all icons displayed after the lesson title apply.

## What is the training approach?

Each course uses the process based training (PBT) approach. PBT is a structured fact-gathering process that combines tax software and tax law training to help you prepare an accurate return. To complete the process, you will use:

- The questions from Form 13614-C to interview the taxpayer for filing status, dependency, credits, deductions, eligibility, validate the information provided, and prepare the return.
- Reference materials, such as Publication 4012, Volunteer Resource Guide; Publication 17, Your Federal Income Tax for Individuals; and tax software help features, as well as other resources available at your site, to prepare the return. These materials will provide you with standardized questions to ask taxpayers during your interview, to help you prepare a 100% accurate tax return.
- Form 13614-C, Quality Review section to conduct a quality review of all returns. Adhering to a quality review process helps ensure accurate returns are prepared at all VITA/TCE sites.

In most cases, when you have completed the return, it will be filed electronically. There should only be rare instances when the taxpayer may need to mail the tax return to the IRS.

## What do I need to get started?

In addition to this publication, VITA/TCE training materials include the following items:

- Publication 4491-W, Comprehensive Problems and Practice Exercises Workbook (electronic only)
- Publication 4012, Volunteer Resource Guide
- Form 6744, Volunteer Assistor's Test/Retest
- Publication 4961, VITA/TCE Volunteer Standards of Conduct – Ethics Training
- Publication 5101, Intake/Interview & Quality Review Training

## What other resources are available to help me learn?

Finalized blank forms can be accessed at [www.irs.gov/Forms-&-Pubs](http://www.irs.gov/Forms-&-Pubs).

Publication 4491-W, a companion book to this course, provides many opportunities to practice tax return preparation using the information taught in this guide.

Directions at the end of many lessons suggest using Publication 4491-W to practice the lesson material. Although it might not be possible to work each exercise with the knowledge you have at that point, at the end of the course, you will have the opportunity to complete all of the comprehensive problems and exercises in Publication 4491-W.

You may use the Practice Lab integrated with the online course, Link & Learn Taxes, to complete exercises, practice returns, and test scenarios using tax software.



Keep in mind that the Practice Lab contains current tax year calculations, but is not updated with late tax law changes.

## What happens after I complete this course?

After completing this course, you will have an understanding of tax law and the guidelines and tools needed to prepare an accurate return. After you have been certified, and have completed and signed Form 13615, you will be ready to volunteer at a VITA/TCE site.

## How does this certification work?

To participate in the VITA/TCE programs, all volunteers must pass the Volunteer Standards of Conduct certification test. In addition, all tax preparers, Quality Reviewers, instructors, and Site Coordinators must pass the Intake/Interview and Quality Review test. To prepare tax returns in the VITA/TCE programs, you must then pass at least the Basic certification test. Alternatively, you may certify at the Advanced level. You are not required to certify in Basic before taking the Advanced test. A minimum score of 80% is required to pass any certification test. You may take online tests that are available in Link & Learn Taxes on [www.irs.gov](http://www.irs.gov). Online testing is fast and efficient; you will know immediately if you passed, and can print out the certification for your Site Coordinator. Volunteers who do not pass the test the first time may review the course material and try again. A paper test option (Form 6744) may also be available. Talk with your instructor or Site Coordinator for more information on these options.



You must pass the Volunteer Standards of Conduct and Intake/Interview and Quality Review tests prior to accessing the Basic or Advanced certification test.

All designated reviewers and peer-to-peer reviewers are required to have Basic certification at a minimum, or higher certification based on the complexity of the return. It is strongly encouraged for volunteers to certify at the Advanced level. SPEC encourages the Quality Reviewers to be the most experienced volunteers in tax law application. Volunteer instructors must certify at Advanced or higher depending on the tax topics instructed.

If a volunteer does not achieve the minimum required score on the test or the retest, the volunteer is encouraged to participate in the program in another capacity such as greeter, client facilitator, communication specialist, or technical support.

When you achieve the certification(s) and present your signed Form 13615, your Site Coordinator or instructor may provide you with a VITA/TCE programs Form 14509, Volunteer ID Insert. The insert was created to acknowledge the accomplishment of certified volunteers, as well as to assist internal and external stakeholders in identifying certified volunteers, but is not intended to be used as proof of certification. You should bring your Form 13615 (and Form 14509 if you have one) and photo ID to the tax preparation site.

## What types of returns can I prepare?

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It is important that you assist only with returns, supporting schedules, and forms for which you have been trained and certified. You are protected by the federal Volunteer Protection Act of 1997 as long as you are only preparing returns within the scope of the VITA/TCE programs. Refer taxpayers with tax situations outside your scope of training and certification to your Site Coordinator and/or a professional tax return preparer. The training resources and tools discussed in this guide only support the completion of a basic Form 1040 and associated tax forms. A complete list of what is within the scope of the VITA/TCE programs can be found in the front of the Volunteer Resource Guide. Do not prepare returns that fall outside the scope of the VITA/TCE programs. Applicable lessons list some out of scope tax law topics for the VITA/TCE programs.

## **Am I legally liable for returns I prepare?**

VITA/TCE program volunteers are not considered paid preparers; therefore, you are not legally liable under federal law for the return you prepare. This means you cannot accept payment of any kind from the taxpayer for preparing a federal tax return or for providing any other tax-related assistance. You are protected by the federal Volunteer Protection Act of 1997, as long as all of the following conditions are true:

- You are acting within the scope of your volunteer responsibilities.
- You completed the level of training and certification required for preparing tax returns at your site.
- The harm was not caused by willful, criminal, reckless, grossly negligent, or conscious, flagrantly indifferent acts.

## **How does the IRS identify volunteer-prepared returns?**

Each return should be identified with the appropriate site identification number (SIDN) to ensure it is readily identifiable by the IRS. Your site's SIDN is an 8-digit number preceded by the letter "S" that must appear in the Paid Preparer Use Only section on all returns you prepare, both paper and electronic. Your Site Coordinator provides this number along with other necessary guidelines for completing the return.

## **Identity Protection PIN (IP PIN) Program**

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Nationwide, identity theft continues to grow at an alarming rate. In 2004, the IRS developed a strategy to address the problem of identity theft-related tax administration issues. The IRS strategy continues to evolve, but is focused on three priorities that are fundamental to addressing this challenge: victim assistance, outreach, and prevention.

- **Victim assistance:** The IRS is working to speed up case resolution and provide more training for employees who assist victims of identity theft.
- **Outreach:** The IRS is educating taxpayers so they can prevent and resolve tax-related identity theft issues quickly.
- **Prevention:** The IRS is implementing new processes for handling returns, new filters to detect fraud, new initiatives to partner with stakeholders, and a continued commitment to investigate the criminals who perpetrate these crimes.

Refer to the IRS Identity Protection Home Page at <http://www.irs.gov/uac/Identity-Protection> to stay current on IRS efforts to combat this growing problem. A wide range of information on identity theft is presented, ranging from how to contact the IRS with a case of identity theft to tips for keeping taxpayer records safe.

## **How to assist taxpayers who may be victims of identity theft at VITA/TCE sites**

Being sensitive towards victims of identity theft is critical to assisting taxpayers through a confusing and frustrating situation. Remember victims of identity theft are:

- Victimized by identity thieves – mostly through no fault of their own and
- Trying to comply with tax laws – file tax return and pay their fair share of taxes

Use the following table when assisting taxpayers who are victims or may be victims of identity theft at a VITA/TCE site.

If...	Then...
Identity Protection PIN (IP) PIN was issued to primary/secondary taxpayer and dependent.	Ensure the IP PIN is input correctly on the tax return.
Taxpayer received an IP PIN but did not bring it.	<ol style="list-style-type: none"> <li>1. Complete a paper tax return for the taxpayer.</li> <li>2. Provide taxpayer with a complete copy of the tax return. (Provide two copies if the taxpayer will mail the tax return.)</li> <li>3. Refer to the Replacing Lost or Missing IP PIN information below.</li> <li>4. If taxpayer wants to e-file, arrange for the taxpayer to provide the IP PIN by returning to the site or via telephone.</li> </ol>
Taxpayer received an IP PIN but misplaced or lost it.	<ol style="list-style-type: none"> <li>1. Complete a tax return for the taxpayer.</li> <li>2. Provide taxpayer with a complete copy of the tax return. (Provide two copies if the taxpayer will mail the tax return.)</li> <li>3. Refer to the Replacing Lost or Missing IP PIN information below.</li> <li>4. If the taxpayer receives an original or a replacement IP PIN and wants to e-file, arrange for the taxpayer to provide the IP PIN by returning to the site or via telephone.</li> </ol>
Taxpayer did <b>not</b> receive an IP PIN, but IRS rejected the e-filed tax return because the IP PIN was not entered.	<ol style="list-style-type: none"> <li>1. Refer to the Replacing Lost or Missing IP PIN information below.</li> <li>2. Provide taxpayer with two complete copies of the tax return.</li> <li>3. If the taxpayer receives the original or a replacement IP PIN and wants to e-file, advise the taxpayer to provide the IP PIN by returning to the site or via telephone.</li> <li>4. If Identity Protection Specialized Unit (IPSU) does not provide the IP PIN, advise taxpayer to follow IPSU instructions in mailing the tax return. There may be processing delays as IRS verifies the taxpayer's identity.</li> </ol>
IRS rejected the taxpayer's tax return because the taxpayer's primary/secondary and dependent SSN was previously used.	<ol style="list-style-type: none"> <li>1. Advise the taxpayer to contact the IPSU for assistance. If required, the IPSU will advise the taxpayer to complete Form 14039 and to mail it with their tax return to the IRS.</li> <li>2. Provide the taxpayer with two copies of the tax return.</li> </ol>

### **Replacing a Lost or Missing IP PIN**

If a taxpayer did not receive a new IP PIN or the taxpayer misplaced it, the taxpayer has two options:

1. Register and create a user profile to get a current IP PIN at <https://www.irs.gov/individuals/get-an-identity-protection-pin>. The registration process will require the taxpayer to provide specific personal information and answer a series of questions to validate his/her identity.
2. Contact IPSU at 1-800-908-4490 to receive a replacement IP PIN if the taxpayer is unable or unwilling to create an account on IRS.gov.



**CAUTION** Using a replacement IP PIN will cause a delay in processing the tax return and the issuance of any refund the taxpayer may be entitled to.





If a replacement IP PIN letter is issued, the mailing date of the replacement IP PIN is generally 4-5 business days after the transaction completion date.

### ***Identity Protection PIN on Form 1040 Series Returns***

The Form 1040 series (1040EZ, 1040A, and 1040) includes a series of six boxes just to the right of the spouse's occupation. These boxes are clearly marked as "Identity Protection PIN." Refer to the Volunteer Resource Guide, Tab P, or go to [www.irs.gov](http://www.irs.gov) to view Form 1040.

If taxpayers choose to file the return on paper, the letter issued by the IRS will instruct them to write the six-digit IP PIN in the area just to the right of the spouse's occupation.



For the IP PIN to be accepted, all six digits must be input on Form 1040. The IP PIN may begin with a zero.

### ***Effect of the IP PIN on Tax Administration***

The IP PIN acts as an identity validation tool only. The IP PIN indicates that taxpayers previously provided IRS with information that validates their identity and that IRS is satisfied that the taxpayers are the valid owners of the SSNs.

Returns that are filed on accounts with an IP PIN indicator present are processed as valid returns using standard processing procedures.

Returns that are filed on accounts with an IP PIN indicator present that do not have an IP PIN, or the IP PIN was not input correctly, will experience delays while IRS validates the identity of the taxpayer against IRS records.

## **What are my responsibilities as a VITA/TCE programs volunteer?**

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As a VITA/TCE programs volunteer, you have a responsibility to provide quality service and to uphold the ethical standards of the program. When you begin as a volunteer, you will be asked to sign Form 13615, which states that you will adhere to these standards:

- Follow the Quality Site Requirements (QSR)
- Not accept payment, solicit donations, or accept refund payments for federal or state tax return preparation
- Never solicit business from taxpayers you assist or use the knowledge gained about a taxpayer for any direct or indirect personal benefit
- Never knowingly prepare false returns
- Never engage in criminal, infamous, dishonest, notoriously disgraceful conduct, or any other conduct deemed to have a negative effect on the IRS
- Treat all taxpayers in a professional, courteous, and respectful manner

As a volunteer, follow these standards for return preparation: become certified, use the intake/interview and quality review process, use reference materials, complete the steps to electronically file tax returns, and adhere to the privacy and confidentiality guidelines.

### **What is due diligence?**

Due diligence means doing your part to ensure tax returns are correct. As an IRS-certified volunteer, you ensure the information on the return you are preparing or reviewing is correct and complete.

Doing your part includes:

- Confirming a taxpayer's (and spouse if applicable) identity
- Providing top-quality service by helping taxpayers understand and meet their tax responsibilities
- Making sure the facts presented by the taxpayer paint a reasonable picture

Generally you can rely on good faith for taxpayer information without requiring documentation as verification. However, exercise caution when taxpayers want to claim a refundable credit such as EIC or education credits, especially if these credits are maximized.

#### ***Top 4 Things to Remember about Due Diligence***

1. Do your part to ensure a tax return is correct.
2. Question any unusual, inconsistent, or incomplete items.
3. If you are unsure about a deduction or credit, make an effort to research the answer, or ask another certified volunteer for assistance.
4. Remind taxpayers that when they sign their tax returns, they are stating under penalty of perjury that the return is accurate to the best of their knowledge.

The following examples illustrate unusual or questionable situations that call for more information from the taxpayer.

#### **example**

Larry goes to a VITA/TCE site to have his taxes prepared. Larry tells the tax preparer:

- His filing status is Head of Household
- He wants to claim his 2-year-old nephew for EIC
- He has no child care expenses
- He earned \$19,000 in wages
- He is 26 years old

Larry's information regarding his qualifying child and filing status is questionable. Further inquiries are needed to determine:

- Why the uncle is claiming the child and not the parents?
- Why isn't there child care expense and who cares for the child while the taxpayer works?
- Is there anyone else living in the household that contributes?
- Is there anyone else eligible to claim the child?
- Do the tie-breaker rules apply?
- If asked, can the taxpayer provide proof that the qualifying child lived with him for more than half of the year?

#### **example**

Steven goes to a VITA/TCE site to have his taxes prepared. Steven tells the tax preparer:

- He is 22 years old
- He has two sons, ages 10 and 11
- He has Social Security cards for both boys and himself
- His W-2 wage indicates earnings of \$20,000

Steven's age and the age of the qualifying children appear to be inconsistent. Further inquiries are needed to determine:

- Are the boys his sons by birth, foster sons, adopted sons, step-sons?
- Is there anyone else eligible to claim the children as qualifying children?
- Do the tie-breaker rules apply?
- If asked, can the taxpayer provide proof that the qualifying children lived with him for more than half of the year?

As a certified volunteer, remember due diligence and take reasonable steps to ensure the tax return is correct:

- Ask enough questions to determine if allowable expenses were incurred and that income reported is correct.
- Add all taxable income to the tax return, even if the taxpayer does not agree with you.
- If the item is questionable and/or unallowable, do not claim the deduction or credit on the tax return.
- If you are uncomfortable with the information and/or documentation provided by a taxpayer, do not prepare the tax return.
- If the taxpayer does not agree with your advice, you should not prepare the return.

Tax return integrity means volunteers must take reasonable steps to ensure the tax return is correct, which includes:

- Verifying that all Social Security numbers presented by the taxpayer match the Social Security numbers listed on the tax return.
- Not preparing out of scope returns.
- Not preparing returns for which you have not been certified.
- Explaining to the taxpayer why the deduction or credit can or cannot be included on their return. Use IRS reference materials to support your statements.
- Having a second certified volunteer review the completed return with the taxpayer.
- Not making changes or corrections to the tax return after the taxpayer leaves the site without notifying the taxpayer.

In conclusion, as an IRS-certified volunteer preparer, you have the responsibility to perform adequate due diligence on EVERY return. The goal is not to prepare as many tax returns as possible, but to accurately report taxpayer income and deductions.

### **How do I maintain the taxpayer's trust?**

You are the key to the integrity of the VITA/TCE programs. Taxpayers will trust that all information you receive from them is protected from disclosure. To maintain this trust:

- Do not disclose any personal tax information gained as a result of the service provided.
- Do not openly discuss taxpayers by name in the presence of other volunteers or taxpayers. You may discuss tax situations with other volunteers. For example, a volunteer may refer to a *situation* (not a taxpayer) and ask or give advice about the appropriate tax treatment for that specific situation.
- Do not retain taxpayers' documents for a follow-up visit. If you cannot fully complete the taxpayer's return at the time of service, return all documents to the taxpayer.
- Do not take taxpayers' information for preparation of the return outside the presence of the taxpayer, unless Virtual VITA/TCE procedures are being used.

- Do not prepare a tax return when you suspect an individual is not providing truthful information.
- Do not exclude any of the taxpayer's relevant income or expenses, regardless of whether they increase or decrease the amount of tax due or refund.

Having the taxpayer present in the tax preparer's site is not always possible. In these cases, Virtual VITA/TCE processes can be used to prepare returns without taxpayer face-to-face contact. Certified volunteers may interview taxpayers over the phone while preparing their return. The alternative process used to prepare returns must be approved by the responsible IRS Territory Manager prior to the start of the filing season to ensure all procedures are in place as described in the QSR. Most importantly, the taxpayer's and government's interests must be properly protected. In some cases, the taxpayer information must be left at the site to be prepared and mailed to the taxpayer. Adequate security and privacy is expected to ensure taxpayer records are properly safeguarded.

Some individuals may attempt to defraud the government by filing false tax returns. If you have any question about the validity of information provided by a taxpayer, or are uncomfortable with a taxpayer situation, discuss your concern with your Site Coordinator.

If you or a taxpayer should have a concern or issue regarding unethical behavior at a site, e-mail [WI.Voltax@irs.gov](mailto:WI.Voltax@irs.gov). Also, see Publications 730, 4454, or 4053 for reporting Civil Rights (Title VI) and EEO concerns.

## **Taxpayer Civil Rights**

The Department of the Treasury – Internal Revenue Service will not tolerate discrimination based on race, color, national origin (including limited English proficiency), disability, reprisal, sex (in education programs or activities) or age in programs or activities receiving federal financial assistance from the Internal Revenue Service.

If a taxpayer believes that he or she has been discriminated against, a written complaint should be sent to:

Operations Director, Civil Rights Division  
Internal Revenue Service, Room 2413  
1111 Constitution Avenue, NW  
Washington, DC 20224

For all questions about taxpayer civil rights, contact us at the above address, or by e-mail at [edi.civil.rights.division@irs.gov](mailto:edi.civil.rights.division@irs.gov)

Do not send tax returns, payments, or other non-civil rights information to this address.

## **Low Income Tax Clinics**

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Low Income Taxpayer Clinics (LITCs) represent low income individuals in disputes with the Internal Revenue Service, including audits, appeals, collection matters, and federal tax litigation. LITCs can also help taxpayers respond to IRS notices and correct account problems. Some LITCs provide education for low income taxpayers and taxpayers who speak English as a second language (ESL) about their taxpayer rights and responsibilities.

LITC services are free or low cost for eligible taxpayers. LITCs are independent from the IRS but receive some of their funding from the IRS through the LITC grant program. Each clinic determines whether prospective clients meet income guidelines and other criteria before agreeing to represent them.

Find a clinic near you on the LITC Map or IRS Publication 4134, Low Income Taxpayer Clinic List. This publication is also available by calling 1-800-829-3676 or at your local IRS office.

## Taxpayer Advocate Service

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The Taxpayer Advocate Service (TAS) is an independent organization within the IRS, led by the National Taxpayer Advocate. Its job is to ensure every taxpayer is treated fairly and that taxpayers know and understand their rights. TAS offers free help to taxpayers in dealing with the often confusing process of resolving tax problems they haven't been able to resolve on their own. TAS has at least one taxpayer advocate office located in every state, the District of Columbia, and Puerto Rico. The local advocate's number is in the local directory and at [taxpayeradvocate.irs.gov](http://taxpayeradvocate.irs.gov).

The Taxpayer Advocate Service's website, [taxpayeradvocate.irs.gov](http://taxpayeradvocate.irs.gov), is a resource for all taxpayers. The website covers a variety of tax-related concepts and problems, breaking each down to describe what the taxpayer should know, what they should do, and where they can get more help if needed. Taxpayers can also learn about their taxpayer rights. The site is mobile-responsive, so it's easy to use on any device.

If a taxpayer comes into a VITA/TCE site with a tax problem for which they have been unsuccessful in resolving with the IRS, TAS may be able to help.

For more information, the taxpayer can call toll-free 1-877-777-4778 (1-800-829-4059 for TTY/TDD) or locate the closest advocate at [taxpayeradvocate.irs.gov](http://taxpayeradvocate.irs.gov).

## Are there other materials available to assist me?

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When you arrive at the tax preparation site, your Site Coordinator will assist you with your resource needs. Your site may even have a technical research library from which you can access various forms, publications, and worksheets. These materials can also be downloaded from [www.irs.gov](http://www.irs.gov).

You should **not** use this guide at your tax preparation site; it is designed for training purposes only. The Volunteer Resource Guide and Publication 17 will be available for use in printed or electronic format. Your Site Coordinator should be able to provide access to the following key resources as well:

- Instruction booklets, schedules, and worksheets for Form 1040
- Frequently used tax publications (e.g., Publication 596, Earned Income Credit; Publication 972, Child Tax Credit; and Publication 3, Armed Forces' Tax Guide)
- Equipment and supplies along with security requirements and use restrictions



Recipients of government property and equipment must certify that the equipment will be used for volunteer tax return preparation purposes. Commercial and certain personal uses of the property may terminate the agreement. This applies to hardware and software, as well as supplies.

You may reinforce your knowledge of tax law by viewing online training courses such as Link & Learn Taxes and Understanding Taxes on [www.irs.gov](http://www.irs.gov).

A toll-free tax information hotline is available for volunteer use only. If you have a tax law question and cannot get the answer from your Site Coordinator or your reference material, call 1-800-829-8482 (1-800-TAX-VITA). **Do not give this phone number to taxpayers.** The volunteer hotline is generally available from February 1 until the filing deadline.

For inquiries about refund offsets, taxpayers can call the Treasury Offset Program toll-free at 1-800-304-3107. Other helpful contact information can be found near the back of the Volunteer Resource Guide.

## **How do I get started using the tax software?**

The majority of VITA/TCE sites use IRS-sponsored tax preparation software. The tax software is used to prepare returns and includes a help feature to assist in understanding the application of tax law; it is available in both desktop and online (Internet-based) versions.

Your instructor or Site Coordinator will provide you with the information, user names, and passwords required for logging into the program for training and tax preparation purposes.

## ***Where do I find information about the tax software?***

The Volunteer Resource Guide contains step-by-step procedures for electronic return preparation and helpful hints for using the tax software within each applicable tax law topic. Information about completing the return is listed in the Volunteer Resource Guide, Finishing the Return tab.

## **Summary**

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Welcome to the VITA/TCE programs. Remember:

- Make sure you have the resources and support you need to provide each taxpayer with high-quality service and an accurate return.
- A return is accurate when tax law is applied correctly and the return is free from error based on the taxpayer's interview and supporting documentation, and a completed Form 13614-C.
- Know your roles and responsibilities, adhere to the Volunteer Standards of Conduct, and follow due diligence.
- Prepare returns that are:
  - within the scope of the VITA/TCE programs
  - within your certification level
- Use VITA/TCE equipment and supplies (including hardware and software) for their intended purposes.
- The procedures for helping a taxpayer with identity theft.



## Legislative Extenders



### Introduction

The content in this lesson is being provided because these are not considered permanent provisions in the tax law. The Protecting Americans from Tax Hikes Act of 2015 (PATH Act) extended the following provisions through 2016. **At the time this publication went to print these provisions were expired for 2017. Do not refer to this lesson unless directed here by Publication 4491X, VITA/TCE Training Supplement.** Publication 4491X, which will be released in mid-January, will contain any legislative changes to these and any other provisions. Tax law provisions that were made permanent have been removed from this lesson and added to the appropriate tax law lesson in this publication.

### How do I handle tuition and fees?

#### What is the deduction?

Taxpayers can deduct up to \$4,000 in qualified tuition and related expenses paid during the tax year. The amount of the deduction is determined by the taxpayer's filing status, modified adjusted gross income (MAGI), and other factors. For the amount of the allowable deduction see the Tuition and Fees Deduction chart in the Legislative Extenders tab of the Volunteer Resource Guide.

#### example

Leonard, a single taxpayer who had a total income of \$24,000, meets all the requirements to take the deduction. He paid \$4,427 in tuition and fees. Because his gross income is well below the MAGI limit, he would be able to deduct the maximum amount (\$4,000) for his tuition and fees payments.

#### Who is eligible for this deduction?

The deduction can be claimed for the taxpayer, the taxpayer's spouse (if filing a joint return), and any dependent (for whom the taxpayer claims a dependency exemption) who attended an eligible educational institution during the tax year.

The tuition and fees deduction *cannot* be claimed by married taxpayers who file as Married Filing Separately or by an individual who is a dependent of another taxpayer.

#### example

Juanita is married but uses the Married Filing Separately status. She cannot deduct tuition and fees.

In order to claim a deduction for expenses paid for a dependent who is the eligible student, the taxpayer must have paid the qualified expenses and claim an exemption for the dependent. If the student is eligible to be claimed as a dependent (even if not actually claimed) and paid his or her own expenses, *no one* can take the adjustment. However, if the student would not qualify as a dependent, he or she can claim the deduction even if tuition and fees were paid by another person. In that case, the student can treat the amounts paid for tuition and fees as a gift.

Taxpayers who are not eligible for the tuition and fees adjustment because of the dependency issue may be eligible for an education tax credit, covered in the Education Credits lesson.

#### example

Joseph is 30. Although he lives at home and goes to school full time, he earns about \$5,000 each year, so his parents cannot claim him as a dependent. Only Joseph can take the tuition and fees adjustment, even if his parents pay his education expenses.

#### example

Carly is 18 and claimed by her parents as a dependent. She took out student loans and paid all of her own tuition and fees. Carly cannot take the deduction because she is a dependent. Carly's parents can't claim the deduction either because they did not pay the education expenses. Carly's parents should look into the education credits.

### What are qualified tuition and fees expenses?

Generally, qualified education expenses are amounts paid for tuition and fees required for the student's enrollment or attendance at an eligible educational institution. Required fees include amounts for books, supplies, and equipment used in a course of study if required to be paid to the institution as a condition of enrollment or attendance. It does not matter whether the expenses were paid in cash, by check, credit card, or with borrowed funds.

Qualified education expenses does not include payments for:

- Insurance, room and board, medical expenses (including health fees), transportation, or similar personal, living, or family expenses
- Course-related books, supplies, nonacademic activities and equipment unless it is paid as a condition of enrollment or attendance
- Any course or other education involving sports, games, hobbies, and noncredit courses unless the course or other education is part of the student's degree program

Ask the taxpayer if the qualified tuition and expenses were offset by distributions from qualified state tuition programs, Coverdell ESAs, or interest from savings bonds used for higher education expenses. Subtract these from the total payments for tuition and fees.

To help you figure the tuition and fees deduction, the taxpayer should have received Form 1098-T, Tuition Statement. Generally, an eligible education institution must send Form 1098-T or a substitute to each enrolled student by January 31.

Beginning in tax year 2016, the deduction for qualified tuition and related expenses will not be allowed unless the taxpayer receives a statement (Form 1098-T) from the educational institution. The receipt of the statement by a dependent is treated as received by the taxpayer.



**CAUTION** Form 1098-T may have incomplete information. You must question the taxpayer to determine the amount of qualified expenses actually paid and adjust this amount by any non-taxable items, such as scholarships or tuition program distributions.

### What is an eligible educational institution?

An eligible educational institution is generally any accredited public, nonprofit, or private post-secondary institution eligible to participate in the student aid programs administered by the Department of Education. It includes virtually all accredited public, nonprofit, and privately owned profit-making post-secondary institutions. Taxpayers who do not know if an educational institution is an eligible institution should contact the school or the U.S. Department of Education website.



## How do I determine the amount of the deduction?

When determining the deduction, use only the amounts actually paid. Remember to reduce the qualified education expenses by any tax-free educational assistance. Also remember that the taxpayer may be able to increase the combined value of an education credit and certain education assistance if the student includes some or all of the educational assistance in income in the year it is received.



**Tax Software Hint:** Form 8917, Tuition and Fees Deduction, is automatically completed from data input in the Education Credits screen.

## How do I determine the best education benefit for the taxpayer?

If taxpayers claim the tuition and fees adjustment to income, they cannot claim an education tax credit. The education credits include the American Opportunity and Lifetime Learning Credits, discussed in more detail in the Education Credits lesson or Publication 970, Education Benefits.

For most taxpayers, the tax credit is more beneficial than the adjustment. However, it is important to calculate and compare the education benefits to determine which one is better for the taxpayer.

Complete the entire tax return separately using first the tuition and fees deduction, then the education credit. Compare the returns and choose the best one for the taxpayer.

To compare the benefits see the Highlights of Education Tax Benefits chart in the Education Benefits tab of the Volunteer Resource Guide.



The tuition and fees deduction may affect state income tax returns. Consider the overall income – both federal and state – before choosing the best option.

## Taxpayer Scenario

Here is how a volunteer helped Glenda deduct the tuition and fees she paid for a class.

SAMPLE INTERVIEW	
VOLUNTEER SAYS...	GLEND A RESPONDS...
<i>Let's talk about your education-related expenses. Were you or someone else in your family going to school?</i>	I took one class in the fall.
<i>You're filing as Head of Household and your income is below the limit for taking the full deduction. Do you know how much you paid for tuition?</i>	Yes, I have a copy of my account statement. Will that work?
<i>I see \$450 for tuition and \$80 for books. Were you required to purchase the books through City College or could you have bought them elsewhere?</i>	Those books were written specifically for the course; I had to purchase them through the school when I registered and they were an enrollment requirement in the course.
<i>OK, then we can include the books. That totals \$530. I just need to ask a few more questions. Did you receive any funds from an educational assistance program from your employer?</i>	Yes, the Educational Assistance Program provided \$100.
<i>Did you make any tax-free withdrawals from a Coverdell educational savings account or another qualified tuition program, or from U.S. savings bonds?</i>	No.

## SAMPLE INTERVIEW (continued)

VOLUNTEER SAYS...

*Did you get any other nontaxable payments, not counting gifts, bequests, or inheritances, that were specifically for educational expenses?*

*The \$100 was a gift, so we don't count it. Your total payments were \$530 and then we must subtract the \$100 employer benefit. You can deduct \$430 for tuition and fees. Do you have any questions about all this?*

*There is also a credit for people who are paying for college expenses. You can take one or the other, but not both. When we get to the end of the return, I will ask you some more questions to figure out if the credit would be better for you than this deduction.*

[Note on the intake and interview sheet that you have addressed this adjustment.]

GLENDA RESPONDS...

Well, my mom gave me \$100 to help with tuition.

No, I'm really glad I can deduct that.

Okay, I'd appreciate that.

## Itemized Deductions

### What about qualified mortgage insurance premiums?

Taxpayers can deduct private mortgage insurance premiums paid or accrued during the current tax year on Schedule A. The insurance must have been in connection with home acquisition debt, and the insurance contract must have been issued after 2006. Volunteers need to be aware that this potential deduction may not be reported on Form 1098. Ask homeowners with a mortgage if they paid mortgage insurance premiums during the tax year. Failure to ask could result in a substantial deduction loss for taxpayers filing Schedule A.



Other itemized deductions are discussed in a later lesson.



### What are residential energy credits?

Individuals who make purchases for qualified energy efficient improvements for their main home may be allowed nonrefundable tax credits. There are two types of residential energy credits:

- Residential energy efficient property credit (Form 5695, Residential Energy Credits, Part I, which is out of scope for the VITA/TCE programs)
- Nonbusiness energy property credit (Form 5695, Part II)



Other credits are discussed in the Miscellaneous Credits lesson.

The IRS provides guidance on what property qualifies for the energy credits, and homeowners generally can rely on manufacturers' certifications. See the Volunteer Resource Guide, Legislative Extenders tab, [www.irs.gov](http://www.irs.gov), or [www.energystar.gov](http://www.energystar.gov) for more information.



**Tax Software Hint:** Answer the questions for Form 5695 in the software. The software will calculate the credit and enter it on Form 1040.

## What is the residential energy efficient property credit?

This residential energy credit is claimed on Form 5695, Part I, and is out of scope for the VITA/TCE programs. For awareness only, taxpayers may claim an energy credit for qualified solar electric, solar water heating, small wind energy, and geothermal heat pump property costs. Check for qualifying energy property purchases to determine if the taxpayer should see a professional tax preparer to claim the credit.

## What is the nonbusiness energy property credit?

The nonbusiness energy property credit is available for certain qualifying energy efficiency improvements or residential energy property costs. The qualifying items are:

- Biomass stoves
- Heating, ventilating, air-conditioning (HVAC)
- Insulation
- Roofs (metal and asphalt)
- Water heaters (non-solar)
- Windows and doors

The nonbusiness energy property credit is subject to the following limitations:

- The total combined credit limit for all tax years after 2005 is \$500, and the combined credit limit for windows is \$200.
- The maximum credit for residential energy property costs is \$50 for any advanced main air circulating fan; \$150 for any qualified natural gas, propane, or oil furnace, or hot water boiler; and \$300 for any item of energy efficient building property.

It is important to note that:

- The credit is only available for existing homes that are the taxpayer's main home – new construction and rentals do not qualify. The taxpayer must own the home to qualify.
- Amounts provided by subsidized federal, state, or local energy financing do not qualify for the credit.



Costs for on-site preparation and installation depend on the type of qualified property. Review the Form 5695 Instructions for more information.



## Cancellation of Debt (COD)

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This lesson will help you recognize when you can help taxpayers who have a canceled debt and when you must refer them elsewhere for help with their tax returns.

### Cancellation of Debt – Basics

A debt includes any indebtedness for which a taxpayer is liable or which attaches to the taxpayer's property. Cancellation of indebtedness can involve auto loans, credit card debt, medical care, professional services, installment purchases of furniture or other personal property, mortgages, and home equity loans. Generally, if a debt for which a taxpayer is personally liable is canceled or forgiven, the taxpayer must include the canceled amount in income. There is no income from canceled debt if the cancellation or forgiveness of debt is a gift or bequest.

Use Form 13614-C, Intake/Interview & Quality Review Sheet, to determine if the taxpayer received one or both of Forms 1099-C, Cancellation of Debt, or 1099-A, Acquisition or Abandonment of Secured Property.

### **In Scope for VITA/TCE Programs**

Refer to Publication 4731-A, Screening Sheet for Foreclosures/Abandonments and Cancellation of Debt, to ensure that the tax return being prepared is within scope of the VITA/TCE programs. This screening sheet is contained in the Volunteer Resource Guide, Legislative Extenders tab.

- Use Publication 4731-A, Part I for taxpayers with Form 1099-A for a foreclosure or abandonment of their principal residence
- Use Publication 4731-A, Part II for taxpayers with Form 1099-C, or Forms 1099-A and 1099-C resulting from cancellation of debt on a home mortgage loan



Cancellation of credit card debt is included in the Other Income lesson of Publication 4491 for Advanced certification.

### **Taxability of Canceled Debt**

Taxpayers often question the taxability of canceled debt because they did not receive money in hand. In situations where property is surrendered, such as a foreclosure, taxpayers feel that by giving up the property they are relieved from any further obligation. Explain that the benefit to the taxpayer is the relief from personal liability to pay the debt. Information in Publication 17, Your Federal Income Tax for Individuals, can assist with the explanation.

Additional resources include:

- Publication 523, Selling Your Home
- Publication 525, Taxable and Nontaxable Income
- Publication 544, Sales and Other Dispositions of Assets
- Publication 4681, Canceled Debts, Foreclosures, Repossessions, and Abandonments

Generally, when debt is canceled, the lender will issue Form 1099-C, Cancellation of Debt, which is then reported as income by the recipients on their tax return. There are exceptions and exclusions to the general rule that determines whether a canceled debt is included as income. This is covered in greater detail later in this lesson.

### **Recourse vs. Nonrecourse Debt**

There are two types of debts: recourse and nonrecourse. A recourse debt holds the borrower personally liable. All other debt is considered nonrecourse.

In general, recourse debt (loans) allows lenders to collect what is owed for the debt even after they've taken collateral (home, credit cards). Lenders have the right to garnish wages or levy accounts in order to collect what is owed.

A nonrecourse debt (loan) does not allow the lender to pursue anything other than the collateral. For example, if a borrower defaults on a nonrecourse home loan, the bank can only foreclose on the home. The bank generally cannot take further legal action to collect the money owed on the debt. Whether a debt is recourse or nonrecourse may vary from state to state, depending on state law.

If a lender cancels a debt and issues Form 1099-C, the lender will indicate on the form if the borrower was personally liable (recourse) for repayment of the debt. Go to [www.irs.gov](http://www.irs.gov) to view Form 1099-C.



If property securing the debt was foreclosed on or abandoned, the taxpayer may need to report the disposition (sale) on Form 8949 and Schedule D. This is covered in more detail later in this course.



Generally, if taxpayers abandon property that secures debt for which they are **personally liable**, they do not have a gain or loss until the foreclosure is completed.

If taxpayers abandon property that secures debt for which they are **not personally liable**, the abandonment is treated as a sale or exchange.

For more information on abandonments see Publication 4681.

**Recourse debt** holds the borrower personally liable for any amount not satisfied by the surrender of *secured property*.

- If a lender forecloses on property subject to a recourse debt and cancels the portion of the debt in excess of the fair market value (FMV) of the property, the canceled portion of the debt is treated as ordinary income from cancellation of indebtedness. This amount must be included in gross income unless it qualifies for an exception or exclusion.
- In addition to this cancellation of indebtedness income, the taxpayer may realize a gain or loss on the disposition of the property; this amount is generally the difference between the FMV of the property at the time of the foreclosure and the taxpayer's basis in the property.

**Nonrecourse debt** is satisfied by the surrender of the *secured property* regardless of the FMV at the time of surrender, and the borrower is not personally liable for the debt.

- If property that is subject to nonrecourse debt is abandoned, foreclosed upon, subject of a short sale, or repossessed by the lender, the circumstances are treated as a sale of the property by the taxpayer.
- In determining the gain or loss on the disposition of the property, the balance of the nonrecourse debt at the time of the disposition of the property is included in the amount realized (generally the selling price). Since the borrower is not personally liable for the debt, the difference between the FMV of the property and the balance of the loan is *not* included in gross income.

	<b>Recourse Debt</b>	<b>Nonrecourse Debt</b>
<b>Borrower is...</b>	Personally liable	Not personally liable
<b>Canceled portion of debt is generally...</b>	Treated as ordinary income and included in gross income (unless it qualifies as an exception or exclusion)	Not applicable. Nonrecourse debt is satisfied by the surrender of the secured property regardless of the FMV at the time of surrender.
<b>Gain or loss on disposition of the property</b>	Generally determined by the difference between the FMV of the property and the adjusted basis	The amount realized includes the balance of the nonrecourse debt at the time of the disposition of the property. This is true even if the FMV of the property is less than the outstanding debt.

#### example

Jason lost his home to foreclosure because he could no longer make his mortgage payments. At the time of foreclosure, he owed a balance of \$170,000 to the lender and the FMV of the property was \$140,000.

If Jason is personally liable for the debt (recourse loan), the selling price would be \$140,000.

If Jason is not personally liable for the debt (nonrecourse loan), the selling price would be \$170,000.

## Exceptions and Exclusions

Some canceled or forgiven debts may be *eliminated* from income by applying exceptions, or *reduced* by applying exclusions to the general rule. **Exceptions are applied before exclusions.**

### Exceptions

Exceptions may allow the taxpayer to eliminate the following types of canceled debt from income:

- Amounts otherwise excluded from income (e.g., gifts and bequests)
- Certain student loans (e.g., doctors, nurses, and teachers serving in rural or low-income areas)
- Deductible debt (e.g., home mortgage interest that would have been deductible on Schedule A)
- Price reduced after purchase (e.g., debt on solvent taxpayer's property is reduced by the seller; basis of property must be reduced)

For more information on exceptions, refer to Publication 4681, Canceled Debts, Foreclosures, Repossessions, and Abandonments.

### Exclusions

There are several exclusions from the general rule for reporting canceled debt as income.

Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness, must be filed with the taxpayer's return to show the amount of the canceled debt excluded.

The exclusions are:

- Discharge of debt through bankruptcy
- Discharge of debt of insolvent taxpayer
- Discharge of qualified farm indebtedness
- Discharge of qualified real property business indebtedness
- Discharge of qualified principal residence indebtedness



**CAUTION** The issues involved in exclusions can be complex. Only cancellation of qualified principal residence indebtedness is within the scope of VITA/TCE.

## Cancellation of Debt (COD) – Principal Residence

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### Mortgage Forgiveness Debt Relief Act 2007

Under the Mortgage Forgiveness Debt Relief Act of 2007, taxpayers may exclude from income certain debt forgiven or canceled on their principal residence. This exclusion is applicable to the discharge of "qualified principal residence indebtedness." If the canceled debt qualifies for exclusion from gross income, the debtor may be required to reduce tax attributes (certain credits, losses, and basis of assets) by the amount excluded.

If a property was taken by the lender (foreclosure) or given up by the borrower (abandonment), the lender usually sends the taxpayer Form 1099-A, Acquisition or Abandonment of Secured Property. Form 1099-A will have information needed to determine the gain or loss due to the foreclosure or abandonment.

If the debt is canceled, the taxpayer will receive Form 1099-C, Cancellation of Debt. If foreclosure/abandonment and debt cancellation occur in the same calendar year, the lender may issue only Form 1099-C, including the information that would be reported on Form 1099-A.

The Mortgage Forgiveness Debt Relief Act of 2007 allows for the exclusion of discharged qualified principal residence indebtedness canceled in 2007, 2008, and 2009.

The Emergency Economic Stabilization Act of 2008 extended the exclusion for tax years 2010 through 2012. The American Taxpayer Relief Act of 2012 extended the exclusion to 12/31/2013.

The Tax Increase Prevention Act of 2014 extended the exclusion to 12/31/2014. The Protecting Americans from Tax Hikes Act of 2015 (PATH Act) extended the exclusion for qualified principal residence indebtedness that is discharged before January 1, 2017, or subject to an arrangement that is entered into and evidenced in writing before January 1, 2017.

## Qualified Principal Residence Indebtedness

Qualified principal residence indebtedness includes:

- Any debt incurred in acquiring, constructing, or substantially improving a principal residence that is secured by the principal residence
- Any debt *secured by the principal residence resulting from the refinancing of debt* incurred to acquire, construct, or substantially improve a principal residence, but only to the extent that the amount of debt does not exceed the amount of the refinanced indebtedness



A principal residence is generally the home where the taxpayer lives most of the time. A taxpayer can have only one principal residence at a time.

## Exclusion Limit

The maximum amount that can be treated as qualified principal residence indebtedness is \$2 million (\$1 million if Married Filing Separately).

Canceled qualified principal residence indebtedness cannot be excluded from income if the cancellation was for services performed for the lender or on account of any factor not directly related to a decline in the value of the residence or the taxpayer's financial condition.

## Criteria for Canceled Principal Residence Debt

Volunteers may assist taxpayers who meet the following requirements:

- The home was never used in a business or as rental property
- The debt was not canceled because the taxpayer filed bankruptcy
- The taxpayer is **not** in bankruptcy when he/she comes to the site for assistance
- Form 1099-C does not include an amount for interest
- The debt must be a mortgage used *only* to buy, build, or substantially improve the taxpayer's primary residence, i.e., this money was not used to pay off credit cards, medical/dental expenses, vacations, etc.
- The mortgage was secured by the taxpayer's primary residence
- The mortgage was not more than \$2 million (\$1 million if Married Filing Separately)

### example

Bob refinanced his personal residence and used the loan proceeds from the equity in his home to build a new master bedroom suite on the main level of his house. This debt is qualified principal residence indebtedness.

### example

Tom refinanced his personal residence and used the loan proceeds from the equity in his home to pay off credit cards and buy a car. This debt is **not** qualified principal residence indebtedness.



### EXERCISES

Use Publication 4731-A, Part II, to answer the following questions. The answers appear at the end of the lesson.

**Question 1:** A volunteer with Advanced certification is working with Angie. Angie confirmed that she had to give up her principal residence and produced Form 1099-C for the cancellation of the mortgage loan. Angie explains that she did not file for bankruptcy, even though she experienced hardship due to the loss of income from no longer being able to rent out an upstairs bedroom and bath. Angie also verified that the mortgage loan was used entirely to purchase the home and was secured by the home. Her Form 1099-C lists the amount of debt canceled as \$60,000.

Should the volunteer assist Angie with her return?  Yes  No

**Question 2:** Fred went to his local VITA site to have his tax return prepared. The volunteer went through Fred's records and noticed Form 1099-C reflecting a canceled debt of \$50,000.

Using Publication 4731-A, Part II, as a guide, the volunteer learned Fred lost his job and could no longer make his mortgage payments. The bank foreclosed on Fred's home. Due to the housing market slump, the value of Fred's home had declined, and his mortgage balance was more than the fair market value of the home. The bank sold Fred's home and canceled the remaining debt (\$50,000) not covered by the sale price.

Upon further questioning, the volunteer learned Fred had refinanced his home two years ago and used the equity in the home to pay off some credit cards and take a trip to Las Vegas.

Should the volunteer assist Fred with the preparation of his return at the VITA site?  Yes  No

## Foreclosures and Capital Gain or Loss

If a taxpayer does not make payments owed on a loan secured by property, the lender may foreclose on the loan or repossess the property. The foreclosure or repossession is treated as a sale from which the taxpayer may realize a gain or loss. This is true even if the taxpayer voluntarily returns the property to the lender.

Figure the gain or loss from a foreclosure or repossession the same way as the gain or loss from a sale. The gain is the difference between the amount realized and the adjusted basis of the transferred property (amount realized minus adjusted basis). The loss is the difference between the adjusted basis in the transferred property and the amount realized (adjusted basis minus amount realized).

When a residence that is security for a mortgage is abandoned or foreclosed upon, the gain or loss must be reported on the return and is subject to the rules for a Sale of Residence.

Generally, the amount realized on a foreclosure is considered to be the selling price. But this selling price depends, in part, on whether the debt was recourse debt or nonrecourse debt. In addition, the taxpayer may also have ordinary income from the cancellation of debt.

Use the Worksheet for Foreclosures and Repossessions in Publication 4681 to figure the ordinary income from the cancellation of debt and the gain or loss from a foreclosure or repossession.





A loss on the sale or disposition of a personal residence is not deductible. A gain may qualify for the Section 121 exclusion (\$250,000 or \$500,000 for Married Filing Jointly taxpayers) for a gain on the sale of a personal residence.

Generally, the taxpayer's gain or loss from a foreclosure or abandonment is reported on Form 8949 and Schedule D.

If the taxpayer is personally liable for the debt (recourse debt), and the amount of outstanding debt (mortgage) is more than the home's FMV, the difference is treated as cancellation of debt income.

- If the canceled debt qualifies as excludable from gross income, the exclusion is reported on Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness (And Section 1082 Basis Adjustment)
- Otherwise, the canceled debt is reportable as ordinary income on Form 1040, line 21 and is beyond the scope of VITA/TCE



If the canceled debt is reportable on Form 1040, line 21 or the canceled debt is not fully excludable from gross income, the issue is beyond the scope of the VITA/TCE programs.

### ***Form 1099-A, Acquisition or Abandonment of Secured Property***

When a personal residence is foreclosed upon, and the lender cancels a portion of the debt, the taxpayer will generally receive Form 1099-A and Form 1099-C. If, in the same calendar year, the debt is canceled in connection with a foreclosure of secured property, the lender has the option of issuing Form 1099-C only.

The filing requirements of Form 1099-A are met by the lender completing the following on Form 1099-C:

- Debt description
- The debtor was personally liable for the repayment of the debt
- Fair market value of property



For more information on determining the basis for sale of residence see the lesson on Income – Capital Gain or Loss, or Publication 17.

Verify with the taxpayer that the information on Form 1099-A and Form 1099-C is correct. Pay particular attention to the amount of debt forgiven and the fair market value reported. Advise the taxpayer to contact the lender immediately if any of the information is not correct.

Form 1099-A, issued by the lender, reports the outstanding debt and the fair market value of the property. This form provides information needed to determine the amount of any gain or loss due to foreclosure or abandonment. Report the gain or loss from Form 1099-A on Form 8949 and Schedule D.

The sale price (amount realized) is based on whether the taxpayer is personally liable (recourse loan) or not personally liable (nonrecourse loan) for the debt.

- If the taxpayer is personally liable, the sale price is the **lesser** of the balance of the principal mortgage debt outstanding or the fair market value
- If the taxpayer is not personally liable, then the sale price is the full amount of the outstanding debt, as reflected on Form 1099-A
- For both recourse and nonrecourse loans, add any proceeds the taxpayer received from the foreclosure sale to the amount realized

Generally, if there is a loss on the sale of a principal residence or the entire gain is excluded under the Section 121 exclusion (\$250,000 or \$500,000 for Married Filing Jointly), the sale does not have to be reported. However, taxpayers who receive Form 1099-A should report the sale to account for the basis in the property.



**CAUTION** Failure to report a foreclosure or abandonment transaction on Form 8949 and Schedule D may result in an IRS notice to the taxpayer.

### **Form 1099-C, Cancellation of Debt**

Lenders or creditors are required to issue Form 1099-C if they cancel a debt owed to them of \$600 or more. Generally, an individual taxpayer must include all canceled amounts (even if less than \$600) on the “Other Income” line of Form 1040.

However, under certain circumstances, a taxpayer may not have to include canceled debt in income. For example, if the canceled debt is related to the taxpayer’s principal residence, the taxpayer may be able to exclude all or a portion of canceled debt if it is “qualified principal residence indebtedness.” The amount excluded due to the “discharge of qualified principal residence indebtedness” is reported on Form 982.

In addition to debtor information, Form 1099-C reports the amount of debt canceled and the date canceled.

**If the form has event code “A” indicating bankruptcy, or if an amount is included for interest, refer the taxpayer to a professional tax preparer.**

Form 982 must be filed with the taxpayer’s return to report the excluded amount of discharged indebtedness and the reduction of certain tax attributes. Taxpayers excluding discharged debt from “qualified principal residence indebtedness” must complete only a few lines on Form 982; check the discharge of qualified principal residence indebtedness box and include the amount of debt discharged from Form 1099-C to Form 982. If the taxpayer kept ownership of the home, the basis adjustment to the principal residence for the excluded canceled debt must be reflected on the form.

### **Coordination with Form 1099-A**

As mentioned earlier, if a personal residence is foreclosed upon, and the debt is canceled in the same year, the taxpayer may receive Form 1099-C *only*. The required filing information from Form 1099-A will be shown on Form 1099-C.

Generally, the gross foreclosure bid price is considered to be the FMV. For an abandonment or voluntary conveyance in lieu of foreclosure, the FMV is generally the appraised value of the property.

For a recourse loan, the sale price is the **lesser** of the balance of the principal debt (mortgage) outstanding or fair market value.

### **Mortgage Workouts and Form 1099-C**

Homeowners whose mortgage debt is partly forgiven through a loan modification, or “workout,” which allows them to continue owning their residence, will receive Form 1099-C reporting the amount of debt discharged. Because the taxpayer kept ownership of the home, there is no gain or loss to be reported.

However, if the canceled debt meets the requirements of “qualified principal residence indebtedness,” Form 982 must be completed to report the amount excluded from gross income and the reduction of tax attributes. See Publication 4012, Legislative Extenders tab, Capital Loss on Foreclosure, on how to complete Form 982.

Taxpayers who are not personally liable for the debt (nonrecourse debt) do not have ordinary income from the cancellation of the debt unless the lender:

- Offered a discount for the early payment of the debt or
- Agreed to a loan modification that resulted in the reduction of the principal balance of the debt

If a lender offers to discount (reduce) the principal balance of a loan that is paid off early, or agrees to a loan modification (“workout”) that includes a reduction in the principal balance of a loan, the amount of the discount or the amount of the principal reduction is  *canceled debt*  whether or not the taxpayer is personally liable for the debt. The amount of the canceled debt must be included in income unless the exceptions or exclusions discussed earlier apply.

**Gain or Loss Reported on Form 8949 and Schedule D**

Form 8949, Sales and Other Dispositions of Capital Assets, includes all capital gain and loss transactions. The subtotals from Form 8949 are carried over to Schedule D, Capital Gains and Losses, where gain or loss is calculated in aggregate.

Losses on a personal residence are never deductible. Gains (all or part) may be excluded under the rules regarding the sale of a personal residence (Section 121 exclusion).

For more information on how to report the gain or losses, see the instructions for Form 8949.

See Publication 4012, Legislative Extenders tab, Capital Loss on Foreclosure that shows how a foreclosure was reported on the Capital Gain or Loss Transaction Worksheet based on the information provided on Form 1099-A.



The following case studies are only examples of how the mentioned issues and forms can look and be reported. The dates and years of the forms are not relevant for these case studies.

**Case Study – Reporting a Foreclosure and Canceled Debt**

Frank bought his home on May 14, 2003. His basis in the home was \$200,000. After he lost his job last year, he was not able to make the payments. The bank foreclosed in June of the current tax year, and Frank moved out. At the time of the foreclosure, the fair market value of the home was \$125,000 and the principal balance of the mortgage was \$195,000. All of the debt was incurred to purchase the home. Frank received Form 1099-C for the amount of debt canceled by his bank.

Frank has qualified principal residence indebtedness. His tax return should include Form 8949 and Schedule D to show the basis of the home disposed of through foreclosure, and Form 982 to exclude the debt cancellation from income.

<input type="checkbox"/> CORRECTED (if checked)				
CREDITOR'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.  <b>FIRST BANK ANYWHERE USA</b>		1 Date of identifiable event <b>6/25/20XX</b>	OMB No. 1545-1424	<b>20XX</b>  Form <b>1099-C</b>
		2 Amount of debt discharged <b>\$ 70,000.00</b>		
		3 Interest if included in box 2 <b>\$</b>		
CREDITOR'S federal identification number <b>XX-XXXXXXX</b>	DEBTOR'S identification number <b>XXX-XX-XXXX</b>	4 Debt description <b>HOME MORTGAGE LOAN 1111 ANYWHERE STREET ANYWHERE TOWN, STATE ZIP</b>		<b>Copy B For Debtor</b>  This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if taxable income results from this transaction and the IRS determines that it has not been reported.
DEBTOR'S name <b>FRANK LINCOLN</b>		5 If checked, the debtor was personally liable for repayment of the debt <input checked="" type="checkbox"/>		
Street address (including apt. no.) <b>ANYWHERE</b> City or town, state or province, country, and ZIP or foreign postal code <b>CITY, STATE ZIP USA</b>				
Account number (see instructions) <b>1234567</b>		6 Identifiable event code	7 Fair market value of property <b>\$ 125,000.00</b>	
Form <b>1099-C</b> (keep for your records)		www.irs.gov/form1099c		Department of the Treasury - Internal Revenue Service

Name(s) shown on return. Name and SSN or taxpayer identification no. not required if shown on other side  
**FRANK LINCOLN**

Social security number or taxpayer identification number  
**XXX-XX-XXXX**

Before you check Box D, E, or F below, see whether you received any Form(s) 1099-B or substitute statement(s) from your broker. A substitute statement will have the same information as Form 1099-B. Either may show your basis (usually your cost) even if your broker did not report it to the IRS. Brokers must report basis to the IRS for most stock you bought in 2011 or later (and for certain debt instruments you bought in 2014 or later).

**Part II Long-Term.** Transactions involving capital assets you held more than 1 year are long term. For short-term transactions, see page 1.

**Note.** You may aggregate all long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS and for which no adjustments or codes are required. Enter the total directly on Schedule D, line 8a; you are not required to report these transactions on Form 8949 (see instructions).

**You must check Box D, E, or F below. Check only one box.** If more than one box applies for your long-term transactions, complete a separate Form 8949, page 2, for each applicable box. If you have more long-term transactions than will fit on this page for one or more of the boxes, complete as many forms with the same box checked as you need.

- (D) Long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS (see Note above)
- (E) Long-term transactions reported on Form(s) 1099-B showing basis was **not** reported to the IRS
- (F) Long-term transactions not reported to you on Form 1099-B

1	(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold or disposed (Mo., day, yr.)	(d) Proceeds (sales price) (see instructions)	(e) Cost or other basis. See the Note below and see Column (e) in the separate instructions	Adjustment, if any, to gain or loss. If you enter an amount in column (g), enter a code in column (f). See the separate instructions.		(h) Gain or (loss). Subtract column (e) from column (d) and combine the result with column (g)
						(f) Code(s) from instructions	(g) Amount of adjustment	
	Main Home Form 1099-A	05/14/03	06/25/XX	\$ 125,000	\$ 200,000	L	\$ 75,000	\$ 0

<b>2 Totals.</b> Add the amounts in columns (d), (e), (g), and (h) (subtract negative amounts). Enter each total here and include on your Schedule D, <b>line 8b</b> (if <b>Box D</b> above is checked), <b>line 9</b> (if <b>Box E</b> above is checked), or <b>line 10</b> (if <b>Box F</b> above is checked) ▶	\$ 125,000	\$ 200,000		\$ 75,000	\$ 0
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**Note.** If you checked Box D above but the basis reported to the IRS was incorrect, enter in column (e) the basis as reported to the IRS, and enter an adjustment in column (g) to correct the basis. See Column (g) in the separate instructions for how to figure the amount of the adjustment.

term capital gains or losses, go to Part II below. Otherwise, go to Part III on the back . . . . .

**Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year**

See instructions for how to figure the amounts to enter on the lines below.

This form may be easier to complete if you round off cents to whole dollars.

	(d) Proceeds (sales price)	(e) Cost (or other basis)	(g) Adjustments to gain or loss from Form(s) 8949, Part II, line 2, column (g)	(h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g)
<b>8a</b> Totals for all long-term transactions reported on Form 1099-B for which basis was reported to the IRS and for which you have no adjustments (see instructions). However, if you choose to report all these transactions on Form 8949, leave this line blank and go to line 8b . . . . .				
<b>8b</b> Totals for all transactions reported on Form(s) 8949 with <b>Box D</b> checked . . . . .				
<b>9</b> Totals for all transactions reported on Form(s) 8949 with <b>Box E</b> checked . . . . .				
<b>10</b> Totals for all transactions reported on Form(s) 8949 with <b>Box F</b> checked. . . . .	\$125,000	\$200,000	\$75,000	\$0
<b>11</b> Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and long-term gain or (loss) from Forms 4684, 6781, and 8824 . . . . .			11	
<b>12</b> Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1 . . . . .			12	
<b>13</b> Capital gain distributions. See the instructions . . . . .			13	
<b>14</b> Long-term capital loss carryover. Enter the amount, if any, from line 13 of your <b>Capital Loss Carryover Worksheet</b> in the instructions . . . . .			14	( )
<b>15</b> <b>Net long-term capital gain or (loss).</b> Combine lines 8a through 14 in column (h). Then go to Part III on the back . . . . .			15	\$0

For Paperwork Reduction Act Notice, see your tax return instructions.

**Reduction of Tax Attributes Due to Discharge of  
Indebtedness (and Section 1082 Basis Adjustment)**

OMB No. 1545-0046

▶ Attach this form to your income tax return.  
▶ Information about Form 982 and its instructions is at [www.irs.gov/form982](http://www.irs.gov/form982).

Attachment  
Sequence No. **94**

Name shown on return

**FRANK LINCOLN**

Identifying number

**XXX-XX-XXXX**

**Part I** General Information (see instructions)

- 1 Amount excluded is due to (check applicable box(es)):
- a Discharge of indebtedness in a title 11 case . . . . .
  - b Discharge of indebtedness to the extent insolvent (not in a title 11 case) . . . . .
  - c Discharge of qualified farm indebtedness . . . . .
  - d Discharge of qualified real property business indebtedness . . . . .
  - e Discharge of qualified principal residence indebtedness . . . . .
- 2 Total amount of discharged indebtedness excluded from gross income . . . . . **2** **\$70,000**
- 3 Do you elect to treat all real property described in section 1221(a)(1), relating to property held for sale to customers in the ordinary course of a trade or business, as if it were depreciable property? . . . . .  Yes  No

**Part II** Reduction of Tax Attributes. You must attach a description of each transaction that results in the reduction in

**Case Study Alternative – Mortgage Workout**

If Frank had been able to negotiate a workout with his mortgage lender (reducing the amount he owed on the mortgage and staying in the home), he would not have completed Form 8949 and Schedule D because he had not disposed of the asset.

Assume Frank’s lender agreed to reduce his mortgage debt from \$195,000 to \$175,000. The lender issued Frank a Form 1099-C showing \$20,000 of canceled debt. Frank’s Form 982 would be completed, but the amount of debt forgiven (or his basis in the home, whichever was smaller) would need to be entered on the form, and his basis in the home would be decreased by that amount.

CORRECTED (if checked)

CREDITOR'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.  <b>FIRST BANK ANYWHERE USA</b>		1 Date of identifiable event <b>6/25/20XX</b>	OMB No. 1545-1424  <b>20XX</b>  Form 1099-C	<b>Cancellation of Debt</b>
		2 Amount of debt discharged <b>\$ 70,000.00</b>		
		3 Interest if included in box 2 <b>\$</b>		
CREDITOR'S federal identification number <b>XX-XXXXXXX</b>	DEBTOR'S identification number <b>XXX-XX-XXXX</b>	4 Debt description <b>HOME MORTGAGE LOAN 1111 ANYWHERE STREET ANYWHERE TOWN, STATE ZIP</b>		<b>Copy B For Debtor</b>  This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if taxable income results from this transaction and the IRS determines that it has not been reported.
DEBTOR'S name <b>FRANK LINCOLN</b>				
Street address (including apt. no.) <b>ANYWHERE</b>		5 If checked, the debtor was personally liable for repayment of the debt . . . . . <input checked="" type="checkbox"/>		
City or town, state or province, country, and ZIP or foreign postal code <b>CITY, STATE ZIP USA</b>		6 Identifiable event code	7 Fair market value of property <b>\$</b>	
Account number (see instructions) <b>1234567</b>				

Form **1099-C** (keep for your records) [www.irs.gov/form1099c](http://www.irs.gov/form1099c) Department of the Treasury - Internal Revenue Service

## Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment)

OMB No. 1545-0046

▶ Attach this form to your income tax return.

Attachment  
Sequence No. **94**

▶ Information about Form 982 and its instructions is at [www.irs.gov/form982](http://www.irs.gov/form982).

Name shown on return  
**FRANK LINCOLN**

Identifying number  
**XXX-XX-XXXX**

**Part I** General Information (see instructions)

- 1** Amount excluded is due to (check applicable box(es)):
- a** Discharge of indebtedness in a title 11 case
  - b** Discharge of indebtedness to the extent insolvent (not in a title 11 case)
  - c** Discharge of qualified farm indebtedness
  - d** Discharge of qualified real property business indebtedness
  - e** Discharge of qualified principal residence indebtedness
- 2** Total amount of discharged indebtedness excluded from gross income **2** **\$20,000**
- 3** Do you elect to treat all real property described in section 1221(a)(1), relating to property held for sale to customers in the ordinary course of a trade or business, as if it were depreciable property?  Yes  No

**Part II** Reduction of Tax Attributes. You must attach a description of any transactions resulting in the reduction in basis under section 1017. See Regulations section 1.1017-1 for basis reduction ordering rules, and, if applicable, required partnership consent statements. (For additional information, see the instructions for Part II.)

**Enter amount excluded from gross income:**

- |   |            |                 |
|---|------------|-----------------|
| <b>4</b> For a discharge of qualified real property business indebtedness applied to reduce the basis of depreciable real property  | <b>4</b>   |                 |
| <b>5</b> That you elect under section 108(b)(5) to apply first to reduce the basis (under section 1017) of depreciable property   | <b>5</b>   |                 |
| <b>6</b> Applied to reduce any net operating loss that occurred in the tax year of the discharge or carried over to the tax year of the discharge                                     | <b>6</b>   |                 |
| <b>7</b> Applied to reduce any general business credit carryover to or from the tax year of the discharge   | <b>7</b>   |                 |
| <b>8</b> Applied to reduce any minimum tax credit as of the beginning of the tax year immediately after the tax year of the discharge   | <b>8</b>   |                 |
| <b>9</b> Applied to reduce any net capital loss for the tax year of the discharge, including any capital loss carryovers to the tax year of the discharge                             | <b>9</b>   |                 |
| <b>10a</b> Applied to reduce the basis of nondepreciable and depreciable property if not reduced on line 5. <i>DO NOT use in the case of discharge of qualified farm indebtedness</i> | <b>10a</b> |                 |
| <b>b</b> Applied to reduce the basis of your principal residence. Enter amount here ONLY if line 1e is checked  | <b>10b</b> | <b>\$20,000</b> |
| <b>11</b> For a discharge of qualified farm indebtedness applied to reduce the basis of:  |            |                 |
| <b>a</b> Depreciable property used or held for use in a trade or business or for the production of income if not reduced on line 5  |            |                 |



### EXERCISES (continued)

**Question 3:** A volunteer with Advanced certification is working with Robert. The volunteer asks Robert if he underwent foreclosure or had to give up his home during the tax year. Robert confirmed that he did, and produced Form 1099-A. The volunteer asked Robert if he had received Form 1099-C, and Robert replied that he did not. Examining the form, the volunteer noted the balance of principal outstanding was \$234,000. What should the volunteer do next?

- A. Ask the questions on Publication 4731-A, Screening Sheet for Foreclosures/Abandonments and Cancellation of Debt
- B. Ask enough probing questions to determine if Robert had a gain or loss on the foreclosure
- C. Refer Robert to a professional tax preparer
- D. Complete Form 982



## EXERCISES (continued)

**Question 4:** Mary purchased her main home in June 2004 for \$175,000. She lost her job and was no longer able to make her mortgage payments during the current year. In July of the current tax year, Mary moved out of the home to live with relatives. On July 15, the bank foreclosed on the home. On November 15, the bank discontinued its collection activity and canceled the remaining debt. The fair market value at the time of foreclosure was \$100,000 because of the poor housing market, but Mary still owed \$150,000 on the mortgage. None of the loan proceeds were used for any purpose other than to buy, build, or substantially improve the principal residence. Mary never used the home for business or rental purposes and has not filed for bankruptcy. Based on this information, what should the volunteer do?

- A. Refer Mary to another source for tax return preparation
- B. Report a loss of \$50,000 on Schedule D
- C. Report \$50,000 debt canceled on Form 982
- D. Include the debt cancellation amount in income

**Question 5:** After Tom became ill and could not work full time, he and his wife, Grace, were having difficulty making their mortgage payments. Rather than go through the expense of a foreclosure, the lender agreed to reduce the principal on their loan and refinance it with a better interest rate and lower payments. The principal balance before November 1 of the current tax year workout was \$130,000, and the lender reduced the loan to \$110,000. None of the loan proceeds were used for any purpose other than to buy, build, or substantially improve the principal residence. The home has never been used for business or as rental property, and the taxpayers have not filed for bankruptcy.

Based on this information, what should the volunteer do?

- A. Refer Tom and Grace to another source for tax return preparation
- B. Report the reduction in the basis of the home on line 10b of Form 982
- C. Report the \$20,000 as a loss on Schedule D
- D. Include the debt cancellation amount in income

**Question 6:** Gene bought his home in 2003. His basis in the home was \$210,000. He lost his job in January of the current tax year and was not able to make the mortgage payments. The bank foreclosed in August and Gene moved out. At the time of the foreclosure, the fair market value was \$145,000 and the principal balance of the mortgage was \$185,000. All of the debt was incurred to purchase the home, it was never used for business or as a rental property, and Gene has not filed for bankruptcy. Gene has a Form 1099-C. Gene is personally liable for repayment of the debt.

How should the foreclosure and loss be reported?

- A. Report the \$40,000 debt cancellation on Form 982, line 10b
- B. Report the \$40,000 debt cancellation on Form 982, line 2, only
- C. Report the \$40,000 debt cancellation on Form 982, line 2, and the foreclosure on Form 8949 and Schedule D
- D. Report the \$40,000 debt cancellation on Form 1040, line 21

## Summary

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Legislative extenders are temporary provisions. At the time this publication went to print these provisions were expired for 2017. Do not refer to this lesson unless directed here by Publication 4491X.

### ***Tuition and Fees***

Taxpayers can deduct up to \$4,000 in qualified tuition and related expenses paid during the tax year as an adjustment to income.

### ***Itemized Deductions***

Taxpayers may be able to deduct qualified mortgage insurance premiums.

### ***Nonbusiness Energy Property Credit***

Taxpayers who make certain energy-efficient improvements to their main home may be eligible for this credit (Form 5695, Part II). The limit for this credit is \$500 for all tax years.

### ***Cancellation of Debt (COD)***

A debt includes any indebtedness for which a taxpayer is liable or which attaches to the taxpayer's property. Cancellation of indebtedness can involve auto loans, credit card debt, medical care, professional services, installment purchases of furniture or other personal property, mortgages, and home equity loans.

Cancellation of debt can be complex. VITA/TCE volunteers may assist a taxpayer with issues related to cancellation of debt as long as the taxpayer meets all the criteria for discharge of qualified principal residence indebtedness or if all debt canceled and reported on Form 1099-C was nonbusiness credit card debt.

Taxpayers who go through a foreclosure or abandonment of their principal residence receive Form 1099-A, Acquisition or Abandonment of Secured Property. Form 1099-A will have information needed to determine the gain or loss due to the foreclosure or abandonment.

If the debt on the principal residence is canceled, the taxpayer will receive Form 1099-C, Cancellation of Debt. If foreclosure/abandonment and debt cancellation occur in the same calendar year, the lender may issue only Form 1099-C, including the information that would be reported on Form 1099-A.

Use Publication 4731-A, Screening Sheet for Foreclosures/Abandonments and Cancellation of Debt, which provides questions and step-by-step guidance to determine whether the cancellation of debt issue is within scope for the VITA/TCE programs.

- Use Publication 4731-A, Part I for taxpayers with Form 1099-A for a foreclosure or abandonment of their principal residence.
- Use Publication 4731-A, Part II for taxpayers with Form 1099-C, and/or Forms 1099-A and 1099-C resulting from cancellation of debt on a home mortgage loan.



## What situations are out of scope for the VITA/TCE programs?

The following are out of scope for this lesson. While this list may not be all inclusive, it is provided for your awareness only.

- Residential energy-efficient property credit (Form 5695, Part I)
- Cancellation of debt for issues other than “qualified principal residence indebtedness” or nonbusiness credit card debt
- Cancellation of debt for a principal residence that was used in a business or as rental property
- Cancellation of debt when Form 1099-C includes an amount for interest
- Cancellation of debt was because the taxpayer filed bankruptcy or was insolvent immediately before the debt was canceled



### EXERCISE ANSWERS

**Answer 1:** No. Because Angie used part of the home as rental property, all the canceled debt may not qualify to be excluded from income. The rules involving mortgage debt exclusions are complex. Angie should be referred to a professional tax preparer.

**Answer 2:** No. Fred’s situation is outside the scope of the volunteer program since a portion of his refinanced debt was used for purposes other than to buy, build, or substantially improve his principal residence. Fred should be referred to a professional tax preparer, per the guidance on Publication 4731-A.

**Answer 3:** A. The volunteer should use Publication 4731-A, Part I to determine if Robert had a gain or loss on the foreclosure. If the taxpayer receives a Form 1099-C, the volunteer would use the screening sheet to determine if the related tax issues are within scope.

**Answer 4:** C. The volunteer would need to complete Form 8949, Schedule D, and Form 982. Although there is a loss, it cannot be deducted. The mortgage debt cancellation is not included in income on the tax return because it is covered by the qualified principal residence indebtedness exclusion on Form 982.

**Answer 5:** B. The volunteer would complete Form 982 and report the reduction in the basis of the home. The \$20,000 in debt cancellation can be excluded as qualified principal residence indebtedness on Form 982 and is not counted as income on the tax return. Form 8949 and Schedule D are not required because Tom and Grace did not dispose of the home.

**Answer 6:** C. Form 982, Form 8949, and Schedule D should be completed. When a residence that is security for a mortgage is abandoned or foreclosed upon, it is treated as having been sold. This results in the foreclosure being reported on Form 8949 and Schedule D as sale of home. Failure to file Form 8949 and Schedule D may result in an IRS notice to the taxpayer.





# Affordable Care Act



## Introduction

This lesson covers some of the tax provisions of the Affordable Care Act (ACA). You will learn how to determine if taxpayers satisfy the individual shared responsibility provision by enrolling in minimum essential coverage, qualifying for an exemption, or making a shared responsibility payment. You will also learn how to determine if taxpayers are eligible to receive the premium tax credit. A list of terms you may need to know is included at the end of the lesson.

## Objectives

At the end of this course, using your resource materials, you will be able to:

- Determine what is minimum essential coverage (MEC)
- Determine if taxpayers qualify for a health care coverage exemption
- Calculate the shared responsibility payment (SRP), if applicable
- Determine eligibility for the premium tax credit (PTC)
- Calculate the premium tax credit, if applicable
- Report taxpayers' health insurance coverage, premium tax credit, exemption from coverage, or shared responsibility payment on the tax return

### What do I need?

- Form 13614-C
- Publication 4012
- Publication 17
- Publication 974
- Form 1095-A & Instructions
- Form 8962 & Instructions
- Form 8965 & Instructions
- Optional**
- Publication 5120
- Publication 5121
- Publication 5156
- Publication 5172
- Form 1095-B & Instructions
- Form 1095-C & Instructions

## What is the Affordable Care Act?

Under the Affordable Care Act (ACA), the federal government, state governments, insurers, employers, and individuals share responsibility for improving the quality and availability of health insurance coverage in the United States. The ACA reforms the existing health insurance market by prohibiting insurers from denying coverage or charging higher premiums because of an individual's preexisting conditions. The ACA also creates the Health Insurance Marketplace. For more information about the Marketplace, see [www.healthcare.gov](http://www.healthcare.gov). Some states have established their own health insurance marketplaces. We will refer to them all simply as the Marketplace.

The Marketplace is where taxpayers find information about health insurance options, purchase health insurance, and, if eligible, obtain help paying premiums and out-of-pocket costs. The Marketplace estimates the amount of the premium tax credit (PTC) that eligible taxpayers may be able to claim on their federal income tax returns. Based on that estimate, eligible taxpayers can decide if they want to have all, some or none of their estimated credit paid in advance to their insurance company to help pay for coverage.

The ACA requires individuals to have qualifying health care coverage (called minimum essential coverage, or MEC) for each month of the year, qualify for a coverage exemption, or make a shared responsibility payment (SRP) when filing their federal income tax returns.

**For each month you must either:**



**Have Health Coverage**  
See the instructions for your tax return for information on reporting full-year coverage.

OR



**Claim a Coverage Exemption on Form 8965**

OR



**Make a Shared Responsibility Payment**

See *Shared Responsibility Payment* in the instructions for Form 8965 for information on how to figure your shared responsibility payment.

Some taxpayers may qualify for a coverage exemption, which means they are not required to have MEC or make an SRP when filing their federal income tax return.

## Who must have health care coverage?

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For each month of the tax year, individuals must:

- Have MEC, or
- Qualify for a coverage exemption, or
- Make an SRP when filing their federal income tax return

Individuals are treated as having MEC for a month as long as they are enrolled in and entitled to receive benefits under a plan or program identified as MEC for at least one day during that month.

A taxpayer is subject to an SRP for the taxpayer, the taxpayer's spouse (if filing a joint return), and any individual who is claimed, or could be claimed, as a dependent on the tax return if they don't have MEC or a coverage exemption.

All U.S. citizens are subject to the individual shared responsibility provision, as are all non-U.S. citizens who are in the U.S. long enough during a calendar year to qualify as resident aliens for federal income tax purposes (see the Resident or Nonresident Alien Decision Tree in the Volunteer Resource Guide, Resident/NR Alien tab). Foreign nationals who are present in the U.S. for a short enough period that they do not become resident aliens for tax purposes are exempt from the individual shared responsibility provision even though they may have to file U.S. income tax returns.

All bona fide residents of U.S. territories are treated as having MEC and are not required to take any action to comply with the individual shared responsibility provision other than to indicate their status on their federal income tax returns if they are required to file.



An individual who cannot claim his or her own exemption, but files a tax return, is generally not required to indicate their coverage or lack thereof on the return.

## What is minimum essential coverage (MEC)?

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Under the ACA, minimum essential coverage (MEC) is a health care plan or arrangement specifically identified in the law as MEC, including:

- Specified government-sponsored programs (e.g., Medicare Part A, Medicare Advantage, most Medicaid programs, CHIP, most TRICARE programs, and comprehensive health care coverage of veterans)
- Employer-sponsored coverage under a group health plan (including self-insured plans)
- Individual health coverage (e.g., health insurance purchased through the Marketplace or directly from an insurance company)
- Grandfathered health plans (in general, certain plans that existed before the ACA and have not changed since the ACA was passed)
- Other plans or programs that the Department of Health and Human Services, in coordination with the Treasury, recognizes as MEC for the purposes of the ACA

The chart in The Volunteer Resource Guide, Tab H, shows these and other types of coverage that qualify as MEC and some that do not. Family members are not required to have the same type of coverage. Each individual may be covered by a different plan.



**Tax Software Hint:** See the Volunteer Resource Guide, Tab H, for software entries.



## EXERCISES

Please use the Minimum Essential Coverage Chart in Publication 4012, Tab H, and this text to answer the following questions.

**Question 1:** Sandy is covered under health insurance offered by her spouse's employer. Does she have MEC?  Yes  No

**Question 2:** Keith and Kathy are married with dependent children. Must they all be covered under the same policy or plan to have MEC?  Yes  No

**Question 3:** James is retired and too young to be eligible for Medicare. He received his health coverage through a retiree health insurance plan offered by his former employer. Is the retiree plan MEC?  Yes  No

**Question 4:** Valerie is a local government employee and she enrolls in group health insurance coverage offered by her employer. Does she have MEC?  Yes  No

**Question 5:** Jessie is 20 years old, going to school full-time and working to support herself (she provides more than half of her own support), although Jessie still lives with her parents. Is Jessie responsible for her health coverage under ACA?  Yes  No

**Question 6:** (Continuing from Question 5) If Jessie's parents provided more than half of Jessie's support, are they responsible for Jessie's health coverage under ACA?  Yes  No

## How do I know if taxpayers have MEC?

While conducting an interview with taxpayers using Form 13614-C, Intake/Interview & Quality Review Sheet, you will determine whether taxpayers, their spouse (if filing a joint return), and their dependents had MEC for the entire year, part of the year, or not at all. Taxpayers may have insurance cards or receive Forms 1095-A, 1095-B, or 1095-C from the Marketplace, their insurance provider, or employer. These forms may indicate the taxpayer or a member of the tax household had MEC for some or all months during the year, but volunteers should rely primarily on their interview with the taxpayer.

### Form 1095-A, Health Insurance Marketplace Statement

- The Health Insurance Marketplace sends this form to individuals who enrolled in coverage through the Marketplace. The form includes information about the coverage, who was covered, and when.

### Form 1095-B, Health Coverage

- Health insurance providers send this form to individuals they cover for one or more months of the calendar year, with information about who was covered and when (e.g., private insurers, Medicaid, Medicare, etc.).

### Form 1095-C, Employer-Provided Health Insurance Offer and Coverage

- Certain large employers send this form to certain employees, with information about what coverage, if any, the employer offered to the employees. Employers that offer health coverage referred to as "self-insured coverage" send this form to individuals they cover, with information about who was covered and when. Note that the offer amounts shown on Form 1095-C are for employee-only coverage. If the employer made an offer for spousal or family coverage, the taxpayer will need to provide those offer amounts.

The deadline for the Marketplaces, insurers, other coverage providers, and certain employers to provide these forms to taxpayers is January 31. Taxpayers expecting to receive a Form 1095-A should wait to file their income tax return until they receive that form. Some taxpayers may not receive a Form 1095-B or Form 1095-C by the time they are ready to file their tax return. While the information on these forms may assist in preparing a return, it is not necessary to wait for Forms 1095-B or 1095-C in order to file. These forms may indicate the taxpayer or a member of the tax household had or was offered MEC for some or all months during the year, but volunteers should rely primarily on their interview with the taxpayer.



Be sure to complete the ACA preparer section of Form 13614-C, Intake/Interview & Quality Review Sheet. Note MEC and coverage exemptions as applicable for the taxpayer, spouse, and dependents.

## What are the health coverage exemptions?

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Members of the tax household may be eligible to claim an exemption from the requirement to have MEC. Some exemptions apply to the entire tax household for the tax year.

### Filing threshold exemptions

- **Household income below the return filing threshold** – The taxpayer’s household income is below the taxpayer’s minimum threshold for filing a tax return. Include the Modified Adjusted Gross Income (as defined in the instructions for Form 8965) of any dependent who has a filing requirement.
- **Gross income below the filing threshold** – Gross income of taxpayer (and spouse if Married Filing Jointly) is below the filing threshold (do not include income of dependents).

The following exemptions apply to each member of the tax household individually and apply on a monthly basis with one exception, as noted below:

- **Coverage considered unaffordable (Code A)** – The required contribution is more than 8.16 percent of household income. See the example later in this lesson.
- **Short coverage gap (Code B)** – The individual went without coverage for **less than** three consecutive months during the year. The exemption is only valid for a 1- or 2-month gap in insurance coverage, which can be sandwiched in between months of coverage or other types of exemptions. For example, if someone was incarcerated in March through the end of the year, they could claim the gap exemption for January and February and then claim the incarceration exemption for March through December.

There is a look-back rule for gaps of coverage at the start of the year. In order to claim the short coverage gap exemption, you must consider gaps at the end of the prior year. So someone without coverage from October 2016 through February 2017 (who is not eligible for another exemption for October through December 2016) does not qualify for the coverage gap exemption for tax year 2017 since it was not less than 3 months. There is no “look forward rule” at the end of the tax year, so gaps from November 2017 through January 2018 would qualify for the exemption for tax year 2017.

- **Citizens living abroad and certain noncitizens (Code C)** – The individual was:
  - A U.S. citizen or resident who spent at least 330 full days outside of the U.S. during a 12-month period;



If taxpayers meet one of these conditions, they qualify for this exemption even if they have a Social Security number (SSN).

- A U.S. citizen who was a bona fide resident of a foreign country or U.S. territory;
- A resident alien who was a citizen of a foreign country with which the U.S. has an income tax treaty with a nondiscrimination clause, and was a bona fide resident of a foreign country for the tax year;
- A nonresident alien; or

- Not a U.S. citizen, not a U.S. national, and not an individual lawfully present in the U.S. For this purpose, an immigrant with Deferred Action for Childhood Arrivals (DACA) status is not considered lawfully present and therefore qualifies for this exemption. For more information about who is treated as lawfully present for purposes of this coverage exemption, visit [www.healthcare.gov](http://www.healthcare.gov).
- **Members of a health care sharing ministry (Code D)** – The individual was a member of a health care sharing ministry.
- **Members of federally recognized Indian tribes (Code E)** – The individual was a member of a federally recognized Indian tribe, including an Alaska Native Claims Settlement Act (ANCSA) Corporation Shareholder (regional or village), or was otherwise eligible for services through an Indian health care provider or the Indian Health Service.
- **Incarceration (Code F)** – The individual was in a jail, prison, or similar penal institution or correctional facility after the disposition of charges. Does not include time in jail pending disposition of charges (being held but not convicted of a crime), time in probation, parole, or home confinement.
- **Resident of a state that did not expand Medicaid (Code G)** – Taxpayer’s household income was below 138 percent of the federal poverty line for the family size and at any time in 2017 the individual resided in a state that didn’t participate in the Medicaid expansion under the Affordable Care Act.
- **Aggregate self-only coverage considered unaffordable (Code G)** – Taxpayers can claim this exemption if: (1) Offers of self-only coverage for two or more members of the tax household are each affordable, but (2) two or more family members’ aggregate cost of self-only employer-sponsored coverage was more than 8.16 percent of household income, (3) as was the cost of any available employer-sponsored coverage for the entire family. Exception: This exemption applies to the whole year for the entire family.



See Publication 5157-A, Affordable Care Act – Taxpayer Scenarios, for detailed instructions on claiming the affordability exemptions.

- **Member of tax household born or adopted during the year (Code H)** – The months before and including the month that an individual was added to a taxpayer’s tax household by birth or adoption. An individual is included in a taxpayer’s tax household in a month only if he or she is alive for the full month. Also, if a taxpayer adopts a child during the year, the child is included in a taxpayer’s tax household only for the full months that follow the month in which the adoption occurs.
- **Member of tax household died during the year (Code H)** – The months after the month that a member of the tax household died during the year.

There are some other coverage exemptions granted by the Marketplace:

- **General hardship** – Taxpayers experienced hardships, such as bankruptcy or eviction, that prevented them from obtaining coverage under a qualified health plan. Refer to the Volunteer Resource Guide, Tab H, for a complete list of hardships identified by the Marketplace.
- **Members of certain religious sects** – The individual was a member of a religious sect in existence since December 31, 1950, that is recognized by the Social Security Administration (SSA) as conscientiously opposed to accepting any insurance benefits, including Medicare and Social Security.

Taxpayers who are granted a coverage exemption from the Marketplace will receive exemption certificate numbers (ECNs) from the Marketplace.

## If taxpayers think they qualify for a coverage exemption, how do they obtain it?

How taxpayers can receive a coverage exemption depends upon the type of exemption for which they are eligible. Some exemptions are granted only by the Marketplace and others are claimed on the tax return.



Some Marketplace exemptions based on hardship may be retroactive.

Taxpayers whose gross income is below their filing threshold are exempt from the individual shared responsibility provision and are not required to file a federal income tax return to claim the coverage exemption. However, if the taxpayer files a return anyway (for example, to claim a refund), he or she can claim a coverage exemption with his or her tax return.

Coverage exemptions are claimed on Form 8965, Health Care Coverage Exemptions.

## How are health care coverage exemptions reported?

Enter ECNs for taxpayers who were granted a coverage exemption from the Marketplace in Part I (Marketplace-Granted Coverage Exemptions for Individuals) of Form 8965, column c. Taxpayers will use Part II (Coverage Exemptions for Your Household Claimed on Your Return) of Form 8965 to claim a coverage exemption based on household or gross income below the filing threshold. All other coverage exemptions may be claimed in Part III (Coverage Exemptions for Individuals Claimed on Your Return) of Form 8965.



If the Marketplace has not processed an individual application for a coverage exemption before the tax return is filed, enter “pending” as the ECN in the software. Refer to the Volunteer Resource Guide, Tab H, for more information.

## What is the unaffordability exemption?

Coverage is “Unaffordable” when the taxpayer’s contribution toward premiums is more than 8.16 percent of household income. The premium that is measured depends on the taxpayer’s circumstances. Household income also has a unique definition for this exemption.

During the taxpayer interview, determine whether each household member for each month:

- Had coverage
- Had an exemption (other than for unaffordable coverage), or had no coverage or exemption

If the taxpayer or a dependent on the tax return had no coverage and no other exemption, try the exemption for unaffordable coverage. Use one of the following three tests to determine if the exemption applies. If circumstances change during the year, you may need to use a different test that matches the circumstances in the different time period. In all cases, compare the premium to the “affordability threshold,” which is 8.16 percent of household income. Note your findings on the Intake/Interview & Quality Review sheet.

## What are the three tests for the unaffordability exemption?

1. *Did the uninsured person have an offer of coverage from his or her own employer?* If no, move to the next test. If yes, compare the employee’s annual premium for the lowest-cost plan for only themselves (self-only coverage) to the affordability threshold of 8.16 percent of household income. This test is done employee by employee. (If both the taxpayer and spouse have offers from their respective employers, for example, measure the affordability of each offer separately.) The required contribution is the amount that the employee would pay (either pre-tax or after-tax) for the coverage. Compare the annual cost of coverage to the annual income, even if the employee only had the offer of coverage for a full month.



#### example

Assume no one in Damon's family has coverage or another exemption. Damon is offered coverage from his employer for himself that would cost 8.7 percent of his household income. Because the coverage costs more than 8.16 percent of income, it is unaffordable and Damon can claim the exemption for himself for all months for which he had this employer offer. No other test is needed. If the coverage had been affordable, Damon would not be eligible for the unaffordable coverage exemption. He would not proceed to the other affordability tests.

#### 2. *Did the uninsured person have an offer of employer coverage as a member of an employee's family?*

If no, move to the next test. If yes, compare the employee's annual premium for family coverage to the affordability threshold of 8.16 percent of household income. Use the lowest-cost offer that covers everyone:

(1) whose personal exemption is claimed on the return, (2) who is eligible for coverage under the terms of the policy, and (3) who doesn't qualify for another coverage exemption. If a family member is excluded (not offered family coverage), that uninsured person would proceed to the third test.

#### example (continued)

Damon is also offered family coverage that would cover himself, his spouse, and his children. He would have to pay a total of 9.3 percent of his household income for the family policy. The coverage is unaffordable and his children and his wife can claim the exemption. If the coverage had been affordable, Damon's spouse and children would not be eligible for the unaffordable coverage exemption. They would not proceed to the other affordability test.

Although the family offer includes coverage for Damon, his exemption eligibility is based on the affordability of his employer's self-only offer (#1 above), not on the cost of family coverage.

#### 3. *The uninsured person did not have an offer of employer coverage.* If the person did not have an offer of coverage from an employer, the affordability of a plan in the Marketplace is measured. Using the Marketplace coverage affordability worksheet (from Form 8965), calculate the premium for the lowest cost bronze plan (LCBP), reduced by the premium tax credit a person would have been eligible for, if any.

For Line 1 of the Marketplace coverage affordability (MCA) worksheet, find the LCBP for any person on the tax return who is not offered employer-sponsored insurance and does not qualify for another exemption. Include individuals who are eligible for government-sponsored coverage, such as Medicare or Medicaid. If more than one person in the tax household is seeking an exemption based on Marketplace affordability, test them together. Find the LCBP for the tax year at [www.healthcare.gov](http://www.healthcare.gov) or at the taxpayer's state-based Marketplace.

#### example (continued)

Damon has a daughter, age 28, who qualifies as his dependent but did not qualify for her own employer coverage or for his (because of her age). He would test the cost of covering his daughter with a marketplace policy using the MCA worksheet. On Line 1 of the MCA worksheet, he would use the lowest cost bronze plan for his daughter only – Damon, his spouse, and his younger children are not included on Line 1 because they have an employer offer of coverage.

For Line 10 of the worksheet, the second lowest cost silver plan (SLCSP) is needed. Look up the plan cost for anyone whose personal exemption is included on the return, who is not eligible for other coverage (other than individual market coverage), and who does not qualify for another exemption. Do not include the premium cost of someone who is eligible for employer coverage, Medicaid or Medicare, for example.

#### example (continued)

Damon's older daughter is not eligible for coverage from Damon's employer or government-sponsored coverage. Damon would look up the SLCSP of his daughter. Again, all other household members are left out because they have an employer offer.

Damon would complete the MCA worksheet calculations and compare the final cost of coverage to his affordability threshold (8.16 percent of income) to determine whether his daughter's coverage was affordable.

### How is the affordability threshold computed for the unaffordability exemption?

The affordability threshold is the MAGI (not including untaxed Social Security income) of the taxpayer plus the MAGI of each dependent who is required to file a return plus the cost of any premium that is paid through a salary reduction arrangement (pre-tax medical). The taxpayer can usually find their pre-tax premium amount on their last paycheck stub of the tax year.

### What about the cost of other coverage?

Each of the three tests above operate independently of each other and independently of other coverage costs. For example, if the taxpayer pays a premium to enroll her child in a children's health insurance program (CHIP, a form of government-sponsored coverage), that amount is not included.

### What are common mistakes with the Marketplace coverage affordability worksheet?

It is important to note the difference between the individuals included in Line 1 and those included in Line 10. For example, if a household member has coverage and does not need an exemption while other household members lack coverage, the covered person is included in Line 1 if they have government-sponsored coverage (Medicare, Medicaid, etc.) or an individual policy. They are excluded from Line 1 if they are eligible for employer-sponsored coverage (either self-only or family) or qualify for another exemption.

Line 10 of the worksheet is used to determine whether the LCBP (Line 1) would have been reduced by a PTC, for the purpose of the unaffordability exemption calculation. If a household member is not eligible for PTC, do not include them in the SLCSP quote. For example, a member eligible for government-sponsored coverage is not eligible for PTC and is not included in the SLCSP quote. Or, if the taxpayer is ineligible for the PTC because her household income is over 400 percent FPL or because she is Married Filing Separately, enter zero on Line 10 (SLCSP).

#### example (continued)

If, instead, Damon's daughter had been eligible for Medicaid, the bronze cost (Line 1) would be the same, but the SLCSP on Line 10 would be zero because the daughter was eligible for coverage outside the individual market, namely government-sponsored Medicaid.

For more information on the unaffordability exemption, refer to Form 8965 and its instructions.



### EXERCISES (continued)

**Question 7:** Randy was covered by Medicaid until February 23rd. He started a new job and his employer-sponsored health coverage started on May 1st. Does an exemption apply?  Yes  No

## What is the shared responsibility payment (SRP)?

If a taxpayer (or anyone the taxpayer can claim as a dependent) doesn't have MEC and doesn't qualify for a coverage exemption, they will need to make an SRP when filing their tax return.

The software will compute the SRP based on the entries you make. The payment computation, to put it as simply as possible, is the greater of a percentage of income or a flat dollar amount, but no more than the national average premium for bronze level coverage.

The percentage of income amount is the percentage of the excess portion of household income over the federal income tax filing threshold for the primary tax filer (or joint filers) in the family. The percentage is 2.5 percent for 2017. In future years, a cost-of-living adjustment will apply.

The "flat dollar amount" is \$695 for tax year 2017. A cost-of-living adjustment will apply to the flat dollar amount each year. These figures are halved if the individual without coverage is under age 18 as of the beginning of the month.

The maximum flat dollar amount for a family cannot exceed 300 percent of the amount for one adult no matter how many dependents are in the family. For 2017, it's \$2,085 per household or \$695 x 3.

Compare the flat dollar amount and the income percentage amount and use the greater of the two amounts. The resulting amount is capped at the National Average Bronze Plan Premium.

The individual shared responsibility payment is the greater of the flat dollar amount or the percentage of income amount, but never more than the national average premium for the bronze level plan.

This ensures that the payment amount is never more than the approximate cost of basic coverage for a year.

In the example below, determine the SRP due for 2017. These amounts will be indexed for inflation for years after 2017.

### example

Single individual with \$40,000 income:

Jim, an unmarried 30-year-old with no dependents, did not have MEC for any month during 2017 and does not qualify for a coverage exemption. For 2017, Jim's household income was \$40,000 and his filing threshold is \$10,400.

- To determine his monthly payment amount using the income formula, subtract \$10,400 (filing threshold) from \$40,000 (2017 household income). The result is \$29,600. Two and a half percent of \$29,600 equals \$740.
- Jim's flat dollar amount is \$695.

Because \$740 is greater than \$695, Jim's payment amount for each month is \$61.67, or 1/12 of the \$740 amount. For Jim, the sum of all monthly payment amounts is \$740.

Because this amount is less than the sum of the monthly national average bronze plan premiums, Jim's SRP for 2017 is \$740, the lesser of the sum of the monthly payment amounts or the sum of the monthly national average bronze plan premiums. Jim will make his SRP for the months without MEC when he files his 2017 income tax return.



## Who is allowed a premium tax credit (PTC)?

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The premium tax credit (PTC) helps eligible taxpayers pay for health insurance. When enrolling in health coverage through the Marketplace, the Marketplace estimates the amount of the PTC that eligible taxpayers may claim on their federal tax return. Based on that estimate, eligible taxpayers choose to have advance payments of the premium tax credit (APTC) made on their behalf to their insurance company, or to forego APTC and get all of the benefit of the PTC when they claim the credit on their federal tax return. Those who choose to get the benefit of APTC must file a federal tax return for the year the payments are made even if they have gross income for the year that is below the income tax filing threshold.

In general, taxpayers are allowed a PTC if they meet all of the following:

- The taxpayer, spouse (if filing a joint return), or dependents were enrolled in a qualified health plan offered through the Marketplace for one or more months in which the enrolled individual was not eligible for MEC, other than coverage in the individual market.
- The premiums for the plan or plans in which the taxpayer and his or her family members enroll is paid by the due date of the taxpayer's return (not including extensions).
- The taxpayer is an applicable taxpayer. A taxpayer is an applicable taxpayer if he or she meets the following three requirements:
  - The taxpayer's income is at least 100 percent but not more than 400 percent of the federal poverty line for the taxpayer's family size. The following exceptions allow a taxpayer with household income below 100 percent of the federal poverty line to be an applicable taxpayer, provided the taxpayer meets the other applicable taxpayer requirements:
    - The taxpayer, the taxpayer's spouse, or a dependent who enrolled in a qualified health plan is not a U.S. citizen, but is lawfully present in the U.S. and not eligible for Medicaid because of immigration status.
    - The taxpayer was determined eligible for APTC by the Marketplace and received the benefit of APTC for one or more months of coverage of a family member.
  - If married, the taxpayer files a joint return with his or her spouse (unless the taxpayer is considered unmarried for Head of Household filing status, or meets the criteria which allows certain victims of domestic abuse or spousal abandonment to claim the PTC using the Married Filing Separately filing status). See the instructions for Form 8962, Premium Tax Credit, for more details about these exceptions.
  - The taxpayer cannot be claimed as a dependent by another person.

### Federal Poverty Line (FPL)

The federal poverty line (FPL) is an income amount adjusted for family size that is considered poverty level for the year. The U.S. Department of Health and Human Services (HHS) determines the FPL amounts annually and publishes a table reflecting these amounts at the beginning of each calendar year. You can also find this information on the HHS website at [www.hhs.gov](http://www.hhs.gov).

HHS provides three sets of federal poverty guidelines:

- one for residents of the 48 contiguous states and D.C.,
- one for Alaska residents, and
- one for Hawaii residents.

If the taxpayer moved at all during the tax year and lived in Alaska and/or Hawaii, or is filing jointly and his or her spouse lived in a different state, use the table with the higher dollar amounts for the family size.

For purposes of the PTC, eligibility for a certain year is based on the most recently published set of federal poverty guidelines as of the first day of the annual open enrollment period. As a result, the PTC for the current tax year is based on the prior year guidelines (for example, the guidelines used for 2017 APTC and PTC are the guidelines published in January 2016, which are the most recently published guidelines at the time of the open season for 2017 enrollments). The FPL tables are in the Volunteer Resource Guide, Tab H.

### What is household income and what are its limits?

A taxpayer's household income is the total of the modified adjusted gross income (MAGI) of the taxpayer (and spouse, if married and filing jointly) and the MAGI of all dependents required to file a federal income tax return because his or her income meets the filing threshold.

#### example

David and Melinda are Married Filing Jointly taxpayers. They have one child, Philip, age 17, whom they claim as a dependent. Philip works part time and has a filing requirement. David and Melinda's household income calculation would include their MAGI, as well as Philip's MAGI.

MAGI, for the purpose of the PTC, is the adjusted gross income on the federal income tax return plus any excluded foreign income, nontaxable Social Security benefits (including tier 1 railroad retirement benefits), and tax-exempt interest. It does not include Supplemental Security Income (SSI).



#### EXERCISES (continued)

**Question 8:** Jocelyn and Larry file jointly and claim their child, Hank. Hank has a part-time job and earns \$5,000. Hank will file a return to get a refund of the tax that was withheld from his paychecks. Will Jocelyn and Larry include Hank's \$5,000 as part of their Household Income for ACA purposes?  
 Yes  No

**Question 9:** (Continuing from Question 8) If Hank earned \$7,000, would Jocelyn and Larry include Hank's income as part of their Household Income for ACA purposes?  Yes  No

In general, only taxpayers and families whose household income for the year is between 100 percent and 400 percent of the FPL for their family size may be eligible for the PTC. A taxpayer who meets these income requirements must also meet the other eligibility criteria to claim PTC.



Please see the Volunteer Resource Guide, Tab H, for the current year Poverty Guidelines.

### Are taxpayers allowed a PTC for all enrolled family members?

A taxpayer is allowed a PTC only for months that a member of the taxpayer's tax family is (1) enrolled in a policy offered through the Marketplace and (2) not eligible for minimum essential health coverage (other than individual market coverage) for one or more months of enrollment. Also, the taxpayer is not allowed a PTC for a month unless the portion of the enrollment premiums for which the taxpayer is responsible has been paid by the unextended due date of the taxpayer's return. The taxpayer's tax family consists of the taxpayer, the taxpayer's spouse if filing jointly, and all other individuals for whom the taxpayer claims a personal exemption deduction. The tax family members who meet the above two requirements (enrolled in coverage through the Marketplace and not eligible for other MEC) are the taxpayer's "coverage family." The importance of the tax family and coverage family in computing the PTC is explained later.

## Are taxpayers allowed a PTC if offered coverage from an employer?

Generally, a person enrolled in Marketplace coverage for months he or she is eligible for employer-sponsored coverage is not eligible for a PTC for those months, even if the person turns down the employer's coverage. This includes the employee or a family member of the employee who is eligible to enroll in the employer coverage as a result of a relationship to the employee. A person may be eligible for a PTC despite an offer of employer coverage if the employer's coverage is unaffordable or fails to meet a minimum value standard (employers will provide employees with information concerning whether the minimum value standard is met).

In general, for individuals requesting the APTC, the Marketplace determines whether the employer coverage is affordable by comparing the employee's cost of the employer coverage for self-only coverage to household income. If for 2017, the employee's cost for the employer coverage is more than 9.69 percent of projected household income for 2017, the Marketplace will conclude that the employer coverage is unaffordable. The affordability test used by the Marketplace for family members of an employee who are eligible for coverage from the employer is the same as the test for the employee (compare the cost of the employee's self-only coverage to household income). If a Marketplace determines that, based on projected household income, the employer coverage would be unaffordable, the employer coverage is considered unaffordable for the employer's plan year even if it turns out to cost 9.69 percent or less of the actual household income reported on the tax return. This is referred to as the employee safe harbor.

If a household member actually enrolls in the employer plan, he or she is ineligible for a PTC for the months of enrollment, regardless of the affordability or minimum value of the plan. That means that a PTC is not allowed for this individual's coverage for the months the individual is enrolled in employer coverage.

### example

Cedric is single and has no dependents. When enrolling through the Marketplace during open enrollment, Cedric was not eligible for employer-sponsored coverage.

In August of the tax year, Cedric began a new job and became eligible for employer-sponsored coverage that is affordable and provides minimum value on September 1st. Since Cedric became eligible for employer-sponsored coverage on September 1st and the coverage was affordable and provides minimum value, he may be able to claim a PTC only for the months January through August.

### example

Maria is single and has no dependents. Her employer offers health insurance, but she didn't enroll because she felt it was too expensive. The Marketplace determined that the employer offer was not affordable, and Maria enrolled in Marketplace coverage and received the benefit of APTC. At the end of the year, she received both a Form 1095-A from the Marketplace and a Form 1095-C from her employer indicating that the employer coverage was affordable. Because of the employee safe harbor rule, Maria is not considered eligible for the employer coverage because in good faith she provided the Marketplace information about her employer offer and the Marketplace determined that the coverage was unaffordable.

## What is a Qualified Small Employer Health Reimbursement Arrangement (QSEHRA)?

New rules enacted under the 21st Century Cures Act of 2016 allow eligible employers to offer a qualified small employer health reimbursement arrangement (QSEHRA) to their eligible employees. Under a QSEHRA, an eligible employer can reimburse eligible employees for health care costs, including premiums for Marketplace health insurance. If taxpayers were covered under a QSEHRA, their employer should have reported the annual permitted benefit in box 12 of Form W-2 with code FF. If the QSEHRA is affordable for a month, no PTC is allowed for the month. If the QSEHRA is unaffordable for a month, taxpayers must reduce the monthly PTC (but not below -0-) by the monthly permitted benefit amount.

## Are taxpayers allowed the PTC if they are eligible for coverage through a government-sponsored program?

An individual eligible for coverage through a government-sponsored program such as Medicaid, Medicare, CHIP or TRICARE, is not a member of the coverage family for the months in which the individual is eligible for government-sponsored coverage. Therefore, a PTC is not allowed for this individual's coverage for the months the individual is eligible for the government-sponsored coverage. However, an individual is treated as not eligible for Medicaid, CHIP, or a similar program for a period of coverage under a qualified health plan if, when the individual enrolls in the qualified health plan, the Marketplace determines or considers the individual to be not eligible for Medicaid or CHIP.



Regarding Medicaid and CHIP, taxpayers are generally considered eligible for a government-sponsored program for a month if they met the eligibility criteria for that month, even if they did not enroll. However, if a Marketplace made a determination that the taxpayer or a family member was ineligible for Medicaid or CHIP and eligible for APTC when the individual enrolls in a qualified health plan, the individual is treated as not eligible for Medicaid or CHIP for purposes of the premium tax credit for the duration of the period of coverage under the qualified health plan (generally, the rest of the plan year), even if the taxpayer's actual income for the tax year suggests that the individual may have been eligible for Medicaid or CHIP.

Accordingly, if a taxpayer was enrolled in both Medicaid coverage and in a qualified health plan for which APTC was paid for one or more months of the year for which a Marketplace determined that he or she was ineligible for Medicaid, the taxpayer can claim the PTC for these months, if otherwise eligible. The Marketplace may periodically check state Medicaid data to identify consumers who may be dual-enrolled, and direct them to return to the Marketplace to discontinue their APTC. If you believe that the taxpayer may currently be enrolled in both Medicaid and a qualified health plan with advance credit payments, you should advise the taxpayer to contact the Marketplace immediately.

Taxpayers may have a limited time to obtain Medicare, during which time they remain eligible for PTC. See Publication 974 for details.

If APTC is being paid for coverage in a qualified health plan and the taxpayers become eligible for government coverage that is effective retroactively (such as Medicaid or CHIP), they will not be considered eligible for the government coverage until the month after the date of approval. Taxpayers can get the PTC for Marketplace coverage until the first day of the calendar month after they are approved for the government coverage.



A person is considered eligible for other MEC only if the person is eligible for MEC for every day of that month. For example, if a person becomes eligible for employer- or government-sponsored coverage on the 5th day of a month, he or she is considered not eligible for the other MEC for the month and may be allowed a PTC for the month. The person should alert the Marketplace to the change and discontinue any APTC being paid for the Marketplace coverage.

### example

Adele is single with no dependents. She works part-time and has no offer of employer-sponsored health coverage. She projects her income to be \$17,500 for the year (roughly 150 percent of FPL), based on her earnings at the same job in the prior year. She enrolls in a qualified health plan in the Marketplace and is determined eligible for APTC.

Adele's place of employment was closed for two weeks, unexpectedly lowering the number of hours she worked. Her employer also didn't pay an end-of-year bonus that she anticipated. Adele's actual household income for the year was \$16,000. This income would make her eligible for Medicaid under her state's eligibility rules. However, based on Adele's projection of income when she enrolled in Marketplace coverage the Marketplace determined that she was not eligible for Medicaid. Therefore, Adele is treated as not eligible for Medicaid for the year and may be eligible for the PTC.

## How does the taxpayer get the APTC?

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During enrollment, the taxpayer projects household income and family composition. The Marketplace verifies this information through various data sources, including prior year tax information, Social Security Administration data, and state-level wage data. Using all of this information, the Marketplace estimates the amount of PTC a taxpayer will be able to claim. The estimated PTC is the maximum amount of APTC for which the taxpayer is eligible.

Taxpayers may choose to:

- Have some or all of the APTC paid to the insurance company to lower what is paid for monthly premiums; or
- Pay all the premiums and get all the benefit of the PTC when they file their tax return

The amount of APTC will appear on Form 1095-A, Health Insurance Marketplace Statement.

## How is the amount of PTC determined?

The law bases the amount of the PTC on a sliding scale. A taxpayer with household income at 200 percent of the FPL for the taxpayer's family size will generally get a larger credit to help cover the cost of insurance than a taxpayer with the same family size who has household income at 300 percent of the FPL. In other words, the higher the household income, the lower the amount of the credit. As explained earlier, FPL is based on household income and tax family size.

The PTC is the sum of the credit amount for each month. The credit amount for a month is the lesser of two amounts: (1) the monthly premium for the plan or plans in which the taxpayer's family enrolled (enrollment premiums) and (2) the monthly premium for the taxpayer's applicable second lowest cost silver plan (SLCSP) minus the taxpayer's monthly contribution amount. This calculation is done on Form 8962. The applicable SLCSP premium is the premium for the second lowest cost silver plan that applies to the coverage family discussed earlier (the members of the taxpayer's tax family enrolled and not eligible for other minimum essential coverage). If the SLCSP premium amount does not appear on Form 1095-A, or the SLCSP premium amount reported on Form 1095-A is incorrect because of a change in circumstances the Marketplace did not know about, the taxpayer must find the correct applicable SLCSP premium on either [www.healthcare.gov](http://www.healthcare.gov) (for taxpayers who enroll in coverage through a federally facilitated Marketplace), the website for the taxpayer's state-based Marketplace, or by calling the Marketplace customer service. If the taxpayer must do a shared policy allocation to determine the correct SLCSP premium (because members of more than one tax family are enrolled in a single policy), the return is out of scope for the VITA/TCE programs.



A taxpayer's contribution amount is a percentage of the taxpayer's household income determined by multiplying the taxpayer's household income by the applicable figure (from the table in the instructions for Form 8962). The applicable figure is based on the FPL; the higher the FPL, the higher the percentage of household income that is used to compute the contribution amount. The contribution amount is an annual amount because it is a percentage of household income, which is an annual amount.

The monthly contribution amount is the contribution amount divided by 12. Taxpayers with no changes in enrollment premiums and applicable SLCSPP premiums for all 12 months can do a single, annual calculation to compute their PTC. See the Volunteer Resource Guide, Tab H, for instructions on completing Form 8962.

Taxpayers who have a Form 1095-A showing changes in monthly amounts must do a monthly calculation to determine their PTC in Part II of Form 8962. Taxpayers who have changes in monthly amounts not shown on Form 1095-A must also do a monthly calculation to determine their PTC (for example, a taxpayer enrolled in a qualified health plan who became eligible for employer coverage during the year, but did not notify the Marketplace).

If taxpayers received the benefit of advance credit payments, they will reconcile the APTC with the amount of the actual PTC that is calculated on the tax return (more information on reconciliation is provided under How is the PTC claimed on the return, later).

The PTC is a refundable tax credit. If the amount of a taxpayer's net PTC (the excess of PTC over APTC) is more than the amount of a taxpayer's tax liability on the return, the taxpayer will receive the difference as a refund. If a taxpayer has no tax liability, all of the net PTC is paid to the taxpayer as a refund.

### **What happens if income or family size changed during the year?**

Part of the PTC calculation is the contribution amount, which will be higher at a higher household income level (and lowers the amount of the credit). The FPL is based on state of residency and family size. Therefore, a taxpayer's PTC for the year will differ from the APTC payment amount estimated by the Marketplace if the taxpayer's family size or household income as estimated at the time of enrollment is different from the family size or household income reported on the return. The more the family size or household income differs from the initial projections used to compute the APTC payments, the more significant the difference will be between the advance credit payments and the actual credit.

Taxpayers should notify the Marketplace about changes in circumstances when they happen, which allows the Marketplace to update the information used to determine the expected amount of the PTC and adjust the APTC payment amount. This adjustment decreases the likelihood of a significant difference between the advance credit payments and the actual PTC. Changes in circumstances that can affect the amount of the actual PTC include:

- Increases or decreases in household income
- Marriage
- Divorce
- Birth or adoption of a child
- Other changes in household composition
- Gaining or losing eligibility for government-sponsored or employer-sponsored health care coverage
- Change of address



If the taxpayer is currently enrolled in Marketplace coverage and has a 2017 repayment, they should contact the Marketplace to adjust their 2018 APTC now to avoid similar repayments for the 2018 tax year.

## What documentation will taxpayers receive to claim the PTC?

By January 31 of the year following the year of coverage, the Marketplace will send Form 1095-A to taxpayers who purchased insurance through the Marketplace. The information statement includes the monthly premium for the applicable SLCS used to compute the credit, the total monthly enrollment premiums (the premiums for the plan or plans the taxpayer and his or her family members enrolled in), the amount of the APTC payments, the SSN and names for all covered individuals, and all other required information. The Marketplace also reports this information to the IRS.

Use the information on Form 1095-A to compute the taxpayers' PTC on their tax returns and to reconcile the advance credit payments made on their behalf with the amount of the actual PTC on Form 8962. If Form 1095-A was lost or never received, the taxpayer must contact the Marketplace. These forms can be downloaded by taxpayers through their Marketplace account. Volunteers cannot prepare a return without this information.

## How is the PTC claimed on the tax return?

Taxpayers claim the PTC on the tax return. Taxpayers who received the benefit of APTC payments must file a tax return even if they otherwise are not required to file. Remember, the PTC is only available to taxpayers who purchased health coverage through the Marketplace for themselves or a tax family member.

A taxpayer computes the amount of PTC on Form 8962 and reconciles it with the APTC payments for the year. If the PTC computed on the return is more than the APTC payments made on the taxpayer's behalf during the year, the difference will increase the refund or lower the amount of tax owed. This will be reported in the Payments section of Form 1040, 1040A, or 1040NR. If the APTC payments are more than the PTC (excess APTC), some or all of the difference will increase the taxpayer's tax liability and result in either a smaller refund or a balance due. This will be entered in the Tax and Credits section of the return. Taxpayers with household income below 400 percent of the FPL for their family size may be allowed a limitation on their excess APTC repayment. The limitation is based on the taxpayer's household income as provided in the repayment limitation table, below.

### Repayment Limitation Table

Household Income Percentage of Federal Poverty Line	Limitation Amount for Single	Limitation Amount for all other filing statuses
Less than 200%	\$300	\$600
At least 200%, but less than 300%	\$750	\$1,500
At least 300%, but less than 400%	\$1,275	\$2,550
400% or more	No limit	No limit

For taxpayers who use the Married Filing Separately filing status, the repayment limitation above applies to the spouses separately based on the household income reported on each return. There are situations where the cap does not apply, such as an individual who is taking the health coverage tax credit (out of scope) and APTC granted to an individual not lawfully in the U.S. Refer to Instructions for Form 8962 for additional information.

Taxpayers who chose to forego the full amount of advance credit payments will get all of the benefit of their PTC on their tax return. This will either increase their refund or lower the balance due.

example

Brandon is single with no dependents. When he enrolled through the Marketplace, Brandon was approved for advance credit payments based on his projected household income. Brandon's Form 1095-A shows advance credit payments of \$1,486. Brandon's actual modified AGI is more than 400 percent of the FPL for a family of 1 (see the Volunteer Resource Guide, Tab H). Since Brandon's household income is above 400 percent of the FPL, he may not claim any PTC. In addition, Brandon is not allowed a repayment limitation. Brandon must increase his tax liability by the amount of his advance credit payments. He will complete Form 8962 and enter \$1,486 on the excess advance premium tax credit repayment line on his tax return.



**EXERCISES** (continued)

**Question 10:** Pedro is retired and covered by Medicare. His wife Camilla is too young for Medicare. Both are U.S. citizens. Even though Pedro is on Medicare, can Camilla get a PTC if she enrolls in coverage through the Marketplace (and is otherwise eligible for a PTC)?  Yes  No

**Question 11:** You are completing the return for Antonio, who purchased health coverage through the Marketplace and received the benefit of APTC. In completing Form 8962, you note that Antonio's MAGI is 401 percent of the FPL and the calculation shows that he has to repay the entire APTC. Assuming that Antonio would be entitled to an IRA deduction if he made an IRA contribution, can Antonio reduce his 2017 MAGI for the PTC calculation even though it is now 2018 and his 2017 tax year has ended?  Yes  No

**Question 12:** Piper's income is 300 percent of the FPL for her family size. She purchased health insurance through her employer. Is Piper eligible to take the PTC for her coverage?  Yes  No

**Question 13:** Harry purchased insurance through the Marketplace. What form will he receive from the Marketplace to prepare his tax return?

- A. Form 8962
- B. Form 1095-A
- C. Form 8965
- D. Form W-2

**Question 14:** Roger's APTC payments are \$2,500. He is single with no dependents, and lives in Mississippi. On Form 8962, he calculates an actual PTC of \$1,000. His household income is over 300 percent of the FPL but under 400 percent of the FPL for a family size of one. How much of the excess APTC will be included as an additional income tax liability on his tax return?

- A. \$0
- B. \$1,275
- C. \$1,500
- D. \$2,550

**Question 15:** Judy is single with no dependents. In December, Judy enrolled through the Marketplace in a qualified health plan for the following year. On July 14, Judy enlisted in the Army and was immediately eligible for government sponsored minimum essential coverage. For what period is Judy able to claim a PTC (if she meets all of the eligibility criteria)?

- A. The entire tax year
- B. January through June
- C. January through July
- D. Judy is not eligible for the PTC

## What about unusual situations?

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This lesson does not cover all the situations you may encounter. For situations listed below, consult the instructions for Form 8962 and Publication 974.

### What if taxpayers receive more than one Form 1095-A?

There is only one PTC calculation on Form 8962. Refer to the Volunteer Resource Guide, Tab H, for instructions on how to enter multiple Forms 1095-A in the software.

### What if taxpayers have a shared policy purchased through the Marketplace?

If a taxpayer is enrolled, or has a family member who is enrolled, in a policy with a person not in the taxpayer's tax family (a shared policy), the taxpayer may have to allocate the items on Form 1095-A (the enrollment premiums, the premium for the applicable SLCSP, and the advance credit payments) with another taxpayer (a shared policy allocation). The following taxpayers may have to do a shared policy allocation:

- Taxpayers who got divorced or legally separated during the tax year
- A taxpayer who claims a personal exemption deduction for an individual enrolled in a policy with a member of another tax family
- A taxpayer who receives a Form 1095-A that includes an individual claimed as a personal exemption by another tax family
- A taxpayer who files a separate return from his or her spouse

Taxpayers complete the shared policy allocation on Form 8962, Part IV. This is out of scope for the VITA/TCE programs.

### What about an individual the taxpayer enrolled for whom no taxpayer will claim a personal exemption?

If the taxpayer indicated to the Marketplace at enrollment that he or she would claim the personal exemption for an individual (including him- or herself) but no taxpayer claims a personal exemption for the individual, the taxpayer must report any APTC paid for that individual's coverage. See the instructions for Form 8962 and Publication 974 for more information.

### What if taxpayers get married during the year?

If taxpayers got married during the tax year and one or both spouses received the benefit of APTC payments for the year, the spouses may be eligible to use an alternative calculation to determine their excess advance credit payments. The alternative calculation can be used to reduce excess APTC, but not to increase net PTC. See the instructions for Form 8962 for eligibility. If eligible, taxpayers will complete Form 8962, Part V, Alternative Calculation of Year of Marriage. This is out of scope for the VITA/TCE programs. If the taxpayers do not have excess APTC, they cannot use the alternative calculation and the return remains in scope.

### What about individuals not lawfully present?

A PTC is not allowed for the coverage of an individual who is not lawfully present in the United States. All APTC paid for an individual not lawfully present who enrolls in a qualified health plan must be repaid. If a member of the family is not lawfully present and is enrolled in a qualified health plan with family members who are lawfully present for one or more months of the year, use the instructions in Publication 974 to find out how much APTC, if any, must be repaid. If all family members enrolled in a qualified health plan are not lawfully present, all APTC must be repaid. There is no repayment limitation on excess APTC attributable to the coverage of an individual not lawfully present in the United States. Complete Form 8962 as directed in Publication 974.



## Summary

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The Affordable Care Act addresses health insurance coverage and financial assistance options for individuals and families, including the PTC. It also includes the individual shared responsibility provision and coverage exemptions from that provision.

In general, individuals must have MEC for each month, qualify for a coverage exemption, or make a payment when filing his or her federal income tax return. Some coverage exemptions are granted only by the Marketplace, and some exemptions can be claimed only on a tax return.

Only taxpayers who purchase MEC through the Marketplace for themselves, their spouse, or their dependents are allowed a PTC. Eligible taxpayers may choose to get the benefit of advance credit payments, the amount of which is based on their estimated PTC, to reduce the cost of monthly premiums. Taxpayers who chose to forgo advance credit payments get all of the benefit of the PTC when they claim it on the tax return. The PTC is calculated and the advance credit payments are reconciled on Form 8962. Taxpayers will receive Form 1095-A from the Marketplace, which will contain the information necessary to complete Form 8962.

Taxpayers who have MEC all year will indicate this on Form 1040 by checking the box in the Other Taxes section. The PTC is claimed in the Payments section of Form 1040. Any excess APTC that must be repaid is entered in the Tax and Credits section of the Form 1040.

Coverage exemptions are claimed on Form 8965.

Any SRP is entered on Form 1040, in the Other Taxes section. Taxpayers can use the Shared Responsibility Payment Worksheet in the instructions to Form 8965 to figure the amount of the SRP due or allow the software to make the calculation.

### **What situations are out of scope for the VITA/TCE programs?**

The following are out of scope for this lesson. While this list may not be all inclusive, it is provided for your awareness only.

- Self-employed health coverage deductions
- Form 8962 Part IV, Allocation of Policy Amounts, and Part V, Alternative Calculation for Year of Marriage
- Individuals eligible for the health coverage tax credit



## EXERCISE ANSWERS

**Answer 1:** Yes. Employer-sponsored coverage is generally minimum essential coverage. If an employee enrolls in employer-sponsored coverage that provides minimum value for himself and his family, the employee and all of the covered family members have minimum essential coverage.

**Answer 2:** No. They do not have to be covered under the same policy or plan. However, they must all have minimum essential coverage or qualify for a coverage exemption, or Keith and Kathy will owe an SRP when they file a return.

**Answer 3:** Yes. Retiree health plans are generally minimum essential coverage.

**Answer 4:** Yes. Employer-sponsored coverage is minimum essential coverage regardless of whether the employer is a governmental, nonprofit, or for-profit entity.

**Answer 5:** Yes. Because Jessie will claim her own exemption, she is responsible for her own coverage.

**Answer 6:** Yes. Jessie's parents would be entitled to claim Jessie if she does not provide more than half of her own support and would therefore be responsible for her coverage.

**Answer 7:** Yes. Randy is eligible for the short coverage gap exemption because he was without coverage for less than three months.

**Answer 8:** No. Hank's gross income is below the filing threshold for a dependent with earned income so his parents will not include his MAGI in the Household Income for ACA purposes.

**Answer 9:** Yes. Hank's income is now above the filing threshold for a dependent with earned income, so his parents will include his MAGI in the Household Income for ACA purposes.

**Answer 10:** Yes. Camilla is eligible for a PTC if she enrolls in coverage through the Marketplace (and is otherwise eligible).

**Answer 11:** Yes, Antonio can make a deductible IRA contribution up until April 17, 2018.

**Answer 12:** No, the coverage must have been purchased through the Marketplace.

**Answer 13:** B. Form 1095-A.

**Answer 14:** B. \$1,275. Roger received a \$1,500 overpayment of APTC. However, his repayment is limited to \$1,275.

**Answer 15:** C. Judy is eligible for the PTC from January through July.

## Terms You May Need to Know

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**Applicable taxpayer** (for purpose of premium tax credit) – A taxpayer must be an applicable taxpayer to claim the premium tax credit (PTC). Generally, an applicable taxpayer is one who has household income at least 100 percent but not more than 400 percent of the federal poverty line (FPL) for the family size, and cannot be claimed as a dependent. If the taxpayer is married at the end of the year, the taxpayer must file a joint return to be an applicable taxpayer unless an exception is met.

See also: **Exception for household income below 100 percent of FPL** and **Exception for alien lawfully present in the United States**.

**Coverage family** – All members of the taxpayer's family who are enrolled in a qualified health plan and are not eligible for minimum essential coverage (other than coverage in the individual market). The members of the coverage family may change from month to month. A taxpayer is allowed a premium tax credit only for health insurance purchased for members of the coverage family.

**Dependents of more than one taxpayer** – The tax household does not include someone that can, but is not, claimed as a dependent if the dependent:

- Is properly claimed on another taxpayer's return, or
- Can be claimed by another taxpayer with higher priority under the tie-breaker rules.

For example, a custodial parent who signed Form 8332 to give the dependency exemption to the noncustodial parent would not include the child on his or her return for ACA purposes. Instead, the noncustodial parent would include the child on the noncustodial parent's return.

**Domestic abuse** – Domestic abuse includes physical, psychological, sexual, or emotional abuse, including efforts to control, isolate, humiliate, and intimidate, or to undermine the victim's ability to reason independently. All the facts and circumstances are considered in determining whether an individual is abused, including the effects of alcohol or drug abuse by the victim's spouse. Abuse of the victim's child or any family member living in the household may constitute abuse of the victim. If the taxpayer is a victim of domestic abuse or abandonment and does not qualify to use Head of Household filing status, the taxpayer may claim a premium tax credit if he or she files a return as Married Filing Separately and meets the exceptions as listed in the married taxpayer definition later in this section. See Publication 974 for a list of documentation that the taxpayer should retain.

**Employee safe harbor** – If the Marketplace determines that, based on projected household income, the employer coverage would be unaffordable, the employer coverage is considered unaffordable for the employer's plan year even if it would have been affordable based on the household income reported on the tax return.

**Exemption Certificate Number (ECN)** – The number the taxpayer received from the Marketplace for the individual listed in Part I (Marketplace-Granted Coverage Exemptions for Individuals) on Form 8965, column c.

**Exception for alien lawfully present in the United States** – A taxpayer with household income below 100 percent of the FPL can be an applicable taxpayer as long as the taxpayer, the taxpayer's spouse, or a dependent who enrolled in a qualified health plan is not a U.S. citizen but is lawfully present in the U.S. and not eligible for Medicaid because of immigration status.

**Exception for household income below 100 percent of FPL** – A taxpayer with household income below 100 percent of the FPL is an applicable taxpayer if all of the following requirements are met:

- The taxpayer, the taxpayer's spouse, or a dependent enrolled in a policy through a Marketplace
- The Marketplace estimated at the time of enrollment that the taxpayer's household income would be between 100 percent and 400 percent of the FPL for the taxpayer's family size

- Advance credit payments were made for the coverage for one or more months during the year
- The taxpayer meets the other applicable taxpayer criteria

**Family/Family size** – For the purposes of Form 8962, tax family consists of the individuals for whom a taxpayer claims a personal exemption on the tax return (generally the taxpayer, spouse if filing a joint return, and dependents).

**Family coverage** – Health insurance that covers more than one individual.

**FPL** – Federal Poverty Line – An income amount considered poverty level for the year, adjusted for family size. Department of Health and Human Services (HHS) determines the federal poverty guideline amounts annually. The government adjusts the income limits annually for inflation. For purposes of the PTC, eligibility for a certain year is based on the most recently published set of poverty lines. As a result, the tax credit for 2017 will be based on the 2016 FPL.

**Form 1095-A** – Used to report certain information to the IRS about family members who enroll in a qualified health plan through the Marketplace. Form 1095-A also is furnished to individuals to allow them to claim the premium tax credit, to reconcile the credit on their returns with advance payments of the premium tax credit (APTC), and to file an accurate tax return.

**Form 1095-B** – Used to report certain information to the IRS and to taxpayers about individuals who have minimum essential coverage.

**Form 1095-C** – Employers with 50 or more full-time employees, including full-time equivalent employees, use this form to report information about offers of health coverage and enrollment in health coverage for their employees.

**Household income** – Total of the modified adjusted gross income (MAGI) of the taxpayer (and spouse, if married filing a joint return) and the MAGI of all dependents required to file a federal income tax return because their gross income exceeds the filing threshold.

**Incarceration** – The taxpayer can claim a coverage exemption for a member of the tax household for any month in which the individual was incarcerated for at least 1 day in the month. An individual is incarcerated if he or she was confined, after the disposition of charges, in a jail, or similar penal institution or correctional facility. This includes detention in a juvenile facility, but not home detention.

**Individual Market** – The insurance market that provides private, individual (non-group) health insurance coverage to individuals who purchase health insurance on their own. This includes qualified health plans offered through the Marketplace. Each individual generally must pay the entire cost of the health insurance premium, but certain individuals may be eligible for insurance premium subsidies for coverage offered through the Marketplace.

**Lowest cost bronze plan (LCBP)** – Used in the Marketplace Affordability Worksheet (for the unaffordable coverage exemption). For this purpose, use the lowest cost bronze plan available through the Marketplace that covers everyone in the tax household:

- For whom a personal exemption deduction is claimed on the tax return,
- Who isn't eligible for employer coverage, and
- Who doesn't qualify for another coverage exemption

For information on the lowest cost bronze plan for the tax household, visit [www.HealthCare.gov/tax-tool](http://www.HealthCare.gov/tax-tool) or contact the Marketplace serving your area.

**MAGI** – See Modified Adjusted Gross Income.

**Marketplace** – A governmental agency or nonprofit entity that makes qualified health plans available to individuals. The term “Marketplace” refers to state Marketplaces, regional Marketplaces, subsidiary Marketplaces, and a federally-facilitated Marketplace.



**Married taxpayers** (for purposes of the premium tax credit) – If a taxpayer is married at the end of the tax year, the taxpayer generally must file a joint return with his or her spouse in order to claim the premium tax credit unless the taxpayer meets one of the following two exceptions:

- Exception 1 (Head of Household filing status). The taxpayer may file their return as if they are unmarried and take the PTC if one of the following applies:
  - The taxpayer files a separate return from their spouse on Form 1040 or Form 1040A because they meet the requirements for married persons who live apart under Head of Household in the instructions for Form 1040 or Form 1040A.
  - The taxpayer files as Single on Form 1040NR because they meet the requirements for married persons who live apart under Were You Single or Married? in the instructions for Form 1040NR.
- Exception 2. If taxpayer is a victim of domestic abuse or abandonment and does not qualify to use Head of Household filing status, the taxpayer may claim a premium tax credit if he or she files a return as Married Filing Separately and meets the following:
  - The taxpayer is living apart from his or her spouse at the time the taxpayer files the current year tax return.
  - The taxpayer is unable to file a joint return because he or she is a victim of domestic abuse or spousal abandonment.
  - The taxpayer checks the box on Form 8962 to certify that he or she is a victim of domestic abuse or spousal abandonment.

**Medicaid Expansion** – The health care law provides states with additional federal funding to expand their Medicaid programs to cover adults under 65 who make up to 138 percent of the federal poverty level. Children (18 and under) are eligible up to that income level or higher in all states.

The U.S. Supreme Court ruled that the Medicaid expansion is voluntary for states. As a result, some states have not expanded their Medicaid programs. Many adults in those states with incomes below 100 percent of the federal poverty level fall into a gap. Their incomes are too high to get Medicaid under their state's current rules but their incomes are too low to qualify for the premium tax credit. These individuals qualify for the Resident of a State That Did Not Expand Medicaid exemption.

**Minimum essential coverage (MEC)** – Coverage under a government-sponsored program, an eligible employer-sponsored plan, a plan in the individual market, a grandfathered health plan, or other coverage recognized by the Department of Health and Human Services (HHS), in coordination with the Secretary of the Treasury, as minimum essential coverage.

**Modified Adjusted Gross Income (MAGI) for PTC** – MAGI is a taxpayer's adjusted gross income plus certain income that is not subject to tax (foreign earned income, tax-exempt interest, and Social Security benefits not included in income).

**Modified Adjusted Gross Income (MAGI) for SRP and coverage exemptions** – MAGI is a taxpayer's adjusted gross income plus certain income that is not subject to tax (foreign earned income and tax-exempt interest).

**National Average Bronze Plan Premium (NABPP)** – This figure is used to determine the maximum shared responsibility payment (SRP) amount.

**Premium tax credit (PTC)** – A refundable tax credit for certain people who enroll in a qualified health plan offered through the Marketplace.

**Qualified health plan** – A health plan certified by the Department of Health and Human Services to be offered through the Marketplace. Plans in the Marketplace are offered in different categories: Bronze, Silver, Gold, and Platinum ("catastrophic" plans are also available to some people, but do not qualify for PTC). See Healthcare.gov for additional information about plan levels.

**Required contribution for PTC** – For individuals or families enrolled in Marketplace coverage, the required contribution amount is the amount of the taxpayers' household income the enrollees would be responsible for paying as their share of premiums each month if they enrolled in the applicable second lowest cost silver plan. It is not based on the amount of premiums the enrollees paid out of pocket during the year.

**Second Lowest Cost Silver Plan (SLCSP)** – The second lowest cost silver plan offered through the Marketplace for the rating area in which the taxpayer resides. A taxpayer who enrolled in a qualified health plan through the Marketplace will receive Form 1095-A from the Marketplace which will include the premium for the SLCSP. This figure is used on Form 8962 to calculate the amount of the premium tax credit that the taxpayer is allowed.

**Self-only coverage** – Health insurance that covers one individual.

**Shared responsibility payment (SRP)** – If the taxpayer or any other member of the tax household has neither minimum essential coverage nor an exemption for any month during the tax year, the taxpayer must compute and pay the shared responsibility payment. An individual filing a return but not claiming their own exemption (because they can be claimed by another taxpayer) is not responsible for SRP.

**Spousal abandonment** – A taxpayer is a victim of spousal abandonment for a taxable year if, taking into account all facts and circumstances, the taxpayer is unable to locate his or her spouse after reasonable diligence. If taxpayer is a victim of domestic abuse or abandonment and does not qualify to use Head of Household filing status, the taxpayer may claim a premium tax credit if he or she files a return as Married Filing Separately and meets the exceptions as listed in the **Married taxpayer** definition above. See Publication 974 for documentation that the taxpayer should retain.

**Tax family** – For the purposes of Form 8962, tax family consists of the individuals for whom the taxpayer claims a personal exemption on the tax return (generally the taxpayer, spouse with whom the taxpayer is filing a joint return, and dependents).

**Tax household** – For purposes of Form 8965, includes the taxpayer, the taxpayer's spouse (if filing a joint return), and any individual claimed as a dependent on the tax return. It also generally includes each person the taxpayer can, but does not, claim as a dependent.

**Unaffordable coverage** – For purposes of Form 8965 for 2017, coverage is unaffordable if the individual's required contribution is more than 8.16 percent of household income. Note: The Marketplace uses a higher percentage (9.69 percent for 2017) to determine whether an employer coverage offer is unaffordable and to determine the taxpayer's eligibility for PTC (or APTC if a Marketplace is making the determination).



## Filing Basics



### Introduction

This lesson will help you determine which taxpayers must or should file a tax return. You will also find information on how to verify a taxpayer's identity, which form to use, and completing the Basic Information Section.

### Objectives

At the end of this lesson, using your reference materials, you will be able to:

- Determine who *must* file a tax return
- Determine who *should* file a tax return
- Verify the taxpayer's identity
- Determine how to file the return

#### What do I need?

- Form 13614-C
- Publication 4012
- Publication 17

#### **Optional:**

- Publication 559
- Form 1040 Instructions
- Form 9452

### Who must file?

U.S. citizens or residents of the United States must file a return based on three factors. There are special rules for dependents, surviving spouses, U.S. citizens and residents living outside the U.S., residents of Puerto Rico, and individuals with income from U.S. possessions.

Remember to use the interview techniques and tools when determining who must file.



**TIP** Taxpayers often want written proof if they are not required to file a tax return. Form 9452, Filing Assistance Program, provides a worksheet to determine a person's filing requirement, and can be given to taxpayers to keep with their records.

### What do I need to know?

To decide whether someone must file a tax return, you need to know the individual's:

- Age
- Gross income
- Filing status

#### **Where do I get information on the taxpayer's age?**

Look at the intake and interview sheet for the taxpayer's date of birth. Confirm this date during the interview. Refer to the sample Intake/Interview & Quality Review sheet in the Volunteer Resource Guide, Tab B.

#### **Where do I get information on the taxpayer's gross income?**

An approximation of gross income is enough to see if a taxpayer must file a return. Gross income is **all** the income the taxpayer received during the tax year in the form of money, goods, property, and services that is not exempt from tax. It includes both earned and unearned income.

The Income section of the Volunteer Resource Guide lists the sources of income that should be included and excluded in determining a person's gross income. You can also refer to the Income lessons in this training guide.

To approximate gross income:

- Add the amounts from all the taxpayer's Form(s) W-2, box 1
- Add taxable amounts reported on any Form(s) 1099
- Using the intake and interview sheet, review the income questions with the taxpayer to see if there was any additional income not reported on Form W-2 or Form 1099 and determine each amount

Total the above amounts to determine the taxpayer's approximate gross income.



Do not include Social Security benefits when determining filing requirement unless the taxpayers are married, are filing a separate return, and lived with their spouse at any time during the tax year.



Use the gross sale price, not the net profit, when estimating gross income for a taxpayer who sold stock or other assets.

### ***Where do I get information on the taxpayer's filing status?***

Taxpayers may or may not know which filing status to use. For the purposes of determining whether a person must file a return, narrowing the choices down to the most likely filing status(es) is adequate in most cases.

Check the Taxpayer Information section of the intake and interview sheet for:

- The taxpayer's marital status
- Whether the taxpayer can be claimed as a dependent on someone else's tax return
- The taxpayer's potential dependents

Use the Volunteer Resource Guide's Determination of Filing Status decision tree and the Interview Tips in the Filing Status tab for helpful probing questions.

### **Who is legally required to file a federal tax return?**

To determine whether a taxpayer is legally required to file a return, start with the Volunteer Resource Guide, Who Must File tab. Use these charts to review the examples.

#### **example**

Lucy is 36 years old and single, and her gross income is \$20,000. She must file a tax return since her income exceeds the amount for her age and filing status.

#### **example**

Henrietta and Javier are married and plan to file a joint return. Henrietta is 67 and had a gross income of \$11,000 for the tax year. Javier is 66. His gross income was \$5,000 for the year. Since their combined gross income is less than the minimum amount for their ages and filing status, they do not have to file a return.

### ***What are special situations that require a taxpayer to file?***

If the Who Must File charts show that an individual is not required to file a return, then continue to Chart C – Other Situations When You Must File in the Volunteer Resource Guide to see if any of the following special conditions require the person to file.

The most common special situations when individuals are legally required to file a return are:

- Self-employed with net earnings of \$400 or more
- Taxpayers who owe special taxes



Taxpayers who received the 2008 first-time homebuyer credit are required to file a return to repay a portion of the credit.



## EXERCISES

Refer to the Who Must File section of the Volunteer Resource Guide to answer these questions. Answers are at the end of the lesson summary.

**Question 1:** Bob is 27 years old. His gross income was \$17,000 during the tax year. Based only on this information, is he required to file a tax return?  Yes  No

**Question 2:** Janet and Harry are married and usually file jointly. During the tax year, she turned 66 and he turned 64. Their gross income was \$19,800. Based only on this information, are they required to file a tax return?  Yes  No

**Question 3:** Juanita has a dependent child and can file as a Qualifying Widow. She is 47 years old. Her gross income was \$25,000. Based only on this information, is she required to file a tax return?  
 Yes  No

## Who should file?

Even if individuals are not required to file a tax return, they should file a return if they qualify for certain credits or a refund. These items are listed in the Volunteer Resource Guide, Who Must File tab.

Individuals *should* file a return if they are eligible to claim:

- A refund of withheld taxes
- The earned income credit (EIC)
- The additional child tax credit
- The health coverage tax credit (out of scope)
- The American opportunity credit

Taxpayers who should file may be entitled to a tax credit, and filing a return is the only way to get it.

Individuals who are not required to file a return and who would not benefit from filing a return can reduce the cost, time, and effort of unnecessary processing by not filing a return.

## How do I find out if a taxpayer is eligible to claim a refund or refundable credit?

The taxpayer may qualify for a tax refund, earned income credit, additional child tax credit, premium tax credit, or American opportunity credit if:

- Federal or state income tax was withheld on any income form
- The taxpayer had earned income
- The taxpayer has a qualifying child
- The taxpayer paid higher education expenses
- The taxpayer made estimated tax payments
- The taxpayer purchased health coverage through the marketplace



Taxpayers who received advance premium tax credits are required to file a return to reconcile the allowable credit.



The earned income credit may apply with or without a child. See the Earned Income Credit and Child Tax Credit lessons for details on determining eligibility.

If a taxpayer is not required to file a tax return, and you are uncertain if they will benefit from filing, begin a return to determine if filing a tax return would benefit the taxpayer.

Refer taxpayers who may qualify for the health coverage tax credit to a professional tax preparer.

## How do I verify taxpayer identity?

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Before you begin the tax return, you should first verify the identity of the taxpayer(s) and the spelling of names entered on the taxpayer's intake and interview sheet.

### What documents do I use to verify identity?

Ask to see photo identification such as:

- Valid driver's license (U.S.)
- State ID (U.S.)
- Passport
- Visa
- Military ID
- National ID
- Employer ID
- School ID

Judgment should be used to accept any other valid form of identification. For example, the Site Coordinator can allow proof of identity in a situation of an elderly person with a disability who has an expired driver's license and passport but also provides a valid birth certificate. IRS-tax-law certified volunteers preparing tax returns are required to confirm the identity of the taxpayer to avoid identity theft, tax fraud, and to validate the correct Social Security number. If a taxpayer cannot substantiate their identity, or if the volunteer is uncomfortable accepting the items presented as proof of identity, the taxpayer should be advised to return with an acceptable form of identification. Exceptions to requiring photo ID should only be made under extreme circumstances and should be approved by the Site Coordinator. For example, there may be limited situations where an exception may apply to a person with a disability, the elderly, or other unique circumstances. Additionally, the Site Coordinator has discretion to approve exceptions to verification of taxpayer identity rules.



A spouse who is Married Filing Separately is not required to provide the Social Security card for the other spouse.

In addition to photo identification for taxpayers, they must also present proof of taxpayer identification numbers (TIN) for themselves and all persons listed on their tax return. (TIN is explained in next section.) Exception to this rule should be rare and only the Site Coordinator has discretion to approve an exception. Taxpayers who **cannot** substantiate their identity should seek professional tax assistance.

## What about taxpayers filing for decedents?

If you are providing assistance to someone who is filing a return for a decedent:

- Be aware that volunteers need to take steps to protect a taxpayer's identity and avoid possible identity theft.
- Ask to see the surviving spouse's identification or a copy of the death certificate.
- A personal representative may be filing the return for the deceased taxpayer. Verify the identity of the person who is filing for the decedent and ask if they have court documents or other documentation authorizing them to file the tax return.
- Representatives or surviving spouses who do not have the necessary documentation with them should be advised to return once they have the information. If they cannot provide the information, refer them to a professional tax preparer.

For additional information about filing a return for a decedent, refer to Form 1040 Instructions, Publication 17, or Publication 559.

## What are Taxpayer Identification Numbers?

IRS regulations require that each person listed on a U.S. federal income tax return have a valid Taxpayer Identification Number (TIN). The types of TINs are:

- Social Security Number (SSN)
- Individual Taxpayer Identification Number (ITIN)
- Adoption Taxpayer Identification Number (ATIN)

### ***Who has a Social Security number?***

Any individual who is legally eligible for employment in the United States must have a Social Security number.



Under the Protecting Americans from Tax Hikes (PATH) Act, ITINs that have not been used on a federal tax return at least once in the last three consecutive years will expire Dec. 31, 2017, and ITINs with middle digits 70, 71, 72 or 80 will also expire at the end of the year. Affected taxpayers who expect to file a tax return in 2018 must submit a renewal application.



Some Canadians have both U.S. and Canadian Social Security numbers. Never use the Canadian number on a U.S. tax return.

### ***Who has an Individual Taxpayer Identification Number?***

Some individuals who need to file tax returns do not have SSNs. The IRS issues ITINs to nonresidents and others living in the U.S. who are required to have a U.S. TIN but who are not eligible to obtain SSNs.

The ITIN contains nine digits and is formatted like a SSN (XXX-XX-XXXX), but begins with the number 9 and has a specified range of numbers in the fourth and fifth digits. You should enter the ITIN on the return whenever the SSN is requested.

## Who has an Adoption Taxpayer Identification Number?

Taxpayers who are in the process of adopting a child and who are able to claim the child as their dependent or are able to claim the child and dependent care credit need an ATIN for their adoptive child.

The IRS issues an ATIN for the child while a final domestic adoption is pending, and the adopting taxpayers do not have the child's SSN.

Like an ITIN, the nine-digit ATIN begins with the number 9. You should enter the ATIN on the return wherever the child's Social Security number is requested.



Taxpayers who cannot obtain a SSN must apply for an ITIN if they file a U.S. tax return or are listed on a tax return as a spouse or dependent. These taxpayers must file Form W-7, Application for Individual Taxpayer Identification Number and supply documentation that will establish foreign status and true identity. A federal tax return must be associated with all Form W-7 applications with exceptions as noted in the Form W-7 Instructions.

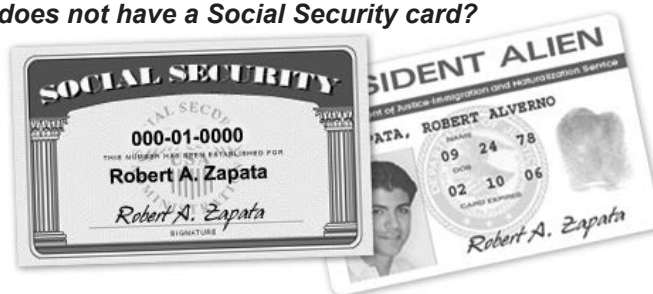


Taxpayer, spouse, or dependent name and Social Security number mismatch is rated as one of the most frequent errors in processing a tax return.

## What are acceptable documents if the taxpayer does not have a Social Security card?

For individuals who do not bring their original or a copy of their Social Security card, you may accept either of the following:

- A SSA letter or a Form SSA-1099 statement
- An ITIN card or letter



Driver's licenses and passports are *not* acceptable substitutes for Social Security or ITIN cards.

## What if the taxpayer does not have a SSN or ITIN?

For individuals without a valid SSN, explain that they must have a taxpayer identification number before you can assist them. Direct them to the Social Security Administration and advise them to complete Form SS-5, Social Security Number Application. If the individual is not eligible for a SSN, refer them to the IRS for Form W-7, Application for IRS Individual Taxpayer Identification Number.

For a taxpayer who cannot obtain a SSN and has not yet applied for an ITIN, you can use a temporary identification number to prepare the return in the tax software. Turn to the Volunteer Resource Guide, Resident/NR Alien tab.

When preparing a tax return for an ITIN application, include all Forms W-2, even if the SSN on the W-2 does not belong to the taxpayer. Do *not* change any information on the W-2. Send it in with the return as it is. Since it is not going to be transmitted electronically, it does not matter if the SSN does not match in the software.



Taxpayers can get an instant benefit verification letter on the Social Security website using their *my Social Security* account.

Attach the tax return behind Form W-7 along with documentation that will establish foreign status and true identity and have the taxpayer submit according to Form W-7 instructions.

- If it is not available at the volunteer site, the taxpayer can obtain Form W-7 by calling the IRS at 1-800-829-3676 (1-800-TAX FORM) or at [www.irs.gov](http://www.irs.gov).



- If taxpayers need assistance in completing Form W-7, refer them to an IRS Taxpayer Assistance Center unless a volunteer at that site has been trained in completion of Form W-7 or a Certifying Acceptance Agent is available. A list can be found on [www.irs.gov](http://www.irs.gov) by entering Certifying Acceptance Agent in the search field. Alternatively, refer the taxpayer to a professional tax preparer.
- An ITIN will expire for any taxpayer who fails to file a federal income tax return for three consecutive tax years. Any ITIN will remain in effect as long as a taxpayer continues to file U.S. tax returns. This includes ITINs issued after Jan. 1, 2013. These taxpayers will no longer face mandatory expiration of their ITINs and the need to reapply. A taxpayer whose ITIN has been deactivated and needs to file a tax return can reapply using Form W-7.



When preparing a return to include with a Form W-7 application, refer to the instructions in the Volunteer Resource Guide, Resident/NR Alien tab.

### What if the SSN on Form W-2 does not match the SSN on the tax return?

The SSN or ITIN on the taxpayer's Form W-2 is expected to match what you enter on the tax return. A mismatch will delay return processing and can create serious errors if the return is filed electronically.

#### ***Taxpayers with a Valid SSN***

If the taxpayer's Form W-2 does not have the correct SSN, you can prepare the return with the materials provided. However, the taxpayer needs to request a corrected Form W-2 from the employer before submitting the tax return.

#### ***Taxpayers with a Valid ITIN***

Taxpayers who file tax returns using their ITINs often have Forms W-2 showing erroneous SSNs. If such an ITIN/SSN mismatch occurs:

- Do *not* change any information on Form W-2
- It is acceptable to e-file a return with an ITIN/SSN mismatch
- The return should reflect the ITIN for the taxpayer, *not* the SSN on Form W-2
- When entering Form W-2 information, the mismatched SSN should be entered exactly as shown on the Form(s) W-2 issued
- The taxpayer is not eligible for the Earned Income Credit (EIC)



ITIN changes were implemented by the PATH Act. Refer to the What's New lesson in this publication, or the tab in Publication 4012 for additional information.



### **EXERCISES** (continued)

**Question 4:** It is your responsibility as a volunteer tax preparer to enter each Social Security number correctly on the tax return.  True  False

## How do I choose the appropriate tax return form?

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All taxpayers can use Form 1040. Individuals must meet certain requirements to use Form 1040EZ or Form 1040A. For more details about choosing the correct form, refer to Publication 17, Filing Information chapter.



For taxpayers who filed Form 1040EZ or Form 1040A the previous year, determine whether their situation has changed. It may be to their advantage to file Form 1040 if additional adjustments or deductions will result in a lower tax.

## How do I file a return?

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Detailed instructions for completing and filing the return are covered in the Concluding the Interview lesson and the Volunteer Resource Guide, Finishing the Return tab.

A return can be filed electronically using IRS e-file or by sending in a paper return.

### What is electronic filing?

IRS e-file is a quick, easy, and more accurate alternative to paper returns. With e-filing, taxpayers receive their refund in half the usual time, and even faster with direct deposit.

## How do I answer taxpayers' administrative questions?

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The Volunteer Resource Guide, Publication 17, and [www.irs.gov](http://www.irs.gov) contain answers to many administrative questions asked by taxpayers during the interview process.

Questions such as “How can I get a copy of my prior year’s return” or “How can I get an IRS form or publication” can be answered by researching your reference materials.

Turn to the “Frequent Taxpayer Inquiries” located in the Volunteer Resource Guide, Partner Resources tab and review this helpful information. For a list of phone numbers you can provide to taxpayers, refer to the bottom portion of the “Contact Information for Volunteers,” located on the back of the Volunteer Resource Guide.

Review the index in the back of Publication 17 and locate answers to taxpayers’ questions that are not answered in the Volunteer Resource Guide.



### EXERCISES (continued)

Using your reference materials, answer the following question.

**Question 5:** A taxpayer wants to know about the Presidential Election Campaign Fund. Where can you find that information?

## What potential pitfalls should I keep in mind?

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To avoid any difficulties when preparing tax returns:

- Always treat the information used to prepare an individual’s income tax return as confidential.
- Canadians have a number that is like a Social Security number, but it is for their old age pension. Do not use this number on a U.S. tax return. Canadians often have both a U.S. and a Canadian Social Security number.

- Be alert to the following possible indications of fraudulent activity:
  - A Form W-2 that is typed, handwritten, or has noticeable corrections
  - A Form W-2 that looks different from other Forms W-2 issued by the same company
  - A suspicious person accompanying the taxpayer and observed on other occasions
  - Multiple refunds directed to the same address or P.O. box
  - Employment or earnings, which are a basis for refundable credits, that are not well documented
  - Similar returns (e.g., same amount of refund, or same number of dependents, or same number of Forms W-2)
- Notify your site's coordinator if you suspect any fraudulent or unusual activity.

## Summary

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### Who must file?

To determine whether an individual is required to file a federal tax return:

- Obtain the person's age
- Calculate the person's approximate gross income
- Determine the person's likely filing status
- Use the table and guidelines in the Volunteer Resource Guide, Who Must File section

### How do I verify taxpayer identity?

Before entering the taxpayer's identity information in the Basic Information section or the appropriate tax return form, first verify the identity of the taxpayer(s), the accuracy of each SSN or ITIN, and spelling of names with the appropriate documents.

### Which tax return form should I use?

The three federal tax return forms are Form 1040EZ, Form 1040A, and Form 1040.

### Filing the Return

E-filing is the safest, fastest, and easiest way to file a tax return. With e-file, taxpayers can generally expect their refund in less than 21 calendar days after the receipt of their tax return.



**CAUTION** No credit for refund for an overpayment for a taxable year shall be made to a taxpayer before the 15th day of the second month (February) following the close of the taxable year if the taxpayer claimed the EITC or additional child tax credit on the tax return.

### What situations are out of scope for the VITA/TCE programs?

The following are out of scope for this lesson. While this list may not be all inclusive, it is provided for your awareness only.

- Taxpayers who may qualify for the health coverage tax credit
- Taxpayers who **cannot** substantiate their identity



## EXERCISE ANSWERS

**Answer 1:** Yes, Bob is required to file a return.

**Answer 2:** No, Janet and Harry are not required to file.

**Answer 3:** Yes, Juanita must file.

**Answer 4:** True. To prevent processing delays, check the accuracy of each Social Security number you enter on the return, as well as the spelling of the name associated with the number.

**Answer 5:** The index in Publication 17 directs us to a paragraph in the chapter on Filing Information.



## Filing Status



### Introduction

This lesson will help you determine the most advantageous (and allowable) filing status for the taxpayer. Selecting and entering the correct filing status is a critical component of completing the taxpayer's return.

See the Filing Status tab in the Volunteer Resource Guide for the Determination of Filing Status decision tree and the interview tips for helpful probing questions to use in your interview with the taxpayer.

### Objective

At the end of this lesson, using your resource materials, you will be able to:

- Determine the most beneficial filing status allowed for the taxpayer.

#### What do I need?

- Form 13614-C
- Publication 4012
- Publication 17
- Optional:**
- Publication 501
- Publication 555
- Publication 971
- Form 1040
- Form 8379

### What are the five filing statuses?

Taxpayers must use one of five filing statuses. Filing status impacts the calculation of income tax, affects the amount of the standard deduction, and determines allowance or limitation of certain credits and deductions. The following list puts them in order from the most beneficial to the least beneficial to the taxpayer.

- Married Filing Jointly
- Qualifying Widow(er)
- Head of Household
- Single
- Married Filing Separately



**TIP** Taxpayers may qualify for more than one filing status. Choose the filing status that results in the lowest tax for the taxpayer. Use the Volunteer Resource Guide to help determine the correct filing status.



**Tax Software Hint:** Filing status is selected in the Basic Information section. Go to the Volunteer Resource Guide to review the software entries.

### How does marital status affect filing status?

The first step in determining taxpayers' filing status is to confirm their marital status on *the last day of the tax year*. Avoid using information from the prior year, as it may have changed.

Generally, taxpayers are considered to be **unmarried** for the entire year if, on the last day of the tax year, they were:

- Unmarried
- Legally separated, under a separate maintenance decree, **or**
- Divorced under a final decree on or before December 31

Taxpayers are considered to be **married** for the entire year if:

- They were married on the last day of the tax year, **or**
- The spouse died during the year and the surviving spouse has not remarried

## What are the requirements for each filing status?

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### Who is considered Single?

Taxpayers can use the Single filing status if, on the last day of the tax year, they were:

- Not married
- Legally separated or divorced, or
- Widowed before the beginning of the tax year and did not remarry

### *Can Single taxpayers qualify for another status?*

Some single taxpayers qualify for Head of Household or for Qualifying Widow(er) with Dependent Child status, which can mean a lower tax. These statuses will be discussed later in this lesson.

### What is Married Filing Jointly?

Married taxpayers who choose to file a joint return will use one return to report their combined income and to deduct combined allowable expenses. Married taxpayers can select this status even if one of the spouses did not have any income or any deductions. The Married Filing Jointly status can be claimed by taxpayers who, on the last day of the tax year:

- Were married and lived together
- Were married and living apart, but were not legally separated or divorced
- Were common law married pursuant to the laws of the state in which they live (or in the state where the common law marriage began) and the marriage has not been dissolved, such as by death or divorce, or
- Did not remarry after their spouse died during the year



A citizen or resident alien married to a nonresident alien may be able to choose from more than one filing status. More information can be found in the Unique Filing Status and Exemption Situations lesson.



Filing a joint return for a common law marriage applies to the federal return only. Volunteers must check state or local laws before completing a state return. Volunteers are not responsible for determining whether a couple is in a common law marriage. If taxpayers are not certain, refer them to a professional tax preparer.

### *What are the responsibilities of each taxpayer on a joint return?*

Both taxpayers must include all worldwide income on their joint return. They each may be held responsible for all the tax and for any interest or penalty due, even if all the income was earned by only one spouse. A subsequent divorce usually does not relieve either spouse of the liability associated with the joint return.

In some cases, a spouse may be relieved of joint liability. Information is available in Publication 971, Innocent Spouse Relief, however, this topic is beyond the scope of the VITA/TCE programs. Refer taxpayers in this situation to a professional tax preparer.

### **What is Married Filing Separately?**

The Married Filing Separately status is for taxpayers who are married, and either:

- Choose to file separate returns, or
- Cannot agree to file a joint return

Taxpayers who file as Married Filing Separately each report their own income and deductions on separate returns. These rules do not apply in community property states. More information on community property is provided later in this lesson.

### ***Can Married Filing Separately taxpayers qualify for another status?***

Some married taxpayers may be considered unmarried even if they are not divorced or legally separated. Such taxpayers may be able to use the Head of Household filing status, which may result in a lower tax than Married Filing Separately. Refer to the topic “Can married taxpayers ever file as Head of Household?” in this lesson to see if the “considered unmarried” definition applies.

### ***Why are taxes usually higher for Married Filing Separately?***

Special rules apply to Married Filing Separately taxpayers, which generally result in a higher tax. For example, when filing separately:

- The tax rate is generally higher than on a joint return.
- Taxpayers cannot take the child and dependent care credit, earned income credit, education credits, and certain other benefits and credits.
- Some credits and deductions are reduced at income levels that are half those for a joint return such as the child tax credit and the retirement savings contribution credit.

If a taxpayer is Married Filing Separately and the spouse itemizes deductions on their return, the taxpayer must itemize *or* take a standard deduction of zero.



Whether or not a spouse is itemizing is only a concern for Married Filing Separately status. Married taxpayers qualified to file as Head of Household can take the standard deduction even if their spouse is itemizing.

For the complete list of special rules, see Publication 17, Filing Status.

### ***Are there special rules for taxpayers who live in community property states?***

The income of taxpayers who lived in Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, or Wisconsin during the tax year and who choose to file separate returns may be considered separate income or community income for tax purposes. Each state has its own community property laws, which may affect the amount of tax owed by taxpayers. See Publication 555, Community Property, for more information.

If your tax assistance program views community property tax laws for taxpayers who are Married Filing Separately or who are filing as Head of Household because they can be considered unmarried for income tax filing purposes as beyond the scope of the program, refer such taxpayers to a professional tax preparer.

For Married Filing Separately taxpayers, you must enter the other spouse's name and Social Security number or ITIN on the tax return. This is explained in the Form 1040 Instructions for line 3.



**Tax Software Hint:** If the taxpayer is in one of the community property states and is married and files a separate return from the spouse, you may need to file Form 8958, Allocation of Tax Amounts Between Certain Individuals in Community Property States. See Form 8958 in the tax software for specific instructions.

### ***If filing jointly generally results in the lowest total tax, why would married taxpayers want to file separately?***

Married taxpayers sometimes choose to file separate returns when one spouse does not want to be responsible for the other spouse's tax obligations, or because filing separately may result in a lower total tax. For example, if one spouse has high medical or miscellaneous expenses, or large casualty losses, separate returns may result in lower total taxes because a lower adjusted gross income allows more expenses or losses to be deducted.

Another common reason taxpayers file as Married Filing Separately is to avoid an offset of their refund against their spouse's outstanding debts. This includes past due child support, past due student loans, or a tax liability the spouse incurred before they were married. If married taxpayers want to file separately, and a potential refund offset is the reason, suggest that they file a joint return with Form 8379, Injured Spouse Allocation.

### ***Who is considered to be an injured spouse?***

When a joint return is filed and only one spouse owes a past-due amount, the other spouse can be considered an injured spouse. Injured spouses may file Form 8379 to receive their share of the refund shown on the joint return. The injured spouse:

1. Must not be legally obligated to pay the past-due amount, *and*
2. Must have made and reported tax payments (such as federal income tax withheld from wages or estimated tax payments), or claimed a refundable tax credit (see the credits listed in Publication 17 under Who Should File?).

Both of these conditions must apply *unless* the injured spouse lived in a community property state at any time during the tax year. In community property states, the injured spouse must meet only the first condition. If the taxpayer meets these requirements, Form 8379 can be e-filed with the joint return. See the Instructions for Form 8379 for details on how to complete the form.

If a taxpayer already filed a joint return and the refund was offset, Form 8379 can be filed by itself. When filed after the offset, it can take up to eight weeks for the taxpayer to receive a refund. Do not attach the previously filed tax return, but *do* include copies of all Forms W-2 and W-2G for both spouses and any Forms 1099 that show income tax withheld. The processing of Form 8379 may be delayed if these forms are not attached. A separate Form 8379 must be filed for each tax year to be considered.



An injured spouse claim is different from an innocent spouse relief request. Form 8379 allows an injured spouse to request the division of the tax overpayment attributed to each spouse. An innocent spouse uses Form 8857, Request for Innocent Spouse Relief, to request relief from joint liability for tax, interest, and penalties on a joint return for items of the other spouse (or former spouse) that were incorrectly reported on the joint return. For information on innocent spouses, see Publication 17, Relief from Joint Responsibility – Filing a Joint Return.

### ***What if a spouse died during the tax year?***

Remember, taxpayers whose spouses died during the tax year are considered married for the entire year, provided they did not remarry. The surviving spouse is eligible to file as Married Filing Jointly or Married Filing Separately.

Surviving spouses who have remarried must file with the new spouse, either jointly or separately. The deceased spouse's filing status becomes Married Filing Separately.



Determine the most advantageous filing status for the taxpayer. Surviving spouses who have a dependent child may be able to use the Qualifying Widow(er) with Dependent Child status in the two tax years following the year of the spouse's death. This is discussed later in this lesson.

### **Who is Head of Household?**

Taxpayers may qualify for the Head of Household filing status, if they:

- Are unmarried or “considered unmarried” on the last day of the tax year, and
- Paid more than half the cost of keeping up a home for the required period of time, and
- Had a qualifying person living in their home for more than half the year (except for temporary absences, such as school)

A qualifying person who is the taxpayer's dependent parent does not have to live with the taxpayer. However, the parent(s) must qualify as the taxpayer's dependent(s) for the taxpayer to qualify as Head of Household. For more information, review the Volunteer Resource Guide, Filing Status tab, Who is a qualifying person for Head of Household status?

For a married taxpayer to be “considered unmarried,” there are special rules, discussed later in this topic.

### ***What are the costs of keeping up a home?***

The costs of keeping up a home include expenses such as rent, mortgage interest, real estate taxes, insurance on the home, repairs, utilities, and food eaten in the home. Under proposed regulations, a taxpayer may treat a home's fair market rental value as a cost of maintaining a household instead of the sum of payments for mortgage interest, property taxes, and insurance. See Publication 17, Filing Status, Keeping Up a Home, for more information.

### ***Who is a qualifying person for Head of Household status?***

Turn to the chart, Who Is a Qualifying Person Qualifying You To File as Head of Household? in the Volunteer Resource Guide. A qualifying person for Head of Household is defined as:

- A qualifying child who is single (whether or not the child can be claimed as a dependent)
- A married child who can be claimed as a dependent
- A dependent parent
- A qualifying relative who lived with the taxpayer more than half the year, *and* is one of the relatives listed on the chart, *and* for whom the taxpayer can claim an exemption



A person may be a qualifying relative dependent, but not qualify the taxpayer for Head of Household filing status. For example, a companion or friend who lives with the taxpayer all year may be the taxpayer's dependent but not a qualifying person for Head of Household filing status.

Refer to the Volunteer Resource Guide, Filing Status tab, Who is a Qualifying Person Qualifying You To File as Head of Household?, when reviewing these examples. You will learn more about who can be claimed as a dependent in a later lesson.

#### **example**

Kate's unmarried 16-year-old daughter, Shelby, lived with her all year. Kate is single, provided all of Shelby's support, and paid all the costs of keeping up the home. Shelby is Kate's qualifying child dependent and is Kate's qualifying person for Head of Household filing status.

### example

Michael provided all the costs of keeping up his home for the year. Michael's son Justin lived with him the entire year. Justin is 22 and was not a full-time student during the tax year, so he cannot be Michael's qualifying child. Although Justin only worked part-time, he earned too much for Michael to claim him as a qualifying relative dependent. Therefore, Michael cannot file Head of Household because he does not have a qualifying person.

### example

Jane and Todd are not married. Their daughter, Amanda, lived all year with Jane in an apartment. Todd lived alone. Todd earns more than Jane, and provides for some of her living expenses. He paid over half the cost of Jane's rent and utilities. He also gave Jane extra money for groceries. Even though Todd paid over half the cost of providing a home for Jane and Amanda, he cannot file Head of Household because Amanda did not live with him over half the year. Jane cannot be Head of Household either because she did not provide more than half the cost of keeping up the home for her daughter.

### example

Nancy is single and lives alone. Nancy's mother, Maxine, lives alone in another city. Maxine receives Social Security payments, but has no other income. Nancy pays all of the costs of keeping up the home her mother lives in, and provides over half her support. Even though Maxine did not live with her, Maxine is Nancy's qualifying person for Head of Household filing status because Nancy can claim her mother as a dependent under the rules for qualifying relative.



## EXERCISES

Answers are after the lesson summary.

**Question 1:** Alexandra's younger brother, Sebastian, is seventeen years old. Sebastian lived with his grandparents for the first two months of the year. From March through July, he lived with Alexandra. On August 1, Sebastian moved in with some friends and stayed there for the rest of the year. Since Sebastian did not have a job, Alexandra gave him money every month. Assuming Alexandra had no other dependents, can she file as Head of Household?  Yes  No

Notice that the relatives who qualify a person for Head of Household may not be the same relatives who could qualify as a taxpayer's dependent.

### example

Since her spouse died five years ago, Joan has lived with her friend, Mary Ann, who is also a widow. Joan is a U.S. citizen, is single, and lived with Mary Ann all year. Joan had no income and received all of her support from Mary Ann. Joan is Mary Ann's qualifying relative because she lived with Mary Ann all year as a member of her household. Mary Ann can claim Joan as a dependent on her return.

However, Joan is *not* a qualifying person for Head of Household filing status because she is not related to Mary Ann in one of the ways listed on the chart in the Volunteer Resource Guide. She is Mary Ann's qualifying relative dependent *only* because she lived with Mary Ann all year as a member of her household.



The qualifying person for Head of Household filing status must be related to the taxpayer.



**Tax Software Hint:** Go to the Volunteer Resource Guide to review the software entries for the Basic Information section.

### **What are the advantages of filing as Head of Household?**

The Head of Household filing status provides a higher standard deduction and, generally, a lower tax rate than Single or Married Filing Separately.

### **Who can be “considered unmarried” for Head of Household?**

Married taxpayers may be “considered unmarried” and file as Head of Household if they:

- File a return for the tax year separate from their spouse.
- Paid more than half the cost of keeping up their home. See the Worksheet for Cost of Keeping Up a Home in the Volunteer Resource Guide.
- Lived apart from their spouse during the entire last six months of the tax year. The spouse is considered to have lived in the home even if temporarily absent due to special circumstances, such as military service or education.
- Provided the main home for more than half the year of a *dependent* child, stepchild, or foster child placed by an authorized agency. This test is also met if the taxpayer cannot claim the exemption only because the noncustodial parent can claim the child using the rules described in Publication 17, Personal Exemptions and Dependents.

#### **example**

Denise is married but has lived apart from her spouse for two years. Denise pays all the costs of keeping up her home for herself and her dependent 12-year-old son, who lives with her. Denise can choose to file as Head of Household for the tax year because she meets the definition of “considered unmarried.”

A taxpayer who is married to a nonresident alien spouse may be able to file as Head of Household even if the taxpayer lived with the spouse for the year. Review the Unique Filing Status and Exemption Situations lesson for more information.

### **Who is a Qualifying Widow(er)?**

Taxpayers who do not remarry in the year their spouse dies can file jointly with the deceased spouse. For the two years following the year of death, the surviving spouse may be able to use the Qualifying Widow(er) filing status. To qualify, the taxpayer must:

- Be entitled to file a joint return for the year the spouse died, regardless of whether the taxpayer actually filed a joint return that year.
- Have had a spouse who died in either of the two prior years. The taxpayer must not remarry before the end of the current tax year.
- Have a child, stepchild, or adopted child who qualifies as the taxpayer’s dependent for the year or would qualify as the taxpayer’s dependent except that he or she does not meet the gross income test, or does not meet the joint return test, or except that the taxpayer may be claimed as a dependent of another taxpayer.
- Live with this child in the taxpayer’s home all year, except for temporary absences.
- Have paid more than half the cost of keeping up the home for the year.



A foster child does not qualify a taxpayer for the Qualifying Widow(er) filing status.

The standard deduction and tax tables are the same for Qualifying Widow(er) and Married Filing Jointly filing statuses. These are more favorable than those for Head of Household filing status.

### example

Laura's spouse, Jim, died in September of the tax year. She has not remarried, and provides all the support for their dependent children, ages 8 and 10. Laura can file as Married Filing Jointly, claiming an exemption for her deceased spouse. For the next two tax years, she can use the Qualifying Widow(er) status if she does not remarry.



**Tax Software Hint:** Go to the Volunteer Resource Guide, Exemptions/Dependency tab, for the software entries.

## How do I determine the correct filing status?

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To determine the correct filing status, follow the Filing Status Interview Tips or the Determination of Filing Status flow chart in the Volunteer Resource Guide, Filing Status tab.



### EXERCISES (continued)

Check your understanding of each filing status. Review the lesson and use the Filing Status Interview Tips in the Volunteer Resource Guide to determine the answer. Answers are after the lesson summary.

**Question 2:** Jane's husband moved out of their home in February of the tax year and has not returned. Jane provides all the cost of keeping up the home for herself and her two dependent children. Jane refuses to file a joint return with her husband. What filing status should she use?

- Single
- Married Filing Separately
- Head of Household
- Qualifying Widow(er)

**Question 3:** Seth lives alone and has never married. He does not support either of his parents. What filing status(es) can he use?

- Single
- Married Filing Jointly
- Married Filing Separately
- Head of Household
- Qualifying Widow(er)

**Question 4:** Tanya's divorce became final in early September of the tax year. She has sole custody of her three children, who lived with her the entire year. The children are all under the age of 19. She provided more than half of the cost of keeping up the home. What filing status(es) can she use?

- Single
- Married Filing Jointly
- Married Filing Separately
- Head of Household
- Qualifying Widow(er)



## EXERCISES (continued)

**Question 5:** Sydney's spouse died two years ago in January. He filed a joint return for that year as the surviving spouse. Since then, Sydney has not remarried, maintains a home for his young children who lived with him all year, and provides their sole support. Using the Filing Status Interview Tips in the Volunteer Resource Guide, determine what filing status Sydney should use?

- Single
- Married Filing Jointly
- Married Filing Separately
- Head of Household
- Qualifying Widow(er)

## Summary

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This lesson covered the five filing statuses:

- Single
- Married Filing Jointly
- Married Filing Separately
- Head of Household
- Qualifying Widow(er)

If taxpayers qualify for more than one filing status, choose the one that results in a lower tax. For example, in most cases, married couples pay less tax if they file a joint return.

In general, the Head of Household filing status is for unmarried taxpayers who paid more than half the cost of maintaining a home for a qualifying person for the required period of time. However, some married taxpayers who lived apart from their spouse during the last six months of the year and provided for dependent children may be "considered unmarried" and qualify to file as Head of Household.

A widow or widower with one or more dependent children may be able to use the Qualifying Widow(er) filing status, which is available for two years following the year of the spouse's death.

### What situations are out of scope for the VITA/TCE programs?

The following are out of scope for this lesson. While this list may not be all inclusive, it is provided for your awareness only.

- A spouse who may be relieved of joint liability as an innocent spouse
- Depending on your tax assistance program, community property tax laws for married taxpayers who file a separate return from their spouse
- Taxpayers who are not certain they are in a common law marriage (rules are complex and differ from state to state)



## EXERCISE ANSWERS

**Answer 1:** No, because Sebastian lived with Alexandra for five months, which is less than half the year.

**Answer 2:** Head of Household. Even though Jane is still married to her husband, she meets the requirements to be “considered unmarried” for filing status purposes and qualifies to file as Head of Household. Although technically she could file as Married Filing Separately, it would not be to her advantage to do so.

**Answer 3:** Because he is not married, has no dependents living in his household, and does not claim his parents as dependents, Seth can only file as Single.

**Answer 4:** Because she is legally divorced, Tanya could file as Single. However, because she has children and meets the requirements for Head of Household, she should use this as her filing status because it will result in a lower tax.

**Answer 5:** Although Sydney meets the requirements to file as Single, Head of Household or Qualifying Widower, the Interview Tips will help you to determine that he should use the Qualifying Widower filing status because it will result in the lowest tax.

### Notes

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# Personal Exemptions



## Introduction

Identifying and entering the correct number of exemptions is a critical component of completing taxpayers' returns, because each allowable exemption reduces their taxable income.

Personal exemptions are reflected in the Exemptions section of Form 1040, page 1.

## Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Distinguish between personal and dependency exemptions
- Determine if a taxpayer can claim a personal exemption
- Determine how many personal exemptions a taxpayer can claim

### What do I need?

- Form 13614-C
- Publication 4012
- Publication 17
- Optional:**
- Publication 501

## What are exemptions?

An **exemption** is a dollar amount that can be deducted from an individual's total income, thereby reducing the taxable income. Taxpayers may be able to claim two kinds of exemptions:

- Personal exemptions generally allow taxpayers to claim themselves (and possibly their spouse)
- Dependency exemptions allow taxpayers to claim qualifying dependents

This lesson discusses personal exemptions.



The exemption amounts are indexed for inflation and are generally updated every year.

## When can a taxpayer claim personal exemptions?

To claim a personal exemption, the taxpayer must be able to answer "no" to the intake question, "Can anyone claim you or your spouse on their tax return?"

This applies even if another person does not actually claim the taxpayer as a dependent. A taxpayer who may be claimed as a dependent by another taxpayer must claim "0" exemptions. This means they will not be able to subtract the exemption amount from their gross income, and they may have to use a smaller standard deduction amount. See the lesson Standard Deduction and Tax Computation for more information on this topic.

If married taxpayers file a joint return, they can take a personal exemption for each spouse. If they file separate returns, they can each take a personal exemption for themselves.

## When can taxpayers claim an exemption for their spouse?

A spouse is never considered the dependent of the other spouse. However, taxpayers may be able to take an exemption for their spouse simply because they are married.

To claim a personal exemption for one's spouse, the taxpayer must meet these conditions:

- Married as of December 31 of the tax year, and
- Spouse may not be a dependent of another taxpayer, and
- Files a joint return, or files a separate return *and* the spouse had no income and is not filing a return



Taxpayers who obtained a final decree of divorce or separate maintenance during the tax year cannot take their (former) spouse's exemption.



A common-law marriage is recognized for federal tax purposes if it is recognized by the state where the taxpayers currently live or in the state where the common-law marriage began, and the marriage has not been legally dissolved, such as by death or divorce. Legal advice may be necessary to determine if a common-law marriage exists. However, filing a joint return for a common-law marriage applies to the federal return only. You must check state or local law before completing a state return.

### ***What about a deceased spouse?***

A taxpayer whose spouse died during the tax year can generally claim the personal exemption for the deceased spouse if the taxpayer meets all of these conditions:

- Did not remarry by December 31 of the tax year, and
- Was not divorced or legally separated from their spouse on the date of death, and
- Would have been able to claim the exemption under the rules for a joint or separate return

## How do I use the interview techniques to determine how many personal exemptions a taxpayer can claim?

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The Interview Tips for Personal Exemptions in the Volunteer Resource Guide, Exemptions/Dependency tab, can help determine whether the taxpayer can claim any personal exemptions. Use these questions as a guide when you interview the taxpayer.

## How do I enter the personal exemptions?

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Check the appropriate boxes and enter the number of exemptions claimed on Form 1040, line 6.



**Tax Software Hint:** The tax software will auto-fill the entries for line 6 once the names and applicable filing status is selected. Review the Volunteer Resource Guide for the required entries if the taxpayer is not able to claim his or her own personal exemption.



## Taxpayer Interview and Tax Law Application

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Ray Jackson is a widower whose wife died during the tax year. Use the Volunteer Resource Guide, Interview Tips for Personal Exemptions, to help you complete lines 6a and 6b on his tax return. Here's how the conversation might sound:

SAMPLE INTERVIEW	
VOLUNTEER SAYS...	RAY RESPONDS...
<i>The questions I'm about to ask you will help us figure out if you can claim any personal exemptions. First of all, you've told me that you were married until your wife died on June 1. I'm sorry for your loss, sir.</i>	Yes, I was. Thank you.
<i>And you did not remarry, right?</i>	That's right.
<i>Are you filing a joint return with your late wife this year?</i>	Yes.
<i>Can any other taxpayer claim either of you as dependents?</i>	Well, I don't think so. We lived off our own income.
<i>Based on your answers, you can claim an exemption for both yourself and for your late wife.</i>	



**Tax Software Hint:** When preparing a return for a deceased taxpayer, refer to Publication 4012, Finishing the Return tab, under Personal Information Part 1 for details.

### Summary

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There are two types of exemptions:

- Personal
- Dependency

A personal exemption can be claimed for:

- The individual taxpayer, unless he or she may be claimed as a dependent on another taxpayer's tax return
- The taxpayer's spouse, if a joint return is filed and the spouse cannot be claimed on another taxpayer's return
- The taxpayer's spouse, if the taxpayer is not filing a joint return and the spouse had no income, is not filing his or her own return, and is not a dependent of another taxpayer

Personal exemptions are claimed in the Exemptions section of the tax return.

Exemptions reduce the taxpayer's taxable income.

Claiming an incorrect number of exemptions is a common error.





## Dependency Exemptions



### Introduction

Identifying and entering the correct number of exemptions is a critical component of completing the taxpayer's return. Taxpayers can claim one exemption for each qualified dependent on their return, thereby reducing their taxable income.

See the Volunteer Resource Guide, Exemptions/Dependency tab for interview tips that can provide helpful probing questions to use when interviewing the taxpayer.

When the interview is complete, the results are documented on the intake and interview sheet. This information will be the basis of your entries in the tax software.

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Determine if a taxpayer can claim an exemption for a dependent by applying the applicable dependency test
- Determine how many exemptions a taxpayer can claim for dependents

#### What do I need?

- Form 13614-C
- Publication 4012
- Publication 17

#### Optional:

- Publication 501
- Form 2120
- Form 8332

### Who are dependents?

Dependents are either a qualifying child or a qualifying relative of the taxpayer. As explained in the Personal Exemptions lesson, the taxpayer's spouse cannot be claimed as a dependent but can be claimed as a personal exemption. Some examples of dependents include a child, stepchild, brother, sister, or parent.



Persons who qualify to be claimed as a dependent may file a return, but they cannot claim any exemptions.

### How do I apply the dependency tests?

The Marital Status and Household Information section of the intake and interview sheet addresses the issues concerning dependency, but you will still need to use your interview skills to clarify whether the individuals listed are eligible to be claimed as dependents.

Use caution when preparing this section of the taxpayer's return. Use the Volunteer Resource Guide, Exemptions/Dependency tab for guidance on asking probing questions to verify the information on the intake and interview sheet. Use the interview tips to apply the dependency tests. Avoid using information from the taxpayer's prior year documents to complete this section.



A taxpayer's spouse *cannot* be claimed as a dependent but can be claimed as a personal exemption.

### Does it matter if I use the interview tips?

Whether you are a new or returning volunteer, the interview tips provide guidelines and definitions to help you apply the dependency tests. They incorporate all of the exceptions, such as the special rules for children of divorced or separated parents as well as the special multiple support rules. As you become more

experienced with the qualifying child and qualifying relative rules, you may find that you prefer the Overview of the Rules for Claiming an Exemption for a Dependent chart instead.

### How do I use the interview tips

When determining if a taxpayer can claim a dependent, always begin with Table 1: Dependency Exemption. If you determine that the person is not a qualifying child, then move to Table 2: Dependency Exemption for Qualifying Relative. Depending on the taxpayer's answers, you may also be prompted to use Table 3: Children of Divorced or Separated Parents or Parents Who Live Apart or the Qualifying Child of More Than One Person chart.

### Who may be claimed as a dependent?

A dependent may be either a qualifying child or a qualifying relative. Both types of dependents have unique rules, but some requirements are the same for both.



The tests for qualifying relative are applied only when the tests for qualifying child are not met.

### What tests must be met for all dependents?

To determine if an individual can be claimed as a dependent, begin with the rules that apply to **both** qualifying child and qualifying relative:

- Dependent taxpayer test
- Joint return test
- Citizen or resident test

### Dependent Taxpayer Test

A taxpayer (or taxpayer's spouse, if filing a joint return) who may be claimed as a dependent by another taxpayer may not claim anyone as a dependent on his or her own tax return. Part I of the intake and interview sheet asks, "Can anyone claim you or your spouse on their tax return?" If taxpayers answer yes, they cannot claim a dependent. Use your interview skills because some taxpayers, particularly students, might not be sure of the answer to this question.

### Joint Return Test

A married person who files a joint return cannot be claimed as a dependent unless that joint return is filed only to claim a refund of withheld income tax or estimated tax paid.

#### example

Ruth, who had no income, was married in November of the tax year. Ruth's husband had \$30,000 income, and had a filing requirement. They claimed two personal exemptions on their return. Although Ruth's father supported her and paid for the wedding, he cannot claim her as a dependent because she is filing a joint return with her husband.

### Citizen or Resident Test

To be claimed as a dependent, a person must be a U.S. citizen, U.S. resident alien, U.S. national, or a resident of Canada or Mexico.

- If a U.S. citizen or U.S. national legally adopts a child who is not a U.S. citizen, U.S. resident alien, or U.S. national, this test is met as long as the child lives with the taxpayer as a member of the household

all year. If all other dependency tests are met, the child can be claimed as a dependent. This also applies if the child was lawfully placed with the taxpayer for legal adoption.

- Foreign exchange students generally are not U.S. residents and do not meet the citizen or resident test; they cannot be claimed as dependents.

#### example

Joan, who is a U.S. citizen, adopted an infant boy from Cambodia who lived with her for the entire tax year. Even though Joan's child is not yet a U.S. citizen, he meets the citizen or resident test because he was a member of Joan's household for the entire year.

## What are the tests for qualifying children?

The next step to determine if the taxpayer has a dependent is to apply the rules for a qualifying child. If these tests are not met, see if the tests for a qualifying relative are met. Remember, a person must meet the requirements of either a qualifying child or a qualifying relative to be claimed as a dependent. While reading about these tests, follow steps 5-9 in the Volunteer Resource Guide, Exemptions/Dependency tab, Table 1 Interview Tips.

### Relationship

To meet this test, the child must be:

- The taxpayer's son, daughter, stepchild, foster child (placed by an authorized placement agency), or a descendant (for example, a grandchild) of any of them
- The taxpayer's brother, sister, half-brother, half-sister, stepbrother, stepsister, or a descendant (for example, niece or nephew) of any of them

An adopted child is treated the same as a natural child. This includes a child who was lawfully placed with the taxpayer for legal adoption.

### Age

To meet this test, the child must be:

- Under age 19 at the end of the tax year and younger than the taxpayer (or the taxpayer's spouse, if filing jointly), or
- A full-time student under the age of 24 at the end of the year and younger than the taxpayer (or spouse, if filing jointly), or
  - To qualify as a student, the child must be enrolled in the number of hours or courses the school considers full-time during some part of at least five months of the year. See Publication 17 for additional details.
- Any age if permanently and totally disabled at any time of the year



Attending an on-the-job training course, correspondence school, or a school offering courses only through the Internet, does not qualify the child as a student.

### Residency

To meet this test, the child must have lived with the taxpayer for more than half the year. The taxpayer's home is any location where they regularly live; it does not need to be a traditional home. For example, a child who lived with the taxpayer for more than half the year in one or more homeless shelters meets the residency test.

## Exceptions to the Residency Test

The child is considered to have lived with the taxpayer during periods of time when either the child or the taxpayer is temporarily absent due to illness, education, business, vacation, military service, institutionalized care for a child who is permanently and totally disabled, or incarceration.

A child who was born (or died) during the year is treated as having lived with the taxpayer for more than half of the year, if the taxpayer's home was the child's home for more than one-half of the portion of the taxable year during which the individual was alive.

Taxpayers may claim an exemption for a child who was born or died, or was kidnapped, during the year, as long as the other dependency tests are met.



In the case of a child who was born and died during the year, a SSN is not required but the return cannot be e-filed. The tax return must be mailed. Refer to Publication 17 for specific rules for these rare situations.

### example

Hugh's daughter died on January 15 of the tax year. If she met all the dependency tests up until her death, Hugh can claim an exemption for her on his return.

A taxpayer may *not* claim a dependency exemption for a stillborn child.

In most cases, because of the residency test, a child is the qualifying child of the custodial parent. However, special rules apply to divorced or separated parents or parents who live apart, which are covered later in this lesson.

## Support

To meet this test, the child cannot have provided more than half of his or her own support during the tax year. This test is different from the support test for qualifying relative. A person's own funds are not support unless they are actually spent for support. If the taxpayer is unsure whether the child provided more than half of his or her own support, review the Worksheet for Determining Support in the Volunteer Resource Guide together.

### example

Bob, 22, is a full-time student and lives with his parents when he is not in the dorm. He worked part-time, but did not pay over half of his total support. Bob meets the relationship, age, and support tests. If he meets the rest of the tests for a qualifying child, he can be claimed as a dependent by his parents.

### example

Doris, a U.S. citizen, is 8 years old and had a small role in a television series. She made \$60,000 during the tax year, but her parents put all the money in a trust fund to pay for college. She lived with her parents all year. Doris meets the relationship, age, and residency tests. Doris also meets the support test since the \$60,000 in earnings were not used for her own support. Since she meets the tests for a qualifying child, she can be claimed as a dependent by her parents.

State benefits provided to a person in need, such as welfare, food stamps or housing, are generally considered support provided by state. A proposed rule on which taxpayers may choose to rely treats governmental payments made to a recipient that the recipient uses, in part, to support others are treated as support of the others provided by the recipient, whereas any part of such a payment used for the support of the recipient would constitute support of the recipient by a third party. For example, if a mother receives Temporary Assistance for Needy Families (TANF) and uses TANF payments to support her children, the proposed regulations treat the mother as having provided that support. If a child receives Social Security benefits, and uses them for the child's own support, the benefits are considered to be provided by the child.

## Can the child be a qualifying child of more than one person?

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Although a child could meet the conditions to be the qualifying child of more than one person, only one taxpayer can claim the child as a qualifying child for the following tax benefits (exception: if the special rule for children of divorced or separated parents or parents who live apart applies):

- Dependency exemption
- Child tax credit
- Head of Household filing status
- Credit for child and dependent care expenses
- Exclusion from income for dependent care benefits
- Earned income credit
- Premium tax credit, generally

See the Volunteer Resource Guide, Qualifying Child of More Than One Person chart.

If two taxpayers have the same qualifying child, then only one taxpayer can claim all of the benefits for that particular qualifying child. They cannot agree to split these benefits. The other taxpayer cannot claim any of the benefits, based on the same qualifying child.

To determine which taxpayer can treat the child as a qualifying child and claim the benefits, apply these rules:

- If only one of the taxpayers is the child's parent, the child is the qualifying child of the parent.
- If the parents file a joint return together and can claim the child as a qualifying child, the child is treated as the qualifying child of the parents.
- If the parents do not file a joint return together but both parents claim the child, IRS will treat the child as the qualifying child of the parent with whom the child lived for the longer period of time during the tax year. If the child lived with both parents the same amount of time, IRS will treat the child as the qualifying child of the parent who had the higher Adjusted Gross Income (AGI) for the tax year.
- If no parent can claim the child as a qualifying child, the child is treated as the qualifying child of the person who had the highest AGI for the tax year.
- If a parent can claim the child as a qualifying child but no parent does, the child is treated as the qualifying child of the person who had the highest AGI for the year, but only if that person's AGI is higher than the highest AGI of any of the child's parents who could claim the child. If the parents file a joint return together, this rule allows the parents to divide their combined AGI equally (between themselves).

Using these tie-breaker rules, taxpayers may be able to choose which one claims the child. If the qualifying child is actually claimed on more than one tax return in a given year, IRS will apply these tie-breaker rules to determine who will receive the benefits.



**CAUTION** When a taxpayer's e-filed return is rejected because he or she claimed a dependent that was already claimed by another person, apply the tie-breaker rules. If the taxpayer is the person eligible to claim the dependent based on these rules, a paper return must be filed. The IRS will disallow the dependency exemption on the other person's return.

### example

Lynne and her mother, Margaret, share a home and both contribute to the household expenses. Lynne's twelve-year-old-daughter, Karen, lives with them. Although Karen meets all the conditions to be a qualifying child for both Lynne and her mother, Lynne is the taxpayer who can claim Karen as a qualifying child, because she is Karen's parent.

However, if Lynne chooses not to claim Karen, then Margaret may claim Karen as a qualifying child if Margaret's AGI is higher than Lynne's.

Publication 17 and Publication 501 provide more information about qualifying children of more than one person.

## What are the tests for qualifying relatives?

Dependents who do not meet the tests for qualifying child might meet the slightly different tests to be a qualifying relative. In addition to the dependent taxpayer, joint return, and citizen or resident tests, there are four additional tests that must be met for a person to be a qualifying relative. The tests are:

- Not a qualifying child test
- Member of household or relationship test
- Gross income test, and
- Support test

Unlike a qualifying child, a qualifying relative can be any age. Turn to the Volunteer Resource Guide, Exemptions/Dependency tab, Qualifying Relative Interview Tips, to follow along as the tests are described.

### Not a Qualifying Child Test

A child is not considered a taxpayer's qualifying relative if the child is the taxpayer's qualifying *child* or is the qualifying child of *another* taxpayer.

However, there is an exception to this statement. A child may qualify as the taxpayer's dependent under the tests for qualifying relative, even if that child is the qualifying child of another taxpayer. This is allowed only when the child's parent (or other person for whom the child is a qualifying child) is not required to file an income tax return and either:

- Does not file a return, or
- Only files to get a refund of income tax withheld or estimated tax paid

### example

Todd has lived with his girlfriend, Eva, and her two children all year in his home. Eva is not required to file, and does not file, a tax return this year. Eva and her two children pass the "not a qualifying child test" to be Todd's qualifying relatives. Todd can claim them as dependents if he meets all the other tests. (Eva and Todd's relationship does not violate local laws.)



## EXERCISES

Answers are after the lesson summary.

**Question 1:** All the facts are the same as in the previous example, except that Eva's gross income is \$25,000, and she is required to file a return. In this situation, is Todd allowed to claim the children as qualifying relative dependents?  Yes  No



### example

Sally has been supporting her friend, Ann, and Ann's young son, Bobby. Ann and Bobby lived with Sally the entire year and meet all the tests to be Sally's qualifying relatives. Ann worked part-time and made \$3,100 in wages. Ann files a return only to have her withholding refunded. She does not claim her own exemption. Sally can claim Ann and Bobby as dependents.



### EXERCISES (continued)

**Question 2:** All the facts are the same as in the previous example, except, when Ann files her tax return, she uses Bobby as her qualifying child to claim the earned income credit. Who is eligible to claim Bobby as a dependent?

### Member of Household or Relationship Test

To meet this test, the person must either:

- Live as a member of the taxpayer's household all year, or
- Be related to the taxpayer in one of the following ways:
  - Child, stepchild, foster child or a descendant of any of them
  - Brother, sister, half-brother, half-sister, stepbrother or stepsister
  - Father, mother, grandparent or other direct ancestor, but not foster parent
  - Stepfather or stepmother
  - Son or daughter of the taxpayer's brother or sister (nephew or niece)
  - Son or daughter of the taxpayer's half-brother or half-sister
  - Brother or sister of the taxpayer's father or mother (uncle or aunt)
  - Son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law

Any of these relationships that were established by marriage are not ended by death or divorce.

### example

Susan and Ted are married and file a joint return. They supported Ted's parents throughout the tax year. Even though Ted's parents do not live with Ted and Susan, Ted's parents meet the member of household or relationship test.

An unrelated person who lived with the taxpayer for the entire year can also meet the member of household or relationship test. If the relationship violates local laws, this test is not met. For example, if the taxpayer's state prohibits cohabitation, then that person cannot be claimed, even if all other criteria are met.

Note that:

- A person is still considered living with the taxpayer as a member of the household during periods when that person or the taxpayer is temporarily absent due to special circumstances such as illness, education, business, vacation, military service, and placement in a nursing home.
- Cousins can meet the relationship test for qualifying relative *only if* they live with the taxpayer for the entire year.
- Qualifying relatives can be unrelated, as long as they lived with the taxpayer all year.
- A taxpayer may not claim a dependency exemption for a housekeeper or other household employee.

#### example

Mary is a live-in nanny for Jack and Jane in exchange for room and board for the entire year. Even if Mary meets the other tests for qualifying relative, Jack and Jane may not claim Mary as a dependent.

### Gross Income Test

To meet this test, the dependent's gross income for the tax year must be less than the personal exemption amount. Gross income is all income in the form of money, property, and services that is not exempt from tax. Specific examples are found in Publication 17, Personal Exemptions and Dependents. Remember this test does not apply to qualifying children, only qualifying relatives. For purposes of this test, the gross income of an individual who is permanently and totally disabled does not include income from a sheltered workshop.

#### example

Joe is 65 years old and lives with his son and daughter-in-law. Joe's taxable pension income for the year was \$10,000. Joe's son and daughter-in-law cannot claim a dependency exemption for Joe because Joe's income exceeds the personal exemption amount.

### Support Test

To meet this test, the taxpayer must have provided more than 50% of the person's total support for the tax year. Note that this support test is different from the one for a qualifying child.

When calculating the amount of total support, taxpayers should compare their contributions with the entire amount of support the person received from all sources (such as taxable income, tax-exempt income, and loans). Review the list of valid support expenses and the Worksheet for Determining Support in the Volunteer Resource Guide, Exemptions/Dependency tab, and the Personal Exemptions and Dependents chapter in Publication 17.

#### example

Sherrie's father received \$2,700 from Social Security and investments, but he put \$300 of it in a savings account and spent only \$2,400 for his own support. Sherrie spent \$2,600 of her income for his support, so she has provided over half of his support.

#### example

Steve provided \$4,000 toward his mother's support during the year. His mother had earned income of \$600, nontaxable Social Security benefit payments of \$4,800, and tax-exempt interest of \$200. She used all of these for her support. Steve cannot claim a dependency exemption for his mother because the \$4,000 he provided was not more than half of her total support of \$9,600.



State benefit payments like welfare, Temporary Assistance for Needy Families (TANF), food stamps, or housing assistance are generally considered support provided by the state, not by the taxpayer. A proposed rule on which taxpayers may choose to rely treats governmental payments made to a recipient that the recipient uses, in part, to support others as support of the others provided by the recipient, whereas any part of such payment used for the support of the recipient would constitute support of the recipient by a third party. For example, if a mother receives TANF and uses the TANF payments to support her children, the proposed regulations treat the mother as having provided that support.

Social Security benefits received by a child and used toward support are considered to have been provided by the child.

Refer to the Worksheet for Determining Support in the Volunteer Resource Guide or the Personal Exemptions and Dependents chapter of Publication 17.

## Multiple Support Agreements (Form 2120)

Sometimes no one provided more than half the support of a person. Multiple support means that two or more people who could claim the person as a dependent (except for the support test) together provide more than half the dependent's support. In this situation, the individuals who provide *more* than 10% of the person's total support, and who meet the other tests for a qualifying relative, can agree that one of them will take the person's exemption.

- The taxpayer claiming the exemption for the dependent must file Form 2120, Multiple Support Declaration or similar statement, with the tax return.
- The other taxpayers providing over 10% of the person's support must provide a written and signed statement agreeing *not* to claim the exemption for that year. The person who claims the exemption must keep a copy of this written statement as a record. A list of the statement requirements can be found in Form 2120 Instructions.



Multiple Support Agreements apply only to a qualifying relative, not to a qualifying child.

### example

Fred's father, Charlie, lives with him and receives 27% of his support from Social Security, 40% from Fred, 24% from Charlie's brother Ray, and 9% from one of Charlie's friends. Either Fred or Ray can take the exemption for Charlie because they each provided more than 10% of Charlie's support, and together contributed more than 50% toward his support. If they agree that Fred should take the exemption, Ray will sign Form 2120 and Fred will attach the form to his tax return.



### EXERCISES (continued)

**Question 3:** Diane and her brother each provided 20% of their grandmother's support for the year. Two persons who are not related to Diane's grandmother, and who do not live with her, provided the remaining 60% of her support equally. Who is entitled to claim the dependency exemption for the grandmother?



The taxpayers who provide multiple support for a dependent decide among themselves who will take the exemption for the year. Volunteer tax preparers do not decide.

## Special Rule for Children of Divorced or Separated Parents or Parents Who Live Apart

In most cases, the child is the qualifying child of the custodial parent. However, a child will be treated as the qualifying child or qualifying relative of his or her noncustodial parent if all the following conditions apply:



This rule does not apply for Head of Household filing status, the credit for child and dependent care expenses, or the earned income credit. For these benefits, the child must meet the residency test. The custodial parent may still qualify for those provisions even though the noncustodial parent can claim the dependency exemption.

1. The parents
  - are divorced or legally separated under divorce or separate maintenance decrees or written separation agreements, or
  - lived apart at all times during the last six months of the year whether or not they are or were married
2. The child received over half of his or her support for the year from the parents. (Multiple Support Agreement rules do not apply.)
3. The child was in the custody of one or both parents for more than half the year.

4. The custodial parent signs a written declaration (Form 8332 or a similar statement) that he or she will not claim the child as a dependent for the year and the noncustodial parent attaches this declaration to his or her return. If the decree or agreement went into effect after 1984 and before 2009, the noncustodial parent may be able to attach certain pages from the decree or agreement instead of Form 8332. For a pre-1985 decree or agreement, see Publication 17.

This special rule is the exception to:

- The residency test for qualifying child
- The support test for qualifying relative

### ***Custodial and Noncustodial Parent***

The custodial parent is the parent with whom the child lived for the greater number of nights during the year. The other parent is the noncustodial parent.

If the parents divorced or separated during the year and the child lived with both parents before the separation, the custodial parent is the one with whom the child lived for the greater number of nights during the rest of the year.

A child is treated as living with a parent for a night if the child sleeps:

- At that parent's home, whether or not the parent is present, or
- In the company of the parent, when the child does not sleep at a parent's home (for example, the parent and child are on vacation together).

#### example

Chloe has one child, Timmy, and is divorced. During the tax year, Timmy lived with Chloe 210 nights and with his father 155 nights. Chloe is the custodial parent because Timmy lived with her more nights during the year.

If the child lived with each parent for an equal number of nights during the year, the custodial parent is the parent with the higher adjusted gross income.



### **EXERCISES** (continued)

**Question 4:** Ted is divorced and has a daughter who lived with him and his ex-spouse for an equal number of nights. Ted's adjusted gross income is \$45,000 and his ex-spouse's adjusted gross income is \$30,000. Who is considered the custodial parent?

If a child is emancipated under state law, the child is treated as not living with either parent.

#### example

When Troy turned age 18 in May, he became emancipated under the law of the state in which he lives. As a result, he is not considered in the custody of his parents for more than half of the year. The special rule for children of divorced or separated parents does not apply.

See more examples and additional information in Publication 17, Personal Exemptions and Dependents.

### **Revocation of Release of Claim to an Exemption**

Custodial parents can revoke a release of claim to exemption they previously provided to the noncustodial parent on Form 8332 or a similar statement. The custodial parent must provide, or make a reasonable effort to provide, the noncustodial parent with written notice of the revocation in the calendar year prior to the tax

year in which the revocation is to take effect. Part III of Form 8332 can be used for this purpose. Attach a copy of the revocation to the return for each tax year the child is claimed as a dependent as a result of the revocation.



**Tax Software Hint:** The tax software determines the taxpayer's dependency exemptions based on the Dependents/Qualifying Person information entered in the Basic Information section.

Be sure to include and verify all the family and dependent information on the taxpayer's intake and interview sheet before entering the data into the tax software.

For detailed instructions, refer to the Volunteer Resource Guide, Exemptions/Dependency tab, Basic Information section.

## Tax Law Application

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Elaine Smith has one Form W-2 from her clerk job of 36 years, showing wages of \$37,000. She has been divorced from her husband for over 20 years. She pays all the costs of keeping up her home and is the main provider for her seven-year-old granddaughter, Lisa and her 30-year-old son, Todd. Lisa is Todd's niece. Both her son and granddaughter lived with Elaine all year. Her son worked part time and earned \$9,000. He is not disabled. She would like to file a tax return and claim her son and granddaughter as dependents.

### How do I apply the dependency tests to Elaine's son?

Use the interview tips in the Volunteer Resource Guide to apply the test to Elaine's son.

### How do I apply the dependency tests to Elaine's granddaughter?

Use the interview tips in the Volunteer Resource Guide to apply the test to Elaine's granddaughter. You will find that Lisa is a qualifying child of both Elaine and Todd. However, under the tie-breaker rules, Elaine would be entitled to the dependency exemption for Lisa because she has the higher AGI.

## Dependent/Nondependent Determinations

Elaine can claim her granddaughter as a dependency exemption, but not her adult son.

## Summary

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For a taxpayer to claim a dependency exemption, the following conditions must be met:

- The taxpayer may not claim a dependency exemption for a person if the taxpayer may be claimed as a dependent on another taxpayer's return.
- A dependent cannot file a joint return unless the joint return is filed only to claim a refund and no tax liability would exist for either spouse on separate returns.
- A person cannot be claimed as a dependent unless that person is a U.S. citizen, U.S. resident alien, U.S. national, or a resident of Canada or Mexico, for some part of the year. (There is an exception for certain adopted children.)
- A dependent must be either a *qualifying child* or *qualifying relative*.





## Unique Filing Status and Exemption Situations



### Introduction

This lesson will assist you in addressing some filing status issues you may encounter when helping taxpayers who are not U.S. citizens.

This lesson also covers exemption issues related to taxpayers who may have:

- A nonresident alien spouse, or
- Nonresident alien stepchildren (children of a nonresident spouse who is married to U.S. citizen or resident alien)

This lesson does not cover the preparation of returns for taxpayers who are in the U.S. on an F, J, M, or Q visa. Refer taxpayers with one of these visas to a volunteer who is certified to prepare tax returns for foreign students or to a professional tax preparer.

The Foreign Student Course and certification test are part of Link & Learn Taxes, which is available on [www.irs.gov](http://www.irs.gov).

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Determine whether an individual is a resident or nonresident alien
- Determine who can claim the personal exemption for a spouse who is a nonresident alien
- Apply the support test and citizen or resident test to determine whether an individual can be claimed as a dependent
- Apply special rules for Head of Household status when the spouse is a nonresident alien

#### What do I need?

- Form 13614-C
- Publication 4012
- Publication 17
- Optional:**
- Publication 3
- Publication 54
- Publication 519
- Form 1040NR
- Form 1040NR-EZ

### How do I apply tax law to nonresident aliens?

Nonresident aliens can be students, teachers, trainees, or undocumented immigrants. Your role is to determine if the nonresident alien can be treated as a resident alien for tax purposes; most tax rules that apply to a U.S. citizen will also apply to the resident alien, including filing status and exemption issues. Resident aliens and U.S. citizens must report worldwide income on their Form 1040.

Keep in mind that a person is considered married no matter where in the world they were married. It does not matter if one spouse is living in another country. The person who is the resident alien or citizen still must follow tax rules for married persons.

Filing a tax return as a resident alien does not affect the person's immigration status in any way.

### Who is a resident alien or nonresident alien?

Let's begin by looking at the intake and interview sheet. Locate the part of the form where taxpayers and

their spouses indicate whether they are U.S. citizens. In another part of the form, taxpayers indicate citizenship or residency of family members and dependents.

If the taxpayer has checked “No” for U.S. citizen on the intake and interview sheet, you must determine if the person can be treated as a resident alien for tax purposes before continuing. An individual must meet **one** of the following tests to be considered a resident alien for tax purposes:

- Green card test
- Substantial presence test

### **What is the green card test?**

Individuals who were lawful permanent residents of the U.S. at any time during the tax year are resident aliens. They were given the privilege, according to immigration laws, of residing permanently in the U.S. They receive alien registration cards, commonly known as a “green cards,” attesting to this status. Green cards are approximately the size of driver licenses. They are no longer green in color but still hold the name. Most green card holders have valid Social Security numbers and must follow the same tax laws as U.S. citizens, including the requirement to report worldwide income on their tax returns.

### **What is the substantial presence test?**

This test is based on a formula of days and years a person is physically present in the United States. Individuals who do not have green cards may still be considered resident aliens if they meet the requirements of the substantial presence test for the calendar year.

Use the Resident or Nonresident Alien Decision Tree in the Volunteer Resource Guide, Resident/NR Aliens tab, to determine an individual’s residency status for tax purposes. Information can also be found in Publication 17, “Do I have to file?” section.

#### **example**

On their intake sheet, Gloria indicated that her husband, Dante, is not a U.S. citizen. During the interview, you learn that Dante does not have a tax home in another country. He was physically present in the U.S. for 150 days during the current tax year and both of the two prior years. Using the Nonresident Alien or Resident Alien? – Decision Tree below, determine if Dante is a resident alien under the substantial presence test for the tax year.

The decision tree indicates that Dante does meet the substantial presence test and is considered a resident alien for tax purposes. You can assist Gloria and Dante in filing their joint return.

Current tax year: 150 days    Prior year:  $1/3$  of 150 = 50 days    Two years prior:  $1/6$  of 150 days = 25 days

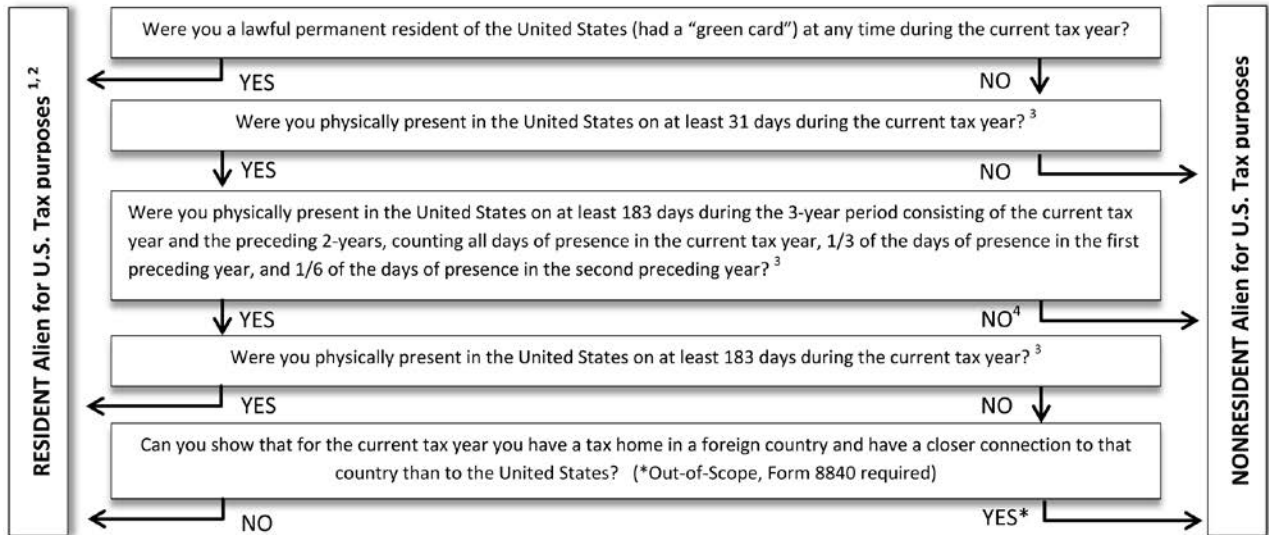
Total = 225 days

The following chart is also included in the Volunteer Resource Guide, Resident/NR Aliens tab.



## Nonresident Alien or Resident Alien? - Decision Tree

Start here to determine your residency status for federal income tax purposes



- 1 If this is your first year of residency, you may have a dual status for the year. See Dual-Status Aliens in Pub 519. (Out-of-Scope)
- 2 In some circumstances you may still be considered a nonresident alien and eligible for benefits under an income tax treaty between the U.S. and your country. Check the provision of the treaty carefully. (Out-of-Scope)
- 3 See *Days of Presence in the United States* in Pub 519 for days that do not count as days of presence in the U.S. (Exempt individuals such as students, scholars, and others temporarily in the U.S. under an F, J, M, or Q visa's immigration status do not count their days of presence in the U.S. for specified periods of time.)
- 4 If you meet the substantial presence test for the following year, you may be able to choose treatment as a U.S. resident alien for part of the current tax year. See *Substantial Presence Test under Resident Aliens and First-Year Choice under Dual Status Aliens* in Pub. 519. (Out-of-Scope)

### What counts as days of presence?

Count any day a person is physically present in the United States, at any time during the day, as a day of presence. There are exceptions to this rule. For example, do not count days a person regularly commutes to work in the United States from their home in Canada or Mexico, or days the person is an exempt individual.

### Who is an exempt individual?

Generally, an exempt individual is a:

- Foreign government-related individual
- Teacher or trainee who is temporarily present under a J or Q visa
- Student who is temporarily present under an F, J, M, or Q visa
- Professional athlete who is temporarily in the United States to compete in a charitable sports event

Do not count the days present in the U.S. for purposes of the substantial presence test for an exempt individual. In general, they will be considered *nonresident aliens for tax purposes* and should file a Form 1040NR or Form 1040NR-EZ if required. Refer these individuals to a VITA site that prepares tax returns for foreign students or to a professional tax preparer.

Publication 519, U.S. Tax Guide for Aliens, has detailed information on determining who is a resident or nonresident alien.



If a person's visa has expired or the person is not complying with the requirements of the visa, then that person is not an exempt individual and cannot exclude those days he or she is physically present in the U.S.

### **What if a nonresident alien meets the substantial presence test?**

Nonresident aliens who meet the substantial presence test are treated as resident aliens for tax purposes. No paperwork or documentation is needed to indicate that a person is a nonresident alien filing as a resident alien under the substantial presence test.

All persons listed on the return must have either a valid Social Security number or an individual tax identification number (ITIN). ITINs are discussed in the Filing Basics lesson.



A return with an ITIN can be e-filed. A return missing an ITIN *cannot* be e-filed.

### **What if a nonresident alien does not meet the green card or substantial presence test?**

If an unmarried nonresident alien does not meet the green card or substantial presence test, refer the taxpayer to a VITA site that handles Foreign Students/Scholars, if appropriate, or a professional tax preparer to file Form 1040NR or Form 1040NR-EZ.

If a U.S. citizen or resident alien is married to a spouse who is not a resident alien using the green card or substantial presence test, you may be able to provide assistance. Their options are discussed next.

#### **example**

Paul, a U.S. citizen, is married to Gabriella, who does not have a green card or a valid visa. They have no children and are not supporting anyone else.

Gabriella lived in the U.S. for 120 days during the current tax year. She was also in the U.S. for 120 days in each of the prior two years. Gabriella does not have a tax home in another country. Does Gabriella meet the substantial presence test?

Following the decision tree, you find that Gabriella does not meet the substantial presence test. For tax purposes, she is considered a nonresident alien.

Current tax year: 120 days    Prior year: 1/3 of 120 days = 40 days    Two years prior: 1/6 of 120 days = 20 days

Total = 180 days



Individuals can be both a nonresident alien and a resident alien during the same tax year. This usually occurs in the year of arrival in or departure from the United States. This is referred to as a dual-status tax year. Individuals with a dual-status for the tax year are out of scope. Refer these individuals to a professional tax preparer. This does not apply to an individual who is married and chooses to be treated as a U.S. resident for the entire year.

### **What are the filing status options?**

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A U.S. citizen or resident alien who is married to a nonresident alien spouse who does not meet either the green card or substantial presence test generally has three filing status options:

- The taxpayer may choose to file as Married Filing Separately
- The couple may choose to file as Married Filing Jointly
- The taxpayer may qualify for Head of Household under the regular rules for a married person who is “considered unmarried” even while living with the nonresident alien spouse

## What happens when a U.S. citizen and nonresident alien spouse file separate returns?

The U.S. citizen can file a Married Filing Separately return and may be able to claim a nonresident alien spouse's personal exemption. The nonresident alien spouse, if required to file a return, would file Form 1040 NR. In this situation, the volunteer can assist in the preparation of Form 1040 for the U.S. citizen but must refer the spouse to a professional tax preparer. Claiming a nonresident alien spouse's personal exemption is covered in more detail in this lesson.

## When can nonresident aliens file a joint return?

A married couple may elect to treat a nonresident alien spouse as a resident alien for tax purposes and file a joint return. If taxpayers make this choice, both spouses are treated for income tax purposes as residents for the entire tax year. Neither spouse can claim under any tax treaty not to be a U.S. resident. Both spouses are taxed on worldwide income.

### *How does a married couple elect to treat the nonresident alien spouse as a resident alien?*

If the nonresident alien spouse agrees to file a joint return, worldwide income of both spouses must be reported. To make this election, a joint return should be paper-filed with an attached declaration, signed by both spouses, stating:

- One spouse was a nonresident alien and the other spouse was a U.S. citizen or resident alien on the last day of the tax year
- They choose to be treated as U.S. residents for the entire year, and
- The name, address, and SSN or ITIN of each spouse

### *How does this election affect the filing status in future years?*

The election continues in future years, but the spouses can file separately after the first year, if they choose. The election to treat the spouse as a resident is terminated by revocation, the death of either spouse, their legal separation, or the IRS may terminate it for failure to keep adequate records. Consult Publication 519 for more details on this option.



For more information, see Publication 17, Filing Status.

### example

In the previous example, you determined that Gabriella, Paul's nonresident alien wife, does not meet either the green card or the substantial presence tests to be considered a resident alien. However, Paul and Gabriella choose to treat Gabriella as a resident alien. They must attach a signed statement to their return that indicates this choice. You can assist Paul and Gabriella in preparing their joint return. They must report their worldwide income for the year and for all later years unless the choice is ended or suspended. Although Paul and Gabriella must file a joint return for the year they make the choice, they may file either joint or separate returns for later years.

## When can a citizen or resident alien, who lives with a nonresident alien spouse, file as Head of Household?

There is an exception that allows U.S. citizens and resident aliens who have a nonresident alien spouse to file as Head of Household. All of the following requirements must be met:

- The taxpayer is a U.S. citizen, or resident alien for the entire year.
- The nonresident alien spouse chooses **not** to file a joint return.

- The taxpayer meets the other requirements for this filing status.
- The spouse is **not a qualifying person** for head of household purposes. The taxpayer must have a qualifying person in order to be eligible for this filing status.



## EXERCISES

Answers are at the end of the lesson summary.

**Question 1:** Gloria’s husband, Dante, meets the substantial presence test. Gloria is a U.S. citizen. They do not have any children and do not support anyone else. Dante is applying for an ITIN. Gloria has an SSN. They live together.

What filing status options do Gloria and Dante have?

**Question 2:** Raul is a U.S. citizen and serving in the U.S. Army in Japan. His wife and his children live with him and he is able to claim the children as dependents. Raul’s wife, a citizen of Japan, chooses not to be treated as a resident alien for tax purposes. She does not want to file a joint return with him.

Raul meets all of the other qualifications for Head of Household. Even though he is married and living with his spouse, can he claim Head of Household status?

Yes  No



**TIP** In the Volunteer Resource Guide, Filing Status tab, note that if a spouse is a nonresident alien, the *living apart* rule does not apply to the taxpayer. This information is also in Publication 17, under Head of Household, Nonresident alien spouse.

### ***Can a taxpayer with a nonresident alien spouse claim the earned income credit?***

Even if a taxpayer is considered unmarried for Head of Household purposes because he or she is married to a nonresident alien, the taxpayer may still be considered married for purposes of the earned income credit. In that case, the taxpayer will not be entitled to the credit. See Publication 596 for more information.

If a taxpayer with a nonresident alien spouse is filing as Head of Household, the Form 1040 Instructions say to enter “NRA” on the head of household line of Form 1040. Additionally, the word “No” should appear on the dotted line next to the earned income credit line of Form 1040.

## **What exemptions can be claimed?**

### **Can a taxpayer claim a personal exemption for a nonresident alien spouse?**

A taxpayer can claim the personal exemption of a nonresident alien spouse who does not choose to file a joint return, if certain tests are met.

Use the Interview Tips for Personal Exemptions in the Volunteer Resource Guide, Exemptions/Dependency tab, to determine if the taxpayer can claim the personal exemption of the nonresident alien spouse. It does not matter if the taxpayer is filing as Married Filing Separately or as Head of Household. For a nonresident alien spouse, income is defined as U.S. source income only. All the other rules apply as stated, including the requirement that the person cannot be claimed as a dependent on another U.S. tax return.

#### example

As mentioned earlier, Raul is a U.S. citizen serving in the U.S. Army in Japan. His wife and children live with him and he is able to claim the children as dependents. Raul’s wife, a citizen of Japan, chooses not to file a joint return with him. Raul can claim his wife’s personal exemption as long as she has no U.S. source income, she is not anyone else’s dependent, and has an SSN or ITIN.

example

Tom is a U.S. citizen. He married Anna, a Korean citizen, during the tax year, but came back to the U.S. without her. Anna is still in Korea getting her paperwork in order. She did not choose to file a joint return with him. Tom is filing as Married Filing Separately. Anna has no U.S. source income and cannot be claimed as a dependent on anyone else's U.S. tax return. She has an ITIN for now. Tom can claim her personal exemption on his tax return.



**Tax Software Hint:** Refer to the Volunteer Resource Guide, Exemptions/Dependency tab, for more information on claiming the spouse's exemption.

### Can a taxpayer claim a dependency exemption for a child born overseas?

A child born overseas to U.S. citizen parents is considered a U.S. citizen for tax purposes. A child can be claimed as a dependent as long as all the other rules for qualifying child or qualifying relative are met.

The birth of a child abroad should be reported as soon as possible to establish an official record of the child's claim to U.S. citizenship. Form FS-240, Consular Report of Birth Abroad, establishes official evidence that the child is a U.S. citizen.

example

Patricia, a U.S. citizen, is married to Gilberto, a nonresident alien from Spain. Their daughter, Eva, was born while they were living in Spain.

Eva is entitled to U.S. citizenship. Eva will need a Social Security number to be claimed as a dependent on her mother's tax return.



While applying for the Consular Report of Birth Abroad, parents should also apply for a Social Security number and passport for their child. Without a Social Security number, the parents will not be able to claim the child as a dependent or take advantage of credits, such as the earned income credit or the child tax credit, even if all of the other prerequisites are met.

### Can a foreign-born stepchild be claimed as a dependent?

Before addressing the dependency exemption question, it is necessary to determine the child's U.S. residency status for tax purposes by answering the questions in the Nonresident Alien or Resident Alien? decision tree. If the foreign-born child is a nonresident alien for tax purposes, the child must be a resident of Canada or Mexico to be claimed as a dependent.

example

Terry, a U.S. citizen, is married to a German citizen whose three children are German citizens and do not have green cards. Terry has not adopted the children. They all live in Germany. The children were not physically present in the U.S. during the tax year.

Since the children are not U.S. citizens and are not residents of the U.S., Canada, or Mexico, Terry cannot claim the children as dependents.

## Can a taxpayer claim an adopted foreign-born child as a dependent?

A U.S. citizen or national can claim a legally adopted child who is not a U.S. citizen, U.S. resident alien, or U.S. national provided the child is a member of the taxpayer's household all year. All the other rules for a qualifying child or qualifying relative must be met, and the child must have a SSN, ITIN, or ATIN to be claimed as a dependent.

An Adoption Taxpayer Identification Number (ATIN) can be obtained when a domestic adoption is pending and other rules are met. An ATIN can be obtained in a foreign adoption when the child already possesses a green card or a certificate of citizenship, which identifies a child born overseas as a U.S. citizen.

See Publication 17, Personal Exemptions and Dependents, for more information about the citizen or resident test, including who is considered a U.S. national.



An adopted nonresident alien child must live with the taxpayer all year to pass the citizen or resident test.



### EXERCISES (continued)

**Question 3:** Terry moved his family to the U.S. in January of the tax year. His stepchildren are still not U.S. citizens and they do not have green cards. They meet the other dependency tests. If he can claim them, he will apply for ITINs for them. Can he claim the stepchildren as dependents on his tax return?

Yes  No

**Question 4:** John, a U.S. citizen, lives in Germany. His wife is a German citizen who has never lived in the U.S. Their two-year-old son was born in Germany. John's 12-year-old stepdaughter, a German citizen whom John has not adopted, also lives with them. John and his wife provide all the support for the two children. How many dependency exemptions can John claim?

- A. One
- B. Two
- C. Three
- D. Zero

## Summary

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Resident aliens follow the same tax laws as U.S. citizens.

To determine the residency status of a noncitizen, use the Nonresident Alien or Resident Alien? decision tree in the Volunteer Resource Guide.

If a citizen or resident alien is married to a person who does not meet the green card or substantial presence test, the couple can elect to treat the nonresident spouse as a resident alien for tax purposes and file a joint return.

A U.S. citizen or resident alien may claim the nonresident alien spouse's personal exemption as long as the spouse:

- Had no U.S. source income
- Cannot be claimed as a dependent on someone else's U.S. tax return, and
- Has an ITIN

A U.S. citizen's child is usually a U.S. citizen by birth, even if the child is born in another country.

A nonresident alien stepchild generally will not pass the citizenship or resident test and therefore cannot be claimed as a dependent, unless the child is a resident of Canada or Mexico.

An adopted nonresident alien child can usually be claimed as a dependent if the child lives with the taxpayer the entire year.

### What situations are out of scope for the VITA/TCE programs?

The following are out of scope for this lesson. While this list may not be all inclusive, it is provided for your awareness only.

- Taxpayers with F, J, M, or Q visas, unless there is a volunteer and quality reviewer at your site with Foreign Student certification
- Nonresident aliens who do not meet the green card or substantial presence test and are not married to a U.S. citizen or resident alien
- Individuals having a dual status for the tax year



### EXERCISE ANSWERS

**Answer 1:** *Since Dante meets the substantial presence test, he is considered a U.S. resident alien for tax purposes and must follow U.S. tax laws. Dante and Gloria can use either the Married Filing Jointly or Married Filing Separately filing status.*

**Answer 2:** *Yes. Raul can claim Head of Household status because his children are his qualifying persons. If Raul did not have a qualifying person, he would have to use the Married Filing Separately filing status since his wife chose not to file a joint return.*

**Answer 3:** *Yes. The children meet the substantial presence test because they were in the United States more than 183 days. Terry's stepchildren are considered resident aliens for tax purposes. As long as the other requirements for qualifying child or qualifying relative are met, Terry can claim the stepchildren as dependents on his tax return. They have to obtain SSNs or ITINs.*

**Answer 4:** *A. John can claim one dependency exemption for his son. The son qualifies as a U.S. citizen because his father is a U.S. citizen. The stepdaughter does not meet the U.S. citizen or resident test. A spouse is never considered a dependent, although John may be able to claim her personal exemption.*







# Income – Wages, Interest, Etc.; Form 1040, Lines 7–11



## Introduction

This is the first of nine lessons covering the Income section of the taxpayer's return. A critical component of completing the taxpayer's return is distinguishing between taxable and nontaxable income and knowing where to report the different types of income on Form 1040, lines 7–21.

## Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Compute taxable and nontaxable income
- Distinguish between earned and unearned income
- Report income correctly on Form 1040, lines 7–11

The income lessons follow the order of the Income section of Form 1040.

The following chart will help you select the appropriate topic for your certification course.

### What do I need?

- Form 13614-C
- Publication 4012
- Publication 17
- Publication 4491-W

#### Optional:

- Form 1040 Instructions
- Schedule B
- Publication 531
- Publication 550
- Publication 926
- Publication 970

Form 1040	Topics	Certification Course			
		Basic	Advanced	Military	International
Line 7	Wages & Reported Tips	■	■		
Line 7	Unreported Tip Income		■		
Line 7	Scholarship and Fellowship Income	■	■		
Line 8	Interest Income	■	■		
Line 9	Dividend Income	■	■		
Line 10	Taxable Refunds	■	■		
Line 11	Alimony Received	■	■		
Line 12	Business Income		■		
Line 13	Capital Gain/Loss		■		
Line 14	Other Gains/Losses	N/A	N/A	N/A	N/A
Line 15	IRA Distributions*	■	■		
Line 16	Pensions/Annuities*	■	■		
Line 17	Rental Income			■	
	Schedule K-1 Distributions		■		
Line 18	Farm Income	N/A	N/A	N/A	N/A
Line 19	Unemployment Compensation	■	■		
Line 20	Social Security Benefits	■	■		
Line 21	Other Income	■	■		
	Foreign Earned Income				■
Line 21	Military Income			■	

\*Basic only if the taxable amount is already determined.

## How do I determine taxable and nontaxable income?

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The Income Quick Reference Guide in the Volunteer Resource Guide, Income tab, includes examples of taxable and nontaxable income.

Gross income is all income received in the form of money, goods, property, and services that is not exempt from tax. It includes income from sources outside the U.S. or from the sale of a primary residence, even if part or all of that income can be excluded. Gross income may include part of Social Security benefits received and certain scholarship and fellowship grants.

- Income that is taxable must be reported on a taxpayer's return and is subject to tax.
- Income that is nontaxable may have to be shown on a taxpayer's return but is exempt from tax.

### What are types of taxable income?

The Income section of Form 1040 is used to report earned and unearned taxable income. The sum of all earned and unearned income is reported on Form 1040, line 22, as total income.

- Earned income – any income received for work, such as wages or business/self-employment income
- Unearned income – any income not produced from work, such as unemployment income or income produced by investments, such as interest on savings, dividends on stocks, or rental income

### What are types of nontaxable or exempt income?

Some nontaxable income such as gifts and inheritances are excludable and not shown on the return.

Exempt income includes such things as interest income produced from certain types of investments. There are some instances when exempt income is shown on the return but not included in the income tax computation, for example, tax-exempt interest income.

Under the Victims of Terrorism Tax Relief Act of 2001, the following amounts are not included in income:

- Certain disability payments received in tax years ending after September 10, 2001, for injuries sustained in a terrorist attack
- Payments from the September 11th Victim Compensation Fund of 2001
- Qualified disaster relief payments made after September 10, 2001, to cover personal, family, living, or funeral expenses incurred because of a terrorist attack
- Death benefits paid by an employer to the survivor of an employee if the benefits are paid because the employee died as a result of a terrorist attack

The Act also provides that the federal income tax liability of those who died as a result of the following attacks is forgiven for certain tax years:

- The September 11, 2001, attacks on the World Trade Center, the Pentagon, and United Airlines Flight 93 in Somerset County, Pennsylvania
- Terrorist attacks involving anthrax occurring after September 10, 2001, and before January 1, 2002
- The April 19, 1995, attack on the Alfred P. Murrah Federal Building

For additional details, see Publication 3920, Tax Relief for Victims of Terrorist Attacks.

## How do I get started?

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To determine a taxpayer's income, discuss and review the Income section of the intake and interview sheet with the taxpayer.

Income is reported on a variety of forms depending on its source. Ask the taxpayer to show you all Forms W-2, Forms 1099, and other statements reporting income. (Do not confuse Form 1099 with Form 1098. Generally, Form 1098 reports expenses the taxpayers have paid, not income they have received.)



**Tax Software Hint:** After you have collected all the income statements, review the pages on Income Documents and How/Where to Enter Income in the Volunteer Resource Guide, Income tab. These pages will show you where to correctly report income items.



## How do I report wages, salaries, tips, etc.?

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### What is Form W-2?

Most employers issue a standardized version of Form W-2, Wage and Tax Statement. Go to [www.irs.gov](http://www.irs.gov) to view Form W-2.

Employers must report wages and other employee compensation on Form W-2. Employers are not required to mail Forms W-2, but they must make them available to employees by January 31. Employees may need to pick up Form W-2 from their employers or obtain it electronically.



Additional Medicare Tax applies to an individual's wages, Railroad Retirement Tax Act compensation, and self-employment income that exceeds a threshold amount based on the individual's filing status. This topic is out of scope for the VITA/TCE programs. Taxpayers affected by the Additional Medicare Tax should be referred to a professional tax preparer. Additional information can be found on [www.irs.gov](http://www.irs.gov).



A Form W-2 with code Q in box 12, indicating combat pay, requires Military certification to complete the return.

### ***What if the taxpayer does not receive Form W-2 by January 31?***

Taxpayers who do not receive Form W-2 by January 31 should first contact the employer and find out if, or when, the form was mailed, or if it can be picked up or accessed online.

If Form W-2 is still not received after allowing a reasonable amount of time for the employer to issue or reissue it, then the taxpayer should contact the IRS for assistance at 1-800-829-1040, but not before February 15.

If taxpayers do not receive Form W-2 before the filing deadline, they should file their tax return with Form 4852, Substitute for Form W-2, Wage and Tax Statement, or Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc. Taxpayers should keep a copy of Form 4852 for their records. Usually Form 4852 can be filed with a state return as well.



If the taxpayer eventually receives the employer's Form W-2, and the numbers differ from those on Form 4852, the taxpayer will need to amend the return to report the correct amounts.

If the earnings reported on Form 4852 are not reflected on the yearly Social Security Statement, the taxpayer should contact the Social Security Administration at the number shown on the statement.



**Tax Software Hint:** Refer to the Volunteer Resource Guide, Income tab, for instructions on entering income. Once you enter all Forms W-2 into the software, it automatically reports the total on Form 1040, line 7, and transfers necessary information for credits, deductions, withholding, etc., to other sections of the tax return.

#### example

During the tax year, Tina earned income from both a full-time and a part-time job. She received two Forms W-2, each listing different employers. Her return will list her wages as the total of the amounts in box 1, but each Form W-2 must be entered into the tax software separately.

## Other W-2 Income

### *What about income received by household employees?*

The term “household employee” refers to one who works in someone’s home performing household duties such as caring for children, cleaning, or cooking. Generally, an employer is not required to provide Form W-2 to a household employee who earns less than the threshold amount for that year. In this situation, neither the employer nor the employee will owe Social Security or Medicare tax on those wages. However, employers who withhold federal income taxes from their employee’s wages must issue Form W-2. Regardless of whether Form W-2 is issued, the income must be included on Form 1040, line 7.

In-home care providers may receive a Form W-2 with Medicaid waiver payments that are excludable from gross income. This is discussed in more detail in the business income lesson, but also applies when such payments are reported on Form W-2.



For further information and a definition of who is a household employee, see Publication 926, Household Employers Tax Guide.



## Tip Income



Self-employed taxpayers who receive tips, such as hair stylists and manicurists, should include their tips in gross receipts on Schedule C.

If taxpayers have jobs in which tips are normally received (e.g., waiter/waitress, bellhop, or motel/hotel housekeeper), be sure to ask about any tips they may have received. All tip income is taxable, whether or not it is reported to the employer.

If individuals receive more than \$20 per month in tips at one job and report their tip income to their employer, the tips will be included in the amount on Form W-2, boxes 1, 5, and 7.

### Allocated Tips

To ensure that everyone reports their fair share of income from tips, some employers have tip allocation programs. These programs are approved by the IRS. If an employee reports tips to the employer that were less than the designated share based on the employer’s formula, the employer reports the difference as “allocated tips” and includes it on the employee’s Form W-2.

Allocated tips are shown separately in Form W-2, box 8. Social Security and Medicare taxes are not withheld on allocated tips. Allocated tips are not included in the amount in Form W-2, box 1. Explain to the

taxpayers that unless they kept a written and reliable record of tips actually received at that job and can prove the allocated amount is inaccurate, the allocated tips must be included in Form 1040, line 7.



**Tax Software Hint:** When allocated tips are reported on Form W-2, the software automatically adds them to Form 1040, line 7, and also completes Form 4137.



## Unreported Tips

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If Form W-2 includes allocated tips, but the amount varies from the taxpayer's reliable written record of the tips they received, then the taxpayer's figures are used instead of the amount in Form W-2, box 8.

### Other Tips

- The individual is not required to report tip income to their employer if it is \$20 or less per month. Since these tips are subject to federal income tax, ask taxpayers if they have any tip income that was not reported to their employer.
- Noncash tips (e.g., tickets or passes) do not have to be reported to the employer, but must be included as taxable income at their fair market value.
- Tips of less than \$20 per month or noncash tips are not subject to Social Security and Medicare taxes.
- If tips of more than \$20 a month were not reported to the employer, the taxpayer must also pay Social Security and Medicare taxes.
- Complete Form 4137 if the taxpayer received tips that were not reported to the employer. This form calculates the appropriate income, Social Security, and Medicare taxes.



**Tax Software Hint:** If the taxpayer has unreported tip income, enter the income on Form W-2, unreported tip income box. This will complete Form 4137. Refer to the Volunteer Resource Guide, Income tab, for instructions on how to enter tip income.



For more information about tip income, see Publication 531, Reporting Tip Income.



## Scholarship and Fellowship Income

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### Are scholarships and fellowships taxable income?

#### *Form W-2 and Form 1098-T*

Scholarships and fellowships may be fully or partially taxable, or nontaxable. Taxable amounts include:

- Payment for services
- Money used for personal living expenses, such as room and board

If the taxpayer received Form W-2 for the scholarship or fellowship, include the amount on Form 1040, line 7, just as you would for any other Form W-2.

Form 1098-T lists qualified tuition and related expenses billed by the school. Verify that these amounts have been paid. It also lists scholarship and grant money the student received. If scholarships or grants exceed the qualified educational costs, some of the grant or scholarship money may be taxable.

In certain situations, the student may choose to include all or part of certain scholarships or fellowship grants in income in order to increase an education credit. This is explained in the education credits lesson, and examples can be found in the Form 8863 Instructions and Publication 970, Tax Benefits for Education.

### **What about loan repayment assistance programs (LRAPs) for health care professionals?**

Education loan repayments are not taxable if they are made to taxpayers by:

- The National Health Service Corps Loan Repayment Program
- A state education loan repayment program eligible for funds under the Public Health Service Act, or
- Any other state loan repayment or loan forgiveness program that promotes increased availability of health professionals/services in underserved areas

### **What about ministers or other members of the clergy?**

The ministry profession presents unique issues, such as the parsonage/housing allowance, whether earnings are covered under FICA or SECA (self employment tax), and the rules for being exempt. Publication 517, Social Security and Other Information for Members of the Clergy and Religious Workers, covers this topic. This information is provided for awareness only and is out of scope for the VITA/TCE programs. Taxpayers who have these issues should be referred to a professional tax preparer.

### **What interest is taxable?**

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Common sources of taxable interest income are checking and savings accounts, certificates of deposit (CDs), savings certificates, U.S. government bonds, interest on insurance proceeds, and loans that the taxpayer makes to others. Some savings and loans, credit unions, and banks call their distributions “dividends.” These distributions are really interest and are reported correctly as interest on Form 1099-INT.



If a taxpayer received less than \$10 in interest, the financial institution might not issue Form 1099-INT. Even if the taxpayer did not receive Form 1099-INT, they must still report all of their taxable interest income.

### **Where do I get interest income information?**

There are many sources of information about interest income. Ask the taxpayer to supply all Form(s) 1099-INT from institutions that pay interest. Some institutions issue a year-end statement with the title “In lieu of Form 1099-INT or Form 1099-DIV” rather than preparing multiple documents.

Original Issue Discount (OID) is a form of interest. A debt instrument generally has OID when issued for an amount that is less than its stated redemption price at maturity. The issuer of the debt instrument will report the amount of OID that is currently taxable on Form 1099-OID, Original Issue Discount, or a similar statement.

If the taxpayers cashed in Series EE or Series I bonds, they should have a Form 1099-INT from the bank. Most taxpayers report the total interest when they cash the bonds. Some taxpayers may report savings bond interest as it accrues each year. This method is out of scope for the volunteer program and taxpayers should be referred to a professional tax preparer.



Interest on qualified U.S. Series EE and Series I savings bonds that are used to pay for higher education expenses may be eligible for exclusion from income using Form 8815, Exclusion of Interest From Series EE and Series I U.S. Savings Bonds Issued After 1989.



A Net Investment Income Tax applies to individuals, estates and trusts that have certain investment income above certain threshold amounts. This topic is out of scope for the VITA/TCE programs. Taxpayers affected by the Net Investment Income Tax should be referred to a professional tax preparer. Additional information can be found on [www.irs.gov](http://www.irs.gov).

If a U.S. savings bond is issued in the names of co-owners, such as the taxpayer and child, or the taxpayer and spouse, interest on the bond is generally taxable to the co-owner who purchased the bond. To determine who is responsible for paying the tax on the interest from the redemption of a bond, see Publication 17, Interest Income.

- Taxpayers with Series HH bonds receive interest twice a year.
- Ask the taxpayer for the bank statements reporting the interest received.
- Ask if the taxpayer holds any loans or seller-financed mortgages.



The manner of reporting interest income on Series E, Series EE, or Series I U.S. savings bonds, after the death of the owner (decedent), depends on the accounting and income-reporting methods previously used by the decedent. See Publication 550 for additional information.

#### example

Bob holds a promissory note for a cash loan that he made to his brother-in-law, Stan. Stan pays Bob principal and interest each month. Even though Bob does not receive a Form 1099-INT, he reports that interest on Schedule B of his tax return.

#### example

Hazel has four savings accounts in four different banks. The total amount of interest earned from the accounts is \$3,000. Hazel will receive four Forms 1099-INT. She will list each payer and amount on Schedule B and file it with her tax return.

### What interest income is tax-exempt?

Certain types of interest are exempt from federal income tax. However, they may be taxable by the state, and sometimes the reverse is true; the interest may be taxable on the federal return and exempt from state income tax.

Interest from bonds issued by the following are exempt from federal income tax:

- State and political subdivisions (county or city)
- District of Columbia
- U.S. possessions and political subdivisions
- Port authorities
- Toll-road commissions
- Utility service authorities
- Community redevelopment agencies

- Qualified volunteer fire departments
- Amounts indicated on broker statements as tax-exempt interest or tax-exempt dividends

Read the taxpayer's Form(s) 1099-INT carefully; both taxable and tax-exempt interest may be listed.

Interest from Private Activity Bonds (PAB) may be shown on the interest statement. It is a subset of tax-exempt interest and may impact the Alternative Minimum Tax. Taxpayers who are subject to the Alternative Minimum Tax should be referred to a professional tax preparer.

Although tax-exempt interest is not taxable, it must be reported on Form 1040, line 8b. Tax-exempt interest is used in calculating the taxability of some income items, such as Social Security benefits.

### **What if a bond is sold between interest payment dates?**

If a bond is sold between interest payment dates, part of the sales price represents interest accrued to the date of the sale. This amount is taxable to the seller and must be reported as interest income for that tax year, even if the seller does not receive a Form 1099-INT. The buyers of the bond may receive a 1099-INT reflecting the accrued interest and will treat this amount as a return of capital investment, reducing their basis in the bond. This topic is complex and is out-of-scope for the VITA/TCE programs. Taxpayers who buy or sell bonds between interest payment dates should be referred to a professional tax preparer. If taxpayers would like additional information, refer them to Publication 550, Investment Income and Expenses.



**Tax Software Hint:** To review information related to the software, go to the Volunteer Resource Guide, Income tab, Interest Income entries.

### **What about the interest on an IRA?**

Generally interest on a Roth IRA is not taxable. However, if the criteria for distribution are not followed, the interest is taxable.

Interest on a traditional IRA is tax-deferred. Do not include that interest in taxable income until the taxpayer receives distributions from the IRA, which will be reported on Form 1099-R. See the Retirement Income lesson, Publication 17, and Publication 590 for more information on IRAs.

#### **example**

Mike makes contributions to a traditional IRA each year. Throughout the year, he gets statements listing the interest earned. Because it is tax-deferred, he does not report any of the interest income from his traditional IRA on his tax return.

### **How do I report interest income?**

Interest income is entered on Form 1040, line 8a or line 8b. Amounts labeled Interest income and Interest on U.S. Savings Bonds and Treasury obligations on Form 1099-INT are reported as taxable interest. Be sure to enter any tax-exempt interest as directed in the software.

If the taxpayer receives Form 1099-OID, report as interest the amounts in boxes labeled Original issue discount, Other periodic interest, and Original issue discount on U.S. Treasury obligations. Ensure that other amounts on Forms 1099-INT and 1099-OID are entered in their proper places on Form 1040. These will be discussed in later lessons. For example, amounts labeled early withdrawal penalty are entered in the Adjustments section and any federal income tax withheld is entered in the Payments section. Investment expenses will be discussed in the Itemized Deductions lesson, and entries for foreign tax paid and foreign country will be discussed in the Foreign Tax Credit lesson.

On Form 1099-INT, if the box labeled Specified private activity bond interest contains an amount, the alternative minimum tax (AMT) may apply, and the taxpayer should be referred to a professional tax preparer. If



taxpayers indicate there are adjustments needed for any of the amounts listed on Form 1099-OID, or if they have income from original issue discount but did not receive a Form 1099-OID, refer them to a professional tax preparer to ensure the correct amount is reported.



**Tax Software Hint:** Refer to the Volunteer Resource Guide, Income tab, for instructions on entering interest income. The software will file Schedule B if required.

## Taxpayer Interview and Tax Law Application

Barbara Smith is a clerk with the United States Postal Service. She has one Form W-2.

### SAMPLE INTERVIEW

VOLUNTEER SAYS...

BARBARA RESPONDS...

*Now we will complete the income section of your return. I believe you told me that you work at the post office?*

Yes. Here is my W-2.

*Are you employed by anyone else?*

No way, they keep me busy enough at the post office!

*Did you have any disability income?*

No, I'm not disabled.

*Now, let's go on to interest income. Did you earn any interest on checking accounts, savings accounts, or a certificate of deposit?*

Yes, I have a savings account that earns interest. Here is the 1099-INT.

*What about U.S. savings bonds? I know that a lot of postal employees buy them at work.*

Yes, I do, every pay period.

*Are they for educational purposes, or just an investment?*

No, they aren't educational. I don't have any information about my bonds with me. Why would I need that?

*Some people report the interest as it accrues every year. You have to make this decision in the first year after you buy the bonds. Have you ever declared accrued interest from your savings bonds on your federal tax return?*

Oh, no, never.

*Well, did you redeem any bonds, or did any of them mature during this tax year?*

No to both questions. I've been buying them for 15 years and they don't become fully mature for 30 years.

*Okay, then it sounds like your only interest income is from the savings account.*



## How do I handle dividends?

The corporate distributions that volunteer tax preparers may handle are:

- Ordinary dividends
- Qualified dividends
- Capital gain distributions
- Nondividend distributions

These are all found on Form 1099-DIV.



If the FATCA (Foreign Account Tax Compliance Act) filing requirement box is checked on Forms 1099-INT, 1099-DIV, or other income reporting document, the taxpayer may have a FATCA filing requirement. Refer these taxpayers to a professional tax preparer.

## What are ordinary dividends?

Ordinary dividends are corporate distributions paid out of the earnings and profits of the corporation. Any dividend received on common or preferred stock is an ordinary dividend unless the paying corporation states otherwise. Total ordinary dividends are reported on Form 1099-DIV.

### example

Olivia held both common stock and preferred stock in several U.S. corporations. Several of them paid dividends during the tax year. The following January, she received Forms 1099-DIV listing these as ordinary dividends.

## What are qualified dividends?

Qualified dividends are ordinary dividends that qualify for lower, long-term capital gains tax rates. See Publication 17, Dividends and Other Distributions, for a detailed definition of qualified dividends.

Taxpayers who have questions about why a dividend is qualified or not qualified should contact the company that issued the dividend.

## What are capital gain distributions?

Capital gain distributions are also called capital gain dividends. They come from mutual funds and real estate investment trusts (REITs). They are taxed at the lower long-term capital gains rate, regardless of how long the taxpayer holds the shares. Capital gain distributions are reported to the taxpayer on Form 1099-DIV. The taxpayer reports these distributions as long-term capital gains on Form 1040, line 13, and on Schedule D if required.



Capital gains are not the same as capital gain distributions. A capital gain *distribution* is the owner's portion of the capital gains that were realized when the mutual fund or REIT sold assets. A volunteer with a Basic certification can prepare a return with this type of income.

A capital gain occurs when the owner of a mutual fund or other capital asset sells the asset for more than its cost. A volunteer must have Advanced certification to prepare a return for taxpayers who actually sold mutual fund shares, or other shares of stock.

## What are nondividend distributions?

Form 1099-DIV also shows nondividend distributions, part of a distribution that is nontaxable because it is a return of the taxpayer's cost or other basis. Taxpayers should keep this information with their tax records in order to calculate the adjusted basis of the stock when it is sold.

## Where do I get dividend information?

Most corporations use Form 1099-DIV to report dividend distributions to each shareholder. Ask the taxpayer for any Form(s) 1099-DIV. If the taxpayers did not receive a Form 1099-DIV for a dividend, ask if they received the information on their annual brokerage statement.

### example

During the tax year, Olivia owned shares in a mutual fund and in a real estate investment trust. Both made capital gain distributions that year. The following January, she received Forms 1099-DIV listing these capital gain distributions.

## How do I report dividend information?

Generally, all dividend income is reported on Form 1040, lines 9a and 9b. Schedule B may be needed if the taxpayer's ordinary dividends exceed a specified amount, or if the taxpayer was the nominee for dividends that actually belong to someone else. On Form 1099-DIV, amounts included in boxes labeled Unrecap. Sec. 1250 gain, Section 1202 gain, Cash liquidation distributions, and Noncash liquidation distributions are out of scope for the VITA/TCE programs. Refer taxpayers with amounts in these boxes to a professional tax preparer.

Any federal income tax withheld is reported in the Payments section of the return. Investment expenses will be covered later in the Itemized Deductions lesson. Foreign tax paid will be covered in the Foreign Tax Credit lesson.



**Tax Software Hint:** Review the Volunteer Resource Guide, Income tab, for guidance for entering dividend income. If the taxpayer has multiple accounts, the software adds all the dividends for you, preventing math errors.

## Taxpayer Interview and Tax Law Application

Leonard and Gloria are filing a joint return. Leonard and the volunteer are discussing dividend income.

### SAMPLE INTERVIEW

VOLUNTEER SAYS...

LEONARD RESPONDS...

*Do you and your wife own shares of stock, mutual funds, or bond funds?*

Yes, I have an IRA and I own shares in several mutual funds and a bond fund. My wife has an IRA. Here are the statements.

*The earnings on the IRAs are tax deferred until you take a distribution. These 1099-DIVs are what we want right now.*

Yes

*Are these the only Forms 1099-DIV that you received?*

*We will enter the information from each of these in the tax software. It will add everything up and display it properly on your tax return.*

## What should be reported on Form 1040, line 10?

Taxpayers who receive a refund of state or local income taxes may receive Form 1099-G listing their refund amount(s). Not everyone must include the refund in their taxable income.

- Taxpayers who claimed the standard deduction on the tax return for the year they received a refund of state or local income taxes do not have to include the refund in their taxable income.
- Taxpayers who itemized deductions and received a state or local refund may have to include all, part, or none of the refund in their federal taxable income.



**CAUTION** Refer taxpayers who received a state or local income tax refund for a year other than the previous tax year to a professional tax preparer.

Only taxpayers who itemized and received a federal income tax benefit for deducting their state or local income taxes have to include their state/local tax refunds in income. If they itemized and deducted the state sales tax instead of the state income tax withheld, none of the refund is taxable.

#### example

Nancy itemized her deductions on last year's federal return. She included the income taxes paid to her state on Schedule A. During the current tax year, she received a state refund on the overpaid portion of those taxes. When filing her current year tax return, she must use the state tax refund worksheet to see how much of the refund to include in her federal taxable income.



**Tax Software Hint:** Refer to the Volunteer Resource Guide, Income tab, for guidance on entering the state tax refund received in a prior year. The software calculates the taxable part of the refund (if any) and enters the amount on Form 1040, line 10.

## What is alimony?

Alimony is a payment to or for a spouse or former spouse under a separation or divorce instrument. It may include payments on behalf of the spouse or former spouse, such as medical bills, housing costs, and other expenses. It does not include child support or voluntary payments outside the instrument. The person receiving alimony must include it as income. The person paying alimony can subtract it as an adjustment to income. This will be discussed in a later lesson.



If the taxpayer is unsure whether a payment is alimony or child support, ask if the payments will stop once the child is grown.



This training covers alimony paid under a divorce or separation instrument executed after 1984. Other rules apply to agreements executed before 1985. If the agreement was executed before 1985, refer the taxpayer to a professional tax preparer.

## Where do I get alimony information?

Ask if the taxpayer received alimony under a divorce or separation instrument. If so, explain that you need the exact amount, since it may also be reported as a deduction by the taxpayer, and the two amounts must agree.

## How do I report alimony income?



**Tax Software Hint:** Enter any alimony income on the alimony received screen. The Social Security number of the person paying the alimony is not needed.

## Summary

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This lesson covered income reported on Form 1040, lines 7–11, including how to differentiate taxable and nontaxable income, and earned or unearned income.

- Earned income is any income received for work, such as wages or business/self-employment income.
- Unearned income is any income produced by investments, such as interest on savings, dividends on stocks, or rental income.
- Form 1040, line 7 income includes wages, salaries, tips, and scholarships, generally reported to the taxpayer on Form W-2.
- Common sources of taxable interest income are checking and savings accounts, certificates of deposit (CDs), savings certificates, or U.S. government bonds. This interest is reported by the payer on Form 1099-INT and included in the taxpayer's income on Form 1040, line 8.
- Interest on certain bonds, such as from state political subdivisions, District of Columbia, or port authorities, are exempt from federal income tax but must be reported on Form 1040, line 8b.
- Lines 9a and 9b on Form 1040 are for reporting ordinary and qualified dividends. Dividends are reported to the taxpayer on Form 1099-DIV. Ordinary dividends are corporate distributions paid out of the earnings and profits of a corporation. Qualified dividends are ordinary dividends that qualify for lower, long-term capital gains tax rates. Capital gain distributions are reported on Form 1040, line 13, and Schedule D, if required.
- Form 1040, line 10 is for taxpayers who received a state or local income tax refund. Taxpayers who itemized deductions in the previous year and received a tax benefit from deducting state or local income taxes may have to report part or all of their refund as income. Taxpayers generally receive Form 1099-G reporting their state or local tax refund.
- Alimony is income received from a spouse or former spouse under a separation or divorce instrument. It is reported on Form 1040, line 11.

### What situations are out of scope for the VITA/TCE programs?

The following are out of scope for this lesson. While this list may not be all inclusive, it is provided for your awareness only.

- Taxpayers with income from the following sources reported on Form 1040:
  - Other gains/losses (line 14)
  - Farm income (line 18)
- Taxpayers affected by the Additional Medicare Tax
- Certain children with unearned income who must file Form 8615
- Accrual method for reporting income
- Taxpayers who buy or sell bonds between interest payment dates
- Form 1099-INT, box labeled Specified private activity bond interest if AMT applies
- Adjustments needed for any of the amounts listed on Form 1099-OID, or if the taxpayer should have received Form 1099-OID but did not receive one
- Form 1099-DIV, boxes labeled Unrecap. Sec. 1250 gain, Section 1202 gain, Cash liquidation distributions, and Noncash liquidation distributions
- State or local income tax refunds received during the current tax year for a year other than the previous tax year
- Alimony/divorce agreements executed before 1985
- Tax returns for ministers and members of the clergy because of unique tax issues





## Income – Business; Form 1040, Line 12



### Introduction

This lesson will help you prepare an accurate return for taxpayers who have business income, including self-employment income. Form 1040, line 12, is used to report income from a business or profession operated as a sole proprietor or independent contractor.

Preparation of tax returns with Schedule C are in scope for VITA/TCE under certain limited conditions and with expenses of \$25,000 or less.

This lesson covers recordkeeping requirements for taxpayers with business income and expenses. Refer to Publication 583, *Starting a Business and Keeping Records*, for more information. You will learn how business income affects eligibility for certain tax credits.

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Determine how to report business income
- Determine when to complete Schedule C-EZ or C
- Determine what business expenses are within the scope for the VITA/TCE programs
- Identify “red flags” when preparing a Schedule C return with earned income credit (EIC)
- Determine what records to maintain

#### What do I need?

- Form 13614-C
- Publication 4012
- Publication 17
- Publication 463
- Publication 4491-W
- Form 1099-MISC
- Schedule C
- Schedule C Instructions
- Schedule C-EZ
- Schedule SE
- Optional:**
- Publication 535
- Publication 583
- Form 1099-K
- Form 1099-K Instructions

### Where do I get business income information?

Business income information may come from the following:

- Forms 1099-MISC, Miscellaneous Income, box 7, Nonemployee Compensation
- Forms W-2, Wage and Tax Statement with Statutory Employee checked in box 13
- Taxpayer’s books and records
- Forms 1099-K, Merchant Card and Third Party Payments

Based on your interview and the completion of the taxpayer’s intake and interview sheet, you may discover that the taxpayer or spouse had business income from being self-employed or working as an independent contractor. Taxpayers are self-employed if they carry on an unincorporated trade or business as a sole proprietor or independent contractor. These taxpayers may not have income statements for their business income and expenses. The information to prepare their tax return comes from their records.

Carefully review the intake and interview sheet and ask follow-up questions to determine if the taxpayer or spouse had business income. Taxpayers may not think of themselves as “self-employed” if they have a small home business or work part-time as an independent contractor.



Income received from all sources in a self-employed taxpayer's business must be reported, unless excluded by law.

### **Cash Income**

Some taxpayers may indicate that they received cash income for self-employment activity. This income must be reported, unless excluded by law.

If taxpayers do not have adequate records of the cash income they received, you may be able to assist them with simple record reconstruction. See the section on reconstructing records later in this lesson.

### **Form 1099-MISC, Miscellaneous Income**

Taxpayers who are independent contractors should receive Form 1099-MISC showing the income they earned from payers who are required to file Forms 1099. The amount from Form(s) 1099-MISC, along with any other business income payments, are reported on their tax return.

A taxpayer does not have to conduct regular full-time business activities to be self-employed. Having a part-time business in addition to a regular job or business may be self-employment. Ask for any Form(s) 1099-MISC that document this income. Subcontractors or individuals (including for-hire drivers) who receive less than \$600 may not receive Form 1099-MISC, but still must report all cash income. Also ask for documentation of any business income that was not reported on Form W-2 or Form 1099-MISC (e.g., payments received from individual clients who do not need to file Form 1099).

#### **example**

Tim works as an independent contractor for ABC Construction Company. The company sent Tim a Form 1099-MISC that shows he received \$15,000 for the work he did for them. He also received cash payments of \$4,000 from several different individuals for the work he completed. He did not receive Forms 1099-MISC for the \$4,000. Tim must include the \$4,000 cash payments as self-employment income along with the \$15,000 from Form 1099-MISC.

### **Form 1099-K Income**

Form 1099-K, Payment Card and Third Party Network Transactions, may be used to report income for taxpayers who use their automobiles for hire or ride share services such as Uber, Lyft, Sidecar, etc. Taxpayers may not receive the Form 1099-K if the amount is less than \$600.

### **Qualified Medicaid Waiver Payments**

Qualified Medicaid waiver payments are treated as difficulty of care payments and are **excludable from gross income**. Medicaid payments for in-home care are classified as Medicaid waiver payments when the care provider and the care recipient reside in the same home.



Excluded Medicaid waiver payments are not earned income for the earned income credit, for the dependent care credit, nor the additional child tax credit.

If the taxpayer received payments described in Notice 2014-7 on or after January 3, 2014, that are excludable from gross income as difficulty of care payments, then the taxpayer must exclude the income under section 131 as provided in Notice 2014-7 for 2014 and later years.

When the care provider and the care recipient do not live together in the same home, the Medicaid payments are fully taxable.

The taxpayer may file a Form 1040X, Amended U.S. Individual Income Tax Return, if they received payments described in Notice 2014-7 in an earlier year if the time for claiming a credit or refund is still open.



Generally, for a credit or refund, the taxpayer must file Form 1040X within three years (including extensions) after the date the taxpayer filed their original return or within two years after the date they paid the tax, whichever is later.

In Part III of Form 1040X, the taxpayer should explain that the payments are excludable under Notice 2014-7. Excluding payments described in the notice in an earlier year may affect deductions or credits that were claimed for the earlier year, as well as other tax items for the earlier year.

For more information, go to [irs.gov](http://irs.gov) and search for Certain Medicaid Waiver Payments.

## How is business income reported?

### **Form 1040**

Form 1040, line 12, is used to report income from a business operated or a profession practiced as a sole proprietor. Schedule C-EZ or Schedule C shows the income and expenses and the net amount is carried to Form 1040, line 12. An activity qualifies as a business if the primary purpose for engaging in the activity is for income or profit and the taxpayer is involved in the activity with continuity and regularity. For example, a sporadic activity or a hobby does not qualify as a business. A hobby is an activity typically undertaken for pleasure during leisure time.

To report income from an activity not for profit, see the instructions for Form 1040, line 21, and Publication 17, Other Income. This topic is out of scope. Refer any taxpayers with not-for-profit activity to a professional tax preparer.

Form 1040, line 12, is also used to report wages and expenses the taxpayer had as a statutory employee or certain income shown on Form 1099-MISC, Miscellaneous Income.



Some employers misclassify workers as independent contractors and report their earnings on Form 1099-MISC. Taxpayers who believe they have been misclassified should contact the IRS and ask for help.

### **Schedule C-EZ and Schedule C**

Business income is reported on either:

- Schedule C-EZ, Net Profit From Business, or
- Schedule C, Profit or Loss From Business

If preparing Schedule C, Part I, the following are out of scope for VITA/TCE programs: return and allowances, cost of goods sold (involves inventory), and other income. Taxpayers with these items should be referred to a professional tax preparer.

Figure the net profit or loss by subtracting the business expenses from business income. The total profit or loss is then transferred to Form 1040, line 12.



Volunteer tax preparers who have Advanced certification can assist with preparation of Schedule C-EZ and the limited Schedule C.

The net profit or loss will be reported on Form 1040, line 12. The net profit will also need to be shown on Schedule SE in order to calculate the self-employment tax. Schedule SE will be covered in a later lesson.



**Tax Software Hint:** The tax software calculates net profit after income and expense entries are made. Next, the software transfers the net profit to the applicable line on Schedule SE to compute the self-employment tax. Amounts are then transferred to the applicable lines of Form 1040.

The following terms are used in the preparation of business returns:

Definition of Terms	
Business expenses	Business expenses are amounts that are ordinary and necessary to carry on the business.
Cash method of accounting	The cash method of accounting reports all income when received and deducts all expenses when paid.
Inventory	Inventory is the items the taxpayer buys or makes for resale to others. Taxpayers having inventory should be referred to a professional tax preparer.
Depreciation	The cost of items that are expected to last more than a year should be spread over a period of years rather than deducted in the year of purchase. If the taxpayers have such a cost, they should be referred to a professional tax preparer.
Asset write-off	An election is available to immediately write off qualifying assets. Taxpayers who wish to write off assets should be referred to a professional tax preparer.

### Who can use Schedule C-EZ?

There are a number of conditions taxpayers must meet in order to use Schedule C-EZ. Taxpayers can use Schedule C-EZ only if they:

- Have less than \$5,000 in business expenses
- Use the cash method of accounting
- Have no inventory at any time during the year
- Did not have a net loss from the business
- Operate only one business as a sole proprietor during the tax year (each spouse on a joint return may use a separate Schedule C-EZ to report business income from separately owned sole-proprietor businesses if other conditions for filing Schedule C-EZ are met)
- Have no employees during the year, or paid contract labor for services
- Are not required to file Form 4562, Depreciation and Amortization, for this business (depreciation and asset write-offs are out of scope for the VITA/TCE programs)
- Do not deduct expenses for business use of a home
- Do not have prior year unallowed passive activity losses from this business

In the interview, if you discover taxpayers have issues that fall outside the scope of the VITA/TCE programs, refer them to a professional tax preparer.

### Who can use Schedule C for purposes of the VITA/TCE programs?

Volunteers can assist taxpayers who have returns that require Schedule C with certain limits. Use the same criteria as Schedule C-EZ, except taxpayers can have expenses up to \$25,000, and more than one Schedule C can be prepared if the taxpayers have more than one business. If taxpayers have a Schedule C that falls outside these parameters, refer them to a professional tax preparer.

## Taxpayer Interview and Tax Law Application

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As you review the intake and interview sheet with taxpayers, ask questions to determine if they have any self-employment income, their accounting method, and their business expenses, as shown in this sample interview:

## SAMPLE INTERVIEW

VOLUNTEER SAYS...	JASON RESPONDS...
<i>What kind of business do you have and were you the sole owner?</i>	I install air conditioners and yes, I own the business myself. No partners or employees.
<i>Do you have a record of your business income and expenses for last year?</i>	Yeah, I've got a separate checking account for my business. I had a pretty decent first year actually.
<i>Do you use the cash method of accounting?</i>	Yes, I have a printout of my year-end summary here.
<i>And what were your expenses?</i>	Well, I do the installations myself; I spend a lot of money on parts, tools that last less than a year, and equipment repairs. My expenses for the year were \$2,212.
<i>Do you keep any parts in inventory?</i>	No, I purchase the parts when an order is placed with me.
<i>And you say you had a good year? In other words, did you make a profit?</i>	That's correct.
<i>Do you plan on deducting expenses for the business use of your home?</i>	No, I don't.
<i>Okay, and how much business income did you have?</i>	My gross totaled \$30,762.

[On page 2 of the intake and interview sheet, indicate Jason's responses to these questions.]



### EXERCISE

**Question 1:** Based on the information in the sample interview, does Jason qualify to fill out a Schedule C-EZ?  Yes  No

## How do you clarify taxpayers' business income and expenses?

All IRS-certified volunteers must exercise due diligence when preparing tax returns. Due diligence means doing your part to ensure tax returns are correct.

This means, as a volunteer, you must do your part when preparing or reviewing a tax return to ensure the information on the return is correct and complete. Generally you can rely in good faith on information from a taxpayer without requiring documentation as verification.

However, when preparing a tax return with a Schedule C/C-EZ and the earned income credit (EIC), take additional steps to determine that the net self-employment income used to calculate the amount of, or eligibility for, EIC is correct and complete. Additional clarification or inquiries should be made if the information furnished by the taxpayer appears to be incorrect, incomplete, or inconsistent. Taxpayers sometimes want to over report or under report their income to qualify for or maximize the amount of EIC.

Ask sufficient questions of taxpayers claiming self-employment income to be satisfied that:

- The taxpayer actually conducts a business
- The taxpayer has records to support income and expenses, or can reasonably reconstruct income and expenses records
- All income and related expenses have been included on the taxpayer's Schedule C/C-EZ

Emphasize to taxpayers that in the event of an IRS audit, they would need to provide receipts to support their figures.

### What Schedule C situations raise a “red flag”?

As a volunteer preparing a tax return with Schedule C/C-EZ, watch for examples of incorrect, incomplete, or inconsistent information, such as:

- Schedule C/C-EZ income in round numbers
- Schedule C/C-EZ cash businesses as the only income on a return claiming EIC
- Schedule C/C-EZ with little or no expenses when expenses would be expected
- Schedule C/C-EZ taxpayers with little or no records for income and expenses
- Any Schedule C/C-EZ income that brings the taxpayer to the maximum EIC
- Schedule C/C-EZ without a Form 1099

### Taxpayer Interview and Tax Law Application

A taxpayer, Dana, comes in to have her tax return prepared. She tells you she runs her own babysitting business and wants to claim the EIC.

To assist the taxpayer in completing an accurate return, you need to ask more questions to determine if Dana did incur allowable business expenses and that the income she reported is correct.

#### SAMPLE INTERVIEW

VOLUNTEER SAYS...

DANA RESPONDS...

*Tell me about your business, and were you the sole owner?*

I have a babysitting service that I handle all by myself.

*Do you have a record of your business income and expenses for last year?*

Well, I'm not very good at keeping records, but I can tell you that I made \$14,000 over the course of the year. I didn't have any expenses.

*How did you determine that you made a net profit of \$14,000?*

I based my income on deposits to my checking account.

*I see. We may be able to reconstruct your business income based on your deposits. Did you bring any bank statements or your checkbook record with you today?*

No, I'm sorry.

*How many children did you care for, and was this a full-time or part-time job for you?*

Babysitting is just part-time. I watch several of my neighbors' children along with my own kids who are 8 and 10 years old.

*What is your fee for babysitting?*

It averages about \$10 an hour.

*Do you have a calendar or schedule of the children present each day?*

No, but I may be able to come up with one.

*Do you have a business license or permit, and do you watch the children in your own home or in a daycare facility or in the client's home?*

My home and sometimes at my neighbors' homes. I don't need a permit.

*Do you buy any supplies such as food, diapers, toys, or other items necessary for the business?*

Sometimes I need to buy supplies. But I didn't bring receipts with me.

## SAMPLE INTERVIEW (continued)

VOLUNTEER SAYS...

DANA RESPONDS...

*Did you intend to deduct expenses for the business use of your home?*

No, I don't think so.

*Be aware that the IRS requires that you report all income and allowable expenses on your tax return. In the event of an IRS audit, you will be responsible for providing support for the income and expenses claimed on your return. Before we can proceed, you'll need to gather some additional facts and records. I'll write down a list of items that could help us more accurately calculate your net profit from your business.*

OK – thanks. I'll see what I can pull together.

The information provided by the taxpayer appears to be both inconsistent and incomplete, because it is unlikely that someone who operates this type of business:

1. Has no business expense. Most businesses have expenses, even if it is just a few dollars here and there.
2. Has annual gross receipts from the business that are an exact round dollar amount, and that amount maximizes EIC.

The volunteer cannot complete a return based on information provided, but gives Dana the chance to gather materials to document her business.

### What business expenses are within scope for the VITA/TCE programs?

Taxpayers deduct the costs of running their business. These costs are known as business expenses. To be deductible, a business expense must be both ordinary and necessary. An ordinary expense is one that is common and accepted in the taxpayer's industry. A necessary expense is one that is helpful and appropriate for the taxpayer's trade or business. All ordinary and necessary expenses incurred in a self-employed taxpayer's business must be reported. See the Instructions for Schedule C for more detailed information on deductible business expenses. Examples of these expenses include the following:

#### Advertising

Advertising expenses are the costs associated with promoting the business through various means including yellow pages, newspapers, magazines, billboards, racing sponsors, and television spots.



Every self-employed taxpayer must claim all allowable deductions in computing net earnings from self-employment.

#### Car and Truck Expenses

A taxpayer who uses a car or truck in a business may be able to deduct the costs of operating and maintaining the vehicle. Vehicle expenses can be calculated using actual expenses or the standard mileage rate. Actual expenses include depreciation. The calculation of depreciation is outside the scope of the VITA/TCE programs. If the taxpayers have used actual expenses in the past, or wish to use actual expenses in the current year, they must be referred to a professional tax preparer. For-hire drivers may have other deductible expenses such as cellular service, fees, and ride sharing insurance in addition to using the standard mileage rate.

For the standard mileage deduction, the current standard mileage rate is multiplied by the number of business miles. Only parking and tolls can be added to this deduction. Commuting and other personal automobile expenses such as depreciation, lease payments, maintenance and repairs, gasoline (including gasoline taxes), oil, insurance, or vehicle registration fees should not be included in this amount.

#### example

Wendy is a self-employed masseuse and does not maintain an office in her home. She does neck massages for office workers and travels to three office buildings each work day. It is 10 miles from home to the first office and 5 miles from the last office back home. These 15 miles are commuting miles and, therefore, not deductible. The 13 miles Wendy drives from the first office to the second office and 5 miles from the second office to the third office are deductible. Of the 33 miles driven each work day, 18 miles are deductible.

### Commissions and Fees

Commissions or fees are paid to both individuals and businesses. If payments to a single individual are \$600 or more, the taxpayer must report the payments on Form 1099-MISC. In this case the taxpayers' return is out of scope for the VITA/TCE programs.

### Insurance

Insurance policies and coverage are deductible for the business operation. This includes property, automobile (business vehicles only), and malpractice.

If the standard mileage rate is used, no deduction is allowed for automobile insurance premiums.

Health insurance for the sole proprietor and his or her family is not deductible as a business expense. These medical premiums may be deducted on Form 1040 as an adjustment to gross income, subject to qualifications. However, the adjustment to gross income deduction on Form 1040 is out of scope for the VITA/TCE programs.

### Other Interest

This category can include interest paid on operating loans, but not mortgage interest.

### Legal and Professional Services

Expenses included on this line are fees paid to professionals, such as attorneys, accountants, appraisers, and engineers.

Legal fees paid to acquire business assets are not deductible. These costs are added to the basis of the property. Some accountant fees and attorney fees may be for personal services (e.g., tax returns, wills, or estates) and are not deductible as business expenses.

### Office Expense

Office expense generally includes supplies such as pens, paper, and postage.

### Rent or Lease – Vehicle, Machinery, and Equipment

This category includes rental fees for cars, trucks, vans, machinery, equipment, and other personal property. Vehicle leases of more than 30 days are out of scope.

### Repairs and Maintenance

Repairs on equipment, office space, and buildings are some possible expenditures reflected in this category. Expenses that should *not* be reflected are:

- Capital equipment that is improperly expensed (see Cost Recovery in Publication 535).
- Repairs that substantially improve a facility or equipment that should be capitalized.

## Supplies

Supplies expense includes costs for general operating supplies not associated with the cost of goods sold.

## Taxes and Licenses

Taxpayers can deduct taxes and license fees paid in the operation of their business. Examples include:

- State and local sales taxes imposed on the taxpayer as the seller of goods or services
- Real estate and personal property taxes on business assets
- Certain licenses and regulatory fees

## Travel/Meals and Entertainment

Travel expenses are the ordinary and necessary expenses of traveling away from home for business. Examples of deductible travel, meal, and entertainment expenses are in the Volunteer Resource Guide, Deductions tab.

## Utilities

Utilities typically consist of normal electric, gas, water, and telephone expenses for the business. The base rate of the first telephone line to a residence cannot be deducted, but additional costs incurred for business purposes can be included as an expense. There should be no deduction for personal expenses or expenses for a home office in this category.

### example

Kiana runs a small business from her home. She has only one phone line and frequently makes long-distance calls for business. The cost of the phone line cannot be deducted, but Kiana can deduct the long-distance charges for her business calls.

## Other Expenses

Taxpayers may also be able to deduct other ordinary and necessary business expenses not deducted elsewhere on Schedule C. See Form Schedule C Instructions (Part V - Other Expenses) and Publication 535 for more information.

Taxpayers may elect to apply a de minimis safe harbor to amounts paid to acquire or produce tangible property used in the taxpayer's trade or business. They may use this safe harbor to deduct amounts paid for tangible property up to \$2,500 per invoice or item (substantiated by invoice) if they have accounting procedures in place whereby they deduct amounts paid for business property if the costs of such property are under a certain de minimis amount. The de minimis safe harbor election does not include amounts paid for inventory and land. The election applies for a taxable year and, if made, applies to each expenditure meeting the criteria for the election in the taxable year. Make the election by attaching a statement titled "Section 1.263(a)-1(f) de minimis safe harbor election" to a timely filed original federal tax return including extensions for the taxable year in which the de minimis amounts are paid. The statement should include the taxpayer's name, address, and Taxpayer Identification Number, as well as a statement that the taxpayer is making the de minimis safe harbor election.

### example

Barry makes his living as a handyman and earned \$17,438 during the tax year. In the same year, Barry bought a new ladder for \$450 and uses it exclusively in his business. In keeping his books and records, Barry uses an accounting procedure whereby he deducts amounts he pays for business equipment if the cost of the equipment is \$1,000 or less. Under the de minimis safe harbor, Barry can deduct the full cost of the ladder as a business expense, as well as any other equipment purchases for \$1,000 or less, by attaching the required statement to his timely filed tax return.

## How do I complete Schedule C-EZ?

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### **Part I: General Information**

Enter the type of business and the Principal Business Code. A list of Principal Business Codes can be found in Schedule C Instructions and in Form 1040 Instructions.



**Tax Software Hint:** Refer to the Volunteer Resource Guide, Income tab, to review software entries for principal business codes.

Enter the business name, if there is one. If the business has an Employer Identification Number (EIN), enter it (most Schedule C-EZ businesses do not need an EIN, since they do not have employees). If the business has an address that is different from the one shown on Form 1040, enter it.

Check “Yes” or “No” box for the question, “Did the business make any payments in the current tax year that would require filing of Form(s) 1099?”

If the answer is Yes, did or will the business file required Forms 1099? Check “Yes” or “No” box.

In general, taxpayers who seek assistance through the VITA/TCE programs may be required to file Form 1099-MISC for payments in the amount of \$600 or more for services performed for a trade or business by people not treated as its employees. Contract labor includes payments to persons the taxpayer does not treat as employees (for example, independent contractors) for services performed for the taxpayer’s trade or business. The taxpayer must file Form 1099-MISC to report contract labor payments. If an individual paid for contract labor expenses, regardless of whether a Form 1099-MISC must be filed, the expenses are out of scope for VITA/TCE. For a complete listing of Forms 1099 and the requirements for issuance, refer to the chart in the Form 1099 General Instructions.

If the taxpayer responds Yes to making payments that would require the filing of Form(s) 1099, the income tax return and any related Form 1099 preparation are both out of scope for the VITA/TCE programs. The Form 1040 must still be referred to a professional tax preparer even if taxpayers indicate they have already filed the Forms 1099.

### **Part II: Figure Net Profit**

Enter on line 1 the amount for gross receipts or sales.

If this income was reported to the taxpayer on Form W-2 and the “Statutory Employee” box on that form is checked, see Schedule C-EZ Instructions before completing this line.



**Tax Software Hint:** Refer to the Volunteer Resource Guide, Income tab, for guidance on entering income reported on Form 1099-MISC and other payments received that are not reported on Form 1099-MISC.

Enter on line 2 the total amount of all deductible business expenses that the taxpayer actually paid during the year. Only the portion of these costs that are attributable to the business can be deducted as a business expense.



Examples of deductible business expenses include advertising, car and truck expenses, commissions and fees, insurance, interest, legal and professional services, office expenses, rent or lease expenses, repairs and maintenance, tools that last less than a year, supplies, taxes, travel, the allowable percentage of business meals and entertainment, and utilities. The base rate of the first telephone line to a residence cannot be deducted, but additional costs incurred for business purposes can be included as an expense.



For earned income credit and self-employment tax purposes, the taxpayer must include all allowable deductions in computing net earnings.



**Tax Software Hint:** Refer to the Volunteer Resource Guide, Income tab, for guidance on entering expenses on the Schedule C-EZ. The tax software will total all the expenses and transfer the amount to line 2.

### **Part III: Information on Vehicles**

If the taxpayer had business expenses for a car or truck, complete the questions in Part III. Business miles do not include commuting miles between home and the business location or between business and lunch locations. Business miles do include travel between home and a temporary workplace when the taxpayer has one or more regular places of work. If the taxpayer has no regular place of work, only the travel from one temporary place to another is counted. See the Volunteer Resource Guide, Deductions tab, and Publication 463, Travel, Entertainment, Gift, and Car Expenses for more details.

Vehicle expenses can be calculated using actual expenses or the standard mileage rate. Actual expenses include depreciation, which is outside the scope of the VITA/TCE programs. If the taxpayer has used actual expenses in the past, or wishes to use actual expenses in the current year, refer the taxpayer to a professional tax preparer.

The standard mileage rate is multiplied by the number of business miles to calculate the vehicle expense.

Add the total vehicle expenses to all nonvehicle expenses in line 2. The standard mileage rate represents all vehicle expenses; taxpayers may add only such fees as parking or tolls.

Complete the information in Schedule C-EZ, Part III.

## **How do I complete Schedule C?**

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Generally the same business expenses are deductible on both Schedule C and C-EZ. The expenses are totaled and included on one line on Schedule C-EZ, whereas on Schedule C, the business expenses are broken down by category.

### **General Information Section**

Complete lines A–J.

- Enter the type of business.
- Enter the Principal Business Code. A list of Principal Business Codes can be found in Schedule C Instructions and in Form 1040 Instructions.
- Enter the business name, if no separate name, leave blank.
- Employer ID Number (EIN), if any.
- Enter the business address.
- Check accounting method. (Only cash method is in scope for the VITA/TCE programs; if taxpayers use another method, refer them to a professional tax preparer.)
- Check “Yes” or “No” box for: Did the taxpayer “materially participate” in the operation of the business?
  - In general, the taxpayer materially participates if based on all the facts and circumstances, the taxpayer participated in the activity on a regular, continuous, and substantial basis during the year. See Schedule C Instructions for specific tests to determine if the taxpayer meets the requirements for material participation.
  - If the taxpayer meets one of the tests for material participation, check the “Yes” box, otherwise the answer is “No.” If there is uncertainty about the taxpayer materially participating in the business, refer them to a professional tax preparer.

- Check the box if business was started or acquired during the tax year.
- Check “Yes” or “No” box for: Did the business make any payments in the tax year that would require filing of Form(s) 1099?
- If Yes, did or will the business file required Forms 1099? Check “Yes” or “No” box.

In general, taxpayers who seek assistance through the VITA/TCE programs may be required to file Form 1099-MISC for payments in the amount of \$600 or more for services performed for a trade or business by people not treated as its employees. Contract labor includes payments to persons the taxpayer does not treat as employees (for example, independent contractors) for services performed for the taxpayer’s trade or business. The taxpayer must file Form 1099-MISC to report contract labor payments. If an individual paid for contract labor expenses, regardless of whether a Form 1099-MISC must be filed, the expenses are out of scope for VITA/TCE. For a complete listing of Forms 1099 and the requirements for issuance, refer to the chart in the General Form 1099 Instructions.

If the taxpayer responds Yes to making payments that would require the filing of Form(s) 1099, the income tax return and any related Form 1099 preparation are both out of scope for the VITA/TCE programs. The Form 1040 must still be referred to a professional tax preparer even if the taxpayer indicates they have already filed the Forms 1099.

## Part I: Income

Enter on line 1 the amount for gross receipts from the taxpayer’s trade or business. If the income was reported on Form W-2 and the “Statutory Employee” box on that form is checked, see Schedule C Instructions before completing this line.



**CAUTION** Determine if the taxpayer received business income that was not reported on Form 1099-MISC. For example, tips received by self-employed hair stylists or manicurists are to be included in gross receipts on Schedule C-EZ/C.

### Statutory Employees

If the taxpayer received Form W-2 and “Statutory employee” was checked in box 13, report the income and expenses related to that income on Schedule C or C-EZ. Enter the statutory employee income from Form W-2, box 1, on line 1 of Schedule C or C-EZ. Social Security and Medicare taxes should have been withheld from the earnings; therefore, the taxpayer does not owe self-employment tax on these earnings. Statutory employees include full-time life insurance agents, certain agent or commission drivers, traveling salespersons, and certain home workers.

Self-employment income and statutory employee income cannot be reported on the same Schedule C. The taxpayer must file two separate Schedules C.



**Tax Software Hint:** If the taxpayer has a Form W-2 with the “Statutory employee” box checked, be sure to follow the guidance for the applicable line of Schedule C or C-EZ. This income is not subject to self-employment tax since Social Security and Medicare taxes have already been withheld.

## Part II: Expenses

On Schedule C there is a separate line for the most common expenses that are incurred in a business. Review the taxpayer’s information to determine if the expenses are **ordinary and necessary**.

## Part III: Cost of Goods Sold

This relates to inventory and is out of scope for the VITA/TCE programs.

## Part IV: Information on Your Vehicle

This includes information for claiming the standard mileage rate for vehicle expenses.

## Part V: Other Expenses

This includes all ordinary and necessary expenses not deducted elsewhere on Schedule C.



### EXERCISES (continued)

**Question 2:** Daniel has his own business. He received Form 1099-MISC for \$13,000 for work he completed as an independent contractor. He also received cash payments that total \$2,500 for other jobs he completed for different individuals. Must Daniel report the cash payments of \$2,500 on his return?  Yes  No

**Question 3:** Ellen has a small business. The gross income from her business is \$40,000, her business expenses total \$11,500, and she must file a Schedule C. Is Ellen's tax return in scope for the VITA/TCE programs?  Yes  No

## Recordkeeping

### Why keep records?

Everyone in business must keep records. See the Volunteer Resource Guide, Deductions tab, for a table on recordkeeping. Good records will help the taxpayer do the following:

- Monitor the progress of their business
- Prepare their financial statements
- Identify source of receipts
- Keep track of deductible expenses
- Prepare tax returns
- Support items reported on tax returns

### Kinds of records to keep

Except in a few cases, the law does not require any specific kind of records. Taxpayers can choose any recordkeeping system suited to their business that clearly shows their income and expenses.

The recordkeeping system should include a summary of business transactions. This summary is usually made in the taxpayers' books (for example, accounting journals and ledgers). The books must show the gross income, as well as the deductions and credits. For most small businesses, the business checkbook is the main source for entries in the business books. In addition, supporting documents must be kept.

### Supporting documents

Purchases, sales, payroll, and other transactions in the business generate supporting documents. Supporting documents include sales slips, paid bills, invoices, receipts, deposit slips, and canceled checks. These documents contain information that must be recorded in the books.



When a business involves the use of a vehicle, a mileage log would be a supporting document.

It is important to keep these documents in an orderly fashion and in a safe place because they support the entries in the books and on the tax return. For instance, organize them by year and type of income or expense.

## Reconstructing records

Make adequate inquiries to be satisfied that the taxpayer is carrying on a business and that the income and expenses reported on the tax return are substantially correct and complete.

You may help a taxpayer with simple record reconstruction. Assisting the taxpayer in reconstruction will help teach the taxpayer about recordkeeping. Extensive record reconstruction should be performed by the taxpayer or a paid preparer. If you are not satisfied with the accuracy of the reconstructed records, you have the right to decline to prepare the return. See your Site Coordinator for guidance.

The goal of record reconstruction is to use available documentation to develop a sound and reasonable estimate of the taxpayer's business income and expenses to support the Schedule C prepared. When reconstructing records, you can use such tools as:

- Appointment books or calendars
- Online map tools
- IRS standard allowances
- Checkbooks
- Canceled checks
- Bank or credit card statements
- Lists of regular clients
- Partial receipts or sales tax records
- Cell phone records, call history, or computer logs
- Prior year returns

## How long to keep records

Generally, taxpayers must keep records that support income or deductions on a return until the period of limitations for that return runs out.

The period of limitations is the time in which a taxpayer can amend a return to claim a credit or refund, or the IRS can assess additional tax. For more information on recordkeeping see Publication 583.

## Taxpayer Interview and Tax Law Application

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Remember our taxpayer, Dana, with a babysitting business? She said she made \$14,000 in net profit from her business, and wants to claim the EIC. After careful interviewing, the volunteer has determined the return cannot be completed without record reconstruction. The volunteer asked Dana to go home and return with some documentation to support her claims.

Based on the taxpayer's materials and additional questions, you can determine if Dana should be claiming expenses for the business use of her home. If so, refer the taxpayer to a professional tax preparer.

## SAMPLE INTERVIEW

### VOLUNTEER SAYS...

*Nice to see you again, and I see you have some additional materials. What kind of documentation were you able to put together?*

*That sounds great. First, let's multiply the number of children that you cared for by the corresponding charged rate to confirm your income figure. Did you also bring documents to support your business expenses?*

*OK, then we'll calculate a reasonable estimate of expenses incurred.*

### DANA RESPONDS...

As you suggested, I completed a calendar that shows the number of children that I cared for on each date.

Yes, I have some grocery store receipts, canceled checks, bank statements, and credit card statements. I have highlighted the regular purchases I made for my business.

Good. I'm sure my first estimate of \$14,000 business income is not accurate after all. I appreciate learning what I need to do to keep track of my income and expenses.

## What about self-employment tax?

A taxpayer must file Schedule SE if he or she has net earnings from self-employment of \$400 or more. The tax is computed on Schedule SE and transferred to Form 1040, to be added to other taxes owed. The Schedule SE is attached to Form 1040, and discussed in the Other Taxes lesson.

Self-employed taxpayers may claim an adjustment to income for part of their Social Security and Medicare taxes.



**Tax Software Hint:** Self employment tax and the deductible part of self-employment tax are automatically calculated. The software then enters these amounts on applicable lines of Form 1040.

## Summary

This lesson explained:

- Where to get business income and expense information
- Cash income must be reported
- Subcontractors or individuals who receive less than \$600 may not receive Form 1099-MISC, but still must report all cash income
- Additional inquiries about the taxpayer's income and expenses may be necessary to ensure an accurate return
- Certain situations involving Schedule C and EIC should raise "red flags"
- How business income or loss is reported
- What business expenses are within scope for the VITA/TCE programs
- Who can use Schedule C-EZ
- How to complete Schedule C-EZ
- How to complete Schedule C
- How to determine what records to maintain
- How to complete simple record reconstruction

## What situations are out of scope for the VITA/TCE programs?

The following are out of scope for this lesson. While this list may not be all inclusive, it is provided for your awareness only.

Schedule C with:

- Hobby income or not-for-profit activity
- Expenses over \$25,000
- Return and allowances
- Cost of goods sold (inventory)
- Expenses for employees
- Business use of home
- Contract labor
- Casualty losses
- Vehicle expenses reported as actual expenses
- Depreciation or asset write-offs
- Rental or lease expenses – vehicle leases of more than 30 days
- Accounting methods other than the cash method
- Net losses
- A “No” response that indicates the taxpayer does not meet any of the tests of material participation, or is uncertain about materially participating in a business
- Taxpayers who receive any credit card or similar payments that are not includible in income
- A “Yes” response indicating there is a requirement to file Form(s) 1099
- Income from the manufacture, distribution, or trafficking of controlled substances (such as marijuana)



### TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem or practice exercise(s) for your course of study in Publication 4491-W.

For practice using the tax preparation software, complete the scenarios using the Practice Lab on L&LT.



### EXERCISE ANSWERS

**Answer 1:** Yes. Jason meets all requirements to qualify for completing Schedule C-EZ.

**Answer 2:** Yes. The cash payments must be included in Daniel's gross receipts the same as the \$13,000 on Form 1099-MISC. Cash payments are compensation for his services and must be reported on his Schedule C-EZ or Schedule C.

**Answer 3:** Yes. Ellen's business expenses are under \$25,000.



## Income – Capital Gain or Loss; Form 1040, Line 13



### Introduction

This lesson will help you assist taxpayers who must use Form 8949, Sales and Other Dispositions of Capital Assets, in conjunction with Form 1040, Schedule D, Capital Gains and Losses, to report capital gains and/or losses on the sale of assets. This lesson includes topics on the sale of stock, mutual funds, and the sale of a personal residence. If the taxpayers have sold any other assets, refer them to a professional tax preparer. This lesson will help you identify the asset's holding period, adjusted basis, net short-term and long-term capital gains or losses, the taxable gain or deductible loss, the tax liability, and the amount of any capital loss carryover.

The intake and interview sheet asks about income from the sale of property such as stock, bonds, or real estate. Ask taxpayers if they sold any stock, securities, other investment property, or a home during the tax year. It is important to ensure that all income is accurately reported on the return.

For additional information on the topics discussed in this lesson, see Publication 544, Sales and Other Dispositions of Assets, Publication 551, Basis of Assets, Publication 550, Investment Income and Expenses, and Publication 523, Selling Your Home.

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Determine the adjusted basis of capital assets
- Determine if the asset's holding period is long-term or short-term
- Calculate the taxable gain or deductible loss from the sale of capital assets
- Determine whether a home is the taxpayer's main home
- Determine if a taxpayer meets the ownership and use tests
- Determine when the 5-year ownership/use test period is suspended

#### What do I need?

- Form 13614-C
- Publication 4012
- Publication 17
- Publication 4491-W

#### **Optional:**

- Publication 523
- Publication 544
- Publication 550
- Publication 551
- Form 1040 Instructions
- Form 1040, Schedule D and Instructions
- Form 1099-B
- Form 1099-DIV
- Form 1099-S
- Form 8949

## What information must I have to report a capital gain or loss?

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To report capital gain or loss, you will need to identify:

- Basis and/or Adjusted Basis:
  - Basis is the original cost of the asset
  - Adjusted basis includes original cost plus any increases or decreases to that cost (such as commissions, fees, depreciation, deductible casualty losses, insurance reimbursements or major improvements)
  - Brokers must report cost or other basis on Form 1099-B, unless the securities sold were noncovered securities
  - Taxpayers must use codes to report if 1099-B was received, and whether or not it showed basis reported to the IRS
- Holding period:
  - Short-term property is held one year or less
  - Long-term property is held more than one year
  - Long-term capital gains are taxed at a lower rate than short-term gains
  - Brokers must report whether the gain or loss is short-term or long-term on Form 1099-B, unless the securities sold were noncovered securities
- Proceeds from the sale:
  - Form 1099-B reflects gross or net proceeds for a stock or mutual fund
  - Form 1099-S usually reflects gross proceeds of real estate transactions
  - Other evidence in the absence of the above



**CAUTION** Taxpayers who have transactions using Bitcoins or other virtual currencies are out of scope for VITA/TCE programs.



**Tax Software Hint:** To review information related to the software, go to the Volunteer Resource Guide, Income tab, Schedule D, Capital Gain or Loss.

## What is the basis of stock?

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### Basis

In order to compute gain or loss on a sale, taxpayers must provide their basis in the sold property. The basis of property is usually its cost.

- If taxpayers need help determining their basis and do not have the original purchase documents, refer them to their stockbroker.
- If taxpayers cannot provide their basis in the property, the IRS will deem it to be zero.

Special rules apply to inherited property; these rules are covered in this lesson, in the topic, “Basis Other Than Cost.” If the taxpayer acquired the stock by means other than a purchase or inheritance, such as a gift or an employee stock option plan (ESOP), and does not know the basis of the stock, refer them to a professional tax preparer. The determination of basis in these situations is beyond the scope of VITA/TCE.



## Adjusted Basis

An adjustment to basis may include additional commissions or fees paid to the broker at the time of purchase or sale.

Stock is bought and sold in various quantities. It is important for the taxpayer to keep track of the basis per share of all stock bought and sold. Events that occur after the purchase of the stock can require adjustments (increases or decreases) to the “per share” basis of stock. The original basis per share can be changed by events such as stock dividends, stock splits, and DRIP (dividend reinvestment plan) accounts.

- Stock dividends are issued in lieu of cash dividends. These additional shares increase the taxpayer’s ownership so the original basis is spread over more shares, which decreases the basis per share.
- A stock split is a method used by corporations to lower the market price of stock. A two for one stock split will decrease the basis per share by half. For example, the original basis of \$200 for 100 shares becomes \$200 for 200 shares.
- DRIP accounts leave cash dividends with the company for the purchase of additional shares. Even though these shares are from the same company, they retain their own individual basis separate from the original purchase. Each new purchased share could have a different basis.



Although stock splits and stock dividends do not occur often, always ask taxpayers if they received any additional shares from these transactions.

Brokers or mutual fund companies will track the basis of mutual fund shares for covered securities. Still, taxpayers should keep track of their basis in mutual fund shares.

- The original basis of mutual fund shares bought is usually their cost or purchase price. The purchase price usually includes any commissions or load charges paid for the purchase.
- The original cost basis of mutual fund shares acquired by reinvesting distributions is the amount of the distributions used to purchase each full or fractional share. This rule applies even if the distribution was an exempt-interest dividend that was not reported as income.
- The basis in mutual fund shares may need to be increased or reduced. For more information, refer to Publication 550.

### example

Alice paid \$1,100 for 100 shares of ABC, Inc. stock (which included the broker’s commission of \$25). The original basis per share was \$11 ( $\$1,100 \div 100$ ). She received 10 additional shares as a tax-free stock dividend. Her \$1,100 basis must be allocated to the 110 shares (100 original shares plus the 10-share stock dividend). This results in an adjusted basis of \$10 per share ( $\$1,100 \div 110$ ).

## Basis Other than Cost

There are times when cost alone cannot be used as basis. In some cases, the fair market value (FMV) or adjusted basis is used.

- Property Received as a Gift – To determine the basis of property received as a gift, taxpayers must know its adjusted basis to the donor just before it was given to the taxpayer. Taxpayers also need to know the FMV at the time of the donation and the amount of any gift tax paid on the donation. Determination of the adjusted basis of property received as a gift can be very complex and is beyond the scope of VITA/TCE.
- Inherited Property
  - Before 2010 and after 2010: the basis of property inherited during this time is generally the FMV of the property on the date of the decedent’s death. However, this can vary if the personal representative of the estate elects to use an alternate valuation date or other acceptable method. If the taxpayer

cannot provide the basis and holding period for the property, refer the taxpayer to a professional tax preparer.

- During 2010 (after December 31, 2009, and before January 1, 2011): special rules may apply to property inherited from a decedent who died in 2010. Determining the basis of such property can be complex. If the taxpayer cannot provide the basis and holding period for the property, refer the taxpayer to a professional tax preparer for determination of basis issues. For more information on the special rules, see Publication 4895, Tax Treatment of a Property Acquired from a Decedent Dying in 2010.
- Wash Sales
  - The reporting of wash sales is in scope only if reported on Form 1099-B (boxes 1f and 1g) or on brokerage or mutual fund statement.
  - A wash sale is the sale of securities at a loss and the acquisition of same (substantially identical) securities within 30 days of sale date (before or after).
  - Taxpayers cannot deduct losses from sales or trades of stock or securities in a wash sale unless the loss was incurred in the ordinary course of business as a dealer in stock or securities.
  - The disallowed loss is added to the cost of the new stock or securities. The result is an increase to the basis in the new stock or securities. This adjustment postpones the loss deduction until the disposition of the new stock or securities.
  - The holding period for the new stock or securities includes the holding period of the stock or securities sold.

#### example

The taxpayer buys 100 shares of X stock for \$1,000. The taxpayer sells these shares for \$750 and within 30 days from the sale buys 100 shares of the same stock for \$800. Because the taxpayer bought substantially identical stock, the taxpayer cannot deduct the loss of \$250 on the sale. However, the taxpayer adds the disallowed loss of \$250 to the cost of the new stock, \$800, to obtain the basis in the new stock, which is \$1,050.

For additional information on how to figure the basis, refer to the Basis of Property chapter in Publication 17, Your Federal Income Tax for Individuals.



If the taxpayer knows the basis of property that was inherited or received as a gift, you can provide assistance. If they do not know the basis of the property, refer the taxpayer to a professional tax preparer.

## How do I determine the holding period?

### Long-Term or Short-Term

For purchases prior to 2011, taxpayers must provide the date the stock was acquired. Beginning in 2011, brokers must report the date of acquisition and whether the gain or loss is short-term or long-term on Form 1099-B, unless the securities sold were noncovered securities. Generally, a noncovered security is:

- Stock purchased before 2011
- Stock acquired in 2011 that was transferred in 2011 to a DRIP
- A security acquired due to a stock dividend, stock split, reorganization, redemptions, stock conversion, recapitalization, corporate division, or similar action

Taxpayers will have to provide the information for noncovered securities not reported on Form 1099-B.

Form 1099-B will also indicate the date the stock was sold. These two dates will determine the holding period. Capital gains and losses are either long-term or short-term, depending on how long the taxpayer owned the stock. Stock held for:

- One year or less has a short-term holding period
- More than one year has a long-term holding period



If a taxpayer acquired property from a decedent who died in 2010, special rules may apply in determining tax items including basis, gain, loss, holding period, and character for the property. Determining these tax items is complex and outside the scope of the VITA/TCE programs.

The holding period begins the day after the shares were purchased and includes the day the shares were sold. If investment property is inherited, the capital gain or loss is treated as long-term. This is true regardless of how long the property is held (except for property inherited in 2010 in certain situations).

You may provide assistance to taxpayers who sold property inherited from someone who died in 2010 as long as the taxpayer knows the basis and the correct holding period. Refer taxpayers who do not know this information to a professional tax preparer. Determining basis and the correct holding period for property inherited in 2010 is complex and outside the scope of VITA/TCE. See Publication 4895 for more information.

Determining the correct holding period is important because short-term gains are taxed at regular income tax rates and long-term gains are taxed at a lower rate than the other income reported on the return.

Stock acquired as a nontaxable stock dividend or stock split has the same holding period as the original stock owned. They are considered to have been acquired on the same day as the original stock. Stock acquired in a DRIP has its own purchase date. The holding period for stock received as a taxable stock dividend begins on the date of distribution.

#### example

Lenny bought 500 shares of XYZ Corporation stock for \$1,500, including his broker's commission. Five years later, XYZ distributed a 2% nontaxable stock dividend (10 shares). Three days after the stock dividend was distributed, Lenny sold all his XYZ stock for \$2,030.

Although Lenny owned the 10 shares for only three days, all the stock has a long-term holding period. Stock acquired as a nontaxable stock dividend has the same holding period as the original stock owned. Because he bought the stock for \$1,500 and then sold it for \$2,030 more than a year later, Lenny has a long-term capital gain of \$530 on the sale of his 510 shares.

If taxpayers do not have the purchase documents or other records showing date of purchase and cost, refer them to their stockbroker or financial planner.

For additional information on the holding period and other tax consequences of selling or trading investment property, refer to the Sale of Property Chapter in Publication 17.



Although brokers and mutual fund companies are not required to report basis information for noncovered securities, most brokers and mutual fund companies provide supplemental basis information that can be used if the taxpayer concurs with the information.

## Mutual Funds

A mutual fund is a regulated investment company generally created by “pooling” funds of investors providing the advantage of a diversity of investments and professional management.

Owners of mutual funds may receive both Form 1099-DIV and Form 1099-B. Form 1099-DIV reports capi-

tal gain distributions from sales of stock held by the mutual fund. Profits of these sales are reported to the shareholders of the fund as capital gain distributions. If taxpayers (owners) decide to sell any of their shares in the mutual fund itself, Form 1099-B will be issued. The taxable gain or loss from the sale or exchange of the taxpayer's shares in a mutual fund is reported on Schedule D as a capital gain or loss.

If mutual fund dividends and capital gain distributions are reinvested in new shares, the holding period of each new share begins the day after that share was purchased. Therefore, if both the new shares and the original shares are sold, there may be both short-term and long-term gains and losses.

To figure the gain or loss on the disposition of mutual fund shares, which shares were sold and the basis of those shares need to be determined. If the shares in a mutual fund were acquired all on the same day and for the same price, figuring their basis is not difficult. However, shares are generally acquired at various times, in various quantities, and at various prices, making it more difficult to figure the basis. Taxpayers can choose to use either a cost basis or an average basis to figure the gain or loss. For more information on how to report the sale or exchange of mutual fund shares, refer to Publication 550.

## Stock

Some taxpayers may own shares of stock they bought on different dates or for different prices. This means they own more than one "block" of stock. Each block may differ from the others in its basis (the amount paid for the stock), its holding period (long-term or short-term), or both.

In directing a broker to sell stock, the taxpayer may specify which block, or part of a block, to sell. This is called "specific identification." To be valid, the specification must be made before or at the time of sale, **not** after the sale. If the taxpayer does not do this, the shares are sold from the earliest block purchased (FIFO method – or First In, First Out).

### example

Marie bought 100 shares of Antrim Corporation stock for \$2,000. A year later, she bought another 100 shares of Antrim for \$2,300. Five years later, she sold 100 shares of Antrim for \$3,000 but she did not identify the specific block at the time of sale.

Because Marie purchased the earliest block of 100 shares at \$2,000, the adjusted basis of the shares she sold was \$2,000. The sales price of the 100 shares sold was \$3,000. Marie had a long-term capital gain of \$1,000.

However, if she had told her broker to sell the 100 shares from the second block of stock she bought, the adjusted basis would have been \$2,300, giving Marie a long-term capital gain of \$700.

## What information do I need from Form 1099-B?

Sale of stock is reported to the taxpayer on Form 1099-B, Proceeds From Broker and Barter Exchange Transactions. Form 1099-B is prepared by the broker who handled the sale of the stock. Refer the taxpayer to a professional tax preparer if any of the following boxes has an entry: Accrued market discount; Profit or (loss) realized on closed contracts; Unrealized profit (loss) on open contracts – prior year; Unrealized profit or (loss) on open contracts – current year; or Aggregate profit (loss) on contracts; Proceeds are from collectibles; Bartering; or if there is a FATCA filing requirement. These boxes provide information about transactions that are out of scope for the VITA/TCE programs.



Most brokers report using a substituted Form 1099-B, not the IRS form. All the same information is included, but the order of the information may vary. Carefully review the broker statement during the interview to confirm that all transactions are in scope.

Form 1099-B includes these boxes for reporting sales of securities:

- Description of property
- Date acquired
- Date sold or disposed
- Proceeds
- Cost or other basis
- Wash sale loss disallowed
- Type of gain (short-term or long term)
- Federal or state income tax withheld
- Whether the basis was reported to the IRS or if it is a noncovered security
- Whether the amount reported is gross proceeds or net proceeds



When the FATCA box is checked, the taxpayer may have additional reporting responsibilities with respect to their foreign accounts or assets. These topics are beyond the scope for VITA/TCE and affected taxpayers should be referred to a professional tax preparer.

Brokers must complete boxes on the Date of sale or exchange; Date of acquisition; Type of gain or loss; Cost or other basis; and Wash sales when reporting sales of securities unless the box for Noncovered security is checked.

### **Date of Sale or Exchange**

The stockbroker reports the date the stock was sold on Form 1099-B. If the securities sold were noncovered securities, use this date, along with the purchase date provided by the taxpayer, to determine the holding period. If the securities sold were covered securities, the stockbroker reports the date the stock was acquired and whether the gain was short-term or long-term.

### **Sales Price**

The stockbroker must reduce the gross proceeds for any commissions or transfer taxes related to the sale:

- If sales price (gross proceeds) is checked, ask the taxpayer for the amount of commissions/fees paid and enter an adjustment on the capital gains worksheet
- If sales price less commissions and option premiums (net proceeds) is checked, the broker subtracted the commissions and fees from the proceeds

#### **example**

Richard sold stock for \$2,300. He paid his broker a commission of \$35 on the sale and received net proceeds of \$2,265. Richard's broker has reported:

- Proceeds on Form 1099-B of \$2,265
- The box next to net proceeds is checked



## EXERCISES

Answers are after the lesson summary.

**Question 1:** Kevin paid his broker a \$75 fee on the sale of his stock. His Form 1099-B shows \$925, and the box next to net proceeds is checked. What is the amount Kevin reports as his sales price?

- A. \$925
- B. \$1,000
- C. \$850
- D. \$75

### Other Information

If the securities sold were noncovered securities, Form 1099-B would not report the date the stock was originally purchased, the original purchase price, or any adjustments to the basis. Some brokers report this information on a tax reporting supplement. If not, the taxpayer must provide this information.

### How do I enter data on Form 8949 and Schedule D?

Generally, transactions are not reported directly on Schedule D. Instead, they are detailed on various Forms 8949. A separate Form 8949, page 1, is required for each of the three types of short-term transactions. The three types of long-term transactions are recorded on a separate Form 8949, page 2. The subtotals from Forms 8949 are carried over to Schedule D, where aggregate gain or loss is calculated.

A check box on Form 8949 identifies the type of transaction reported; a taxpayer with more than one type of transaction must file a separate form for each type.

Some taxpayers may be able to enter capital gains transactions directly on Schedule D. See the Volunteer Resource Guide, Income tab, for the current information on Schedule D and Form 8949.



**Tax Software Hint:** All entries are made on the Capital Gains Transactions screen. The software determines the holding period and enters the information on Form 8949, pages 1 and/or 2, provided correct transaction codes are properly entered in both the Capital Gains Transactions screen and Form(s) 8949. Use Volunteer Resource Guide, Income tab, to review software information.

### How do I report capital gain distributions?

Capital gain distributions are reported to the taxpayer on Form 1099-DIV. If there is no sale or disposition of capital assets to report, the Form 1099-DIV amount is reported directly on Form 1040, line 13 with a checkmark in the box to indicate a Schedule D is not required.

If a taxpayer has both Form 1099-DIV *and* Form 1099-B, then capital gain distributions are added to Schedule D, Part II, line 13.



## EXERCISES (continued)

**Question 2:** Which of the following taxpayers is required to file Form 1040 and Schedule D?

- A. Marriah, who received one Form 1099-B and no Forms 1099-DIV
- B. Lorraine, who received Forms 1099-DIV for capital gain distributions from three different mutual funds
- C. Both of the above



**Tax Software Hint:** If the source documents (Forms 1099-DIV and 1099-B) are recorded properly in the tax preparation program, then the numbers will be reported in the proper places. The amount from Form 1099-DIV, box 2a, will be entered on the Dividend entry screen (along with the other information) and will automatically carry over to the capital gain distributions line (line 13) in Schedule D, Part II.

**example**

Eldridge received a Form 1099-DIV. Box 2a shows he received a total capital gain distribution of \$170.

Eldridge also received a Form 1099-B that shows net proceeds of \$1,200 on the sale of 600 shares of ABC Group, Inc. He held the stock for over 6 years. His basis in ABC, including commission, is \$1,455.

Eldridge must use Schedule D to report his capital gain distribution because he sold stock that must be reported on Schedule D.

## How do I complete reporting of capital gain or loss?

Form 8949 contains most capital gain and loss transactions. The subtotals from Form 8949 are carried over to Schedule D, where gain or loss is calculated in the aggregate.

Combining all the amounts in the gain or (loss) column on Schedule D, Part I, results in a net short-term capital gain or loss. Combining all the amounts in the gain or (loss) column on Schedule D, Part II, results in a net long-term capital gain or loss.

The combination of the net short-term and net long-term capital gains or losses impacts the tax liability. If there is a combined net capital loss in excess of \$3,000 (or if Married Filing Separately, in excess of \$1,500), then the excess is carried to the next tax year and forward until exhausted. Carryover losses retain their original holding period.

**example**

Bill bought 1,000 shares of stock for \$15,000 (including commission). One year later he sold 600 shares of the stock for \$7,800, net proceeds. Bill had a net loss of \$1,200 as shown below:

$$\text{Basis} = (\$15,000 \div 1,000) \times 600 = \$9,000$$

$$\text{Sales Price} = \$7,800$$

$$\text{Gain or Loss} = \text{Sales Price} - \text{Basis} = \$7,800 - \$9,000 = -\$1,200$$

Bill had a short-term loss of \$1,200.

**example**

Margo bought stock for \$1,500, plus a \$25 commission; 18 months later she sold all the stock for \$2,000 and paid a \$25 commission. Her Form 1099-B shows the net proceeds of \$1,975 as the sales price.

$$\text{Basis} = (\$1,500 + \$25) = \$1,525$$

$$\text{Sales Price} = \$1,975$$

$$\text{Gain or Loss} = \text{Sales Price} - \text{Basis} = \$1,975 - \$1,525 = \$450$$

Margo had a long-term gain of \$450.

The Volunteer Reference Guide contains a list of adjustment codes that can be used when completing Forms 8949. When reporting transactions on a grouped basis, use code M. If another code is needed for the grouped transactions, enter both codes in the software.



In the rare event that the net proceeds on Form 1099-B are not correct, do not change the sales price amount. Instead, use the adjustment column on Form 8949 with the proper code.

## How do I calculate and report a carryover of a capital loss?

A taxpayer cannot take net losses of more than \$3,000 (\$1,500 for married taxpayers filing separately) in figuring taxable income for any single tax year. The allowable loss is referred to as the deduction limit. Unused losses can be carried over to later years until they are completely used up. Any prior year carryover losses are combined with the capital gains and losses in future years.

### Capital Loss Carryover Worksheet

To figure any capital loss carryover from the year prior to the current tax year, use the Capital Loss Carryover Worksheet from the Schedule D instructions. To complete the worksheet, you will need information from the prior year return.

Ask taxpayers for their Schedule D Worksheet (Capital Loss Carryovers from This Year to Next Year) from the previous year to determine the carryover amounts from the prior year to the current year and enter them in the software as detailed in the Volunteer Resource Guide.

If the taxpayer's current year capital loss exceeds the deduction limit and the remainder must be carried forward to the next tax year, remind the taxpayer to bring a copy of the current year's return to assist in preparing next year's return. Make a note on the outside of the taxpayer's tax return record envelope to alert next year's preparer. Next year, whoever assists the taxpayer will use this information to figure how much capital loss the taxpayer can carry over from the prior tax year to the current tax year.

For additional information on Schedule D, capital gains and losses, and carryovers, refer to the Reporting Gains and Losses chapter in Publication 17.



**Tax Software Hint:** Tax software automatically calculates the taxpayer's capital loss. If the loss is over the limit, the tax software reports the maximum allowable deduction. The tax software also completes the capital loss carryover worksheet showing the amount of loss that can be carried over to future tax years.

## Taxpayer Interview and Tax Law Application

Taxpayers Jeremy and Janice Smith checked the "Yes" box for income from the sale of stock on the intake and interview sheet. The volunteer asks for details.

### SAMPLE INTERVIEW

VOLUNTEER SAYS...

JEREMY RESPONDS...

*Previously we discussed your dividends from the Pembroke Fund, reported on Form 1099-DIV. Did you have any other income from the sale of stock, securities, or other investments?*

Yes, I sold some stock this year.

*Do you have a 1099 for that?*

Yes, I have this Form 1099-B and this stockbroker's statement.

*We already discussed the capital gain distribution from the mutual fund when we entered the dividends. We'll examine the stock sale information now. I see the broker's statement has the sale details I need, but do you know when you purchased the Purdue stock?*

I bought the Purdue stock back on July 13, 2000.



## SAMPLE INTERVIEW (continued)

VOLUNTEER SAYS...

JEREMY RESPONDS...

*I see the sale date was March 10 of the current tax year. That means the holding period for the stock was more than one year. They call that long-term, and it determines both where the information is reported and the tax rate for any gain. Now, do you know the basis for the stock?*

What is that?

*That's what it cost you, including any broker fees or commissions.*

Yes, it cost \$10,053, plus I had to pay \$35 in fees.

*Have you had any other costs, stock dividends, or stock splits related to the stock since then, such as additional fees?*

No, that's it. Wait, when I sold it, I had to pay \$35 more.

*That means that the basis for the stock is \$10,088. The 1099-B shows that you received net proceeds of \$8,859 when you sold the stock so the \$35 you paid on the sale is already taken into account. We'll put all these numbers into the tax software.*

*After I enter these other transactions from the broker's statement, we'll get a final net gain or loss on Schedule D. This will determine the amount that will be reported on Form 1040, line 13.*

[Indicate Jeremy's responses to these questions on the intake and interview sheet.]

### Who must file Form 8949 and Schedule D for the sale of a home?

To determine if the sale of the taxpayer's residence must be reported on Form 8949 and Schedule D, identify whether the home was the taxpayer's main home, if the taxpayer meets the ownership and use tests, and if the gain, if any, is more than the allowed exclusion amount. For additional guidance in making this determination, refer to the Selling Your Home Chapter in Publication 17 or Publication 523.

The intake and interview sheet lists income from the sale of real estate. Ask taxpayers if they sold any real estate, such as their principal residence or "main home" during the tax year. The taxpayer may be eligible to exclude all or part of the gain from their taxable income.

### Who must report the sale of a home?

Taxpayers must report the sale of a home when one of the following is true:

- The taxpayer does not meet the ownership test
- The taxpayer does not meet the use test
- During the two-year period ending on the date of the sale, the taxpayer has excluded the gain from the sale of another home
- The taxpayer has a gain and does not qualify to exclude all of it
- The taxpayer has a gain and chooses not to exclude it
- The taxpayer received Form 1099-S

### Exclusion Amount

Taxpayers who sold their main home may be able to exclude gain up to a maximum of \$250,000 (\$500,000 for married taxpayers who file a joint return).

Generally, if the taxpayer can exclude all of the gain, it is not necessary to report the sale. If the taxpayer has gain that cannot be excluded, it is taxable and reported on the return.

A loss on the sale cannot be deducted, however, the taxpayer may be required to report it.

## What is considered a “main” home?

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Only gain from the sale of a taxpayer’s main home may be excluded from the taxpayer’s income; gain from the sale of a home that is *not* the taxpayer’s main home will generally have to be reported as income.

A taxpayer’s “main” home is where they live most of the time. It does not have to be a traditional house; for example, it may be a houseboat, mobile home, cooperative apartment, or condominium, but it must have cooking, sleeping, and bathroom facilities. The taxpayer’s main home may also be a rented house or apartment. Taxpayers with more than one home cannot choose which home to designate as their main home.

### example

Lucille owns a home in a Colorado ski area (the ski home). She stays at the ski home most weekends and spends the entire months of December, January, and February there. When she is not at the ski home, she lives in a four-room apartment that she rents in Denver. Even though she does not own it, Lucille’s main home is her rental apartment in Denver, because she lives there most of the time.

## What are the ownership and use tests?

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To claim the exclusion on the gain from the sale of a home, the taxpayer must meet the ownership and use tests. This means that during the five-year period ending on the date of the sale, taxpayers must have:

- Owned the home for at least two years (the ownership test), and
- Lived in the home as their main home for at least two years (the use test)

There are special rules for members of the Armed Forces, intelligence personnel and Peace Corps volunteers in the application of the five-year period. See “Five-year Test Period Suspension” later in this lesson.

The required two years of ownership/use do not have to be continuous. Taxpayers meet the tests if they can show that they owned and lived in the property as their main home for either a total of 24 full months or 730 days (365 x 2) during the five-year period ending on the date of sale. Short, temporary absences are counted as periods of use even if the property is rented during those absences.

Ownership and use tests can be met during different two-year periods. However, a taxpayer must meet both tests during the five-year period ending on the date of the sale.

### example

Helen lived in a rented apartment in 2008. The apartment building was later changed to a condominium, and she bought her apartment on December 1, 2013. In 2015, Helen became ill and on April 14 of that year she moved into her daughter’s home. On July 10, 2017, while still living in her daughter’s home, she sold her apartment.

For the 2017 tax year, Helen can exclude all the gain on the sale of her apartment because she met the ownership and use tests. Her five-year period is from July 11, 2012, to July 10, 2017, the date she sold the apartment. She owned her apartment from December 1, 2013, to July 10, 2017 (over two years). She lived in the apartment from July 11, 2012 (the beginning of the five-year period) to April 14, 2015 (over two years).



## EXERCISES (continued)

**Question 3:** Emily, who is single, bought a home in 2000. She lived in the home until January 1, 2009, when she accepted a temporary job assignment in Venezuela and left the house vacant. Emily returned to her home on December 31, 2010 and lived there until she sold the house on January 10, 2014. Does Emily meet the ownership and use test?  Yes  No

### Reduced Exclusion

Taxpayers who owned and used a home for less than two years (do not meet the ownership and use test) may be able to claim a reduced exclusion under certain conditions. These include selling the home due to a change in place of employment (beyond a certain distance), health, or unforeseen circumstances. If any apply, refer the taxpayer to a professional tax preparer. Reduced exclusion computations/determinations are beyond the scope of VITA/TCE.

### Prior Exclusions

In addition, during the two-year period ending on the date of the sale, the taxpayer must not have claimed an exclusion on a gain from the sale of another home.

### Married Homeowners

The ownership and use tests are applied somewhat differently to married homeowners. Married homeowners can exclude up to \$500,000 if they meet *all* of these conditions:

- They file a joint return
- Either spouse meets the ownership test
- Both individuals meet the use test
- Neither one excluded gain in the two years before the sale of the current home

If either spouse does not satisfy all these requirements, they cannot claim the maximum exclusion (\$500,000). The most they can claim is the total of the maximum exclusions each would qualify for if not married and the amounts were figured separately. For this purpose, each spouse is treated as owning the property during the period that either spouse owned the property. This calculation is outside the scope of VITA/TCE.

### Sale of Main Home by Surviving Spouse

Beginning with main home sales after 2007, the maximum exclusion (\$500,000) by an unmarried surviving spouse is allowed if the sale occurs no later than two years after the date of the spouse's death, and all other requirements are met.

### How do I figure the gain (or loss) from the sale of a home?

After determining that a taxpayer is eligible for the exclusion, figure the gain (or loss) on the sale based on the selling price, amount realized, basis, and adjusted basis. If the selling price of the taxpayer's home is less than the allowable exclusion of up to \$250,000 (\$500,000 if Married Filing Jointly), it is not necessary to calculate the gain; none of it will be taxable. Loss on the sale of a residence is not deductible. For more information, see the Selling Your Home section in Publication 17.



If the taxpayer used the home for business purposes or as rental property, refer them to a professional tax preparer. The taxpayer cannot exclude the part of the gain equal to the depreciation allowed or allowable as a deduction.

## Selling Price

The selling price is the total amount taxpayers (the seller) received for their main home. It includes money, all notes, mortgages, or other debts taken over by the buyer as part of the sale, and the fair market value of any other property or services that the seller received.

If the taxpayer received Form 1099-S, Proceeds from Real Estate Transactions, use it to figure the selling price. Box 1 shows the date of sale (closing) and box 2 shows the gross proceeds received from the sale of the home. For taxpayers who did not receive a Form 1099-S, use sale documents and other records.

Use the gross selling price on Form 8949. Selling expenses are discussed below.



If the taxpayer can exclude the entire gain from the sale of a main home, the person responsible for closing the sale (i.e., a real estate broker or settlement agent) generally will not issue Form 1099-S. If Form 1099-S is issued and you determine that the gain is excludable, the sale should be reported on Form 8949 and Schedule D to notify the IRS of the exclusion.



If the taxpayer has a loss on the sale of a main home for which Form 1099-S was received, the taxpayer *must* report the loss on Form 8949 and Schedule D even though it is not deductible.

Enter an adjustment to zero out the loss (nondeductible loss that will show as code L on Form 8949).

## Basis

The basis in a home is determined by how the taxpayer obtained the home. If a taxpayer bought or built a home, the basis is what it cost the taxpayer to buy or build that home. If the taxpayer inherited the home, the basis is its fair market value on the date of the decedent's death, or on the later alternate valuation date chosen by the representative for the estate.



Alternative valuation issues and determining the adjusted basis of property received as a gift can be very complex and are outside the scope of this training. Advise taxpayers to seek assistance from a professional tax preparer if they do not know the basis and the correct holding period.



Determining the basis of property inherited in 2010 is complex and outside the scope of the VITA/TCE programs. Taxpayers who sold such property should be referred to a professional tax preparer if they do not know the basis and the correct holding period.

## Adjusted Basis

The adjusted basis is the taxpayer's basis in a home increased or decreased by certain amounts.

Increases include additions or improvements to the home such as building a recreation room or adding a bathroom. In order to be considered an increase, the improvement must have a useful life of more than one year. Repairs that maintain the home in good condition are not considered improvements and should not be added to the basis of the property.

Decreases to basis include deductible casualty losses and gains a taxpayer postponed from the sale of a previous home before May 7, 1997. Decreases can also include depreciation during the time the home was used for business purposes or as rental property. If any of these decreases apply, the taxpayer should be referred to a professional tax preparer.

Adjusted basis = Basis + Increases - Decreases



To figure the adjusted basis of a home, use Worksheet 1, Adjusted Basis of Home Sold, in Publication 523.

## Selling Expenses

Selling expenses reduce the gain or increase the loss. Selling expense may include commissions, advertising fees, legal fees, and loan charges paid by the seller, such as points, courier charges, and many other expenses. Selling expenses would not include items such as proration of homeowner fees, property taxes, interest on the loan to the date of sale, among others. Some items may be claimed as itemized deductions (property taxes and qualified home mortgage interest). Others are never deductible because they are personal expenses.

Report the total selling expenses as an adjustment (code E). Do not reduce the gross proceeds. Use the gain after the selling expense adjustment to determine the amount of exclusion available, if any.

## How much of the gain from a home sale can a taxpayer exclude?

Once you've determined the gain or loss on the sale of a taxpayer's main home, next figure the exclusion and any taxable gain from the sale.

If all the requirements are met, an individual taxpayer may exclude up to \$250,000 of the gain from taxable income; taxpayers who use the Married Filing Jointly filing status may exclude up to \$500,000.



Publication 523 contains Worksheet 2, Taxable Gain on Sale of Home, which may be used to figure the gain or loss, the exclusion, and the taxable gain from a sale.



Taxpayers who claimed the first-time homebuyer credit may be required to repay the credit in the year of sale. The repayment is limited to the amount of gain on the sale. This situation is out of scope for VITA/TCE. Refer taxpayers to the Form 5405 Instructions or to a professional tax preparer for more information on how to adjust the basis of the home and exceptions to the repayment rule.

Gain from the sale or exchange of a main home is not excludable from income if allocable to periods of nonqualified use. Generally, nonqualified use means any period in 2009 or later where neither the taxpayer nor spouse (or former spouse) used the property as a main home (with certain exceptions). A list of exceptions to a period of nonqualified use can be found in Publication 523. To figure the portion of nonqualified use, multiply the gain by the following fraction:

$$\frac{\text{Total nonqualified use during period of ownership in 2009 or later}}{\text{Total period of ownership}}$$

This issue can be complex. Refer taxpayers with "nonqualified use" issues to a professional tax preparer.

## Where do I report any taxable gain from the sale of a home?

Proceeds from the sale of a main home that meets the ownership and use tests must be reported only if the gain is greater than the taxpayer's allowed exclusion; only the excess must be reported. Gain from the sale of a home that is *not* the taxpayer's main home will generally have to be reported as income.

In both cases, the gain is taxable gain. The sale must be reported on Form 8949 and Schedule D.

Adjustment code H is used to claim the allowable exclusion. Enter both code E (for selling expenses) and code H (for the excluded gain) and the aggregate amount of both as an adjustment. If the home was used for business purposes or as rental property, the gain would be reported on Form 4797 and the taxpayer should be referred to a professional tax preparer.

If the amount realized is less than the adjusted basis, the difference is a loss, which cannot be deducted. However, taxpayers who received Form 1099-S for a loss on the sale of a main home must report the loss on Form 8949 and Schedule D even though it is not deductible. Reporting the transaction should prevent the taxpayer from receiving a notice from the IRS.



**Tax Software Hint:** To review information related to the software, go to the Volunteer Resource Guide, Income tab, for software entries on the Sale of a Home.

## **How do I report a nondeductible loss if taxpayer received Form 1099-S on the sale of a main home?**

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If the taxpayer has a loss on the sale of a main home for which Form 1099-S was received, you must report the loss on Form 8949 and Schedule D even though it is not deductible. Adjustment code L is for a nondeductible personal loss. Enter both code E (for selling expenses) and code L (for the nondeductible loss) and the net amount of both as an adjustment to zero out the loss.

## **Taxpayer Interview and Tax Law Application**

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Jeremy and Janice Smith checked the “Yes” box for selling some real estate on the intake and interview sheet. The volunteer asks for details.

## SAMPLE INTERVIEW

VOLUNTEER SAYS...

JEREMY RESPONDS...

*Did you sell a home during this tax year?*

Yes, I was going to mention that to you because I should get a tax break on that.

*Well, you may be able to exclude all or part of your gain from that sale, but to find out, I have to ask you a few questions.*

Three and a half years.

*First, how long did you own the home?*

*And was it the main place you lived for at least two years of that time?*

Yes, we lived there the whole time.

*Great, you meet the ownership and use tests. During the two years before you sold the house did you claim an exclusion on a gain from another house?*

No, this is my only house.

*Did you receive Form 1099-S?*

No, but I do have my paperwork from the sale. My real estate broker said I wouldn't need that form because I was within the limits.

*Your paperwork shows a selling price of \$360,000. Do you have anything that lists the basis in the home, that is, the cost of the home at the time you bought it?*

Yes, I bought it for \$280,000 and put in \$20,000 of improvements – mostly new bathrooms.

*With a basis of \$300,000, your gain from the sale is \$60,000.*

*As a married couple who meets the ownership and use tests, you can exclude up to \$500,000 from the sale, so you don't have to report the sale on your return.*

[Indicate Jeremy's responses to these questions on the intake and interview sheet.]

### What is the Five-Year Test Period Suspension?

Taxpayers can choose to have the five-year test period for ownership and use suspended during any period the homeowner (either spouse if married) served on "qualified official extended duty" as a member of the uniformed services or Foreign Service of the United States, as an employee of the intelligence community, or as an employee or volunteer of the Peace Corps. This means that the taxpayer may be able to meet the two-year use test even if the taxpayer and/or spouse did not actually live in the home during the normal five-year period required of other taxpayers.

Taxpayers are on qualified official extended duty if they serve at a duty station at least 50 miles from their main home or live in government quarters under government order. Taxpayers are considered to be on extended duty when they are called to active duty for more than 90 days or an indefinite period.

### Period of Suspension

The period of suspension cannot last more than ten years. Together, the ten-year suspension period and the five-year test period can be as long as fifteen years. The suspension can be used on only one property at a time.

For more information about the suspension of the five-year test period, see Members of the Uniformed Services or Foreign Service, Employees of the Intelligence Community, or Employees or Volunteers of the Peace Corps, in Publication 523.



This extension of time can apply to taxpayers who have recently left the military.

#### example

For the 2014 tax year: Peter bought a home in 2004 and lived in it for 2½ years. Beginning in 2007, he was on qualified official extended duty in the U.S. Army. He sold his home in 2014 and had a \$12,000 gain. Peter would normally not meet the use test in the five-year period before the sale (2009-2014). Because of the suspension, Peter's test period is the five years before he went on qualified official extended duty.



#### EXERCISES (continued)

**Question 4:** In this exercise, John purchased a home in 2003. Through your interview process, you discover that he sold his main home in 2014. John had not lived in the home for six years. Which of the following conditions would allow John to exclude his gain?

- A. John went on sabbatical for four years and backpacked through Europe.
- B. John lived with a co-worker for four years and let his brother occupy his home.
- C. John was deployed to Europe on official extended military duty for five years.
- D. John married and his bride had her own home. The couple chose to live in the wife's home and rent out John's home, until it was sold.

## Summary

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This lesson covered how to report the sale of capital assets and the sale of a principal residence. In most cases, a taxpayer must use Form 8949 and Schedule D to report capital gains and losses on the sale of assets. You learned how to identify the asset's holding period, adjusted basis, net short-term and long-term capital gains or losses, the taxable gain or deductible loss, and the amount of capital loss carryover.

Qualified taxpayers may be able to exclude a portion of the gain on the sale of their main home if they meet the ownership and use tests. Taxpayers can choose to have the five-year test period for ownership and use suspended during any period the homeowner (either spouse if married) served on qualified official extended duty as a member of the uniformed services or foreign service of the United States, as an employee of the intelligence community, or as an employee or volunteer of the Peace Corps. A loss on the sale of a principal residence is not deductible but must be reported if the taxpayer received Form 1099-S.

The worksheets in Publication 523 help you figure the taxable gain from the sale of a home using selling price, amount realized, basis and adjusted basis, along with the maximum allowed exclusion.



## What situations are out of scope for the VITA/TCE programs?

The following are out of scope for this lesson. While this list may not be all inclusive, it is provided for your awareness only.

- Taxpayers who have sold any assets other than stock, mutual funds, and a personal residence
- Taxpayers who trade in options, futures, or other commodities, whether or not they disposed of any during the year
- Determination of basis issues:
  - Basis of any asset acquired other than by purchase or inheritance, such as a gift or employee stock option, unless the taxpayer provides the basis and holding period
  - Basis of inherited property determined by a method other than the FMV of the property on the date of the decedent's death, unless the taxpayer provides the basis and holding period
- Like-kind exchanges and worthless securities
- Form 1099-B, boxes on Bartering: Profit or (loss) realized on closed contracts; Unrealized profit (loss) on open contracts – prior year; Unrealized profit or (loss) on open contracts – current year; or Aggregate profit (loss) on contracts; Proceeds from collectibles; or FATCA filing requirement
- Reduced exclusion computations/determinations in the sale of a home
- Married homeowners who do not meet all requirements to claim the maximum exclusion on the sale of a home
- Decreases to basis, including:
  - Deductible casualty losses and gains a taxpayer postponed from the sale of a previous home before May 7, 1997
  - Depreciation during the time the home was used for business purposes or as rental property
- Taxpayers with “nonqualified use” issues
- Sale of a home used for business purposes or as rental property



### TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem or practice exercise(s) for your course of study in Publication 4491-W.

For practice using the tax preparation software, complete the scenarios using the Practice Lab on L&LT.

You may not be able to complete the entire exercise if some of the technical issues in the exercise are not covered until later lessons in the training. In these instances, complete as much of the exercise as you can. Come back later to finish the exercise after you cover all the technical topics.





## Income – Retirement Income; Form 1040, Lines 15-16



### Introduction

This lesson will help you identify and report the taxable portion of retirement income received by the taxpayer. To do this, you must understand the types of retirement income and the forms used to report them. You should also be able to recognize when taxpayers should adjust their withholding and determine which form to use.

This lesson does not cover Social Security benefits or tier 1 railroad retirement benefits (Social Security equivalent benefits), which are discussed in the Social Security Benefits lesson.

For more information on the topics discussed in this lesson, see Publication 575, Pension and Annuity Income; Publication 590-B, Individual Retirement Arrangements (IRAs); Publication 721, Tax Guide to U.S. Civil Service Retirement Benefits; and Publication 939, General Rule for Pensions and Annuities.

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Identify how retirement income is reported to the taxpayer using Form 1099-R series
- Calculate the taxable portion of different types of retirement income
- Determine how to report retirement income on the tax return
- Determine when an adjustment to withholding should be made

### What is retirement income?

Retirement income can include Social Security benefits as well as benefits from annuities, retirement or profit sharing plans, insurance contracts, IRAs, etc. Retirement income may be fully or partially taxable. For information about Social Security benefits and tier 1 railroad retirement benefits, see the Social Security Benefits lesson.

#### What do I need?

- Form 13614-C
- Publication 4012
- Publication 17
- Publication 4491-W

#### Optional:

- Publication 575
- Publication 590-B
- Publication 721
- Publication 939
- Form 1040 Instructions
- Form 1040-ES
- Form 1099-R
- Form 5329
- Form 8606
- Form W-2
- Form W-4P
- Form W-4V
- Simplified Method Worksheet

### Where can I get information about a taxpayer's retirement income?

To determine if the taxpayer must report retirement income, review the taxpayer's completed intake and interview sheet, particularly the Income section. If the taxpayer had retirement income, you may need to ask additional questions to clarify the type of plan, whether the taxpayer's contributions to the plan were before-tax or after-tax dollars, etc. This is explained later in this lesson.

Be considerate when probing for the information you need to complete the return. When taxpayers cannot provide the required information (and have not retained the packet of “retirement papers” they received when they retired), suggest that they contact their former employer or annuity administrator. You may even give the taxpayer a written list of questions that need to be resolved.

### **New: Tax Law for Hurricane Victims**

Participants in 401(k)s and similar employer-sponsored retirement plans can make loans and hardship distributions to certain victims of hurricanes and members of their families. Retirement plans can provide this relief to employees and certain members of their families who live or work in disaster area localities affected by Hurricanes Harvey and Irma and designated for individual assistance by the Federal Emergency Management Agency (FEMA).

This broad-based relief means that a retirement plan can allow a hurricane victim to take a hardship distribution or borrow up to the specified statutory limits from the victim’s retirement plan. It also means that a person who lives outside the disaster area can take out a retirement plan loan or hardship distribution and use it to assist a son, daughter, parent, grandparent, or other dependent who lived or worked in the disaster area.

The tax treatment of loans and distributions remains unchanged. Ordinarily, retirement plan loan proceeds are tax-free if they are repaid over a period of five years or less. Under current law, hardship distributions are generally taxable and subject to a 10-percent early-withdrawal tax.

For more information about other tax relief related to Hurricane Harvey, Hurricane Irma, and other disasters, see the [IRS disaster relief page](#). For information on government-wide relief efforts, visit [www.usa.gov/hurricane-harvey](http://www.usa.gov/hurricane-harvey) or [www.usa.gov/hurricane-irma](http://www.usa.gov/hurricane-irma).

### **Form 1099-R Series**

Retirement income can be reported on:

- Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.,
- Form CSA 1099-R, Statement of Annuity Paid (civil service retirement payments),
- Form CSF 1099-R, Statement of Survivor Annuity Paid, and
- Form RRB 1099-R, Annuities or Pensions by the Railroad Retirement Board

If Form 1099-R is for an IRA-type distribution, it will be indicated in box 7.

Examples of these forms can be found in Publication 4491-W. These forms indicate such information as the amount received, the taxable portion, and the taxpayer’s cost (investment) in the plan.

If the taxable amount is indicated, Basic certified volunteers can complete the return. In general, if the taxable amount is not indicated, volunteers with Advanced certification must calculate the taxable portion using the Simplified Method Worksheet covered later in this lesson.



Qualified disability income reported on Form 1099-R with a Distribution Code 3 in Box 7, is reported as earned income wages on Form 1040, line 7, until the minimum retirement age is met.

## What if the taxable portion is already calculated?

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In many instances, the payer will compute the taxable portion of the distribution and report the taxable amount on Form 1099-R. Taxpayers with Form RRB-1099-R can only be helped by Advanced certified volunteers, because the taxable portion is not shown on the form.



**Tax Software Hint:** Refer to the Volunteer Resource Guide, Income tab, Form 1099-R Pension and Annuity Income.

Amounts from Form 1099-R are reported as follows:

- If the IRA/SEP/SIMPLE box is **not** checked on Form 1099-R
  - the gross amount (box 1 of Forms 1099-R, CSA- and CSF-1099-R) should be shown on Form 1040, line 16a, Pensions and annuities
  - the taxable amount (box 2a of Forms 1099-R, CSA- and CSF-1099-R) should be shown on Form 1040, line 16b, Taxable amount (pensions and annuities)
- If the IRA/SEP/SIMPLE box is checked on Form 1099-R
  - report the gross amount on Form 1040, line 15a, IRA distributions
  - report the taxable amount on Form 1040, line 15b, Taxable amount (IRA distributions)

Note: The IRA/SEP/SIMPLE box is not checked for Roth IRAs. Instead, Roth IRAs are identified on Form 1099-R with a distribution code Q, J, H, or T. (Only code Q is in the scope of the VITA/TCE program.) Roth IRA distributions are reported on Form 1040, Line 15.

Any amount of federal income tax withheld on Forms 1099-R, CSA- and CSF-1099-R should be entered in the Payments section of the tax return.



## What if the taxable portion is not calculated?

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If the payer did not include the taxable amount on Form 1099-R, CSA- or CSF-1099-R, or if taxpayers have Form RRB 1099-R, you will need to compute the taxable portion of the distribution. The following will help you determine the additional information needed to calculate the taxable portion of distributions from IRAs, pensions, or annuities.

## What do I need to know about retirement income distributions?

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Retirement plans are funded by either before-tax or after-tax contributions. “Before-tax” simply means that the employee did not pay taxes on the money at the time it was contributed, i.e., the taxpayer has no cost basis in the plan. “After-tax” means the employee paid taxes on the money when it was contributed, i.e., the taxpayer *has* a cost basis in the plan.

If the taxpayer made all contributions to a plan with before-tax dollars, the entire distribution will be fully taxable. The funds are taxed at the time of the distribution because neither the contributions nor the earnings/investment gains were previously taxed. This is common in 401(k) and Thrift Savings Plans.



If the taxpayer did *not* contribute to the retirement plan, all the distributions are fully taxable.

If the taxpayer made all contributions to a plan with after-tax dollars, then the distributions will be partially taxable. The portion of the distribution that is considered a return of the after-tax dollars will not be taxed again. It is considered a return of the taxpayer's cost basis (an amount for which taxes have already been paid). The portion of the distribution that represents the earnings/investment gains *is* taxable since it has not been previously taxed. This is common in employer retirement plans. Qualified distributions from an employer plan designated ROTH account are wholly nontaxable, similar to a ROTH IRA.

Employee Contributions	Contributions		Taxability of Distributions		
	Before-Tax	After-Tax	Fully	Partially	Nontaxable
No	n/a	n/a	Yes	—	—
Yes	Yes	—	Yes	—	—
Yes	—	Yes	—	Yes	—
Yes, ROTH	—	Yes	—	—	Yes

#### example

Mark retired after working 30 years for a construction company. Each week, he contributed to the Carpenter's Pension Plan. Every year, Mark paid tax on the gross amount of his salary, including his pension contribution. This means his pension contributions were made with dollars that had already been taxed. Now that he is receiving payments from the pension, he will not be taxed on the portion that represents his contribution; he *will* be taxed on the portion that represents earnings.



Taxpayers may not always understand why they must pay taxes on their retirement income. When this is the case, take the time to clearly explain what retirement funds are taxed and why. It is usually a good idea to question taxpayers about the nature of their contributions to ensure that they will not be taxed twice on the same funds.

## How do I find the taxable portion of IRA income?

### Individual Retirement Arrangements

IRA distributions are reported on Form 1099-R. Earnings and investment gains in a taxpayer's IRA generally accumulate tax free or tax deferred until they are withdrawn as fully- or partially-taxable distributions. There are four kinds of IRAs, each with different tax implications:

- Traditional IRA
- Roth IRA
- Savings Incentive Match Plans for Employees (SIMPLE) IRA
- Simplified Employee Pension (SEP) IRA

#### **Traditional IRA**

Distributions from traditional IRAs are fully taxable unless nondeductible contributions have been made. See the Adjustments lesson for additional information. Form 8606, Nondeductible IRAs, is used to keep track of nondeductible contributions. Taxpayers who made nondeductible contributions should be referred to a professional tax preparer.



When you learn about IRA accounts in the Adjustments to Income lesson, be sure to note the difference between “contributions” and “deductions.” Simply put, contributions are the amounts deposited into an IRA account, and deductions are the portion of the contribution that is deducted on the tax return. The deductible portion may be less than the amount allowed as a contribution.

#### example

Richard contributed \$500 a year to a traditional IRA. Each year, he deducted these contributions from his income. This year he received his first distribution from the traditional IRA. It is fully taxable: Richard will pay income tax on the distributions he receives, which represent the contributions he made and deducted, as well as the earnings on these contributions over the years.

### **Roth IRA**

Distributions from a Roth IRA are tax free and may be excluded from income if the following requirements are met:

- The distribution is made after the 5-year period beginning with the first day of the first taxable year for which a contribution was made to a Roth IRA set up for the taxpayer's benefit, *and*
- The distribution is:
  - Made on or after age 59½, or
  - Made because the taxpayer was disabled, or
  - Made to a beneficiary or to an estate, or
  - To pay certain qualified first-time homebuyer amounts (up to a \$10,000 lifetime limit)



You can identify Roth IRAs from the distribution code used on Form 1099-R. Distribution codes Q, J, H, and T are specific to Roth IRAs. **Only code Q is in scope for the VITA/TCE programs.** See instructions for code Q in Publication 4012.

### **Nonqualified Distributions**

If the above requirements are not met, the distribution is nonqualified and additional taxes may apply. Taxpayers who made nonqualified Roth IRA distributions should be referred to a professional tax preparer.

### **Qualified Distributions**

The IRA trustee will indicate the distribution is qualified by using Code Q in box 7. The entire distribution is not taxable.

### **Savings Incentive Match Plans for Employees (SIMPLE) IRA**

Some employers offer their employees (including self-employed individuals) the chance to contribute part of their pay to an IRA as part of a SIMPLE plan. The employer is also generally required to make contributions on behalf of eligible employees. Generally, SIMPLE IRA contributions are not included in an employee's income when paid into an IRA, and the distributions are fully taxable when the employee receives them in later years.

## ***Simplified Employee Pension (SEP) IRA***

Some employers offer their employees (including self-employed individuals) the chance to contribute part of their pay to an IRA as part of a SEP plan. Generally, SEP IRA contributions are not included in an employee's income when paid into the IRA. Because of this, distributions are generally fully taxable when the employee receives them in later years.



### **EXERCISES**

Answers follow the lesson summary.

**Question 1:** Distributions from all IRAs discussed in this topic are fully taxable with the exception of the Roth IRA.  True  False

**Question 2:** Mary opened a Roth IRA 3 years ago. This year, she took the full amount of her Roth IRA as a distribution to help her purchase her first home. The entire distribution is excluded from her taxable income.  True  False

**Question 3:** Amy contributed to a Roth IRA for 5 years. In year 6 (at age 60), she took a distribution from her IRA. The entire distribution is excluded from her taxable income.  True  False

## **How are IRA distributions reported?**

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### ***Traditional IRA***

If IRA/SEP/SIMPLE is checked on Form 1099-R, ask the taxpayer:

- Was this a distribution from a traditional IRA?
- Were the contributions deducted from income in the year they were made?

If so, the entire distribution is taxable. Report the distributions on Form 1040, line 15b. It is not necessary to enter the amount on line 15a. If not, the distribution is partially taxable. In that case, refer the taxpayer to a professional tax preparer.



An early distribution from a traditional or Roth IRA may be subject to a 10% additional tax. Refer to the Other Taxes lesson for more information.

### ***SIMPLE and SEP IRAs***

Distributions from SIMPLE and SEP IRAs are in scope for VITA/TCE, because they are taxable and are generally reported on the return just like taxable traditional IRA distributions.

Exception: Funds distributed from a SIMPLE IRA in the first two years are subject to a 25% early distribution penalty. If this is applicable, Form 1099-R will be issued with distribution code S. If an exception to the penalty applies, complete Form 5329 as you would do with traditional IRA distributions.

### ***Roth IRA***

Distributions from a Roth IRA are not taxable as long as they meet all the criteria discussed previously. If the distribution does not meet the criteria, then all or part of the funds **MAY** be taxable; refer the taxpayer to a professional tax preparer.



## How are rollovers handled?

Generally, a rollover is a tax-free distribution to the taxpayer from one retirement account (traditional IRA or employer's pension plan) that rolls over into another qualified retirement account within 60 days.

Form 1099-R will be issued to the taxpayer by the financial institution. If the distribution was a direct rollover by the institution to another institution, it will show distribution code G. **If there is also a taxable amount in box 2 of the 1099-R, the distribution may be partially or fully taxable. No further action is needed.**

If the taxpayer indicates that a rollover occurred but the distribution code is NOT G, then the taxpayer must have re-deposited the full amount into an appropriate account within 60 days. If this was not done, the distribution may be partially or fully taxable; refer the taxpayer to a professional tax preparer.

Note: Distributions from SIMPLE IRAs in the first two years (distribution code S) can only be rolled over tax-free into other SIMPLE IRAs. Taxable SIMPLE IRA rollovers are out of scope for VITA/TCE.



**CAUTION** Starting in 2015, there is a limit of one IRA rollover per twelve months. This does not affect the ability of an IRA owner to transfer funds from one IRA trustee directly to another because such a transfer is not a rollover.

## What about a rollover from a Roth IRA?

Most of the rules for rollovers to traditional IRAs apply to Roth IRAs. Generally, a withdrawal of all or part of the assets from one Roth IRA and a contribution to another Roth IRA within 60 days is tax free. A rollover from a Roth IRA to an employer retirement plan is not allowed.

If there is a direct rollover of a designated Roth account distribution to a Roth IRA, the distribution code for Form 1099-R will be code H.

If the distribution does not meet the tax-free rollover requirements, all or part may be taxable; refer the taxpayer to a professional tax preparer.



**Tax Software Hint:** Additional information must be entered for retirement account rollovers. Refer to the Volunteer Resource Guide, Income tab, Form 1099-R.



### EXERCISES (continued)

**Question 4:** Andrew changed jobs and received Form 1099-R from his previous employer. The gross distribution amount in box 1 is \$11,200. Andrew deposited the entire \$11,200 into his IRA within 30 days of receiving the check (rollover).

Which of the following statements is true?

- A. The entire distribution is includible as income
- B. The entire distribution is excludable from income
- C. The distribution is eligible for the ten-year tax option
- D. The distribution is eligible to be taxed at a special rate

A qualified charitable distribution (QCD) is generally a nontaxable distribution made directly by the trustee of the IRA to an organization eligible to receive tax-deductible contributions. The taxpayer must be at least age 70 1/2 when the distribution is made. Also, the taxpayer must have the same type of acknowledgment of

the contribution that is needed to claim a deduction for a charitable contribution. A QCD counts towards the taxpayer's required minimum distribution.

The maximum annual exclusion for QCDs is \$100,000. Any QCD in excess of the \$100,000 exclusion limit is included in income as any other distribution. On a joint return, the spouse can also have a QCD and exclude up to \$100,000.

## What is the IRA self-certification procedure?

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### Procedure Helps People Making Retirement Plan Rollovers

Revenue Procedure 2016-47 explains a self-certification procedure designed to help recipients of retirement plan distributions who inadvertently miss the 60-day time limit for properly rolling these amounts into another retirement plan or individual retirement arrangement (IRA). Eligible taxpayers can qualify for a waiver of the 60-day time limit and avoid possible taxes and penalties on early distributions, if they meet certain circumstances. Taxpayers who missed the time limit will ordinarily qualify for a waiver if one or more of 11 circumstances, listed in the revenue procedure, apply:

- An error was committed by the financial institution making the distribution or receiving the contribution.
- The distribution was in the form of a check and the check was misplaced and never cashed.
- The distribution was deposited into and remained in an account that the taxpayer mistakenly thought was a retirement plan or IRA.
- Taxpayer's principal residence was severely damaged.
- One of the taxpayer's family members died.
- Taxpayer or a family member was seriously ill.
- Taxpayer was incarcerated.
- Restrictions were imposed by a foreign country.
- A postal error occurred.
- The distribution was made on account of an IRS levy and the proceeds of the levy have been returned.
- The party making the distribution delayed providing information that the receiving plan or IRA required to complete the rollover despite reasonable efforts to obtain the information.



Ordinarily, the IRS and plan administrators and trustees will honor a taxpayer's truthful self-certification that they qualify for a waiver under these 11 circumstances. Even if a taxpayer does not self-certify, the IRS now has the authority to grant a waiver during a subsequent examination. Other requirements, along with a copy of a sample self-certification letter, can be found in the revenue procedure.

The IRS encourages eligible taxpayers wishing to transfer retirement plan or IRA distributions to another retirement plan or IRA to consider requesting that the administrator or trustee make a direct trustee-to-trustee transfer, rather than doing a rollover. Doing so can avoid some of the delays and restrictions that often arise during the rollover process.

For more information, visit the ["Can You Move Retirement Plan Assets?"](#) section in Publication 590-A or the [Rollovers of Retirement Plan and IRA Distributions](#) page on [www.irs.gov](http://www.irs.gov).

## How do I find the taxable portion of pensions and annuities?

### Fully Taxable Pensions and Annuities

Pension and annuity income is reported on Form 1099-R (the distribution box is unchecked), Form CSA 1099-R, and Form RRB 1099-R. In general, pension or annuity payments are fully taxable, if the following is true:

- Taxpayers did not pay any part of the cost of their pensions or annuities
- Employers did not withhold part of the cost from the taxpayers' pay while they worked
- Employers withheld part of the cost from the taxpayer's before-tax pay while they worked



Social Security benefits and IRA distributions are not reported on the pension line of the tax return.

#### example

Sue worked for a software development company for 20 years. She retired and began receiving pension income the same year. Sue never contributed to the pension plan while she was working; her employer made all of the contributions. Her pension is fully taxable.

### Partially Taxable Pensions and Annuities

Two methods used to figure the taxable portion of each pension or annuity payment are the General Rule and the Simplified Method. Unless an exception applies, retirees must use the Simplified Method for annuity payments from a qualified plan. A qualified plan is established by an employer to provide retirement benefits for employees and their beneficiaries. Employees typically do not pay taxes on plan assets until the assets are distributed; furthermore, earnings on qualified plans are tax deferred. If a taxpayer tells you they have been using the General Rule to figure the taxable portion for past years, refer them to a professional tax preparer.



If the taxpayer's annuity starting date is before July 2, 1986, the General Rule has to be used unless the Three-Year Rule was used.

The Simplified Method is used to calculate the tax-free portion of each pension or annuity payment. The Simplified Method Worksheet calculates the taxpayer's cost basis for each monthly payment. The number of monthly payments is based on the taxpayer's age (and the spouse's age if a joint/survivor annuity is selected by the taxpayer) on the annuity start date. This calculation is not changed for subsequent events, such as divorce, marriage or death.

Taxpayer's cost basis ÷ Number of monthly payments = Monthly Tax-Free Portion



**Tax Software Hint:** Refer to the Volunteer Resource Guide, Income tab, Form 1099-R for more information on calculating the taxable portion using the Simplified Method.

Be sure to include any amount of federal income tax withheld on Form 1099-R in the Payments section of the tax return.

To calculate the taxable portion of a pension or annuity using the Simplified Method, you will need certain information:

- The cost in the plan (total employee contribution on Form 1099-R)
- The taxpayer's age on the date the annuity began (and the spouse's age if joint/survivor annuity is

selected); note if the annuity starting date is before or after the taxpayer's birthday for that year

- Total of tax-free amounts from previous years, available from the taxpayer's prior year worksheet

If the taxpayer has more than one Form 1099-R that is not fully taxable, calculate the tax-free portion for each form separately.

#### example

Melvin retired from a manufacturing plant. While he was working at the plant, his employer withheld money from each paycheck and sent it to the Engineer's Pension Fund. Melvin will receive a monthly pension payment for the rest of his life. Melvin will use the Simplified Method Worksheet to determine the tax-free part of monthly payments.



#### EXERCISES (continued)

**Question 5:** Dotty worked for the local tire plant for 32 years. She retired in June and receives a monthly pension of \$1,679. (She received six payments for July through December.) Dotty never contributed to the pension plan; her employer made all of the contributions. How much of her pension is taxable?

- A. \$12,074
- B. \$11,074
- C. \$10,074
- D. \$1,679

### Disability Pension Income

Generally, taxpayers who retire on disability must include all of their disability payments in income.

**Disability payments are taxed as wages until the taxpayer reaches the minimum retirement age – this age is set by the employer.** After the taxpayer reaches the minimum retirement age, disability payments are treated as pension income to determine taxability.



When disability pay is treated as wages, it might affect the earned income credit and the taxpayer's ability to make an IRA contribution.



Taxpayers are considered disabled if they cannot engage in any substantial gainful activity because of any medically determinable physical or mental condition that can be expected to result in death or to be of long-continued and indefinite duration.

Minimum retirement age is generally the earliest age at which taxpayers may receive a pension, whether or not they are disabled.

Employers may report disability income on one of the following forms:

- Form W-2, if the taxpayer has not reached the minimum retirement age set by the employer
- Form 1099-R, if the taxpayer has reached the minimum retirement age



Some employers report qualified disability income on Form 1099-R with Distribution Code 3 in box 7 regardless of the taxpayer's age. **You must confirm the employers' minimum retirement age.** If the taxpayer is under the retirement age, the volunteer must take steps in the software to ensure the income is properly reflected as **wages** on Form 1040, line 7.

If both the taxpayer and the employer pay for a disability insurance plan, only the amount the taxpayer receives because of the employer's payments is taxable as income. The taxpayer's employer should be able to give specific details about the pension plan and the amount the taxpayer paid for the disability pension.

If the taxpayer is disabled and has not reached the minimum retirement age, report the disability income as wages on Form 1040, line 7. If the taxpayer has reached the minimum retirement age, report the taxable portion of the disability income as a taxable pension on Form 1040, line 16b.



**Tax Software Hint:** If Form 1099-R, box 7, indicates a distribution code 3, and the taxpayer is on disability but under retirement age, check the box stating the taxpayer is disabled. The tax software will place the amount on Form 1040, line 7, Wages, rather than the pension line.

Refer to the Volunteer Resource Guide, Income tab, Form 1099-R for more information on how to report disability pay to ensure it is reported on the correct line of Form 1040.



## EXERCISES (continued)

**Question 6:** Annie Jo is 47 years old and has retired on disability from her job. While loading cargo for a tractor-trailer company, a large box fell on her and left her paralyzed. She receives a monthly payment from her former employer's pension plan to which Annie Jo had not contributed. She has not reached the minimum retirement age set by her company's pension plan. On which line of her Form 1040 should you report her disability income?

- A. Line 63, estimated tax payments and amount applied from return
- B. Line 16a, pensions and annuities
- C. Line 16b, taxable pensions and annuities
- D. Line 7, wages

## Retired Public Safety Officers

Eligible public safety officers can elect to exclude from income distributions of up to \$3,000 made directly from a government retirement plan to the provider of accident, health, or long-term disability insurance. A public safety officer includes a law enforcement officer, firefighter, chaplain, or member of a rescue squad or ambulance crew. See Insurance Premiums for Retired Public Safety Officers in Publication 575 for more information.



**Tax Software Hint:** If the taxpayer is eligible for the exclusion, refer to the Volunteer Resource Guide, Income tab, Form 1099-R.

## What other retirement income issues are there?

There are a few other issues related to reporting retirement income that you may encounter. Some of the following distributions are subject to various additional taxes that are computed on Form 5329, Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts. If certain exceptions are met, the additional tax does not apply.

Only the exceptions for early distributions not subject to the additional tax (Part I of Form 5329) are included in scope for the VITA/TCE training. Refer taxpayers who must complete other information on Form 5329 to a professional tax preparer. Form 5329 and exceptions are covered in the Other Taxes lesson.

## Lump-Sum Distributions

A lump-sum distribution is the distribution or payment within one tax year of an employee's entire balance from all qualified pension, stock bonus, or profit-sharing plans that the employer maintains. The distribution does not include certain deductible voluntary employee contributions and certain amounts forfeited or subject to forfeiture. Distributions from IRAs or tax-sheltered annuities do not qualify as lump-sum distributions.

To qualify as a lump-sum distribution, the plan participant must have been born before January 2, 1936 and the payment must have been made:

- Because the plan participant died, or
- After the participant reached age 59½, or
- Because the participant (not including a self-employed individual) separated from service with the employer, or
- After the participant, if self-employed, became totally and permanently disabled

Lump-sum distributions are reported on Form 1099-R like any other pension distribution. Some lump-sum distributions qualify for special tax treatments. If Form 1099-R indicates a distribution code of A, it is a lump-sum distribution qualifying for special tax treatments. Taxpayers with this situation should be referred to a professional tax preparer.

## Premature Distributions

A premature distribution is an early withdrawal from a retirement fund, for purposes other than retirement, by a taxpayer who is under 59½. Early distributions can be subject to an additional 10% tax. The additional tax applies to the taxable portion of the distribution or payment.

Certain early distributions are not subject to the early distribution tax. When the distribution code on Form 1099-R is 1, the taxpayer will not be subject to the additional 10% tax if an exception applies.

If the distribution code is 2, 3, or 4, the taxpayer does not have to pay the additional tax. The exceptions for excluding early distributions from the additional tax are covered in more detail in the Other Taxes lesson.

## Minimum Distributions

To avoid an additional tax, participants in retirement plans must begin taking a Required Minimum Distribution (RMD) by a specified date. That date is April 1 of the calendar year following the year in which the taxpayers either reached age 70½, or retired, whichever is later. For IRAs, it does not matter whether the taxpayer has retired. These rules do not apply to Roth IRAs. The trustee of the qualified plan will contact the taxpayer at the appropriate time to begin RMD.

After the starting year for RMDs, taxpayers must receive the minimum distribution for each year by December 31 of that year. (The starting year is the year in which the taxpayer reaches 70½ or retires.) If no distribution is received during the taxpayer's starting year, the required minimum distributions for two years must be received the following year, one of which must be taken by April 1.



If the taxpayer does not receive the minimum distribution, an additional tax may be imposed. The tax is 50% of the difference between the minimum distribution and the amount actually distributed for the tax year.

This information is provided for your information only, to help you answer any questions a taxpayer may ask about RMD. RMD distributions are reported on Form 1099-R and included on the return using the procedures previously discussed.

example

Peter turned 70½ on August 20 of this year. He must receive the first required minimum distribution from his IRA by April 1 of next year. He must receive a second required minimum distribution by December 31 of next year.

example

Ralph retired five years ago. He turned 70½ this tax year. He must begin taking minimum distributions from his qualified plans by April 1 of the following year.

example

Myrna was 72 when she retired this year. She was required to begin taking minimum distributions from her traditional IRA after age 70½ even though she has not retired. Myrna has until December 31 to take her minimum distribution for the current tax year.

### Withdrawal of Excess IRA Contributions

An excess IRA contribution is the amount contributed to a traditional and/or Roth IRA during the year that is more than the smaller of:

- \$5,500 (\$6,500 if age 50 or older), or
- The taxable compensation for the year

The taxpayer may not know that a contribution is excess until the tax return is completed after the end of the year. In this situation, the excess amount, with any earnings on that amount, must be withdrawn by the due date of the return (including extensions). If the excess amount is not withdrawn by the due date of the return, the taxpayer will be subject to an additional 6% tax on this amount.

The withdrawn excess contribution is not included in the taxpayer's gross income if both of the following conditions are met:

- No deduction was allowed for the excess contribution
- All interest or other income earned on the excess contribution is withdrawn by the due date of the return, including extensions

However, taxpayers must include the earnings on the excess contribution as income on the return. This income is reported on the return for the year in which the excess contribution was made. The withdrawal of interest or other income may also be subject to an additional 10% tax on early distributions.

If the taxpayer is subject to an additional tax due to excess IRA contributions, refer them to professional tax preparer.



## EXERCISES (continued)

**Question 7:** Taxpayers who withdraw excess contributions and earnings on the excess contributions by the due date of the tax return are not subject to an additional 6% tax on the excess contribution.

True  False

**Question 8:** Helen turned 70½ on March 17, 2015. She retired in 2004. She has never taken any distribution from her traditional IRA accounts. The bank told her that she now needs to take a minimum distribution of \$1,479 per year. Helen is required to:

- A. Take a distribution of \$1,479 by December 31, 2015
- B. Take a distribution of \$1,479 by April 1, 2015, and another \$1,479 by December 31, 2015
- C. Take a distribution of \$2,958 by December 31, 2015
- D. Take a distribution of \$1,479 by April 1, 2016, and another \$1,479 by December 31, 2016



## How do I determine when an adjustment to withholding should be made?

After the completion of the return, if the taxpayer owes \$1,000 or more on the tax return, you should discuss their withholding and estimated tax options with them. This is covered in more detail in the Completing the Return lesson.

Sometimes taxpayers are not aware they can request that federal income tax be withheld from their retirement income by filing Form W-4P, Withholding Certificate for Pension or Annuity Payments. This form is sent to the payer. Also, Form W-4V, Voluntary Withholding Request, is used to request withholding from Social Security benefits. This form is sent to the Social Security Administration. Every year, the Social Security Administration reports taxpayers' retirement benefits and/or voluntary withholdings on Form 1099-SSA.



**TIP** Taxpayers who receive a very large refund may make better use of their funds if tax withholding is lowered. Explain ways they can reduce their withholding.

For additional help, taxpayers can refer to Publication 17, Withholding, Form W-4, or visit the IRS Web site at [www.irs.gov](http://www.irs.gov) and use the "Withholding Calculator." A taxpayer who chooses not to have tax withheld may have to pay estimated tax each quarter. Failure to pay enough federal income tax throughout the year can result in a large amount of tax being owed when the return is due. It can also result in a penalty. Form 1040-ES, Estimated Tax for Individuals, is used to calculate the estimated quarterly payment and provides vouchers with which to remit the payments.



## EXERCISES (continued)

**Question 9:** Faith comes to your site to get her tax return done. When you finish her return, you explain to her that she owes \$985, and that she needs to pay this amount by April 15. She says that she will pay the amount, but wants to know if there is some way to have more tax withheld from her pension so that she doesn't owe so much at the end of the year. Which form should she complete to increase the withholding from her pension?

- A. Form W-4P
- B. Form W-4V



## Summary

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This lesson helped you identify, calculate, and report the taxable portion of retirement income received by the taxpayer. It reviewed the types of retirement income and the forms used to report them. You learned when taxpayers of retirement age are required to take a minimum distribution from a retirement plan and when they may need to adjust their withholding.

### What situations are out of scope for the VITA/TCE programs?

The following are out of scope for this lesson. While this list may not be all inclusive, it is provided for your awareness only.

- The taxpayer needs to file Form 8606
- Taxpayers who made nondeductible contributions to a traditional IRA
- Taxpayer subject to additional tax due to excess IRA contributions
- Roth IRA distributions that are taxable or partially taxable, and distributions with Form 1099-R, code J or T
- IRA rollovers that do not meet the tax-free requirements
- Taxpayers who used the General Rule to figure the taxable portion of pensions and/or annuities for past years
- Form 1099-R, distribution code A (lump-sum distribution qualifying for special tax treatments)



### TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem or practice exercise(s) for your course of study in Publication 4491-W.

For practice using the tax preparation software, complete the scenarios using the Practice Lab on L&LT.

You may not be able to complete the entire exercise if some of the technical issues in the exercise are not covered until later lessons in the training. In these instances, complete as much of the exercise as you can. Come back later to finish the exercise after you cover all the technical topics.





## Income – Schedules K-1 and Rental



### Introduction

This lesson covers the reporting of:

- Certain income from Schedules K-1 (Forms 1065, 1120S, and 1041). Only volunteers who certify at the Advanced level are permitted to prepare a Schedule E with Schedule K-1 income items identified in this lesson or Form 1099-MISC, Box 2, Royalties, with no associated expenses.
- Rental income and expenses are in-scope only for military families renting their personal residence. Taxpayers are not required to report income and expenses if their home is rented less than 15 days.
- Rental income and expenses **only** for the Military course. Volunteers must certify at Military level to prepare Schedule E for rental income.



Rental income and expenses are in-scope only for military families renting their personal residence. Generally, the at-risk and passive activity issues in this lesson are beyond the scope of the VITA/TCE programs. These issues are referenced for those assisting military members living abroad who have limited access to resources and professional preparers.

The intake and interview sheet provides a line to list income from rental property but does not provide a place to list income from Schedules K-1. It is important to ensure that all income is accurately reported on the return. For military families, ask taxpayers if they rented out their home during the tax year or if they received a Schedule K-1 (Form 1041, Form 1065, or Form 1120S) from an estate, trust, partnership, or S corporation.



This lesson does not apply to taxpayers who are in the business of renting properties.

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Identify Schedule K-1 income items that are within the scope of the VITA/TCE programs
- Determine how to report Schedule K-1 income items
- Determine which types of rental income must be reported
- Identify how to report rental expenses

#### What do I need?

- Form 13614-C
- Publication 4012
- Publication 17
- Publication 4491-W
- Schedule A
- Schedule E
- Optional:**
- Publication 527
- Publication 541
- Publication 551
- Publication 559
- Publication 925
- Publication 946
- Form 8582
- Schedule K-1 (Form 1041 and Instructions)
- Schedule K-1 (Form 1065 and Instructions)
- Schedule K-1 (Form 1120S and Instructions)



## Schedule K-1

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### What is reported on Schedule K-1?

Schedule K-1 is used to report the taxpayer's share of income, other distributions, deductions, and credits from partnerships, S corporations, and some estates and trusts. One copy of Schedule K-1 is sent to the IRS and is later matched with individual returns. Another copy of Schedule K-1 is sent to the taxpayer. Ask taxpayers if they received a Schedule K-1 from such an entity that reflects their share of income, reportable on their Form 1040. It is important to correctly report this income to avoid notices or correspondence from the IRS.

### How and where can income be reported?

Income reported on Schedule K-1 will be included on the taxpayer's return in various places depending upon the type of income. Income reported on Schedule K-1 that is within the scope of the VITA/TCE programs includes:

- Interest income (1040, line 8a)
- Dividend income (1040, line 9a)
- Qualified Dividends income (1040, line 9b)
- Net short-term capital gains and losses (Schedule D, line 5)
- Net long-term capital gains and losses (Schedule D, line 12)
- Tax-exempt interest income (Form 1040, line 8b)
- Royalty income (Schedule E)

In Part I of Schedule E, enter a code 6 for royalties. Refer to the Schedule E Instructions for more information.



**CAUTION** Royalty income is in scope for the VITA/TCE programs only when the source document of the royalty income is reported on Schedule K-1 or Form 1099-MISC, Box 2, Royalties, with no associated expenses. For these investors, the depletion allowance would already have been figured for them by the partnership or S corporation. Any other income, deductions, credits, etc., reported on Schedule K-1 is out of scope for the VITA/TCE programs, and the taxpayer should be referred to a professional tax preparer.

### Schedule K-1 (Form 1041)

The fiduciary of a domestic decedent's estate, trust, or bankruptcy estate uses Form 1041 to report income, gains, losses, etc., of the estate or trust.

Taxpayers receive Form 1041, Schedule K-1, to report their share of income from interest, dividends (ordinary and qualified), and capital gains (net short-term and net long-term). The taxpayer's income from these sources should be reported on the appropriate forms and schedules as listed on Form 1041, Schedule K-1, page 2.

## Schedule K-1 (Forms 1065 and 1120S)

Partnerships use Form 1065, Schedule K-1, to report the taxpayers' share of the partnership's income, deductions, credits, etc. In general, a partnership is not subject to income tax and is a flow-through entity. This means the income flows through to the partners, who pay tax on their allocated share of the partnership income.

S corporations use Form 1120S, Schedule K-1, to report the taxpayers' share of the corporation's income (reduced by any tax the corporation paid on the income), as well as any deductions, credits, etc. The S corporation is also a flow-through entity with the reported income flowing to each shareholder. Shareholders pay tax on their allocated share of the income.

Taxpayers receive a Schedule K-1 (Form 1065 or Form 1120S) reporting their share of income from interest, dividends (ordinary and qualified), and capital gains (net short-term and net long-term) from partnerships and corporations. Schedule K-1, page 2, lists the appropriate forms and schedules where taxpayers' income from these sources should be reported.



Schedules K-1 are not filed with the tax return. Advise taxpayers to keep Schedules K-1 with their records.



## What is rental income?

Generally, payment received for renting a room or a home to a tenant is rental income reportable on Form 1040, Schedule E. U.S. citizens and resident aliens must report rental income, regardless of whether the rental property is located in the U.S. or in a foreign country. Gross rental income may include other payments in addition to the normal and ordinary rents received, such as:

- Advanced rent
- Security deposits, if it represents rental income
- Payments for breaking a lease
- Expenses paid by the tenant
- Fair market value of property or services received instead of rental payments



The security deposit is not included in income when the taxpayer plans on returning the deposit at the end of the lease. However, if the security deposit is intended to serve as the last month's rent, then it should be included in income when received.

The taxpayer's method of accounting affects when the rental income is reported. The cash method reports income when received and expenses when paid; most individuals use this method. The accrual method reports income when earned and expenses when incurred, and is out of scope for the VITA/TCE programs. Refer taxpayers using the accrual method of accounting to a professional tax preparer.

In completing Schedule E, the following should be answered:

- Question A – Check the box “Yes” or “No” to the question: Did the taxpayer make any payments in the current year that would require the filing of Form 1099? If Yes, the return is out of scope.
- Question B – If Yes, did or will the taxpayer file all required Forms 1099? Check the box “Yes” or “No.”
- In Part I, line 2 – The number of fair rental value days and number of personal use days is reported on Schedule E.



Landlords who are not in the business of renting property are not required to file Form 1099 even if they pay a service provided more than \$600 a year.



**Tax Software Hint:** Use Schedule E to report rental income only when the taxpayer is not in the business of renting property. For software entries, see the Volunteer Resource Guide, Income tab, Schedule E – Rental and Royalty Income and Loss (Limited).



It is important that property be rented at fair rental value. If a property is rented at less than fair rental value, the income and expenses are reported in a different manner than discussed in this lesson. Refer taxpayers who rent their property at less than fair rental value to a professional tax preparer.

## What qualifies as a rental expense?

Taxpayers who reside in homes they own generally itemize and deduct mortgage interest and property taxes on Schedule A. However, when a taxpayer rents out a home, those become rental expenses along with the cost of certain other operating expenses. Taxpayers who do not use the rental home as their residence should:

- Include the rent as income and
- Deduct all of the rental expenses, even if they exceed income

### Mortgage interest and property taxes

Mortgage interest on a loan used to buy or improve the property and property taxes are deductible as rental expenses. If the residence (or a portion of the residence) was used as rental property for any part of the year, the taxpayer must allocate the property tax and mortgage interest deductions between Schedule A and Schedule E.

In general, taxpayers use Schedule A, Itemized Deductions, to report the portion of the mortgage interest and property taxes that apply to their use of the home. That portion can be based on a percentage of time (4 months as a residence and 8 months used as rental) or based on an area (1,500 sq. ft. as a residence and 500 sq. ft. as the rental portion). For the part of the year and/or the portion of the home that is rented out, taxpayers report rental income and expenses (including a portion of the mortgage interest, property taxes, and other expenses that relate to the rental time/portion of the home) on Schedule E, Supplemental Income and Loss.

If any part of the property tax is designated for local benefits that increase the value of the property, such as streets and sidewalks, that portion of the tax is added to the basis of the property rather than as an ordinary rental expense or an itemized deduction.

Mortgage interest is reported to the taxpayer on Form 1098, Mortgage Interest Statement. This statement may also include property taxes. If it does not, the taxpayer will have a document from the local taxing authority.



Generally, mortgage interest expense is fully deductible. However, refer taxpayers with rental-related interest expenses other than mortgage interest to a professional tax preparer.

### example

Paul Kingman lived in his home through September, when he was notified he was being transferred overseas. He rented his home beginning in October. The total amount of Kingman's mortgage interest for the tax year was \$2,400 and his property taxes were \$600. Report nine months (January–September) of mortgage interest and property taxes as itemized deductions on Schedule A, that is, \$1,800 and \$450, and the other three months (October–December) as expenses on Schedule E, that is, \$600 and \$150.

### What are other deductible rental expenses?

In addition to mortgage interest and property taxes, deductible rental property expenses include these items listed on Schedule E:

- Advertising
- Auto and travel expenses to check on the property
- Cleaning and maintenance
- Commissions paid for collecting rental income
- Insurance premiums
- Mortgage points
- Legal and professional fees
- Property management fees
- Repairs
- Utilities
- Other rental-related expenses, such as rental of equipment, long distance phone calls, and condominium/cooperative maintenance fees
- Small assets, each less than \$2,500, can be expensed immediately as “de minimis”



When a tenant does not pay the rent, a cash-basis landlord cannot take a deduction for the unpaid rent. Taxpayers cannot take a deduction for a payment they did not include in income.



### EXERCISES

**Question 1:** John Princeton was transferred overseas and began renting out his residence on September 1 of the tax year. How much of his mortgage interest and property taxes should be reported on his Schedule E?

- A. All of it
- B. Eight-twelfths ( $2/3$  or 67%)
- C. Four-twelfths ( $1/3$  or 33%)
- D. None of it

### What about property insurance?

The property insurance that taxpayers pay on their residence is deductible as a rental expense for the time it is considered rental property. If the residence is rented for part of the year, only the amount that covers

the rental time is deductible. If a portion of the residence is rented, the deductible portion must be allocated and deducted on Schedule E.

Insurance premiums paid more than one year in advance cannot be deducted in one year. All taxpayers must prorate advanced premium payments over the period covered by the policy. The only portion deductible in the current year is that amount that covers the current year. The remainder is spread out over the life of the insurance coverage.

### Can auto and travel expenses be deducted as rental expenses?

Taxpayers can deduct ordinary and necessary travel and transportation expenses attributable to the production of rental income. If the travel was in or outside of the U.S., taxpayers should substantiate the pleasure vs. business portions of the trip and allocate the expenses accordingly.

Taxpayers who use their personal automobile for rental-related trips may use either the standard mileage rate or the actual expense method for business mileage. However, if the taxpayers wish to use the actual expense method, refer them to a professional tax preparer.

The standard mileage method multiplies the miles driven for business by a standard cost. The standard rate includes all expenses of operating the vehicle. Only parking and tolls can be added to the standard mileage deduction. See Publication 17, Car Expenses and Other Employee Business Expenses, for the current year standard mileage rate. Taxpayers may use the standard mileage rate only if they meet one of these requirements:

- The vehicle was owned and used the standard method the first year the vehicle was put into service or
- The vehicle was leased and used the standard method for the life of the lease

The actual expense method figures the deduction based on a variety of factors, including gasoline, oil, repairs, insurance, and rentals and may even involve depreciation or the value of a vehicle provided by the taxpayer's employer.



This lesson discusses only the standard mileage rate. If taxpayers wish to use the actual method, refer them to a professional tax preparer.

### Are repairs and improvements deductible?

Taxpayers often misunderstand when an expense qualifies as a repair or an improvement. A repair keeps the property in good operating condition; the cost is a current year deduction. An improvement adds to the life or material value of the property, prolongs its useful life, or adapts it to new uses. This cost must be depreciated over the recovery period for the improvement. The total cost of an improvement includes material, labor, and installation.



**Tax Software Hint:** Tax Software Hint: For software entries, go to the Volunteer Resource Guide, Income tab, Entering Rental Income in TaxSlayer®.

Repairs (Deduction)	Improvements (Depreciation)
Painting	Adding a room
Fixing gutters	Installing a new fence
Repairing driveways	Putting in plumbing or wiring
Replacing window glass	Replacing a hot water tank
Repairing the roof	Putting on a new roof
Repairing appliances	Replacing/adding major appliances





Additional information on rental income can be found in Publication 527, Residential Rental Property and Publication 946, How to Depreciate Property.



## EXERCISES (continued)

**Question 2:** All of the following are examples of deductible rental expenses *except* \_\_\_\_\_.

- A. Carpet cleaning fees
- B. Charges for phone calls made to the property manager
- C. Gas and electric bills paid for the rental property
- D. Repairs made to the homeowner's personal residence

**Question 3:** Which of the following rental expenses must be recovered by taking depreciation?

- A. Home insurance premiums
- B. Painting
- C. Installing a backyard fence at a cost of \$3,500
- D. Repairing a broken furnace

### How do I handle depreciation of rental property?

The cost of property with a useful life of one year or more, and used in a trade or business or held for the production of income (such as rent), is recovered by deducting an expense called depreciation.

"Depreciable property" includes buildings, machinery, furniture, equipment, vehicles, and any cost for additions or improvements to rental property. The value of land, however, is not depreciable; therefore, the cost of clearing, grading, planting, or other land improvements are also not depreciable.

Depreciation allows the taxpayers to deduct some of the cost of the property each year on their tax return. The annual amount of depreciation on property reduces the taxpayers' basis in that property. Taxpayers should claim the correct amount of depreciation every year. Even if they did not deduct the depreciation during any tax year, they must still reduce their basis in the property by the amount of depreciation that they should have deducted.

### What factors determine the amount of depreciation to deduct?

The factors that determine the depreciation amount are:

- Depreciation method used
- Basis of the property
- Recovery period for the property

#### **Depreciation Method**

The most common methods for determining depreciation are:

- Straight line or declining balance: Property placed in service before 1981
- ACRS (Accelerated Cost Recovery System): Property placed in service after 1980, but before 1987
- MACRS (Modified Accelerated Cost Recovery System): Property placed in service after 1986

### ***What is considered the basis and adjusted basis for depreciation purposes?***

Generally, the basis for depreciation is the purchase price of the property, including the cost of improvements, but not including the value of the land. When property is converted from personal use to rental use, the basis is the lesser of the adjusted basis or fair market value (FMV) at the time of conversion. The total of the yearly deductions for depreciation can never total more than the basis of the property.

### **Form 4562 Depreciation and Amortization**

Taxpayers must complete and attach Form 4562 for rental activities only if claiming:

- Depreciation, including the special depreciation allowance, on property placed in service during 2016 (out of scope)
- Depreciation on listed property (such as a car), regardless of when it was placed in service (out of scope)
- Any other car expenses, including the standard mileage rate or lease expenses (out of scope)

Otherwise, taxpayers should figure the depreciation on their own worksheet. Do not attach these computations to the return, but taxpayers should keep them in their records for future reference.



**Tax Software Hint:** For depreciation software entries, go to the Volunteer Resource Guide, Income tab, Entering Rental Income in TaxSlayer®.

### **How do I handle rental property that the taxpayer also uses?**

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When the rental property is a portion of the taxpayer's residence, the rental income and expenses must be allocated separately from the taxpayer's personal expenses.

### **How do I differentiate between rental expenses and personal use expenses?**

Expenses that apply to only the rental part of a property are direct business expenses and should be reported in full on Schedule E. The cost of installing a second phone line strictly for a tenant's use, for example, is deductible as a rental expense. However, the taxpayer cannot deduct any part of the cost of the *first* phone in a partially-rented property, even if tenants use it.

Expenses that benefit the entire property (indirect expenses) must be divided between rental use and personal use; the rental portion is reported on Schedule E. If deductions are itemized, the personal portion of home mortgage interest and property tax may be reported on Schedule A. The taxpayer can choose any reasonable method to allocate the expenses. The most common methods are based on the number of rooms in the dwelling or on the total area of the dwelling.

On Schedule E, report expenses that apply exclusively to the rental room and the allowed percentage of expenses that benefit the entire house. For example, if the rented portion is 10% of the property, the taxpayer could deduct:

- 100% of the cost to wallpaper the tenant's room
- 10% of property taxes, utilities, mortgage interest, and depreciation

#### **example**

Gloria rents one room in her 1,200 square foot house to a tenant. The rental room measures 10 feet by 12 feet (120 square feet, or 10% of the total house). She may deduct:

- 100% of any expenses that relate only to the rental portion of the house, such as repairs or upgrades to the rented room
- 10% of any qualified expense that benefits the entire house

When taxpayers can itemize personal deductions on Schedule A, they can report the deductible expenses that benefit the entire house minus the percentage that applies to the tenant's room. In Gloria's case, if she is treating the rental portion as 10% of the residence, she can deduct the following on Schedule A:

- 90% of the mortgage interest
- 90% of the property taxes



Expenses related to days of personal use do not qualify as rental expenses. The taxpayer must allocate the expenses based on the number of days of personal use to total use of the property.

#### example

Charles used his rental property for personal use 7 days and rented it for 63 days. In most cases, 10% of Charles' expenses are not rental expenses and cannot be deducted on Schedule E (7 = 10% of 70 total days: 7 personal days + 63 rented days).



#### EXERCISES (continued)

**Question 4:** For taxpayers who rent part of a property in which they live, which expenses are reported only on Schedule E and not on Schedule A?

- A. Home insurance and mortgage interest
- B. Property taxes and repairs
- C. Utilities and home insurance
- D. Depreciation and property taxes

### How should taxpayers report rental expenses that exceed their rental income when they live in the home for part of the year?

Questions in Part I, line 2 of Schedule E ask for information on the number of rental days at fair rental value and the number of days for personal use. If taxpayers rented out a dwelling unit that they also used for **personal purposes** during the year, they may not be able to deduct all the expenses for the rental part.

**Dwelling unit** (the unit) means a house, apartment, condominium, or similar property. A day of **personal use** is any day, or part of a day, that the unit was used by:

- The taxpayer for personal purposes,
- Any other person for personal purposes, if that person owns part of the unit (unless rented to that person under a "shared equity" financing agreement),
- Anyone in the taxpayer's family (or in the family of someone else who owns part of the unit), unless the unit is rented at a fair rental price to that person as his or her main home,
- Anyone who pays less than a fair rental price for the unit, or
- Anyone under an agreement that lets the taxpayer use some other unit

#### **Are there any exceptions?**

Taxpayers who used a dwelling unit as their main home may not have to count all that time as "days of personal use." Do not count as personal use any day the taxpayer:

- Spends working substantially full time repairing and maintaining the unit, even if a family member used it for recreational purposes on that day, or

- Used the unit as the taxpayer's main home before or after renting it or offering it for rent, if the taxpayer rented or tried to rent it for at least 12 consecutive months (or for a period of less than 12 consecutive months at the end of which the taxpayer sold or exchanged the home)

#### example

On February 28, 2011, Trent moved out of the house he had lived in for six years because he was deployed overseas. He rented his house at a fair rental price from March 15 last year to May 14 this year. On June 1 this year, he returned from his deployment and moved back into his house. Because he rented his property for 12 or more consecutive months, his use of the house is not counted as personal use. Since these days are not counted as days of personal use, the limitations on deductions do not apply.

## Are there any limitations?

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There are limitations based on whether the taxpayer used the dwelling unit as a home and it meets the personal use test. The personal use test is met if the taxpayer used the unit for personal purposes in the current tax year **more than the greater of:**

- 14 days or
- 10% of the total days it was rented to others at a fair rental price

Fair rental days and personal use days are reported in Part I, line 2, of Schedule E.

If the taxpayer did not use the dwelling unit as a home, the taxpayer can deduct all the expenses for the rental part, subject to the At-Risk Rules and the Passive Activity Loss Rules. For more details on these rules, refer to Publication 527, Residential Rental Property.

If the taxpayer used the dwelling as a home and rented the unit for **fewer than 15 days** in the current tax year, do not report the rental income and do not deduct any rental expenses. If the taxpayer itemizes deductions on Schedule A, the taxpayer can deduct allowable interest, taxes, and casualty losses. (Remember that the topic of casualty losses is out of scope for the VITA/TCE programs.)

If the taxpayer used the dwelling as a home and rented out the unit **at least 15 days** in the current tax year, the taxpayer may not be able to deduct all of the rental expenses. The taxpayer can deduct all of the following expenses for the rental part on Schedule E:

- Mortgage interest
- Real estate taxes
- Casualty losses (out of scope)
- Other rental expenses not related to the taxpayer's use of the unit as a home, such as advertising expenses and rental agents' fees

If there is rental income left after deducting these expenses, the taxpayer can deduct other expenses, including depreciation, up to the amount of remaining income. The taxpayer can carry over to the following tax year the unused expense amounts.



**Tax Software Hint:** If the property was used as a rental for the entire year, the income and expenses can be reported on Schedule E. If the property was used partially as a rental and partially as a residence, some expenses may need to be allocated. For software entries, go to the Volunteer Resource Guide, Income tab, Entering Rental Income in TaxSlayer®.

## How do I handle rental losses?

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Deducting all rental expenses and depreciation from the rent received may result in a net loss. Rental losses are not always fully deductible. There are two restrictions on how much a loss can offset other sources of income:

- At-risk rule
- Passive activity rules

### What is the at-risk rule?

The at-risk rule places a limitation on the amount the taxpayer can deduct as losses from activities often described as tax shelters. Generally, any loss from an activity subject to the at-risk rules is allowed only to the extent of the total amount the taxpayer has at risk in the activity at the end of the tax year.

### What are the passive activity rules?

The passive activity rules state that passive activity losses can be deducted only from passive activity income. Passive income does not include salary, dividends, or investments but is generally attributed to such things as rental income. Therefore, losses that exceed rental income (the passive activity) are not deductible; however, some losses may be deductible if an exception is met.

#### *Passive income and active participation*

The limits on deducting rental losses are affected by the degree to which renting out the property is a passive activity or involves active participation:

- Passive rental activity means receiving income mainly from the use of property rather than for services.
- Active participation means making significant management decisions, such as approving rental terms, repairs, expenditures, and new tenants. Taxpayers who use a leasing agent or property manager could be considered active participants if they retain final management rights.

#### *Exception*

Rental activities are generally considered passive activities. For this reason, rental losses are not fully deductible. However, an exception to the passive activity rule provides that taxpayers who actively participate in the rental activity can use up to \$25,000 of their rental losses to offset any other nonpassive income (\$12,500 for married taxpayers filing separately and living apart for the entire year). Examples of nonpassive income are salaries, wages, commissions, tips, self-employment income, interest, dividends, annuities, and some royalties. (This deduction is subject to phaseout if the taxpayer's adjusted gross income (AGI) exceeds certain limits.)

### What is active participation?

It is considered active participation when taxpayers own at least 10% of the rental property and make management decisions in a significant and bona fide sense. Management decisions include approving new tenants, deciding on rental terms, approving expenditure, and similar decisions.



For more information, see Publication 925, Passive Activity and At-Risk Rules.

### ***Phase-Out of Offset***

The amount allowed to offset nonpassive income is:

- Reduced once the taxpayer's Adjusted Gross Income (AGI) exceeds \$100,000 (\$50,000 for Married Filing Separately)
- Completely phased out when AGI exceeds \$150,000 (\$75,000 for Married Filing Separately)



### **EXERCISES** (continued)

**Question 5:** Which restriction limits the deductibility of rental loss to the amount of rental income?

- A. Phase-out of offset
- B. Passive activity rules
- C. Active participation rule

### **How are passive rental losses reported?**

Taxpayers use Form 8582 to figure the amount of any passive activity loss allowed for the current tax year. Form 8582 summarizes losses and income from all passive activities.

Generally, taxpayers are not required to file Form 8582 if they have:

- Only one passive loss generated from a rental activity and
- An AGI of less than \$100,000

Completing Form 8582 is out of scope if volunteers are required by software to enter additional data in Form 8582.

## Summary

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Taxpayers receive Schedule K-1 (Form 1065, Form 1041, or Form 1120S) reporting their share of income from flow through entities. Interest, dividends (ordinary and qualified), capital gains (net short-term and net long-term) are in scope. Schedule K-1, page 2, lists the appropriate forms and schedules where the taxpayers' income from these sources should be reported. Additionally, royalties on Schedule K-1, Forms 1065 and 1120S are within scope. Volunteers must certify to the Advanced level or above to prepare a Schedule E with entries from Schedule K-1.

Rental income and deductible rental expenses are reported on Part I of Schedule E, Supplemental Income and Loss. Volunteers must certify at the Military level to prepare a Schedule E for rental income. Rental income and expenses are in-scope **only** for military families renting their personal residence.

U.S. citizens and resident aliens must report rental income for the months their home is rented, regardless of whether the rental property is located in the U.S. or in a foreign country.

When renting out part of the property, certain expenses must be divided between rental use and personal use; some are reported on Schedule A and some on Schedule E.

Taxpayers who do not use a dwelling unit as a home (for personal purposes) should include all the rent in their income and deduct all the rental expenses. There are special rules and limitations if the taxpayer used the dwelling unit as a home and it meets the personal use test.

Rental income and expenses are not reported if the taxpayer used the dwelling as a home and rented the unit for fewer than 15 days in the current tax year. If the taxpayer itemizes deductions on Schedule A, the taxpayer can deduct allowable interest, taxes, and casualty losses. (Remember that the topic of casualty losses is out of scope for the VITA/TCE programs.)

Because rental activities are generally considered passive activities, rental losses are not fully deductible. However, taxpayers who actively participated in the renting of the property may deduct up to \$25,000 of their rental losses, up to \$12,500 for married taxpayers filing separately and living apart. This deduction is subject to phase-out if the taxpayer's AGI exceeds certain limits.

The passive activity rules state that passive activity losses can be deducted only from passive activity income. Taxpayers with rental losses may be required to file Form 8582, Passive Activity Loss Limitations.

### **What situations are out of scope for the VITA/TCE programs?**

The following are out of scope for this lesson. While this list may not be all inclusive, it is provided for your awareness only.

- Income reported on Schedules K-1 (other than what is listed in the introduction to this lesson)
- Deductions, credits, and other items reported on Schedules K-1
- Royalty income reported on Form 1099-MISC with associated expenses
- Rental income and expenses for non-military taxpayers
- Taxpayers who rent their property at less than fair rental value
- Rental-related interest expenses other than mortgage interest
- The actual expense method (auto and travel expense deductions)
- Casualty loss
- Completing Form 8582
- Completing Form 4562
- Taxpayers who filed or need to file Form(s) 1099



## TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem or practice exercise(s) for your course of study in Publication 4491-W.

For practice using the tax preparation software, complete the scenarios using the Practice Lab on L&LT.



## EXERCISE ANSWERS

**Answer 1:** C. You would deduct four-twelfths (33%) of his mortgage interest and taxes on Schedule E, and report the other 67% on Schedule A.

**Answer 2:** D. Repairs made to the homeowner's personal residence are not deductible as rental expenses. However, the other expenses are deductible, along with repairs made to rental property, legal and professional fees, and property management fees.

**Answer 3:** C. The fencing adds value to the property and would have to be capitalized and depreciated. It cannot be expensed because it exceeds the amount allowed as an immediate de minimis write-off.

**Answer 4:** C. The rental portions of utilities, home insurance, repairs, and depreciation are rental deductions on Schedule E, but the personal portions are not a deductible expense reported on Schedule A. Taxpayers who rent out part of a property allocate mortgage interest and property taxes separately on both schedules.

**Answer 5:** B. Passive activity losses can be deducted only from passive activity income. Taxpayers who are not active participants may not deduct rental losses that exceed rental income.





## Income – Unemployment Compensation; Form 1040, Line 19



### Introduction

This lesson will help you assist taxpayers who have unemployment compensation payments.

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Identify unemployment compensation income
- Determine how to report unemployment compensation on the tax return

#### What do I need?

- Form 13614-C
- Publication 4012
- Publication 17
- Publication 4491-W

#### **Optional:**

- Form 1099-G

### What is unemployment compensation?

Unemployment compensation generally includes any amount received under an unemployment compensation law of the United States or of a state in the U.S. In most cases, unemployment compensation is taxable. If taxpayers contribute to a governmental unemployment compensation program or a governmental paid family leave program and the contributions are not deductible, amounts received under the program are not included as unemployment compensation until the taxpayers recover their contributions. If the taxpayer has already deducted all of the contributions to the program, the entire amount received under the program is taxable.

### Where can I get unemployment compensation information?

Begin with the unemployment question on intake and interview sheet. Ask the taxpayer for any Form(s) 1099-G, Certain Government Payments that document unemployment compensation payments from each government entity.

In most states, taxpayers can elect to have federal income taxes withheld from their unemployment compensation benefits. Be sure to review Form 1099-G, box 4, for any federal income tax withheld.

### How do I report unemployment compensation?

The total for all amounts of unemployment received in Form(s) 1099-G, box 1, should be entered on Form 1040, line 19.

The amount of withholding from Form 1099-G, box 4 should be entered in the payment section on Form 1040.



**Tax Software Hint:** To review information related to the software, go to the Volunteer Resource Guide, Income tab.





## Income – Social Security Benefits; Form 1040, Line 20a



### Introduction

This lesson will help you assist taxpayers who have Social Security and equivalent railroad retirement benefits. These benefits may or may not be taxable.

The intake and interview sheet lists Social Security and Railroad Retirement Benefits in the Income section.

Ask the taxpayer about the receipt of either of these benefits. The Social Security Administration issues Form SSA-1099, Social Security Benefit Statement, to Social Security benefit recipients. The Railroad Retirement Board issues Form RRB-1099, Payments by the Railroad Retirement Board, and Form RRB-1099-R, Annuities or Pensions by the Railroad Retirement Board.

See Publication 575, Pension and Annuity Income, and Publication 915, Social Security and Equivalent Railroad Retirement Benefits, for additional information on the topics discussed in this lesson.

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Determine the taxable portion of Social Security and railroad retirement benefits
- Determine the most advantageous method of reporting lump sum Social Security benefits
- Report Social Security and railroad retirement benefits on the tax return

#### What do I need?

- Form 13614-C
- Publication 4012
- Publication 17
- Publication 4491-W

#### Optional:

- Publication 575
- Publication 915
- Form RRB-1099
- Form RRB-1099-R
- Form SSA-1099

### What are Social Security and railroad retirement benefits?

#### Social Security Benefits

Social Security benefits are payments made under Title II of the Social Security Act. They include Old-Age, Survivor, and Disability Insurance (OASDI) benefits.

Social Security benefits include monthly retirement, survivor, and disability benefits. They do not include Supplemental Security Income (SSI). Certain government retirees who receive a pension from work are not covered by Social Security.

Some portion of the Social Security benefits received may be taxable. Generally, if Social Security benefits are the only source of income, then the benefits are not taxable. In this instance, taxpayers may not be required to file a return. However, if the taxpayers are Married Filing Separately and lived with their spouse at any time during the tax year, 85% of the benefits will be taxable.

## Railroad Retirement Benefits (RRBs)

Railroad Retirement Benefits (RRBs) are benefits paid to railroad employees working in jobs that are covered by the Railroad Retirement Act (RRA). The RRA benefits have two components: tier 1 (Social Security equivalent benefits) and tier 2 (treated as a qualified employee plan). The tier 2 benefits are reported on Form RRB 1099-R. These funds are discussed in the previous lesson on Retirement Income.

### How are these benefits reported to the taxpayer?

#### **Form SSA-1099**

Social Security benefits are reported on Form SSA-1099. Box 5 shows the amount of net benefits. Taxpayers who did not receive Form SSA-1099, or have misplaced it, may be able to get an instant printout of benefits from their personal “my Social Security” account on the Social Security Administration website at SSA.gov. Or taxpayers may call toll-free to request a benefit statement to be sent by mail. Effective October 1, 2014, Social Security stopped providing benefit verification letters in their offices.

#### **Form RRB-1099**

Tier 1 railroad retirement benefits are equal to the Social Security benefit that a railroad employee or beneficiary would have been entitled to receive under the Social Security system. These benefits are called “Social Security equivalent benefits” and, for tax purposes, are treated like Social Security benefits. They are shown on the BLUE Form RRB-1099. Box 5 shows the net Social Security equivalent benefits for tier 1.

#### example

Jacob is a retired railroad switchyard operator. Using the intake and interview sheet, the volunteer determined Jacob received Railroad Retirement Benefits. He received Form RRB-1099 and Form RRB-1099-R. The amount from Form RRB-1099 will be added to any amount of Social Security benefits that he may have received from other employment.

### When are Social Security benefits and tier 1 RRBs taxable?

Part of the following benefits received by the taxpayer may be taxable:

- Social Security benefits
- Railroad retirement benefits, tier 1 (Social Security equivalent portion)

To correctly calculate the taxable portion, you need to know the amount in box 5 of Form SSA-1099 or Form RRB-1099. The taxable amount, if any, of a taxpayer’s Social Security benefits depends upon filing status and other reportable income. Generally, if Social Security (or Social Security equivalent) benefits were the taxpayer’s only source of income, the benefits are not taxable and the taxpayer does not need to file a federal income tax return.

A portion of the benefits is taxable if total income (including tax-exempt interest), plus one-half of the benefits received, is more than certain base income amounts, which vary based upon the taxpayer’s filing status. A portion of the benefits is also taxable if the taxpayers are Married Filing Separately and lived with their spouse at any time during the year.



The taxable portion of Social Security benefits is never more than 85% of the net benefits the taxpayer received. In many cases, the taxable portion is less than 50%.

If the taxpayer files a joint return, enter the amounts from each Form SSA-1099 and the software will compute the portion that is taxable, if any.



Taxpayers can use Form W-4V, Voluntary Withholding Request, to request withholding from Social Security benefits.

#### example

Wanda and Dan are both retired and will file a joint return. Wanda received Form SSA-1099 with an amount of \$4,300 appearing in box 5. Dan retired from the railroad, and box 5 of his Form RRB-1099 shows an amount of \$6,800. Wanda and Dan will use the combined benefits of \$11,100 and only one calculation to see if any of their benefits are taxable.

### How do I report Social Security or railroad tier 1 benefits?



**Tax Software Hint:** The tax software will perform all the calculations to determine the taxable amount based on other information on the return. Be sure to enter all income, including tax-exempt interest, in order for the software to correctly calculate taxability of benefits. If the taxpayer is itemizing deductions, include Medicare premiums (Part B and D) from Forms SSA-1099 and RRB-1099 so that it flows to Schedule A. Additionally, be sure to enter any federal income tax withholding. Go to the Volunteer Resource Guide, Income tab, for software entries.



#### EXERCISES

Answers follow the lesson summary.

**Question 1:** Hank comes to your site to get some help with his tax return. He is upset because his neighbor told him that he would have to pay tax on all of his Social Security benefits this year. After talking to Hank, you learn that his wife died several years ago. This tax year, he sold all of his stock and moved into senior housing. The sale of the stock created \$31,896 of taxable income for Hank. His neighbor told him, with that much income, the entire \$11,724 of his Social Security benefits would be taxable. What is the maximum taxable amount of Hank's benefits?

- A. \$31,896
- B. \$20,172
- C. \$11,724
- D. \$9,965

### What are lump-sum benefit payments?

Some taxpayers may have received a lump-sum benefit payment. This payment could be for the current tax year and for prior tax years. Box 3 of the taxpayer's Form SSA-1099 or Form RRB-1099 will include the lump-sum payment. The form will also show the year, or years, of the payment. The additional information will be shown in Description of Amount in box 3 on Form SSA-1099 or in boxes 7–9 on Form RRB-1099.



Do not confuse this type of lump-sum benefit payment with the lump-sum death benefit that both the SSA and RRB pay to many of their beneficiaries. No part of the lump-sum death benefit is subject to tax.

When figuring the taxable portion of Social Security benefits, two options are available for lump-sum benefit payments:

- The **first option** allows the taxpayer to report the whole payment the year it was received. When the taxpayer chooses this option, complete the Social Security Benefits Worksheet as usual by including the entire lump-sum payment on line 1.

- The **second option** is to treat the payment as received in the earlier year or years. This is done by figuring whether any part of these benefits is taxable, based on the earlier year's income. Any part that is taxable is then added to any taxable benefits for the current year and included on Form 1040, line 20b. The taxpayer can elect this method if it lowers the taxable benefits.

### Will the lump-sum election method lower taxable benefits?

Figuring the taxable benefits under the lump-sum election method is in scope for the VITA/TCE programs.

If the taxpayer chooses the second option, only the current year income will be adjusted. You do not file amended returns for the earlier years.

Under the lump-sum election method, refigure the taxable part of all the benefits for the earlier year (including the lump-sum payment) using that year's income and filing status; then subtract any taxable benefits for that year that were previously reported. The remainder is the taxable part of the lump-sum payment and is added by the software to the taxable part of the benefits for the current year (figured without the lump-sum for the earlier year).

In order to compute the taxable benefits, you will need copies of the taxpayer's prior year returns.

For additional information on the lump-sum election, see Publication 915.

#### example

In 2014, Jane applied for Social Security disability benefits but was told she was ineligible. She appealed the decision and won. In 2015, she received a lump-sum payment of \$6,000, of which \$2,000 was for 2014 and \$4,000 was for 2015. Jane also received \$5,000 in Social Security benefits in 2015, so her 2015 Form SSA-1099 shows benefits paid of \$11,000.

Jane had other taxable income in both 2014 and 2015. She should figure her taxable benefits under the lump-sum election method to see if it is lower.



When a lawyer is hired to file the appeal, Form 1099-SSA will show the amount paid to the lawyer. A miscellaneous itemized deduction is allowed for the legal fees to the extent that the benefits are taxable. As an example: If, based on the taxpayer's filing status and income level, 40% of the lump-sum benefit is taxable, then 40% of the legal fees can be deducted on Schedule A.



Because the earlier year's taxable benefits are included in the current year's income, no adjustment is made to the earlier year's return. Do not file an amended return for the earlier year.



Once a taxpayer elects this method of figuring the taxable part of a lump-sum payment, the election can only be revoked with the consent of the IRS.



**Tax Software Hint:** The tax software will figure all the calculations after you enter the prior year tax return information. Go to the Volunteer Resource Guide, Income tab, Form 1099-R for software entries.

## Summary

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This lesson explained how to determine whether income from taxpayers' Social Security benefits and railroad retirement benefits is taxable.

Generally, if Social Security benefits were the taxpayer's only source of income, the benefits are not taxable and the taxpayer does not need to file a federal income tax return. If the taxpayer received Social Security benefits and other income, the Social Security Benefits Worksheet found in the Form 1040 Instructions is completed by the software to calculate the taxable portion.

When figuring the taxable portion of Social Security benefits, two options are available for lump-sum benefit payments. The taxpayer may report the whole payment in the year it was received or treat the payment as received in the applicable earlier year or years.



### TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem or practice exercise(s) for your course of study in Publication 4491-W.

For practice using the tax preparation software, complete the scenarios using the Practice Lab on L&LT.

If you are unable to complete the entire exercise, complete as much as you can. Come back later to finish the exercise after you cover all the technical topics in later lessons.



### EXERCISE ANSWERS

**Answer 1:** D. \$9,965 or 85% of the net benefits, is the maximum amount that could ever be taxable.







## Income – Other Income; Form 1040, Line 21



### Introduction

This lesson will help you determine other forms of income and how to report other sources of income. Part of the lesson is for all course levels and part is only for the International level.

The International part of this lesson will help you report income earned from worldwide sources. To do this, you need to be able to identify the type of income and, if reportable, convert it to the equivalent U.S. dollar value of the foreign currency.

This lesson will cover the foreign earned income exclusion reported on Form 2555 or Form 2555-EZ.

### Objectives

At the end of this lesson, using your resource materials, you will be able to determine:

- Other types of income and how to report other sources of income
- Determine the requirements for the cancellation of debt on nonbusiness credit card debt when preparing tax returns
- Determine when canceled credit card debt is included in gross income on Form 1040
- How to properly report income earned from worldwide sources
- Who is eligible for the foreign income exclusion and how to calculate the excludable amount using Form 2555, Foreign Earned Income, or Form 2555-EZ, Foreign Earned Income Exclusion

#### What do I need?

- Form 13614-C
- Publication 4012
- Publication 17
- Publication 54
- Publication 4491-W
- Form 1040 Instructions
- Form 2555
- Form 2555-EZ

#### **Optional:**

- Form W-2G
- Form 1099-Misc
- Form 1099-Q
- Form 525
- Form 970

### How do I handle other income?

“Other income” is income that does not have its own line on Form 1040. Generally, these amounts are reported on line 21. Here are examples:

- Prizes and awards
- Gambling winnings, including lotteries and raffles
- Jury duty pay
- Alaska Permanent Fund dividends
- Nonbusiness credit card debt cancellation

Even if the taxpayer does not receive an income document from the payer, the taxpayer is required to report the income.

If you are unsure about sources of other income, consult the Volunteer Resource Guide, Income tab – Income Documents page, and Publication 17, Other Income, or discuss the income item with your Site Coordinator.

Use the interview techniques and tools discussed in earlier lessons to ensure that all taxable income has been included.

## HSA Topic

Certain Health Savings Account (HSA) distributions not used to pay or reimburse the taxpayer for qualified medical expenses are generally reported as other income on Form 1040, line 21. This topic is not covered in this lesson. It is covered in a specialty course on Link & Learn taxes for volunteers with a Basic or higher certification. This online course is optional. Check with your Site Coordinator to determine if you should be certified in this topic. To access this course and earn a certification, go to [www.irs.gov](http://www.irs.gov) and use the keyword/search “Link & Learn.”

## How do I report other income?

In most cases, if taxpayers have “other income,” they must file Form 1040 and report the income on line 21.

### ***Gambling Winnings***

The taxpayer may receive one or more Forms W-2G reporting gambling winnings. Total gambling winnings must be reported on Form 1040, line 21. If the taxpayer also had gambling losses, the losses can only be deducted on Schedule A. See the Itemized Deductions lesson for more details.



**Tax Software Hint:** To review information related to reporting gambling income, go to the Volunteer Resource Guide, Income tab, Income Quick Reference Guide.

### ***Cash for Keys Program***

Cash for Keys Program income, which is taxable, is income from a financial institution, offered to taxpayers to expedite the foreclosure process. Report this income on Form 1040, line 21 as “other income.” The taxpayers should receive Form 1099-MISC with the income in box 3.

### ***Inmate’s Income***

Amounts received for work performed while an inmate is in a penal institution aren’t earned income for the earned income credit. This includes amounts received for work performed while in a work release program or while in a halfway house. If the taxpayer received any amount for work done while an inmate in a penal institution and that amount is included in the total on Form 1040, line 7, put “PRI” and the amount on the dotted line next to line 7.



**CAUTION** Under the PATH Act, a wrongfully incarcerated individual does not include in income any civil damages, restitution, or other monetary award received that relates to his or her incarceration. See the What’s New lesson for additional information.

### ***Qualified Medicaid Waiver Payments***

On January 3, 2014, the IRS issued Notice 2014-7 addressing the income tax treatment of certain payments to an individual care provider under a state Home and Community-Based Services Waiver (Medicaid waiver) program. The notice provides that “qualified Medicaid waiver payments” as difficulty of care payments are excludable from gross income. Qualified Medicaid waiver payments are payments by a state, a political subdivision of a state, or a certified Medicaid provider under a Medicaid waiver program to an individual care provider for nonmedical support services provided under a plan of care to an individual (whether related or unrelated) living in the individual care provider’s home.

If taxpayers received payments described in Notice 2014-7, they may receive a Form 1099-MISC reporting these payments in box 3, Other income, or in box 6, Medical and health care payments. Generally, an amount reported in box 3 or box 6 of Form 1099-MISC is reported on Form 1040, line 21, Other income. Qualified Medicaid waiver payments must be excluded and should not be included on line 21. If filing a

paper return, enter “Notice 2014-7” on the dotted line next to line 21 of Form 1040. Refer to the Volunteer Resource Guide for specific software instructions.

If the taxpayer is in the business of providing care services, refer to the business income lesson earlier in this publication.

If the taxpayer received a Form W-2, Wage and Tax Statement, with the amount of the payments reported in box 1, Wages, tips, other compensation and chooses to exclude the payment from income, include the full amount of those payments on Form 1040, line 7. On line 21, enter the excludable portion of the payments as a negative amount that will reduce the adjusted gross income. If filing a paper return, enter “Notice 2014-7” on the dotted line next to line 21 of Form 1040. No additional entry is needed on the Form 1040 if filing electronically. Refer to the Volunteer Resource Guide for specific software instructions.



For more information, go to [irs.gov](https://www.irs.gov) and search for Certain Medicaid Waiver Payments.

### **Are distributions from ABLE accounts taxable?**

A qualified ABLE program is a program established and maintained by a state agency under which a person may make cash contributions to an ABLE account to pay for the qualified disability expenses of an eligible individual (the designated beneficiary). Qualified beneficiaries can have only one ABLE account. Contributions are made in after-tax dollars and can be made by any person. Contributions must be made in cash and are not deductible for federal income tax purposes. Total annual contributions cannot exceed the gift tax exclusion in a single year.

Distributions from an ABLE account that do not exceed the qualified disability expenses of the beneficiary during the taxable year are excluded from gross income. A distribution from an ABLE account that exceeds the qualified disability expenses of the beneficiary is subject to an additional tax of 10% imposed on the amount not used for qualified disability expenses. A distribution from an ABLE account that exceeds the qualified disability expenses of the beneficiary will be included in the gross income of the beneficiary on Form 1040, line 21, and is out of scope.

Qualified disability expenses include: education, housing, transportation, employment training and support, assistive technology and personal support services, health, prevention and wellness, financial management and administrative services, legal fees, expenses for oversight and monitoring, funeral and burial expenses.

Form 1099-QA, Distributions from ABLE Accounts, is used to report distributions from an ABLE Account.

### **Are distributions from an Educational Savings Account (ESA), such as a Coverdell ESA and a 529 plan, taxable?**

Distributions from Coverdell ESAs and Qualified Tuition Plans (QTPs) are reported on Form 1099-Q, Payments From Qualified Education Programs (Under Sections 529 and 530). Coverdell ESA distributions can be used to pay for qualified elementary, secondary, and postsecondary expenses. QTP distributions can only be used to pay qualified postsecondary expenses.

A portion of the distributions is generally taxable to the beneficiary if the total distributions are more than the beneficiary’s adjusted qualified education expenses for the year. Qualified education expenses are discussed in more detail in the Education Credits lesson.

The taxable portion is the amount of the excess distribution that represents earnings that have accumulated tax free in the account. The taxable amount must be reported on Form 1040, line 21.

For additional information about educational savings accounts, distributions, and qualified education expenses, refer taxpayers to Publication 970, Tax Benefits for Education.



An American opportunity credit or lifetime learning credit or tuition and fees deduction can be claimed in the same year the beneficiary takes a tax-free distribution from a QTP or Coverdell ESAs, as long as the same expenses are not used for both benefits. See Publication 17 and Publication 970, Tax Benefits for Education, for more details.



## Cancellation of Debt – Nonbusiness Credit Card Debt

Generally, if a taxpayer receives Form 1099-C for canceled credit card debt and was **solvent** (assets greater than liabilities) immediately before the debt was canceled, all the canceled debt will be included on Form 1040, line 21, Other Income. No additional supporting forms or schedules are needed to report canceled credit card debt.

Sometimes, Form 1099-C will show an interest amount in box 3. Because only **nonbusiness** credit card debt income is in scope, any interest on the account would not have been deductible. The amount shown in box 3 is included in box 2; therefore, the full amount shown in box 2 should be reported as other income on Form 1040, line 21.

### example

John made a deal with his credit card company to pay \$2,000 on his \$7,000 balance, and the company agreed to take it as payment in full. In January of the current year, John received a Form 1099-C from his credit card company reporting \$5,000 (the amount of debt canceled). John was solvent immediately before the debt was canceled. John would include the entire \$5,000 in income on Form 1040, line 21.

Lenders and creditors are required to issue Form 1099-C if they cancel a debt of \$600 or more. If the debt canceled is less than \$600, some lenders or creditors may send a letter or some other form of notification to the taxpayer. Generally, taxpayers must include all canceled amounts (even if less than \$600) on the Other Income line of Form 1040.

## Insolvency (Out of Scope for VITA/TCE)

Insolvency is a condition in which the FMV of all assets is less than one's liabilities. The amount or level of insolvency is expressed as a negative net worth.

For purposes of determining insolvency, assets include the value of everything owned (including assets that serve as collateral for debt, and exempt assets which are beyond the reach of creditors under the law, such as an interest in a pension plan and the value of a retirement account).

Liabilities are amounts owed and include:

- The entire amount of recourse debts
- The amount of nonrecourse debt that is not in excess of the FMV of the property and is security for the debt

Use the Insolvency Determination Worksheet as a resource to determine whether a taxpayer is considered insolvent.



## Insolvency Determination Worksheet



Assets (FMV)	
Homes	
Cars	
Recreational vehicles, etc.	
Bank accounts	
IRAs, 401Ks, etc.	
Jewelry	
Furniture	
Clothes	
Misc.	
Other assets	
<b>Total Assets:</b>	<b>\$0.00</b>

Liabilities	
Mortgages	
Home equity loans	
Vehicle loans	
Personal signature loans	
Credit card debts	
Past-due mortgage interest, real estate taxes, utilities, and child care costs	
Student loans	
Other liabilities	
<b>Total Liabilities:</b>	<b>\$0.00</b>

### Total Assets minus Total Liabilities =

(Negative amount equals insolvency)

(Positive amount equals solvency)



If the taxpayer had nonbusiness credit card debt canceled, all or part of the debt may be excluded if the cancellation occurred in bankruptcy, or if the taxpayer was insolvent immediately before the cancellation. These situations are beyond the scope of VITA/TCE. If any of these situations apply, refer the taxpayer to a professional tax preparer. See IRS Publication 4681 for more information.



Publication 4731, located in the Volunteer Resource Guide (Income Tab), provides step-by-step guidance for the volunteer tax return preparer to determine if the cancellation of credit card debt is within scope.

## Taxpayer Interview and Tax Law Application

Here is how a volunteer advised Michelle regarding her canceled credit card debt.

### SAMPLE INTERVIEW

VOLUNTEER SAYS...

*I notice you received a 1099-C from a credit card company.*

*Yes, Form 1099-C shows the amount of debt discharged.*

*Do you think your debts at the time exceeded your assets?*

*Let's fill out the Insolvency Determination Worksheet to help us determine whether you were insolvent.*

*According to the worksheet, you are insolvent. I am afraid I am not able to help you. VITA/TCE volunteers are not trained to compute the nontaxable portion of canceled credit card debt.*

*I suggest you seek assistance from a professional tax preparer.*

MICHELLE RESPONDS...

Yes, I negotiated with them to cancel \$3,000 of my debt.

I could only afford to pay them \$1,000, so it really helped me.

I'm not sure, but it's certainly possible.

O.K.

Oh, I understand.

I will, thank you.



### Insolvency Determination Worksheet



Assets (FMV)	
Homes	\$120,000.00
Cars	\$15,000.00
Recreational vehicles, etc.	
Bank accounts	\$1,000.00
IRAs, 401Ks, etc.	\$60,000.00
Jewelry	
Furniture	\$2,000.00
Clothes	\$1,550.00
Misc.	
Other assets	
<b>Total Assets:</b>	<b>\$199,550.00</b>

Liabilities	
Mortgages	\$180,000.00
Home equity loans	\$50,000.00
Vehicle loans	\$18,000.00
Personal signature loans	
Credit card debts	\$3,000.00
Past-due mortgage interest, real estate taxes, utilities, and child care costs	
Student loans	
Other liabilities	
<b>Total Liabilities:</b>	<b>\$251,000.00</b>

**Total Assets minus Total Liabilities = (\$51,450.00)**

(Negative amount equals insolvency)

(Positive amount equals solvency)



## EXERCISES

**Question 1:** Greg was released from his obligation to pay \$5,000 of personal credit card debt. The credit card company sent Form 1099-C showing canceled debt of \$5,000. Greg is fairly certain he has more debt than he has assets.

Can the VITA/TCE site provide tax return preparation assistance to Greg?

- A. Yes, since the entire \$5,000 in canceled debt is considered income and reported on Form 1040, line 21.
- B. No, because it appears Greg is insolvent, which might mean some of the canceled credit card debt would be nontaxable and beyond the scope of the VITA/TCE programs.

**Question 2:** Kay was released from her obligation to pay personal credit card debt. She owed \$10,000 to her credit card company, which agreed to accept \$2,500 as payment in full. Before paying the credit card company, it was determined Kay was solvent (assets greater than liabilities) and not in bankruptcy. The credit card company issued Kay a Form 1099-C, reporting \$7,500 as the amount of debt discharged.

Based on the information above, can Kay be assisted at her local VITA/TCE site?  Yes  No

**Question 3:** Review the information in Question 2 about Kay's canceled debt. If the VITA/TCE site is able to assist Kay, what amount would be reported on Kay's Form 1040, line 21?

- A. \$0
- B. \$10,000
- C. \$2,500
- D. \$7,500



## What is worldwide income?

U.S. citizens and U.S. resident aliens are required to report worldwide income on a U.S. tax return regardless of where they live and even if the income is taxed by the country in which it was earned. Filing requirements are the same as for U.S. citizens and U.S. resident aliens living in the United States and apply whether income is from within or outside the U.S.

U.S. citizens and U.S. resident aliens living abroad may be able to claim tax benefits such as the foreign earned income exclusion or the foreign tax credit. This part of the lesson covers the foreign earned income exclusion. The foreign tax credit will be covered in another lesson.

### example

In the current year, Alfredo Kendall earned \$40,000 while working in Dallas, Texas, for Dade Corporation. In September of this year, he transferred to their office in Stuttgart, Germany. While in Germany, he earned \$30,000 (U.S. dollars). All of Alfredo's wages, including the income he earned in Germany, is included in his gross income. His Form 1040, line 7, will show \$70,000.

Income is treated the same on the return regardless of the country from which it is derived. Similar income earned inside or outside the U.S. is generally taxed in the same way on the return. Likewise, income earned in the U.S. and not taxed will be treated in the same way if earned outside the U.S. The lines on which income is reported on Form 1040 are the same whether the U.S. citizen or U.S. resident alien is living within or outside U.S. boundaries.



Foreign income might be reported to taxpayers on forms or in ways that are not used in the United States. Question taxpayers closely to ensure that they are reporting all worldwide income. Review the income records to ensure that includible amounts are accurate and complete.



**Tax Software Hint:** To review information related to income from a foreign employer, go to the Volunteer Resource Guide, Income tab.



## EXERCISES (continued)

Answers are listed following the lesson summary.

**Question 4:** Marta Bremer, a U.S. citizen, lives in Mussbach, Germany. Her income included \$22,000 in wages earned in Germany. She earned \$300 in interest from her U.S. bank. What is Marta's total income?

- A. \$0
- B. \$22,300
- C. \$300
- D. \$22,000

**Question 5:** Mary Carleton, a U.S. citizen, lives in Belgium. Her income included \$10,000 in wages from her Belgian employer, \$200 in interest from her U.S. bank, \$8,000 in alimony payments, and \$7,000 in child support payments from her ex-spouse. What is Mary's gross income?

- A. \$8,000
- B. \$10,200
- C. \$18,200
- D. \$25,200

## How do I convert foreign income to U.S. dollars?

### Exchange rates

All amounts on the U.S. tax return must be stated in U.S. dollars. Convert income that taxpayers received in foreign currency into U.S. dollars using the appropriate exchange rate. U.S. exchange rates are stated in two ways:

- Units of foreign currency to one U.S. dollar: 0.74855 Euro = 1 U.S. dollar
- U.S. dollars to one unit of the foreign currency: 1.33592 U.S. dollar = 1 Euro



Exchange rates shown here are for example only. Use the exchange rates in effect when the income was received.



To convert a sum of money into U.S. dollars, **divide** the amount of foreign currency by the exchange rate for the foreign currency to one U.S. dollar.

**example**

Ryan received 3,000 Euros (€3000) on a day that the exchange rate was 0.74855 Euros to one U.S. dollar. Based on this exchange rate, the value of Ryan's €3000 is:  $€3000 \div 0.74855 = \$4,007.75$

In other words:

$$\frac{\text{Amount of foreign currency}}{\text{Exchange rate of foreign currency to one U.S. dollar}} = \text{Amount in U.S. dollars}$$

$$\frac{3,000 \text{ Euros}}{0.74855} = \$4,007.75$$



**EXERCISES** (continued)

**Question 6:** Caryn received 200 Euros on a day that the exchange rate was .75514 Euros to one U.S. dollar. In U.S. dollars, she would have \_\_\_\_.

- A. \$264.85
- B. \$377.57
- C. \$115.03
- D. \$11.50

**Question 7:** Given an exchange rate of .7000, how much is 36,000 Euros worth in U.S. dollars?

- A. \$252.00
- B. \$25,200.00
- C. \$51,428.57
- D. \$61,614.00

**Which exchange rate should I use?**

The exchange rate for a particular currency is likely to change every day. Use the exchange rate prevailing when the taxpayer receives the pay or accrues the item. The exchange rate is determined by the date of transaction, which is either the date on the check or the date the money is credited to the taxpayer's account. If there is more than one exchange rate, use the one that most properly reflects the income.

However, the taxpayer can use the average annual exchange rate if:

- Foreign income was received evenly throughout the year, and
- The foreign exchange rate was relatively stable during the year

Taxpayers may use the monthly average exchange rates if they earned foreign income evenly for one or more months, but less than twelve months.

### example

Edward Hall worked in Dallas for Lubbock Incorporated from January until September. On September 29, he was transferred to Lubbock's Mexico City office, where he will be working for three more years. In Mexico, he is paid in Mexican pesos. Because he received the majority of his annual salary in U.S. currency, he should not use the annual average exchange rate for the Mexico source income. If he does not know the exchange rate at the time he received the funds, he can use the monthly average exchange rate for October, November, and December.

### **Where to obtain exchange rates**

In mid-January, the IRS distributes exchange rates for various currencies to its worldwide offices, including the prior year's average annual exchange rate information.

To obtain exchange rates, call the U.S. Embassy or the overseas IRS offices. The phone numbers of these offices are listed in Publication 54, Tax Guide for U.S. Citizens and Resident Aliens Abroad. You can also look up exchange rates in Publication 54, under currency rates. Or, exchange rates can be found at [www.irs.gov](http://www.irs.gov) by typing "foreign currency rates" in the search box. You may also contact banks that provide international currency exchange services.

Because taxpayers should use the rate that most nearly reflects the value of the foreign currency at the time they receive the income, taxpayers may use an exchange rate that is different from the rates posted in IRS worldwide offices if they find it to be a true representation.

### **What is the foreign earned income exclusion?**

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Use Form 2555-EZ or Form 2555 to claim the foreign earned income exclusion. Certain taxpayers can exclude income earned in, and while living in, foreign countries. The maximum amount of the foreign earned income exclusion is indexed to inflation annually. For the current year amount go to [www.irs.gov](http://www.irs.gov) or Publication 17. The foreign earned income exclusion **does not** apply to wages and salaries of U.S. military members and civilian employees of the U.S. government.

If the taxpayer qualifies to exclude foreign earned income, the excludable amount will be reported as a negative amount on Form 1040, line 21. Since the foreign earned income would have been reported on Form 1040, line 7 as taxable wages or on line 12 as self-employment income, the exclusion (negative amount) will reduce the total income calculated on line 22. The method of calculating the tax when the taxpayer elects the foreign earned income exclusion is based on the Foreign Earned Income Tax Worksheet. The tax software will do this calculation automatically.



The child tax credit is not refundable for taxpayers electing to exclude foreign earned income from tax or claim the earned income credit or take the child and dependent care credits.



**Tax Software Hint:** To review information related to the software for the foreign earned income exclusion, go to the Volunteer Resource Guide, Income tab.

### **When do I choose the exclusion?**

The foreign earned income exclusion is voluntary. It is not always an advantage to claim the exclusion. If taxpayers wish to claim the exclusion, they must file either Form 2555-EZ or Form 2555 with a timely return (including extensions). If the taxpayer is not eligible for the foreign earned income exclusion, any taxes paid on this income to a foreign government may be eligible for the foreign tax credit. See the lesson Foreign Tax Credit for more information.

Once the taxpayer chooses to exclude foreign earned income, that choice remains in effect for that year and all later years until revoked. The taxpayer may revoke the exclusion for any tax year by attaching a statement. When the exclusion is revoked, the taxpayer may not claim the exclusion again for the next five tax years without the approval of the IRS.

### What are the eligibility requirements?

To claim the foreign earned income exclusion, taxpayers must:

- Demonstrate that their tax home is in a foreign country
- Meet either the bona fide residence test or the physical presence test
- Have income that qualifies as foreign earned income

The requirements are applied separately to each individual. If a married couple is working overseas, each spouse must meet all requirements to qualify for the exclusion. If they do qualify, each is entitled to an exclusion of up to the maximum amount for the current year.



The terms “foreign,” “abroad,” and “overseas” do not include Puerto Rico, U.S. Virgin Islands, American Samoa, Guam, the Commonwealth of the Northern Marianas, Wake Island, the Midway Islands, and Johnston Island.



### EXERCISES (continued)

**Question 8:** Miranda has lived in Puerto Rico since 2003. Is she eligible for the foreign earned income exclusion?  Yes  No

### How do I determine the tax home?

To claim the foreign earned income exclusion, the taxpayer’s tax home must be in a foreign country. The tax home is defined as the country in which the taxpayer is permanently or indefinitely engaged to work as an employee or a self-employed individual, regardless of where the family home is maintained.

For taxpayers who work abroad but do not have a regular place of business because of the nature of the work, their tax home is the place where they regularly live. The tax home for members of the U.S. Armed Forces is the permanent duty station, either land-based or on a ship.

#### example

John and Mary are both in the Armed Forces and have been permanently stationed in Germany since August 2007. Their tax home for the current year is Germany.



### EXERCISES (continued)

**Question 9:** Alan has lived and worked in China since August 16, 2005. China is his tax home.  
 True  False

### What is a regular place of abode?

For purposes of the foreign earned income exclusion, if taxpayers work overseas for an indefinite period of time, and their regular place of abode is the U.S., the taxpayers cannot designate the foreign country as the tax home.

“Regular place of abode” is defined as one’s home, habitation, domicile, or place of dwelling. It does not necessarily include one’s principal place of business.

If the taxpayer maintains a place of business, or is assigned to overseas employment in a foreign country for an indefinite period, *and does not maintain a regular place of abode in the U.S.*, the tax home is overseas and the taxpayer may be eligible for the foreign earned income exclusion.

### How do I determine whether the U.S. is the taxpayer’s regular place of abode?

Ask three questions to determine whether a U.S. home is the taxpayer’s regular place of abode:

1. Did you use your home in the U.S. as a residence while you worked at your job in the U.S. just before going abroad to your new job, and did you continue to maintain work (e.g., contacts, job seeking, leave of absence, ongoing business) in that area in the U.S. during the time you worked abroad?
2. Are your living expenses duplicated at your U.S. and foreign homes because your work requires you to be away from your U.S. home?
3. Do you have a family member or members living at your U.S. home, or did you frequently use your U.S. home for lodging during the period you worked abroad?

If the answer to two of the questions is “no,” the taxpayer is considered to be indefinitely assigned to the new location abroad and is eligible for the foreign earned income exclusion.

If the answer to all three questions is “yes” and the job duration is for less than one year with the taxpayer returning to the U.S. home, the taxpayer is considered “temporarily away” from home. In this case, the taxpayer does not qualify for the foreign earned income exclusion, but may qualify to deduct *away-from-home* expenses.

If the answer to two of the three questions is “yes,” with the same expectation of job duration and return to the U.S. home, the location of the tax home depends on the facts and circumstances.

#### example

Henry is a member of the Armed Forces. He was assigned to a post in Japan last year. This assignment was for an indefinite period that exceeds one year. Margaret, his wife, accompanied him to Japan and has foreign earned income. They have not used their home in the U.S. as a place of residence for over a year. Therefore, their tax home for this year is Japan.



#### EXERCISES (continued)

**Question 10:** Stan is employed on an offshore oil rig in the territorial waters of a foreign country and works a 28-day on/28-day off schedule. He returns to his family residence in the U.S. during his off periods. Does Stan’s employment satisfy the tax home test?  Yes  No

### What is the period of stay requirement?

The period of stay is the amount of time the taxpayer stays in the foreign country. To meet the period of stay requirement, the taxpayer must be either:

- A U.S. citizen or U.S. resident alien from a tax treaty country who is a **bona fide** resident of a foreign country (or countries) for an uninterrupted period that includes an entire tax year, or
- A U.S. citizen or U.S. resident alien who is **physically present** in a foreign country or countries for at least 330 full days during any period of 12 consecutive months

## What is the bona fide residence test?

To meet the bona fide residence test, taxpayers must show that they have set up permanent quarters in a foreign country for an entire, uninterrupted tax year. Simply going to another country to work for a year or more is not enough to meet the bona fide residence test. A taxpayer must establish a residence in the foreign country.

A brief trip to the U.S. will not prevent the taxpayer from being a bona fide resident, as long as the intention to return to the foreign country is clear.

### example

Charles is a military spouse who has lived and worked in England since 2006. His mother still lives in the U.S. Charles came to the U.S. for two weeks this year to be with his mother after she had surgery. Charles' trip to the U.S. does not affect his status as a bona fide resident of a foreign country.



## EXERCISES (continued)

**Question 11:** Zach, a U.S. citizen, has homes in the U.S. and in Spain, where he has worked for the last two years. Zach's spouse, who is also a U.S. citizen, lives with him in Spain. Zach visits the U.S. frequently. Does Zach meet the bona fide residence test in Spain?  Yes  No

## What is the physical presence test?

If the taxpayers do not meet the bona fide residence test, then they may qualify under the physical presence test rules. To qualify, the taxpayers must be physically present in a foreign country 330 full days during a period of twelve consecutive months.

In order for a day to count for the test, it must be a full day in a foreign country. When arriving from the U.S., or returning to the U.S., any day in which part of the time is spent in the U.S. or over international waters does not count as a qualifying day in a foreign country.

The taxpayer may move about from one place to another in a foreign country or to another foreign country without losing full days. If any part of the taxpayer's travel is not in any foreign country and takes less than 24 hours, you are considered to be in a foreign country during that part of travel. See Publication 54, Physical Presence Test column for additional information.

### example

If a taxpayer left England by ship at 10:00 p.m. on July 6 and arrived in Lisbon at 6:00 a.m. on July 8, the taxpayer would lose July 6, 7, and 8 as full days because the trip took more than 24 hours. In this example, if the taxpayer remained in Lisbon, the first full day would be July 9.

## Figuring the 12-Month Period

Any 12-month period may be used if the 330 full days in a foreign country fall within that period. If necessary, more than one period may be used, including periods that overlap. See Publication 54 for clarification on the physical presence rules.

## What is qualifying income?

To qualify for the exclusion, income must be earned income.

## How does earned income qualify for the exclusion?

To qualify for the exclusion, the earned income must be for services performed in a foreign country. Amounts paid by the United States or its agencies to its employees *do not qualify* for the exclusion. This includes military pay and payment for such activities as post exchanges, commissaries, and officers clubs.

Earned income **does not include**:

- Dividends
- Interest
- Capital gains
- Alimony
- Social Security benefits
- Pensions
- Annuities

### example

Alisa, a U.S. resident, is a member of the Armed Forces and has lived in Japan since 2010. Her military pay is not eligible for the foreign earned income exclusion. In her spare time, she is a self-employed DJ in Tokyo. The income from her self-employment may qualify for the exclusion.

## What are sources of earned income?

To qualify for the exclusion, services must be performed in a foreign country. Where the payments come from or where they are deposited is not a factor in determining the *source* of the income.

If a taxpayer works predominantly in a foreign country, but does some work in the U.S., an adjustment must be made to the total foreign earned income.

### example

Earl works and lives in the Bahamas. During the tax year, he worked 50 weeks in the Bahamas. He attended a business meeting in Florida for one week, and was on vacation for two weeks. One-fiftieth or 2% of his wages are not foreign earned income because of the week spent working in Florida.

### example

Ron and his wife Amy, both U.S. citizens, have lived in England for two years. Ron is in the military and Amy works in a pastry shop in a nearby town. Ron's military income does not qualify for the foreign earned income exclusion but Amy's wages from the company in England does qualify. The source of Amy's income is England.



## EXERCISES (continued)

**Question 12:** Juanita lives in Scotland. She is retired and her income consists of U.S. Social Security, a pension, and several stock dividends. Does she qualify for the foreign earned income exclusion?

Yes  No

## When do I complete and file Form 2555 or Form 2555-EZ?

If the taxpayer qualifies to exclude foreign earned income, Form 2555 or Form 2555-EZ must be completed. Publication 54, Tax Guide for U.S. Citizens and Resident Aliens Abroad has an illustration of a tax return with Form 2555 completed for the husband and Form 2555-EZ completed for the wife.

To be able to use Form 2555-EZ, the taxpayer must:

- Be a U.S. citizen or resident alien who has wages and salaries, but not self-employment income
- Have total foreign earned income of the annual maximum amount or less
- Have no business or moving expense deductions

Taxpayers who do not meet these requirements must use Form 2555 to claim the exclusion. For example, a taxpayer who receives self-employment income and is eligible for the exclusion must use Form 2555.

### example

Michael and his wife, Eva, have been stationed in Australia since 2009. Michael is a member of the U.S. Armed Forces and Eva operates a home day-care business. Their tax home is Australia, and they meet the bona fide residence test. Eva wants to exclude her self-employment income from U.S. taxation.

Because her income is from self-employment, she will need to complete Form 2555 instead of Form 2555-EZ to exclude the income, and must complete Schedule SE to pay Social Security and Medicare taxes.



### EXERCISES (continued)

**Question 13:** Mallory is a U.S. citizen who has \$34,000 of foreign earned income (wages). She has no other income. Which form should she file?

- A. Form 2555
- B. Form 2555-EZ

## How do I complete Form 2555-EZ?

Taxpayers who are eligible to file Form 2555-EZ should complete Parts I, II, and IV of the form. Complete Part III if the taxpayer was in the United States or any of its possessions during the tax year.

## How do I complete Form 2555?

Use the following guidelines when completing Form 2555.

- Part I is completed by all taxpayers
- Part II is completed by taxpayers who qualify under the bona fide residence test
- Part III is completed by all taxpayers who qualify under the physical presence test
- Part IV is completed by all taxpayers – list all foreign earned income
- Part V is completed by all taxpayers
- Part VI is completed by taxpayers claiming the housing exclusion and/or housing deduction
- Part VII is completed by taxpayers claiming the foreign earned income exclusion

- Part VIII is completed by taxpayers claiming the foreign income exclusion, the foreign housing exclusion, or both.
- Part IX is completed by taxpayers claiming the housing deduction if line 33 is more than line 36, and line 27 is more than line 43



**Tax Software Hint:** To review information related to the software, go to the Volunteer Resource Guide, Income tab – Form 2555.

## Taxpayer Interview and Tax Law Application

Look at the following sample interview for taxpayers Hudson and Hope Howard.

SAMPLE INTERVIEW	
VOLUNTEER SAYS...	HOPE RESPONDS...
	Will we be able to exclude any of my income on our tax return? I worked for Bavaria Advertising in Munich this past year and made \$24,000 in U.S. dollars. I heard that you don't have to pay taxes on income earned in a foreign country and I've never done this before.
<i>That is possible. First, we will have to determine if you meet the requirements. Were you working as a military or civilian employee of the U.S. government?</i>	No, Bavaria Advertising is a foreign company owned by a family right there in Munich.
<i>Great. That would qualify, but Hudson's military pay won't.</i> [Volunteer links to Form 2555–EZ on the tax software.] <i>Let's see. You are a U.S. citizen. You earned wages in a foreign country and the total was less than the maximum amount. You have no self-employment income or business/ moving expenses and since you lived on base, you won't have a foreign housing exclusion. OK, we can use Form 2555-EZ.</i>	Yeah, that all sounds right.
<i>Now we have to determine if you meet the bona fide residence or physical presence test and if your tax home is in a foreign country.</i>	It sounds complicated to me.
<i>Don't worry, I just need to ask you a few questions. How long did you say you were in Germany?</i>	We moved on base in Germany on March 3, 2011 and just returned to the states on January 10 this year.
<i>No problem then. You were living in Germany for the entire year so you are considered a bona fide resident this tax year. Since your home and place of employment were both in Germany, you meet the tax home test. Now, what was your address while you were living in Germany?</i>	1567 Albion Street, Munich.
<i>What did you do for Bavaria Advertising?</i>	I was a copywriter.
<i>Do you have Bavaria Advertising's address?</i>	I sure do; it is right here on this statement.
<i>Were you present in the U.S. during this tax year? I have to enter the dates on this form.</i>	Not this year. But we did come home for the holidays last year.





## Summary

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Total income from all sources is entered on Form 1040, line 22 (the sum of lines 7-21).

Taxpayers are sometimes alarmed at how high their total income is. If this happens, reassure the taxpayer that the return is not finished yet! It is very likely that adjustments, deductions, and credits will considerably reduce the total tax owed.

Line 21, Other Income, includes any taxable income for which there is not a specific line identified on Form 1040, lines 7–20b.

If a taxpayer receives Form 1099-C for canceled credit card debt and was solvent immediately before the debt was canceled, all the canceled debt will be included on Form 1040, line 21, Other Income.

U.S. citizens and resident aliens are taxed on worldwide income. They must file a U.S. tax return even if all the income is from foreign sources, and even if they pay taxes to another country.

When taxpayers living abroad receive income in foreign currency, the amounts reported on the return must be converted into U.S. dollars. Use the exchange rate prevailing when the taxpayer receives the pay or accrues the item. If there is more than one exchange rate, use the one that most properly reflects the income.

If the taxpayers are eligible to exclude some or all of their foreign earned income, then Form 2555 or Form 2555-EZ must be completed. The excludable amount will be entered as a negative number on line 21 to offset the income reported on line 7 or line 12.

### What situations are out of scope for the VITA/TCE programs?

The following are out of scope for this lesson. While this list may not be all inclusive, it is provided for your awareness only.

- Distributions from an ABLE account in which the funds were not fully used for qualified disability expenses
- Distributions from Educational Savings Accounts in which the:
  - Funds were not used for qualified education expenses, or
  - Distribution was more than the amount of the qualified expenses
- Taxpayers who are insolvent and had debt canceled



### TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem or practice exercise(s) for your course of study in Publication 4491-W.

For practice using the tax preparation software, complete the scenarios using the Practice Lab on L&LT.



## EXERCISE ANSWERS

**Answer 1:** B. Greg is fairly certain that he has more debt than he has assets, which means he is insolvent. This situation is beyond the scope of the VITA/TCE programs.

**Answer 2:** Yes. Kay was solvent and not in bankruptcy, and the credit card company issued her a Form 1099-C.

**Answer 3:** D. Kay would report \$7,500 on line 21 of her Form 1040.

**Answer 4:** B. Marta's gross income includes her wages and interest, both of which should be reported on her tax return.

**Answer 5:** C. Mary's gross income includes her wages, interest, and alimony, all of which should be reported on her tax return. Her child support payments are her only nontaxable income.

**Answer 6:** A. Dividing 200 Euros by the .75514 exchange rate comes to \$264.85.

**Answer 7:** C. Dividing 36,000 Euros by the .7000 exchange rate comes to \$51,428.57.

**Answer 8:** No. Miranda is not eligible for the foreign earned income exclusion because Puerto Rico is not a foreign country.

**Answer 9:** True. Generally, the tax home is the country in which taxpayers maintain their place of business. Because Alan works in China, it is considered to be his tax home. For taxpayers who do not have a regular place of business because of the nature of the work, their tax home is the place where they regularly live.

**Answer 10:** No. Stan is considered to have a residence in the United States and does not satisfy the tax home test in the foreign country. He is not eligible for the foreign earned income exclusion.

**Answer 11:** Yes. Since Zach went to Spain to work and has established a permanent residence there with his spouse, he meets the bona fide residence test.

**Answer 12:** No. Social Security benefits, pension, and dividends do not qualify as earned income; therefore, Juanita does not qualify for the foreign earned income exclusion.

**Answer 13:** B. Since Mallory's earned income is wages (not self-employment) and is less than the ceiling amount, she can file Form 2555-EZ.



# Military Income



## Introduction

This lesson will help you determine which income items received by current and former members of the U.S. Armed Forces are reportable on the return, and the status of any medical separation pay or pay related to service in a combat zone.

Community property laws may impact the income reported by some military members on their returns.

## Objectives

At the end of this lesson, using your resource materials, you will be able to determine:

- Which income items received by members of the U.S. Armed Forces are reportable on the tax return and
- The status of any medical separation pay or pay related to service in a combat zone

### What do I need?

- Form 13614-C
- Publication 4012
- Publication 3
- Publication 525
- Publication 555

## What are the types of income?

U.S. Armed Forces members receive many different types of pay and allowances. Some are includible in gross income while others are excludable from gross income.

Refer to the Volunteer Resource Guide, Income tab for detailed lists of these types of military pay and to determine if they are included in gross income, or excluded.

## What income is includible?

Includible items are subject to tax and must be reported on the tax return. The items listed in Publication 3, Table 1, and the Volunteer Resource Guide, Income tab are included in gross income, unless the pay is for service in a combat zone or in a qualified hazardous duty area. All includible military income will generally be shown on Form W-2, box 1, and reported on Form 1040, line 7, Wages.



If the amount shown on Form W-2, box 1, differs from the last Leave and Earnings Statement for the current tax year, advise the taxpayer to contact the local accounting and finance or payroll office for an explanation.

## What income is excludable?

Excludable income does not have to be reported as income on the tax return. The exclusion applies whether the item is furnished in kind, or is a reimbursement or an allowance.

For example, the Basic Allowance for Housing (BAH) can be excluded from gross income as a qualified military benefit. Excludable income will not be included in the amount on Form W-2, box 1.



If U.S. Armed Forces members were provided a commuter highway vehicle (such as a van) by their employer, refer them to Publication 525, Taxable and Nontaxable Income, and to a professional tax preparer.



## EXERCISES

Answers follow the lesson summary.

**Question 1:** You need to account for enlistment and reenlistment bonuses separately when preparing a service member's tax return because the income information is not shown on Form W-2. Refer to Publication 3.  True  False

**Question 2:** Which of the following items is excludable from U.S. Armed Forces members' income?

- A. Student loan repayments
- B. Basic Allowance for Housing (BAH) and Basic Allowance for Subsistence (BAS) income
- C. Basic pay
- D. Hardship duty pay

## Homeowners Assistance Program (HAP)

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HAP was created to compensate qualified military and civilian employee homeowners when base closures negatively impact the real estate market or when they are required to permanently relocate during the home mortgage crisis. These payments for qualified military base realignments and closures are excluded from income. For additional information go to <http://hap.usace.army.mil/overview.html>.

## What is military separation with disability severance pay?

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Disability severance pay has varying effects on a service member's income and taxes.

### What is severance pay?

U.S. Armed Forces members who have been separated from the military after years of service or for medical reasons are given severance pay, which is generally taxable as wages. If the member receives disability severance pay and is later awarded Veteran's Affairs (VA) disability benefits, 100% of the disability severance benefit may be excluded from income. The VA makes the determination that the member is entitled to medical disability benefits, and the determination process can take several months, and sometimes years.

### What is VA disability compensation?

VA disability compensation is a monetary benefit paid to veterans who are disabled because of injury or disease incurred or aggravated during active military service. The veteran's service must have been terminated through separation or discharge under honorable conditions. Disability compensation varies with the degree of disability and the number of dependents, and is paid monthly. The benefits are not subject to federal or state income tax. The VA does not issue Form W-2, Form 1099-R, nor any other document for nontaxed veteran's disability benefits.

## What happens after a service member receives a letter of determination?

Once the VA sends a letter of determination, all future pension payments from the government are offset by the disability amount paid directly from the VA. Disability payments received directly from the VA are not taxable and are not included on Form W-2 or Form 1099-R.

Although pension payments made before the letter of determination was issued have already been taxed, the letter exempts from taxes the same amount of previous pension payments. U.S. Armed Forces members who have already filed a tax return and reported that pension income should file Form 1040X, Amended U.S. Individual Income Tax Return and attach a copy of the letter of determination.



### EXERCISES (continued)

**Question 3:** Disability payments sent directly from the VA to the discharged service member \_\_\_\_\_.

- A. Are taxable
- B. Appear on the taxpayer's Form W-2 or 1099-R
- C. Are not included on the taxpayer's Form W-2 or 1099-R
- D. May begin before the VA issues the letter of determination

### example

Anita Zapata was an active duty service member who was separated due to a medical condition, and began receiving her military pension in February of the previous tax year. Here are the payments she reported on that year's tax return:

<i>Payments</i>	<i>Amount</i>
• Disability severance pay	\$10,000
• Service pension	\$33,000
• Active duty pay	\$ 5,000

In the current tax year, the VA determined that she was retroactively entitled to a VA disability pension of \$837 each month from the date of her discharge (February of the previous tax year). She can amend her current tax return to exclude \$9,207 ( $\$837 \times 11$  months) of the pension she received plus the entire \$10,000 disability severance payment.

She must attach a copy of her letter of determination to the amended return. Her current tax year Form 1099-R will not include the nontaxable VA disability retirement payments received during that year.

## What is a combat zone?

A combat zone is any area the President of the United States designates by Executive Order as an area in which the U.S. Armed Forces are engaging or have engaged in combat. An area becomes a combat zone and ceases to be a combat zone on the dates the President designates by Executive Order. Publication 3 lists the specific areas and dates.



A taxpayer serving in a combat zone may qualify for relief from certain IRS compliance actions, such as audits or enforced collections, until 180 days after the taxpayer has left the zone.

Taxpayers qualifying for such combat zone relief may notify the IRS directly of their status through a special e-mail address: [combatzone@irs.gov](mailto:combatzone@irs.gov). They should provide name, stateside address, date of birth and date of deployment to the combat zone. They should not include any Social Security numbers in an e-mail. This notification may be made by the taxpayer, spouse, or authorized agent or representative. For more information visit [www.irs.gov](http://www.irs.gov).

Hazardous duty areas are determined by Congress. Members of the Armed Forces deployed overseas, away from their permanent duty station, in support of operations in a qualified hazardous duty area, or performing qualifying service outside the qualified hazardous duty area, are treated as if they are in a combat zone for federal income tax purposes.

### **What is the combat zone exclusion?**

Members of the U.S. Armed Forces who serve in a combat zone may exclude certain pay from their income. The entitlement to the pay must have fully accrued in a month during which they served in the combat zone or were hospitalized due to wounds, disease, or injury incurred while serving in the combat zone. They do not have to receive the pay while in a combat zone, in a hospital, or in the same year they served in a combat zone.

The following section is to help you understand when pay is considered excludable as combat pay. You will not be making any decisions about what is excludable. The information on the military member's Form W-2 indicates the amount of combat pay with a code Q. If military members feel the amount is incorrect, refer them to the local accounting and finance or payroll office for clarification. Do not change any amounts on Form W-2 when entering them in the tax software.

### **What qualifies as service in a combat zone?**

Service in a combat zone includes periods that military members are absent from duty because of illness, wounds, or leave. If, as a result of serving in a combat zone, military members become prisoners of war or are missing in action, they are considered to be serving in the combat zone as long as they remain in that status for military pay purposes.

### **When does service outside a combat zone qualify as service inside a combat zone?**

Military service outside a combat zone is considered to be performed in a combat zone if the service:

- Is in direct support of military operations in the combat zone, and
- Qualifies a member for hostile fire/imminent danger pay due to dangers or risks from the combat zone

Military pay received for this service will qualify for the combat zone exclusion if the other requirements are met.

### **What is nonqualifying presence in a combat zone?**

The following military service does not qualify as service in a combat zone:

- Presence in a combat zone while on leave from a duty station located outside the combat zone
- Passage over or through a combat zone during a trip between two points that are outside a combat zone, and
- Presence in a combat zone solely for a member's personal convenience

#### **example**

Sgt. Bobby Osage was not assigned to a combat zone but he performed duty that qualified for hostile fire pay. He can exclude that income.



U.S. service members are considered to be serving in a combat zone if they are either assigned on official temporary duty to a combat zone or they qualify for hostile fire/imminent danger pay while in a combat zone.



## EXERCISES (continued)

**Question 4:** Which of the following may qualify as service in a combat zone?

- A. Temporary duty in a combat zone
- B. Traveling through a combat zone between two points outside of the combat zone
- C. Presence in a combat zone while on leave from a duty station located outside the combat zone
- D. Direct support of a qualified hazardous duty area but not entitled to hostile fire/imminent danger pay

### What is the amount of the combat zone exclusion?

- Enlisted members, warrant officers, or commissioned warrant officers who serve in a combat zone during any part of a month (even one day) can exclude all of that month's military pay, including awards and re-enlistment bonuses for which the member becomes eligible while in the combat zone. Military pay earned while hospitalized due to wounds, disease, or injury incurred in the combat zone can also be excluded.
- Commissioned officers (including limited duty officers) may exclude pay according to the rules for enlisted members. However, the amount of the exclusion is limited to the highest rate of enlisted pay plus the amount of imminent danger/hostile fire pay received for each month during any part of which they served in a combat zone or were hospitalized as a result of their combat zone service.

Combat pay is not included in box 1 wages on the service member's Form W-2, but the amount is shown in box 12, with code Q. If service members believe the taxable wages on Form W-2 are incorrect, they should contact the local accounting and finance or payroll office to request a corrected Form W-2.

Nontaxable combat pay may increase the Child Tax Credit or Earned Income Tax Credit. Enter all fields from Form W-2 when preparing the tax return. Be sure to consider the combat pay amount when calculating these credits. Compare the credits with and without the inclusion of combat pay; choose the one that is most beneficial to the taxpayer.



**Tax Software Hint:** To review information related to the software, go to the Volunteer Resource Guide, Finishing the Return tab, for the entries related to combat zone, "Special Processing."

## Taxpayer Interview and Tax Law Application

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Here's how a volunteer might help taxpayers with combat pay:

### SAMPLE INTERVIEW

VOLUNTEER SAYS...

*Let's talk for a minute about where your husband was stationed.*

*The combat pay is not taxable, but it's shown on your husband's W-2, here in box 12, with code Q. I will enter that into the system with the rest of the W-2 information, because combat pay can increase some tax credits. I can show on the tax return that he was in the combat zone, but I don't need to know the exact dates. Is he serving in Iraq?*

MRS. FANNIN RESPONDS...

My husband was in a combat zone for part of the year. Do I need to tell you the dates or anything?

That's right.

## What are the laws regarding community property?

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The community property states are Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin. Special rules apply to married taxpayers who file separately or who were divorced during the tax year and their **domicile** is in a community property state. For military members residing in these states, the key word is domicile, which describes someone's legal, permanent residence. It is not always where the person presently lives.

Married taxpayers who choose to file separately, when subject to community property rules, have to figure community income and separate income for state and federal income tax.

## How do community property laws affect Armed Forces pay?

State community property laws apply to active military pay. Generally, the pay is either separate or community income based on the marital status and domicile of the couple while the service member was/is in active military service.

Whether an item is subject to community property laws depends on whether the payment is classified as active pay or retired/retainer pay:

- State community property laws apply to active military pay. Generally, the character of the pay as separate from community income is determined by the marital status and domicile of the service member and spouse while the member is on active military service.
- Armed Forces retired or retainer payments may be subject to community property laws. For more information see Publication 555, Community Property.



## Summary

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Special rules may govern whether certain income received by members of the U.S. Armed Forces is includable or excludable from taxable income reported on the return:

- Homeowners Assistance Program (HAP)
- Medical separation with disability severance pay
- Combat zone exclusion
- Community property laws

### What situations are out of scope for the VITA/TCE programs?

The following are out of scope for this lesson. While this list may not be all inclusive, it is provided for your awareness only.

- U.S. Armed Forces members who were provided a commuter highway vehicle (such as a van) by their employer



### TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem or practice exercise(s) for your course of study in Publication 4491-W.

For practice using the tax preparation software, complete the scenarios using the Practice Lab on L&LT.



### EXERCISE ANSWERS

*Answer 1: False. The payments and withholdings for the enlistment and reenlistment bonuses are reflected on the service member's Form W-2.*

*Answer 2: B. The Basic Allowance for Housing (BAH) and Basic Allowance for Subsistence (BAS) are both nontaxable income.*

*Answer 3: C. Once the VA sends the letter of determination, all pension payments are offset by the disability amount paid directly from the VA, which is not taxable and not included on any Form W-2.*

*Answer 4: A. Military members are considered to be serving in a combat zone if they are either assigned on official duty to a combat zone or they qualify for hostile fire/imminent danger pay while serving in direct support of a combat zone.*





## Adjustments to Income



### Introduction

This lesson covers the Adjusted Gross Income (AGI) section of the tax return. Taxpayers can subtract certain expenses, payments, contributions, fees, etc. from their total income. The adjustments, subtracted from total income on Form 1040, establish the AGI.

Some items in the Adjusted Gross Income section of the tax return are out of scope. This lesson will cover all in-scope topics. Refer to the Volunteer Resource Guide or go to [www.irs.gov](http://www.irs.gov) to view Form 1040.

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Identify which adjustments are within the scope of the VITA/TCE programs
- Calculate and accurately report the adjustments to income that are within the scope of the VITA/TCE programs

### How do I determine if the taxpayer has adjustments to income?

To identify the adjustments to income that taxpayers can claim, you will need to ask the taxpayers if they had the types of expenses listed on the Adjusted Gross Income section of the tax return. Review the taxpayers' answers on their intake and interview sheet.

During the tax year did the taxpayer or spouse:

- Pay qualified educator expenses?
- Receive income from self-employment?
- Pay a penalty for early withdrawal of savings?
- Pay alimony?
- Make contributions to a traditional IRA?
- Make a contribution to a health savings account?
- Pay student loan interest?
- Receive income from jury duty that was turned over to an employer?



Please refer to the Extenders section in this publication for information regarding Tuition and Fees Deductions.

There are other adjustments to income on Form 1040, such as self-employed health insurance deduction, self-employed SEP, SIMPLE, and qualified plans and domestic production activities deductions. These are beyond the scope of the VITA/TCE programs. If you believe a taxpayer could benefit from one of these other adjustments, encourage the taxpayer to consult a professional tax preparer.

#### What do I need?

- Form 13614-C
  - Publication 4012
  - Publication 17
  - Publication 4491-W
- Optional:**
- Publication 504
  - Publication 590-B
  - Publication 970
  - Form 1040 Instructions
  - Form 1040 (Sch SE)
  - Form 1098-E
  - Form 1099-INT
  - Form 1099-OID
  - Form 8606
  - IRA Deduction Worksheet
  - Student Loan Interest Deduction Worksheet

There is a specialty course on health savings accounts on Link & Learn Taxes for volunteers with a Basic certification or higher. To access this online course and earn a certification for this specialty topic, go to [www.irs.gov](http://www.irs.gov) and use the keyword/search “Link & Learn.” This specialty course on health savings accounts is optional. Check with your Site Coordinator to determine whether you should be certified in this topic.



**Tax Software Hint:** To review the tax software entry screen for Adjustments to Income, go to the Volunteer Resource Guide, Adjustments tab.

## How do I handle educator expenses?

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### Who is eligible?

Eligible educators can deduct up to \$250 of qualified expenses paid during the tax year. If the taxpayer and spouse are both eligible educators, they can deduct up to \$500, but neither can deduct more than their own expenses up to \$250. Any expenses exceeding \$250 for either spouse may be treated as an itemized employment-related deduction on Schedule A. The deduction amount will be indexed for inflation for future years.

If the taxpayer and/or spouse are educators, probe a little deeper to see if they qualify for this adjustment. Ask questions such as:

- Are you or your spouse a teacher, instructor, counselor, principal, or aide in a school? (Cannot be a home school)
- What grade or grades do you teach? (Must be K-12)
- Were you employed for at least 900 hours during the school year? (Required minimum)



Professional Development expenses were added under the PATH Act. This includes courses related to the curriculum in which the educator provides instruction.

### What expenses qualify?

If the taxpayer or spouse is an eligible educator, ask about their qualified expenses. Advise taxpayers that they must have receipts for verification if they get audited.

Expenses that qualify include books, supplies, equipment (including computer equipment, software, and services), and other materials used in the classroom. Expenses that do not qualify are home schooling, nonathletic supplies for physical education, or health courses.

#### example

Gloria is a 5th and 6th grade teacher who works full-time in a year-round school. She had 1800 hours of employment during the tax year. She spent \$262 on supplies for her students. Of that amount, \$212 was for educational software. The other \$50 was for supplies for a unit she teaches sixth graders on health. Only the \$212 is a qualified expense. She can deduct \$212.

#### example

Debbie is a part-time art teacher at an elementary school. She spent \$185 on qualified expenses for her students. Because she has only 440 hours of documented employment as an educator during the tax year, she cannot deduct her educator expenses.

### What other rules apply?

Probe to learn if the taxpayer or spouse received reimbursement that would reduce the amount of their educator expenses. For example, ask:

- Did you receive reimbursement that is not listed as income on Form W-2?
- Did you redeem U.S. Series EE and I Savings Bonds where the interest would be tax-free, such as redeeming savings bonds to pay educational expenses?
- Did you receive a nontaxable distribution from a qualified tuition program (QTP) or a distribution of nontaxable earnings from a Coverdell education savings account (ESA)?

Educator expenses are reduced by any of these applicable reimbursements.

### How do I report this?

Educator expenses are reported in the adjustment section of Form 1040. Don't forget to reduce the total educator expenses by any reimbursements, nontaxable savings bond interest, nontaxable distribution from a QTP, or nontaxable distribution of earnings from an ESA.

### Taxpayer Example

Bob teaches elementary school. His wife Janet teaches high school chemistry. Here is how a volunteer helped them determine if they can take the deduction for educator expenses.

SAMPLE INTERVIEW	
VOLUNTEER SAYS...	JANET & BOB RESPOND...
<i>You've already mentioned that you both work full-time as teachers, so you may be able to deduct some of the money you spent on qualified educator expenses. Can you tell me how much you spent, or did you bring your receipts?</i>	[Janet] Yes, all teachers keep careful records of their expenses. Here are my receipts and here are Bob's.
<i>Can you tell me what you purchased? Janet, maybe you could go first.</i>	[Janet] Sure. Three receipts are for quick reference cards for my chemistry students. And two are for special reagents the department doesn't stock.
<i>Your receipts add up to \$382. Now, we can count only the first \$250 of educator expenses, but because you are married and filing jointly, we can count up to \$250 for Bob. Bob, tell me about your expenses.</i>	[Bob] These four receipts are for art supplies – paint and brushes, as you can see – and these two are for special papers and sculpting clay.
<i>Yours total \$263. Now, did either of you receive any reimbursement that is not listed on Form W-2?</i>	[Janet] No, we paid these expenses out of our own pockets.  [Bob] Wait, now that I think about it, I got reimbursed \$50 for the clay.
<i>That would bring your total down to \$213.</i>	[Janet] Can't we apply some of my excess expense to Bob and bring his total up to \$250?
<i>No, I'm sorry, each person's expenses have to stand alone. However, the amount over \$250 can be claimed on Schedule A and is subject to 2% of AGI. Did either of you receive any reimbursement that is not listed on a Form W-2, from any other source?</i>	[Janet] No.

## SAMPLE INTERVIEW

VOLUNTEER SAYS...

JANET & BOB RESPOND...

*Did you redeem U.S. series EE and I Savings Bonds during the tax year?*

[Janet] No, we didn't. What if we had?

*We would complete a form to see what percentage of the tax-free interest should be applied as a reimbursement. One more thing: did you receive distributions from a qualified tuition program or a Coverdell education savings account?*

[Bob] No, neither of those.

*Okay, we can claim \$213 for Bob and the maximum \$250 for Janet. That gives you a total of \$463 on your joint return as a deduction for educator expenses. Any questions before we go on?*

[Janet] No, I think we understand.

[On the intake and interview sheet, indicate that the taxpayers are entitled to the educator expense adjustment.]  
[Schedule A itemized deductions are discussed in a later lesson.]



### How do I handle self-employment tax?

Self-employed taxpayers can subtract a deductible portion of their self-employment tax from their income. Self-Employment Tax is covered in the Other Taxes Lesson.



**Tax Software Hint:** The deductible portion of the self-employment tax is automatically calculated from Schedule SE. To review information related to the software, go to the Volunteer Resource Guide, Adjustments tab.



### How do I handle penalties for early withdrawal?

Taxpayers can adjust their income to deduct penalties they paid for withdrawing funds from a deferred interest account before maturity. Ask if the taxpayer and/or spouse made any early withdrawals during the tax year. If so, ask to see Form 1099-INT, Interest Income, or Form 1099-OID, Original Issue Discount, documenting the penalty.



**Tax Software Hint:** The early withdrawal penalty amount should be entered in the interest income section if it is listed on Form 1099-INT. Otherwise, go to the Deductions section, then Adjustments, and click begin on the Penalty on Early Withdrawal of Savings or CD line.

#### example

Gloria withdrew \$5,000 early from a one-year, deferred-interest certificate of deposit. She had to pay a penalty of three months' interest. She can claim this penalty amount as an adjustment to income.

## How do I handle alimony paid?

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Alimony is a payment to a spouse or former spouse under a divorce or separation instrument. The payments do not have to be made directly to the ex-spouse. For example, payments made on behalf of the ex-spouse for expenses specified in the instrument, such as medical bills, housing costs, and other expenses can qualify as alimony. Alimony does not include child support or voluntary payments outside the instrument. The person paying alimony can subtract it as an adjustment to income; the person receiving alimony must treat it as income. A summary of the alimony requirements can be found in the Adjustments section of the Volunteer Resource Guide.

When you conduct the interview, ask if the taxpayer paid alimony under a divorce or separation instrument. If so, explain that you need the exact amount, as well as the Social Security number of the recipient, because the recipient must report the payment to the IRS as income and the two amounts must agree.

For additional information on alimony, refer to the Alimony chapter in Publication 17 and Publication 504, Divorced or Separated Individuals.

### example

Anthony has been divorced for three years. Under his divorce instrument, he paid his ex-wife \$8,000 during the tax year. As a favor, he also made \$4,000 in payments to cover part of her vehicle lease so she could keep steady employment. He can take the \$8,000 as an adjustment to income. He cannot count the lease payments because those were payments not required by the divorce instrument.



### EXERCISES

Answers are at the end of the lesson summary.

**Question 1:** Victoria divorced in 2007. Her divorce settlement states that she must pay her ex-husband \$12,000 a year. She is also required to pay his ongoing medical expenses for a condition he acquired during their marriage. During the tax year, the medical expenses were \$11,400. How much can she deduct as an adjustment to income?

- A. \$12,000
- B. \$11,400
- C. \$23,400
- D. \$600



## How do I handle IRA contributions?

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“IRA” stands for “Individual Retirement Arrangement.” It is a personal savings plan that offers tax advantages to set aside money for retirement. This section discusses “traditional” IRAs. A traditional IRA is any IRA that is not a Roth or SIMPLE IRA. See the Individual Retirement Arrangements (IRAs) chapter in Publication 17, and Publication 590, Individual Retirement Arrangements, for more information on all types of IRAs.

Some of the features of a traditional IRA are:

- Taxpayers may be able to deduct some or all of their contributions to the IRA (depending on circumstances).

- Generally, amounts in an IRA, including earnings and gains, are not taxed until distributed.
- Contributions may be eligible for the retirement savings contributions credit.

Although contributions to a Roth IRA cannot be deducted, the taxpayer may be eligible for the retirement savings contributions credit, discussed in the lesson on Miscellaneous Credits.

#### example

Fred has a traditional IRA account and a Roth IRA account. During the tax year, Fred contributed \$2,200 to his traditional IRA and \$1,000 to his Roth IRA. The most Fred will be able to deduct is the \$2,200 contribution to his traditional IRA.

## What are the eligibility requirements for an IRA contribution?

The taxpayer, and the taxpayer's spouse if applicable, must meet these eligibility requirements in order to make an IRA contribution:

- **Types of IRAs:** Verify the types of IRAs to which the taxpayer and spouse contributed. Only contributions to traditional IRAs are deductible.
- **Age limit:** Taxpayers can contribute to a traditional IRA only if they are less than 70½ years of age at the end of the tax year. Check the taxpayer's birth date (and spouse's if applicable) indicated on the intake and interview sheet.
- **Compensation:** Individuals must have taxable compensation (i.e., wages, self-employment income, commissions, taxable alimony, or taxable scholarships or fellowships).
- **Time limits:** Contributions must be made by the due date for filing the return, not including extensions. Verify with the taxpayer and spouse that they made the contribution(s) (or will make them) by the due date of the return.



Be sure the taxpayer knows that if a contribution is reported on the tax return but is not made by the deadline, the taxpayer must file an amended return.

## How much can a taxpayer contribute to an IRA?

Generally, you can deduct the lesser of:

- The contributions to your traditional IRA for the year, or
- The general limit or the spousal IRA limit, if it applies (see the Volunteer Resource Guide, Adjustments Tab)

## What is the compensation requirement?

Compensation is generally the income a taxpayer has earned from working; it also includes alimony, and other forms of earned income. (See Publication 17 for more information on compensation.) Taxpayers cannot make IRA contributions that are greater than their compensation for the year.



An IRS certified volunteer preparer must exercise due diligence when preparing or assisting in the preparation of, approving, and filing tax returns. Based on this, volunteers may rely in good faith without requiring certain documents from the taxpayer. However, the volunteer preparer may not ignore the implications of information furnished to, or actually known by, the preparer. The preparer must ask questions if the information furnished appears to be incorrect, inconsistent, or incomplete.



If taxpayers file a joint return, and one spouse's compensation is less than the other spouse's compensation, the most that can be contributed for that spouse is the lesser of:

- The general limits, or
- The total compensation includible in the gross income of both spouses for the year, reduced by:
  - Traditional IRA contributions for the spouse with the greater compensation
  - Any contribution for the year to a Roth IRA for the spouse with the greater compensation

In other words, as long as they file a joint return, married taxpayers' combined IRA contributions cannot exceed their combined compensation, and neither spouse can contribute more than the spousal IRA limit to their own IRA.

#### example

Gene and Sue are married and are both over 50 years old. Gene earned \$70,000 and Sue earned \$1,500. During the tax year, Gene contributed \$3,500 to his traditional IRA and \$2,000 to a Roth IRA, making his total contributions \$5,500. To figure the maximum contribution to Sue's IRA, use a total compensation of \$66,000 (i.e., \$71,500 – \$5,500). If Gene and Sue file jointly, they can contribute up to \$6,500 to Sue's IRA even though her own compensation was just \$1,500.

Although a person may have IRA accounts with several different financial institutions, the tax law treats all of their traditional IRA accounts as one single IRA.

#### example

Bill is 29. He has a traditional IRA account at City Home Savings Bank and another traditional IRA account through his stockbroker. He also opened a Roth IRA through his stockbroker. Bill can contribute to any or all of his accounts this year, but the combined contributions for the tax year cannot exceed the ceiling amount.



### EXERCISES (continued)

**Question 2:** Stan, an unmarried college student working part time, earned \$4,500 during the tax year. He contributed \$1,000 to a Roth IRA. What is the maximum he can contribute?

- A. \$1,000
- B. \$3,500
- C. \$4,500
- D. \$2,000

**Question 3:** Bob and Carol are married and both are 55 years old. They both work and each has a traditional IRA. During the tax year, Bob earned \$2,000, and Carol earned \$50,000. If they file separate returns, what is the maximum that Bob can contribute to his IRA? \$\_\_\_\_\_.

### Are there special rules for certain military personnel?

Current or former members of the Armed Forces may qualify for additional retirement benefits. Under the Heroes Earned Retirement Opportunities (HERO) Act, taxpayers can count tax-free combat pay as compensation when determining whether they qualify to contribute to either a Roth or traditional IRA. Before this change, members of the Armed Forces whose earnings came entirely from tax-free combat pay were generally barred from using IRAs to save for retirement.

## When can IRA contributions be deducted?

Deductions cannot be taken for contributions to other types of IRAs. The taxpayer's deduction for IRA contributions may be "phased out" (i.e., reduced or eliminated) depending on their income, filing status, and whether the taxpayer is covered by a retirement plan at work. The difference between the permitted contributions and the IRA deduction, if any, is the taxpayer's nondeductible contribution. Form 8606, Nondeductible IRAs, must be completed for any nondeductible traditional IRA contributions.

If taxpayers do not report nondeductible contributions, all of the contributions to a traditional IRA will be treated as having been deducted. This means all distributions will be taxed when withdrawn unless the taxpayer can show, with satisfactory evidence, that nondeductible contributions were made.

Form 8606 requires basis information in IRAs from prior years and can be complex. If Form 8606 is required, refer the taxpayer to a professional tax preparer.

## How do I determine the deduction amount?

The factors that affect whether traditional IRA contributions are deductible include:

- Whether the taxpayer (or spouse, if filing a joint return) is covered by a retirement plan at work.
- The taxpayer's Modified Adjusted Gross Income (MAGI) before taking the deduction. If the taxpayer or spouse is covered by a retirement plan, the deduction amount will be reduced or eliminated if the MAGI on the tax return is above a certain limit. Use the IRA Deduction Worksheet from Form 1040 Instructions to figure their MAGI without the deduction.

### ***Retirement coverage at work***

Ask if the taxpayer and/or spouse were covered by a retirement plan at work at any time during the tax year. If so, their deduction may be limited. Employees covered by a retirement plan will have box 13 on Form W-2 checked.

### ***Filing status and income***

If the taxpayer or spouse was covered by an employer retirement plan, they may not be able to deduct the full amount. Notice that the income limitation amount may be different for each spouse on a joint return, but that the MAGI computation is the same. This is because, if one spouse is covered by a retirement plan but the other is not, the noncovered spouse will have a higher income limit before their IRA deduction is phased out.

If the MAGI is greater than the income limits, the deduction cannot be taken. If this is the case, explain to the taxpayers and answer any questions they may have about why the deduction cannot be taken. The contribution may still be made, it is just not deductible.



If the taxpayers' IRA contribution is more than the general limit or their compensation, advise the taxpayers that their excess contributions (and all related earnings) should be withdrawn from the IRA before the due date. If the excess contributions are not withdrawn, an additional tax will be assessed. This tax on excess contributions is discussed in the lesson on Other Taxes.

Enter the total contributions to traditional IRAs that were made (or will be made) for each spouse (on a joint return) by the due date of the return.

## How do I report the IRA deduction?

Report the deduction in the adjustment section of Form 1040.



**Tax Software Hint:** To review information related to the software, go to the Volunteer Resource Guide, Adjustments tab.

## What if the taxpayer has excess IRA contributions?

An excess IRA contribution is an amount contributed to a traditional IRA that is more than the smaller of:

- The taxable compensation for the year, or
- General limit amount

The taxpayer may not know that a contribution qualifies as “excess” until the tax return is completed. When this situation is identified, the excess amount, with any earnings on that amount, must be withdrawn by the due date of the return (including extensions). If the excess amount is not withdrawn by the due date of the return, including extensions, the taxpayer will be subject to an additional 6% tax on this amount. This additional tax is covered in the Other Taxes lesson, but is out of scope for the VITA/TCE programs. Taxpayers subject to the additional 6% tax should be referred to a professional tax preparer.

The withdrawn excess contribution is not included in the taxpayer’s gross income from the IRA before the tax return is due if both of the following conditions are met:

- No deduction was allowed for the excess contribution
- All interest or other income earned on the excess contribution is withdrawn

If taxpayers timely filed the tax return without withdrawing a contribution that they made during the tax year, they can still have the contribution returned to them within 6 months of the due date of the tax return, excluding extensions.

Taxpayers must include in gross income the interest or other income that was earned on the excess contribution. Taxpayers must report it on their return for the year in which the excess contribution was made. The withdrawal of interest or other income may be subject to an additional 10% tax on early distributions.

### Form 1099-R

Taxpayers will receive Form 1099-R indicating the amount of the withdrawal. If the excess contribution was made in a previous tax year, the form will indicate the year in which the earnings are taxable.

#### example

Maria, age 35, made an excess contribution of \$1,000, which she withdrew by the due date of her return. At the same time, she also withdrew the \$50 income that was earned on the \$1,000. She must include the \$50 in her gross income (for the year in which the excess contribution was made). She must also pay an additional tax of \$5 (the 10% additional tax on early distributions because she is not yet 59½ years old), but she does not have to report the excess contribution as income or pay the 6% excise tax. Maria receives a Form 1099-R showing that the earnings are taxable for the current year.



## How do I handle student loan interest?

The student loan interest deduction is generally the smaller of \$2,500 or the interest payments paid that year on a qualified student loan. This amount is gradually reduced (phased out) or eliminated based on the taxpayer's filing status and MAGI.

### example

Robert has taken his first job after completing law school. His filing status is Single. He paid \$3,000 in interest on his student loans during the tax year. With all adjustments to income (except student loan interest adjustment), his MAGI is below the limits. He can deduct \$2,500 of his student loan interest as an adjustment to income.

### example

Veronica and her husband are filing jointly. Their MAGI is above the fully deductible income limits. She completed her doctoral degree last year and paid \$2,400 in student loan interest during the tax year. Due to their high MAGI, their deduction must be calculated; it will be less than the full amount of interest that she paid.

## What type of interest qualifies?

Generally, student loan interest is paid during the year on a loan for qualified higher education expenses. The loan must meet all three of these conditions:

- It was for the taxpayer, the taxpayer's spouse, or a person who was the taxpayer's dependent when the loan was obtained
- The qualified higher education expenses were paid within a reasonable period of time before or after obtaining the loan
- It was for an eligible student

Interest does not qualify if the loan was from a related person, a qualified employer plan, or if the taxpayer is not legally liable for the loan.

### *What are the exceptions?*

For purposes of the student loan interest deduction, the following are exceptions to the general rules for dependents:

- An individual can be your dependent even if you are the dependent of another taxpayer
- An individual can be your dependent even if the individual files a joint return with a spouse
- An individual can be your dependent even if the individual had gross income for the year that was equal to or more than the exemption amount for the year



### EXERCISES (continued)

**Question 4:** Todd and Janet have a MAGI below the limits. They are filing jointly. Two years ago, they took out a loan so Todd's mother could earn her RN degree at night school. Todd could not claim her as a dependent on his return. This year, they paid \$1,000 in interest on the loan. Does his mother meet the student qualifications?  Yes  No

## **Who is eligible for the deduction?**

Generally, a taxpayer can claim the deduction if all the following are true:

- The taxpayer is not using the Married Filing Separately filing status
- The taxpayer will not be claimed as a dependent on someone else's return
- The taxpayer is legally obligated to pay interest on a qualified student loan
- The taxpayer paid interest on a qualified student loan
- The interest is on a loan to pay tuition and other qualified higher education expenses for the taxpayer, the taxpayer's spouse, or someone whom the taxpayer could claim as a dependent when the loan was taken out
- The education expenses were paid or incurred within a reasonable period of time before or after the loan was taken out
- The person for whom the expenses were paid or incurred was an eligible student

Conduct a probing interview to verify that the taxpayer meets all these tests for the deduction.

## ***What are qualified higher education expenses?***

Qualified expenses include: tuition and fees; room and board; books, supplies and equipment; and other necessary expenses (such as transportation).

Qualified expenses must be reduced by certain other educational benefits. Ask the taxpayer if the expenses were offset by any of the following:

- Employer provided educational assistance benefits
- Tax-free distributions from a Coverdell ESA or from a qualified tuition program
- U.S. savings bond interest excluded from income because it is used to pay qualified higher education expenses
- Certain scholarships and fellowships
- Veteran's educational assistance benefits
- Any other nontaxable payments (other than gifts, bequests, or inheritances) received for educational expenses

## ***No double benefit allowed***

Taxpayers cannot deduct as interest on a student loan any amount that is an allowable deduction under any other provision of the tax law (e.g., as home mortgage interest).

## ***What is an eligible educational institution?***

An eligible educational institution is generally any accredited public, nonprofit, or private post-secondary institution eligible to participate in the student aid programs administered by the Department of Education. It includes virtually all accredited, public, nonprofit, and privately owned profit-making post-secondary institutions. If the taxpayers do not know if an educational institution is an eligible institution, they should contact the school. A searchable database of all accredited schools is available on the U.S. Department of Education website.

## ***Who is an eligible student?***

An eligible student is someone enrolled at least half-time in a program leading to a degree, certificate, or other recognized educational credential. The standard for what is half the normal full-time work load is determined by each eligible educational institution.

### example

This year, Jeremy paid interest on a loan that allowed his 21-year-old daughter, Kate, to complete a program in holistic medicine as a full-time student at the Southwestern College of Synergistic Therapy. Although she qualifies as his dependent, and the loan paid for books, supplies, and equipment, the college is not accredited. Therefore, Jeremy cannot deduct the interest on the student loan.

## Where can I get the information?

If the taxpayer paid \$600 or more in interest to a single lender, the taxpayer should receive Form 1098-E, Student Loan Interest Statement, or another statement from the lender showing the amount of interest paid. This information will assist you in completing the student loan interest deduction.

The taxpayer should keep documentation of all qualified student loan interest paid during the tax year.

See Publication 970, Tax Benefits for Education, for more information on the Student Loan Interest Deduction.



**Tax Software Hint:** To review information related to the software, go to the Volunteer Resource Guide, Adjustments tab.

## Taxpayer Interview and Tax Law Application

Here is how a volunteer helped Brenda determine if she can take the deduction for her student loan interest.

### SAMPLE INTERVIEW

#### VOLUNTEER SAYS...

*In reviewing your intake and interview sheet, I see you did not indicate if you had any educational expenses. Did you pay any student loan interest this year?*

*Well, you might be able to take a deduction for that. You are filing as Single, and your income before adjustments is not more than the limit for your filing status. Do you know how much interest you paid?*

*The interest amounts add up to \$2,600. Now, if your interest payments qualify for the deduction, the most we can claim is \$2,500. Do you have any questions about that?*

*I just need to ask a few questions to see if you qualify, okay? Earlier we decided that you can't be claimed as a dependent on someone else's return, so that's no problem. Can you tell me what you used the loan to pay for?*

*Did you receive any educational assistance, like from your employer or the Veteran's Administration?*

*How about tax-free withdrawals from a Coverdell educational savings account, another qualified tuition program, or from U.S. savings bonds?*

*Did you get any other nontaxable payments, not counting gifts, bequests, or inheritances, which were specifically for educational expenses?*

#### BRENDA RESPONDS...

Yes, I just graduated a year ago and I'll be paying those loans for a while.

I have two loans; here are the statements.

No, I understand.

My tuition and fees, and my books.

No.

No, none of those.

Heavens, no, I wish I had!

## SAMPLE INTERVIEW

VOLUNTEER SAYS...

BRENDA RESPONDS...

*It looks like you can claim the maximum deduction of \$2,500.*

[Indicate on the intake and interview sheet whether Brenda is eligible for this adjustment.]

### Is pay for jury duty an adjustment to income?

As you learned earlier, jury duty pay received by taxpayers is included in Other income on Form 1040. Some employees receive their regular wages from their employers while they are serving on a jury instead of working at their jobs.

Often, employees must turn their jury duty pay over to their employers. This may be claimed as an adjustment to income.

### How do I determine Adjusted Gross Income?

The taxpayer's total Adjusted Gross Income (AGI) is the amount that is used to compute some limitations, such as the medical and dental deduction on Schedule A and the credit for child and dependent care expenses. To find the taxpayer's AGI:

1. Add the Income section. This is the taxpayer's total income.
2. Add the Adjustments to Income section. These are the total Adjustments.
3. Subtract the Adjustments section from the Income section. This is the AGI.

### Taxpayer Interview and Tax Law Application

Here is how a volunteer helped Daniela with the adjustments to income covered in this lesson.

## SAMPLE INTERVIEW

VOLUNTEER SAYS...

DANIELA RESPONDS...

*Daniela, we've totaled your income, so we can go on to Adjustments to Income. We might find ways to reduce the income that you're taxed on. Do you have any questions before we go on?*

No, it all makes sense.

*Now, let's review the expenses listed on your intake and interview sheet and the deductions listed in the Adjustments to Income section of Form 1040. Do you have a Health Savings Account?*

No, I don't.

*Okay. We can skip moving expenses because you haven't moved for your job. That brings us to self-employment tax. As you can see, tax software has calculated the deductible portion of your self-employment tax and shows it here as an adjustment to income. The same with the penalty for an early withdrawal, right? Since I put that in when I entered your interest income, it already shows up as an adjustment.*

Cool!

*Did you pay any alimony?*

No, I've never even been married.

## SAMPLE INTERVIEW

VOLUNTEER SAYS...

DANIELA RESPONDS...

*Now, did you contribute to an IRA?*

I put in \$2,000 right after Christmas.

*Good for you. Will you be contributing any more? You can put money in your IRA before the deadline for filing the return.*

I don't think so, but that's good to know.

*Was it a traditional, Roth IRA, or a SIMPLE IRA?*

It was just a plain old IRA. Here's the statement.

*There we go; it is what we call a traditional IRA. You certainly are under 70½ years of age. Were you covered by any kind of employer retirement plan at any time during the tax year?*

No, none.

*Because you weren't covered by a retirement plan, you will be able to deduct the full \$2,000 you contributed.*

[The volunteer reviews all expenses listed on the intake and interview sheet and moves down each line of the Adjustments section of Form 1040, asks more questions, and determines that Daniela does not qualify for the remaining adjustments.]

*We've entered all the adjustments that apply to you. Here is your total income... here are your total adjustments... and here is what we call your Adjusted Gross Income, that will carry over to the second page of the return where we will determine your deductions and exemption amounts.*

That's great! This program makes it really easy!

[On the intake and interview sheet, note that you have addressed this adjustment.]

## Summary

In this lesson, you learned how to identify and work with these adjustments to income:

- Educator expenses
- Deductible portion of self-employment tax
- Penalty on early withdrawal of savings
- Alimony paid
- IRA deduction
- Student loan interest deduction
- Jury duty pay turned over to the taxpayer's employer

There is an optional specialty course on health savings accounts on Link & Learn Taxes for volunteers with Basic certification or higher.

If you believe a taxpayer could benefit from an adjustment that is out of scope and was not covered in this lesson, encourage the taxpayer to consult a professional tax preparer.



## What situations are out of scope for the VITA/TCE programs?

The following are out of scope for this lesson. While this list may not be all inclusive, it is provided for your awareness only.

- Other adjustments to income on Form 1040, such as:
  - Self-employed health insurance deduction
  - Self-employed SEP, SIMPLE, and qualified plans
  - Domestic production activities deduction
- Form 8606, Nondeductible IRAs



### TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem or practice exercise(s) for your course of study in Publication 4491-W.

For practice using the tax preparation software, complete the scenarios using the Practice Lab on L&LT.



### EXERCISE ANSWERS

**Answer 1:** C. She can deduct the full \$23,400 because it is all required by the divorce instrument.

**Answer 2:** C. His IRA contributions are limited to \$4,500, the amount of his compensation.

**Answer 3:** If Married Filing Separately, Bob can contribute no more than \$2,000, the amount of his compensation.

**Answer 4:** No. Todd's mother was not their dependent at the time they took out the loan.





# Military Moving Expenses



## Introduction

This lesson will help you determine which members of the U.S. Armed Forces are entitled to an adjustment to income for moving expenses. To do this, you will need to determine qualifying moves, allowances and reimbursements, and deductible moving expenses.

To determine if the taxpayer has incurred moving expenses, it is important to ask probing questions during the taxpayer interview.

To deduct moving expenses as an adjustment to income, the taxpayer generally must meet certain time and distance tests. However, a member of the Armed Forces on active duty who moves because of a permanent change of station does not have to meet these tests.

Unreimbursed moving expenses are deducted using Form 3903, *Moving Expenses*. Armed Forces members receive a variety of moving reimbursements and allowances that must be considered when determining if the expenses are deductible. The travel voucher will contain much of the information needed to compute the deduction.

See Publication 521, *Moving Expenses*, for additional information on the topics discussed in this lesson.

## Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Determine if a move qualifies as a permanent change of station (PCS)
- Identify deductible moving expenses
- Determine when allowances and reimbursements must be included in income

### What do I need?

- Form 13614-C
- Publication 4012
- Publication 17
- Publication 4491-W
- Form 3903

#### **Optional:**

- Publication 3
- Publication 521
- Form 1040 Instructions

## What is a permanent change of station?

Only expenses incurred as a result of a permanent change of station (PCS) are deductible. A permanent change of station includes a move from:

- Home to the area of the first post of duty.
- One permanent post of duty to another.
- The last post of duty to home or to a nearer point in the U.S. The Armed Forces member must move within one year of ending active duty or within the period allowed under the Joint Travel Regulations.

## What does a permanent change of station include for spouses and dependents?

If the Armed Forces moves service members and their spouses or dependents to or from separate locations, the moves are treated as a single move and the qualified expenses of both moves are combined and deducted on the same tax return.



## EXERCISES

Answers are at the end of the lesson summary.

**Question 1:** Which of the following is a permanent change of station?

- A. A move by an Air Force pilot to an airbase for a six-month detail
- B. A move by an Army sergeant to his home two years after he ended active duty
- C. A move by a new enlistee from her home to her first post of duty
- D. A temporary move by a U.S. Marine to attend a six-month training program

### What expenses are included in the moving expense adjustment?

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Qualifying military moving expenses fall into the following two categories, the cost of:

- Moving household goods and personal effects
- Reasonable travel and lodging expenses

To qualify as “reasonable,” the route taken must be the shortest, most direct route available, from the former home to the new home. Additional expenses for stopovers, side trips, or pre-move house hunting expenses are not deductible as moving expenses.

Qualifying expenses that exceed government allowances and reimbursements are deductible.

Use Publication 521 as a resource for additional information. This publication has detailed information on deductible and nondeductible moving expenses. It also contains a special section on members of the Armed Forces.

### How do I handle military reimbursements?

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Determine whether any moving allowances or reimbursements provided by the government should be included in a service member’s income, and how to accurately report the deduction on Form 1040.

### What is a Personally Procured Move (PPM)

Typically, Armed Forces members move their own household items in a personal or rented vehicle; this is called a Personally Procured Move (PPM), formerly known as a Do-It-Yourself (DITY) move. The Armed Forces provides an incentive payment equal to 95% of the estimated cost to the government for PPM. When the move is completed, the Armed Forces member provides receipts and paperwork to substantiate authorized expenses. The net financial profit is taxable and is reported on a separate Form W-2.

### How do I report a PPM?

PPM payments are entered as income on Form 1040, line 7.

Armed Forces members may not take a moving expense deduction based on the expenses approved by the finance office when settling the PPM, as they have already been used to reduce taxable income.

### example

Captain Cook receives orders for a PCS. He chooses to pack and drive his household goods to the new duty station in his own vehicle. The Air Force estimates that the move would have cost the government \$2,500. Captain Cook's actual expenses for the move were \$1,750. He receives a payment for \$2,375 (95% of the government's estimate), but Form W-2, box 1, will show only \$625 (\$2,375 minus \$1,750) for the PPM. Captain Cook cannot deduct any of his expenses, since he's already been reimbursed.

### What forms of reimbursement are *not* included as income?

Certain forms of reimbursement provided by the government are *not* to be included as income on the Armed Forces member's tax return.

- Moving or storage services furnished to the Armed Forces member
- Nontaxable allowances such as:
  - Dislocation allowance
  - Temporary lodging allowance
  - Mileage allowance in lieu of transportation
  - Per diem allowance
  - Move-in housing allowance (MIHA)



### EXERCISES (continued)

**Question 2:** Sgt. Bishop received Form W-2 for \$1,000 as a result of a PPM to a new Permanent Duty Station (PDS). In addition, the government paid her a mileage allowance of \$300, a lodging allowance of \$200, and a dislocation allowance of \$1,200. How much should Sgt. Bishop include in her gross income on Form 1040, line 7?

- A. \$1,500
- B. \$1,000
- C. \$300
- D. \$200

### How do I calculate the adjustment?

Deductions can only be claimed for expenses not covered by a nontaxable reimbursement or moving allowance. If the taxpayers have allowable expenses that exceed the amount they were reimbursed, Form 3903 should be completed. Form 3903 is not needed if all the taxpayers' reimbursements were nontaxable allowances that were greater than their expenses.



**Tax Software Hint:** The tax software addresses the Armed Forces PCS move and calculates the standard mileage amount based on miles traveled for the move.

## Taxpayer Interview and Tax Law Application

Here's how a volunteer could help Mrs. Fannin determine if she had any deductible moving expenses:

### SAMPLE INTERVIEW

VOLUNTEER SAYS...

*You said you just moved here during June of this year. Was this a PCS move?*

*If your expenses were more than the Armed Forces reimbursement, you may be able to use the difference to reduce your gross income. We'll complete Form 3903 to see how it comes out. Did you bring your travel voucher with you?*

*Did you drive directly here, or did you take any side trips?*

*The IRS will let you use the standard mileage rate for a military move, or we can use actual expenses if you kept track. To determine the standard mileage rate, let's look at Publication 4491X or Publication 521 and multiply the rate times the number of miles..*

*The IRS allows lodging costs, but not food. So your total allowable expenses includes \$300 for the motels and your mileage expenses. The travel voucher shows a total of \$400 in reimbursements – did you receive any other reimbursements or allowances?*

*Then you'll get to deduct the amount you spent that was more than your reimbursement.*

[On the intake and interview sheet, be sure to note that you've addressed this adjustment.]

MRS. FANNIN RESPONDS...

Yes, my husband was transferred here in March, shortly before he deployed. I have family close by, so I'd rather stay here while he's overseas.

It's right here. We drove our own car 1,000 miles to get here, and paid \$120 for gas. We paid \$300 for motels and \$135 for meals on the way. The military moved our household goods, and we didn't have any overweight.

We came right here so we could settle in before he deployed.

I only kept the gas receipts, so the standard rate would probably be best.

No, that's it.

### When should an Armed Forces member claim the deduction?

Armed Forces members who use the cash method of accounting (the most common) and have qualified expenses exceeding their reimbursement can deduct the expenses either in the year they paid them, in the year reimbursement was received, or immediately after the year of reimbursement but by the due date, including extensions, for filing the return for the reimbursement year.

If expenses are deducted and reimbursement is received in a later year, the reimbursement must be included in income.



## EXERCISES (continued)

**Question 3:** In November of the current year, Petty Officer Wharton moved from California to Washington. The move qualified as a PCS. He incurred \$800 in mileage expenses and \$1,600 in lodging. He paid \$1,400 to ship household goods over the allowed weight limit, and \$500 to ship his dog. The following year, he filed his travel voucher and received \$2,400 mileage and travel allowance. He also received a \$1,500 dislocation allowance.

For what tax year(s) can Petty Officer Wharton claim his moving expenses on Form 3903?

- A. Next year only
- B. Current year only
- C. Either current year or next year

## Taxpayer Interview and Tax Law Application

Amanda was relocated to another Air Force base. Here's how a volunteer could help Amanda determine if she had any deductible moving expenses:

### SAMPLE INTERVIEW

VOLUNTEER SAYS...

AMANDA RESPONDS...

*So, you were transferred from Maxwell Air Force Base to Scott Air Force Base last year, right?*

Yes, I was reimbursed \$400 for travel expenses on the way to Scott Air Force Base.

*Did you receive any other allowances?*

Yes, I also received a \$1,000 dislocation allowance.

*Well the reimbursements were not reported on your W-2. You can only deduct expenses that are larger than your combined reimbursements and allowances. First, let's add all your qualified expenses. How much was your travel and lodging?*

I spent \$575 on travel and lodging and another \$200 for meals along the way.

*Any other expenses?*

Yes, I gave a \$350 security deposit to my new landlord.

*Only the travel and lodging en route can be claimed on Form 3903, line 2. The security deposit and meals are not deductible expenses. Your reimbursement and dislocation allowances add up to \$1,400. Since that's more than your expenses, you don't have anything to deduct. But, you don't have to include any of the excess reimbursement as income, either.*

## Summary

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This lesson described the types of Armed Forces moves that qualify for tax benefits, the kinds of expenses that are deductible, and the use of Form 3903 to compute the moving expense deduction. These expenses are deductible as an adjustment to income on Form 1040.



### TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem or practice exercise(s) for your course of study in Publication 4491-W.

For practice using the tax preparation software, complete the scenarios using the Practice Lab on L&LT.

You may not be able to complete the entire exercise if some of the technical issues in the exercise are not covered until later lessons. In these instances, complete as much of the exercise as you can. Come back later to finish the exercise after you cover all the technical topics.



### EXERCISE ANSWERS

**Answer 1:** C. A move by a new enlistee from her home to her first post of duty is considered a PCS.

**Answer 2:** B. The \$1,000 PPM payment should be included as gross income on line 7. However, nontaxable allowances such as dislocation allowances, temporary lodging allowances and mileage allowances provided by the Armed Forces should not be included as gross income on the service member's tax return, even if they exceed allowable expenses.

**Answer 3:** C. Because Petty Officer Wharton paid for moving expenses in the year prior to the year of reimbursement, he can claim all of his moving expenses on Form 3903 in either the year he paid or the year he was reimbursed.





## Standard Deduction and Tax Computation



### Introduction

This is the first of eight lessons covering the Tax and Credits section of the taxpayers' return. After completing this lesson on standard deductions and the Itemized Deductions lesson, you will be able to subtract the appropriate deduction from the taxpayers' adjusted gross income to figure their taxable income.

Some taxpayers may need to use the standard deduction worksheet in the Form 1040 Instructions.

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Determine the standard deduction amount for most taxpayers
- Determine the standard deduction amount for taxpayers claimed as dependents
- Identify how taxable income and income tax are computed and reported

#### What do I need?

- Form 13614-C
- Publication 4012
- Publication 17
- Publication 4491-W
- Form 1040

#### **Optional:**

- Publication 501

### What are deductions?

Deductions are subtractions from a taxpayer's adjusted gross income (AGI). They reduce the amount of income that is taxed. Most taxpayers have a choice of taking a standard deduction or itemizing their deductions. When taxpayers have a choice, they should use the type of deduction that results in the lower tax. Use the interview techniques and tools discussed in earlier lessons to assist you in determining if the standard deduction will result in the largest possible deduction for the taxpayer.

### What is a standard deduction?

A standard deduction for most taxpayers is a set dollar amount based on the taxpayer's filing status. An increased standard deduction is available to taxpayers who are 65 or older or blind. There are limitations on the standard deduction for taxpayers who can be claimed as a dependent on someone else's return. The Volunteer Resource Guide, Deductions tab, includes references for calculating the standard deduction.

#### example

James, 44, and Sara, 39, are filing a joint return. Neither is blind, and neither can be claimed as a dependent. They decided not to itemize their deductions. They will use the married filing jointly standard deduction amount. Their standard deduction is computed using the Standard Deduction Chart for Most People in the Volunteer Resource Guide.

## What is an itemized deduction?

Itemized deductions allow taxpayers to reduce their taxable income based on specific personal expenses. If the total itemized deductions are greater than the standard deduction, it will result in a lower taxable income and lower tax. In general, taxpayers benefit from itemizing deductions if they have mortgage interest, very large unreimbursed medical or dental expenses when compared to their income, or other large expenses such as charitable contributions. Itemized deductions will be covered in the next lesson.

## Who cannot take the standard deduction?

Some taxpayers cannot take the standard deduction and must itemize. During the interview, find out if the taxpayer is:

- Filing as Married Filing Separately and the spouse itemizes
- A nonresident or dual-status alien during the year (and not married to a U.S. citizen or resident at the end of the year)

If either situation applies, the taxpayer must itemize personal deductions and the box on Form 1040, page 2, must be checked.

### example

Chase files as Married Filing Separately. Her spouse, Grant, will be itemizing his deductions. Chase cannot use the standard deduction; she will have to itemize her deductions.



**Tax Software Hint:** The standard deduction is automatically calculated based on entries in the Basic Information section. If the taxpayer cannot take the standard deduction, the tax software will prompt the preparer to itemize deductions.

## How does age or blindness affect the standard deduction?

The standard deduction is higher if the taxpayer or spouse is 65 or older, and if one or both are blind. This information is reported in the check boxes located on Form 1040, page 2. The more check boxes marked, the higher the standard deduction. Be sure to verify the taxpayer's and spouse's age and level of blindness as described below.



**Tax Software Hint:** These boxes are automatically checked. For software entries, go to the Volunteer Resource Guide, Starting the Return tab.

### example

Sherman is 73 years old and blind. He files as Single using Form 1040. Because Sherman is over 65 and blind, enter 2 in the appropriate box on Form 1040, page 2.

## Who qualifies as 65 or older?

Taxpayers are entitled to a higher standard deduction if they are 65 or older at the end of the year. They are considered to be 65 on the day before their 65th birthday. In other words, a person born on January 1 is considered to be 65 on December 31 of the previous year.

The standard deduction for decedents is the same as if they had lived the entire year; however, if taxpayers die before their 65th birthday, the higher standard deduction does not apply.

**example**

Armando died on November 24. He would have been 65 if he had reached his birthday on December 12 of that same year. He does not qualify for a higher standard deduction for being 65 because he died before reaching his 65th birthday.

### Who qualifies as blind?

Taxpayers are entitled to a higher standard deduction if they are considered blind on the last day of the year and they do not itemize their deductions. A taxpayer who is not totally blind must have a certified statement from an eye doctor (ophthalmologist or optometrist) that:

- The taxpayer cannot see better than 20/200 in the better eye with glasses or contact lenses or
- The field of vision is not more than 20 degrees

If the eye condition is not likely to improve beyond these limits, the statement should include that fact. Taxpayers should keep the statement for their records.



If vision can be corrected beyond those limits only by contact lenses *and* the taxpayer can only wear the lenses briefly because of pain, infection, or ulcers, the taxpayer can take the higher standard deduction for blindness.

### What if only one spouse is over 65 or blind?

Taxpayers can take the higher standard deduction if one spouse is 65 or older, or blind, and if:

- The taxpayer files a joint return, or
- The taxpayer files a separate return and can claim an exemption for the spouse because the spouse had no gross income and an exemption for the spouse could not be claimed by another taxpayer

### What is the standard deduction based on age or blindness?

The standard deduction for taxpayers who are 65 or older or are blind increases for each box checked for age or blindness. This amount can also be computed using the Standard Deduction Chart in the Volunteer Resource Guide, Deductions tab.



These amounts do not apply if the taxpayer (or spouse if Married Filing Jointly) can be claimed as a dependent on someone else's return.

**example**

Tim is 67 and is filing as Single. He is not blind and he cannot be claimed as a dependent on someone else's return. His standard deduction is computed using the chart in the Volunteer Resource Guide, Deductions tab.

**example**

Kevin and Jane are both 60, and Jane is blind. They are filing as Married Filing Jointly. Neither can be claimed as a dependent on someone else's return. They are entitled to the regular standard deduction for married filing jointly plus an additional amount for being blind.



## EXERCISES

Use the Standard Deduction Chart in the Volunteer Resource Guide, Deductions tab to complete the following exercises. Answers are at the end of the lesson summary.

**Question 1:** Roderick is 64 and blind. Can he claim an additional deduction?  Yes  No

**Question 2:** Leticia died in May just before reaching her 65th birthday. Does she qualify as age 65?  
 Yes  No

## What about individuals who can be claimed as dependents?

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The standard deduction is generally lower for an individual who can be claimed as a dependent by another taxpayer. Taxpayers who can be claimed as a dependent must use the Standard Deduction for Dependents Worksheet to determine their standard deduction. The worksheet can be found in the Volunteer Resource Guide, Deductions tab.



**Tax Software Hint:** A dependent's standard deduction will be automatically calculated, as long as the box indicating they can be claimed as a dependent by another taxpayer has been checked. For software entries, go to the Volunteer Resource Guide, Starting the Return tab.

### example

Janet is single, 22, a full-time student, and not blind. Her parents claimed her as a dependent on their current year tax return. She has no itemized deductions, so she will compute her standard deduction using the Standard Deduction Worksheets for Dependents.

## How do I determine which deduction is best for the taxpayer?

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If taxpayers are not required to itemize, they should take the higher of the standard deduction or the itemized expenses deduction. In general, taxpayers will benefit from itemizing their deductions if they have mortgage interest, qualified charitable contributions, or if unreimbursed medical/dental expenses are large compared to their income. During the interview, ask the taxpayer if any of the following were applicable during the tax year:

- Large out-of-pocket medical and dental expenses
- State and local income taxes, real estate taxes, and/or personal property taxes, state and local general sales tax
- Mortgage interest
- Gifts to charity
- Certain other miscellaneous deductions

If the taxpayer's expenses qualify, itemizing may be a better choice.



**Tax Software Hint:** The taxpayer's standard deduction is automatically calculated and displayed on page 2 of the Form 1040 screen. The software automatically selects the deduction method that gives the taxpayer the best result, but only if Schedule A information is entered. For software entries, go to the Volunteer Resource Guide, Deductions tab.

## How are taxable income and tax determined?

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Tax is based on the amount of taxable income, which is determined by the taxpayer's AGI, exemption amount, and standard deduction or itemized deductions. Taxable income is determined by subtracting from the AGI:

- Personal and dependency exemptions
- Standard or itemized deductions



A separate worksheet is used to calculate the tax (instead of the tax tables) for taxpayers with certain types of income, such as capital gains, qualifying dividends, or foreign earned income.



**Tax Software Hint:** Tax is automatically calculated based on previous entries. It is important to enter all income, deduction, and credit information correctly for the tax to be computed accurately. The tax software also calculates the exemption amount and applies any limitations in determining the tax.



Please see the Affordable Care Act (ACA) lesson contained in this publication for additional information on calculating the Excess Advanced Premium Tax Credit.

## Summary

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You should be able to identify those who can take the standard deduction, and how the deduction is affected by their filing status, age, blindness, and status as a dependent. All of this will make it easier for you to help taxpayers understand how their deduction is computed and its impact on their tax.

You should also understand that the tax computation is based on taxable income. The tax may be further reduced by tax credits to be covered in an upcoming lesson.

You are now ready to work with itemized deductions in the next lesson.



### TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem or practice exercise(s) for your course of study in Publication 4491-W.

For practice using the tax preparation software, complete the scenarios using the Practice Lab on L&LT.



## EXERCISE ANSWERS

**Answer 1:** *Yes. Roderick is entitled to an additional amount for blindness.*

**Answer 2:** *No*



## Itemized Deductions



### Introduction

This lesson will assist you in determining if a taxpayer should itemize deductions. Generally, taxpayers should itemize if their total allowable deductions are higher than the standard deduction amount.

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Determine if a taxpayer should itemize deductions
- Determine the type of expenses that qualify as itemized deductions
- Report accurately itemized deductions on Schedule A, Itemized Deductions
- Explain the recordkeeping requirements for claiming charitable contributions

### What are itemized deductions?

Itemized deductions are subtractions from a taxpayer's Adjusted Gross Income (AGI) that reduce the amount of income that is taxed. Most taxpayers have a choice of taking a standard deduction or itemizing deductions. Taxpayers should use the type of deduction that results in the lowest tax.

### Who should itemize?

Taxpayers who have a standard deduction of zero should itemize their deductions. Taxpayers who normally fall within this category are:

- Married, filing a separate return, and their spouse is itemizing
- Filing a return for a short tax year due to a change in the annual accounting period
- Considered to be nonresident aliens or dual status aliens during the year (and not married to a U.S. citizen or resident at the end of the tax year)

### How do I decide if a taxpayer should itemize deductions?

In general, taxpayers who have mortgage interest or a very large amount of unreimbursed medical/dental expenses compared to their income would benefit from itemizing their deductions.

Use the Interview Tips – Itemized Deductions in the Volunteer Resource Guide, Deductions tab, to determine if itemizing deductions would be more beneficial for the taxpayer. If you think the taxpayer may benefit from itemizing, enter the qualified expenses on Schedule A. The tax software will automatically select the larger of itemized versus standard deduction.

#### What do I need?

- Form 13614-C
- Publication 4012
- Publication 17
- Publication 4491-W
- Form 1040
- Schedule A

#### **Optional:**

- Publication 502
- Publication 526
- Publication 529
- Publication 530
- Publication 936

Itemized deductions include amounts paid for qualified:

- Medical and dental expenses
- Certain taxes paid
- Mortgage interest
- Gifts to charity
- Casualty and theft losses
- Miscellaneous deductions



**CAUTION** Casualty and theft losses are outside the scope of the VITA/TCE programs. Refer taxpayers with these losses to a professional tax preparer.



**TIP** For taxpayers using the Married Filing Separately status, if one spouse itemizes, the other must also itemize (even if their itemized deduction amount is zero).



**Tax Software Hint:** For software entries, go to the Volunteer Resource Guide, Deductions tab.

## What medical and dental expenses are deductible?

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Taxpayers must be able to itemize in order to deduct medical and dental expenses. Taxpayers can deduct only the amount of unreimbursed medical and dental expenses that exceeds 10% of their Adjusted Gross Income (AGI).



**Tax Software Hint:** Review the Deductions tab in the Volunteer Resource Guide.



**TIP** The standard mileage rate allowed for out-of-pocket expenses for a car when used for medical reasons can be found in Publication 17. Taxpayers can also deduct parking fees and tolls.

## Whose expenses are covered?

Qualified medical and dental expenses paid by the taxpayer during the tax year can be included for:

- The taxpayer
- The taxpayer's spouse
- Dependents claimed at the time the medical services were provided or at the time the expenses were paid
- Individuals who could be the taxpayer's dependent except:
  - They do not meet the gross income test, or
  - They do not meet the joint return test, or
  - The taxpayers, or their spouse if filing jointly, could be claimed as a dependent on someone else's return



**TIP** If a child of divorced or separated parents is claimed as a dependent on either parent's return, each parent may deduct the medical expenses that they individually paid for the child.



Review *Whose Medical Expenses Can You Include?* in the Medical and Dental Expenses chapter of Publication 17.

**example**

Stewart and Carmen are divorced. Their son, Raymond, lives with Carmen, who claims him as a dependent. Carmen paid for and deducted Raymond's standard medical and dental bills. Stewart deducted the emergency bill he paid when Raymond broke his arm.

**What types of expenses are covered?**

Refer to Publication 17 for the medical and dental expenses checklist, and Publication 502 for more information on medical, dental, and other expenses. Be sure the expenses were not paid with pretax dollars or reimbursed by an insurance company.



Retired public safety officers cannot include as medical expenses any health or long-term care premiums they elected to have paid with tax-free distributions from their retirement plan.



If you and a taxpayer disagree as to whether a particular expense is deductible, politely refer the taxpayer to the Site Coordinator. The taxpayer may be correct, but you should not deduct an expense unless you are sure it is deductible.



**EXERCISES**

Answers are at the end of the lesson summary.

**Question 1:** Bill and Kathy Ferris file a joint return. They paid the medical and dental bills listed below. The total of Bill and Kathy's qualified medical expenses is \$\_\_\_\_\_.

Medical Expenses	Amount	Deductible
Unreimbursed doctors' bills	\$500	?
Unreimbursed orthodontist bill for braces	\$1,200	?
Hospital insurance premiums	\$300	?
Life insurance premiums	\$500	?
Unreimbursed prescription medicines	\$100	?
Vitamins	\$70	?
Hospital bill (before insurance company's reimbursement of \$1,000)	\$2,000	?
Smoking-cessation program	\$150	?
<b>Total</b>	<b>\$4,820</b>	<b>?</b>



Taxpayers may only deduct unreimbursed medical expenses. They may not deduct medical insurance premiums paid with pretax dollars or reimbursed by an insurance company. For taxpayers who receive the premium tax credit (PTC), only the premiums paid out of pocket by the taxpayer and not covered by the PTC, may be used as a medical expense when itemizing deductions. For example, if the taxpayer's insurance policy premium was \$12,000 and they received a PTC of \$10,000, they would only be able to deduct the \$2,000 premiums paid out of pocket by the taxpayer as a medical expense deduction, subject to the appropriate applicable adjusted gross income threshold for itemized medical expenses and any excess advanced premium tax credit repayment from this return.

## What taxes may be deductible?

Taxpayers can deduct certain taxes if they itemize. To be deductible, the tax must have been imposed on and paid by the taxpayer during the current tax year. Taxes that are deductible include:

- State and local income taxes – This includes withheld taxes, estimated tax payments, or other tax payments (such as a prior year state or local income tax refund that the taxpayer chose to credit to their estimated tax for the following year) are deductible.
- Sales taxes – It may be possible to deduct sales taxes in lieu of state and local income taxes (from the optional sales tax tables or actual sales tax paid). Taxpayers who use the tables may be able to add the state and local general sales taxes paid on certain specified items to the tax table amounts.



State and local taxes withheld are shown on Form W-2 in either box 17 or 19.

- Real estate taxes
  - State, local, or foreign real estate taxes based on the assessed value of the taxpayer's real property, such as the taxpayer's house or land, are deductible.
  - Taxes based on other than the assessed value of the property may be deductible in certain circumstances if they are levied:
    - For the general public welfare
    - By a proper taxing authority
    - At a similar rate
    - On owners of all properties in the taxing authority's jurisdiction



Taxpayers may deduct either sales tax or state and local income tax, but not both.

- Real estate taxes, which are generally reported on Form 1098, Mortgage Interest Statement, or a similar statement from the mortgage holder, are deductible. If the taxes are not paid through the mortgage company, the taxpayer should have a record of what was paid during the year.
- Some real estate taxes are not deductible, including taxes for local benefits and improvements that tend to increase the value of the property, itemized charges for services, transfer taxes, rent increases due to higher real estate taxes, and homeowners' association fees.



Real estate taxes reported on Form 1098 may include nondeductible amounts. Use the interview techniques with taxpayers to determine if nondeductible amounts such as sanitation pickup and water fees are included in their Form 1098. These items should not be included on Schedule A.

### **Which taxes are not deductible?**

Not all taxes are deductible and some items aren't actually classified as taxes. Some examples include employment taxes, federal income taxes, and license fees.

### **How do I handle taxes that are deductible?**

Deductible taxes are reported on Form 1040, Schedule A in the Taxes You Paid section.

#### **State and local income taxes or state and local sales taxes**

Include tax withheld, estimated tax payments to a state or local government, and tax payments for an earlier year paid during the current tax year. Do *not* include penalties or interest. Enter both the state and local

income taxes and the state and local sales taxes. The software will use the greater amount.

### **Foreign income taxes**

Generally, income taxes that were paid to a foreign country can be taken as an itemized deduction on line 8 of Schedule A, or as a credit against U.S. income tax on Form 1040. More information will be provided on this credit in subsequent lessons. You should compare claiming the foreign taxes paid as a nonrefundable credit to taking it as an itemized deduction and use whichever results in the lowest tax.



See the Taxes chapter in Publication 17 for more information.



**Tax Software Hint:** For software entries, go to the Volunteer Resource Guide, Deductions tab.



### **EXERCISES** (continued)

**Question 2:** Which of the following taxes are deductible on Schedule A?

- A. Federal income tax
- B. State, local, and foreign income tax and real estate tax
- C. Tax on alcohol and tobacco
- D. Foreign sales tax

**Question 3:** For a tax to be deductible, a tax must be \_\_\_\_\_. (Select all that apply.)

- A. Imposed during the tax year
- B. Imposed on the taxpayer
- C. Paid during the tax year
- D. Paid by the taxpayer

## **How do I handle interest paid?**

Certain types of interest payments qualify as itemized deductions. Home mortgage interest, points (paid as a form of interest), and investment interest can be deducted on Schedule A. Investment interest is outside the scope of the VITA/TCE programs and should be referred to a professional tax preparer.

### **Home Mortgage Interest**

Generally, home mortgage interest is any interest paid on a loan, line of credit, or home equity loan secured by the taxpayer's home. The flow chart *Is My Home Mortgage Interest Fully Deductible?* in Publication 17 will help you determine if interest paid by the taxpayer should be included on Schedule A.



Members of the clergy and military can subtract qualified mortgage interest even if they receive a nontaxable housing allowance.

Generally, the total amount of home mortgage interest paid by a taxpayer is shown on Form 1098, Mortgage Interest Statement. Only taxpayers who are legally liable for the debt can deduct the interest in the year it is paid. Remember that taxpayers may have more than one mortgage or may have refinanced during the year and may have multiple Mortgage Interest Statements.



See the Legislative Extender's lesson contained in this publication for information regarding qualified mortgage insurance premiums.



A taxpayer may be able to deduct interest on a main home **and** a second home. A home can be a house, cooperative apartment, condominium, mobile home, house trailer, or houseboat that has sleeping, cooking, and toilet facilities.

Review "Home Mortgage Interest" in Publication 17, Interest Expense chapter, for details on determining deductible amounts of mortgage interest.

Any interest (including original issue discount) accrued on a reverse mortgage is not deductible until the loan is paid in full.

#### example

From 1991 through 1998, Alfredo and Cindy Kendall obtained home equity loans totaling \$91,000. Alfredo and Cindy used the loans to pay off gambling debts, overdue credit payments, and some nondeductible medical expenses.

The current balance of Alfredo and Cindy's home equity loan is \$72,000. The fair market value of their home is \$230,000, and they carry \$30,000 of outstanding acquisition debt (the amount used to buy, build, or improve their home).

If Alfredo and Cindy file a joint return, they can deduct the interest on their loans because:

- The total of these loans (\$72,000) does not exceed \$100,000 and
- The total amount of the home equity (\$72,000) is not more than the home's fair market value minus any outstanding acquisition debt ( $\$230,000 - \$30,000 = \$200,000$ )

## What are points?

Points are the charges paid by a borrower and/or seller to a lender to secure a loan. They are also called:

- Loan origination fees (including VA and FHA fees)
- Maximum loan charges
- Premium charges
- Loan discount points
- Prepaid interest

## When are points deductible?

Only points paid as a form of interest (for the use of money) can be deducted on Schedule A. Generally, points must be spread over the life of the mortgage. However, if the loan is used to buy or build a taxpayer's main home, the taxpayer may be able to deduct the entire amount in the year paid. See the Interest Expense chapter of Publication 17 for more information.

Points paid to refinance a mortgage are generally not deductible in full the year they were paid, unless the points were paid in connection with the improvement of a main home and certain other conditions are met.

Beware of certain charges that some lenders call points. Points paid for specific services, such as appraisal fees, preparation fees, VA funding fees or notary fees, are *not* interest and are *not* deductible.



Use the flow chart in the Interest Expense chapter of Publication 17 to help determine if points are fully deductible.

## What types of interest are *not* deductible?

Interest that *cannot* be deducted includes:

- Interest on car loans where the car is used for nonbusiness purposes
- Other personal loans
- Credit investigation fees
- Loan fees for services needed to get a loan
- Interest on a debt the taxpayer is not legally obligated to pay
- Finance charges for nonbusiness credit card purchases



### EXERCISES (continued)

**Question 4:** Joe and Angela file a joint return. During the year, they made the interest payments listed below. The total of Joe and Angela's fully deductible interest for the tax year is \$\_\_\_\_\_.

Interest Payments	Amount	Deductible
Qualified interest on their home mortgage, reported on Form 1098	\$2,180	?
Credit card interest	\$400	?
Points paid to refinance their mortgage for a better interest rate (None of the points qualify as interest.)	\$1,500	?
Interest on a car loan	\$2,000	?
<b>Total</b>	<b>\$6,080</b>	<b>?</b>

## How do I handle gifts to charity?

A charitable contribution is a donation or gift to a **qualified organization**, which may be deductible if the taxpayer itemizes. Cash, check, and noncash contributions should be reported on Schedule A, line 16 and line 17, respectively. Deductions may be taken for contributions to:

- Organizations that operate exclusively for religious, charitable, educational, scientific, or literary purposes
- Organizations that work to prevent cruelty to children or animals
- Organizations that foster national or international amateur sports competition if they do not provide athletic facilities or equipment
- War veterans' organizations
- Certain nonprofit cemetery companies or corporations
- The United States, or any state, the District of Columbia, a U.S. possession (including Puerto Rico), a political subdivision of a state or U.S. possession, or an Indian tribal government or any of its subdivisions that perform substantial government functions



To be deductible, contributions must be made to a qualifying organization, not an individual.



Qualified organizations are listed in Publication 78, Cumulative List of Organizations. An online version is offered to help taxpayers efficiently search organizations that are eligible to receive tax-deductible charitable contributions.

To find out if the organization is a qualified charity, go to [www.irs.gov](http://www.irs.gov).

Deductible items include:

- Monetary donations
- Dues, fees, and assessments paid to qualified organizations above the value of benefits received
- Fair market value of used clothing, furniture, and other items in good condition
- Cost and upkeep of uniforms that have no general use but must be worn while performing services donated to a charitable organization
- Unreimbursed transportation expenses that relate directly to the services the taxpayer provided for the organization
- Part of a contribution above the fair market value for items received such as merchandise and tickets to charity balls or sporting events
- Transportation expenses, including bus fare, parking fees, tolls, and either the cost of gas and oil or the standard mileage deduction may be taken. See Publication 4012 for the standard mileage deduction for charitable contributions.

Form 1098-C, Contributions of Motor Vehicles, Boats and Airplanes, is out of scope. Taxpayers who have made these contributions should be referred to a professional tax preparer.

### **Which gifts to charity are *not* deductible?**

Contributions to the following types of organizations do *not* qualify as deductible:

- Business organizations, such as the Chamber of Commerce
- Civic leagues and associations
- Political organizations and candidates
- Social clubs
- Foreign organizations
- Homeowners' associations
- Communist organizations

Amounts that may *not* be deducted include:

- Cost of raffle, bingo, or lottery tickets
- Tuition
- Value of a person's time or service
- Blood donated to a blood bank or Red Cross
- Car depreciation, insurance, general repairs, or maintenance

- Direct contributions to an individual
- Sickness or burial expenses for members of a fraternal society
- Part of a contribution that benefits the taxpayer, such as the fair market value of a meal eaten at a charity dinner

#### example

Susan ran a 10K organized by the Chamber of Commerce to benefit a qualified charitable organization. She paid the race organizers a \$30 entry fee and received a “free” T-shirt and pancake breakfast after the race.

Susan did not make a contribution to the qualifying organization. She paid the Chamber of Commerce, which allotted funds to the benefiting organization. Therefore, none of Susan’s entry fee is tax deductible. If the race had been organized by the qualifying organization itself, part of her entry fee may have been deductible.

### **What limits apply to charitable deductions?**

Taxpayers whose charitable contributions total more than 20% of their AGI may be able to deduct only a percentage of their contributions and must carry over the remainder to a later tax year. The percentage varies depending on the type of gift and the type of charitable organization. More information on these limitations is available in Publication 17. Individuals affected by limits on charitable deductions should be referred to a professional tax preparer.

### **What records should the taxpayer keep for charitable contributions?**

*Taxpayers must keep records* to verify the cash and noncash contributions they make during the year. Advise taxpayers that they cannot deduct a cash contribution, regardless of the amount, unless one of the following records of the contribution is kept:

- A credit card statement or a bank record, such as a canceled check, a bank copy of a canceled check, or a bank statement containing the name of the charity, the date, and the amount
- A written communication from the charity, which must include the name of the charity, date of the contribution, and amount of the contribution

### ***Out-of-pocket expenses related to donated services***

For unreimbursed expenses related to donated services, the taxpayer must have:

- Adequate records of the expenses
- Organization’s written acknowledgment and description of the taxpayer’s services for unreimbursed expenses more than \$250

Only out-of-pocket expenses that are directly related to the donated services can be deducted. The value of time or services donated cannot be deducted. See Publication 17, Contributions chapter, for the rules applicable to out-of-pocket expenses incurred when rendering services to a qualifying organization.

## What records should the taxpayer keep for noncash contribution deductions?



Deductions are not allowed for the charitable contribution of clothing and household items if the items are not in good used condition or better.

### **Noncash contributions less than \$250**

For any single contribution of less than \$250, the taxpayer must keep:

- A receipt or other written communication from the organization or the taxpayer's own reliable written records for each item, showing:
  - Name and address of organization
  - Date and location of the contribution
  - Reasonably detailed description of the donated property
  - Fair market value of the donated property



If the taxpayer is donating capital gain property or property that was previously depreciated, refer them to a professional tax preparer.

### **Noncash contributions of at least \$250 but not more than \$500**

For any single contribution of at least \$250 and not more than \$500, the taxpayer must have all the documentation described for noncash contributions less than \$250. In addition, the organization's written acknowledgment must state whether the taxpayer received any goods or services in return and a description and good faith estimate of any such items.

### **Noncash contributions of more than \$500**

Taxpayers with more than \$500 in total noncash contributions must file Form 8283 and should be referred to a professional tax preparer.



## EXERCISES (continued)

**Question 5:** Julia made the following contributions last year:

- \$600 to St. Martin's Church (The church gave her a letter verifying the amount.)
- \$32 to Girl Scouts (not for cookies!)
- \$40 to a family whose house burned
- \$50 for lottery tickets at a fundraiser
- \$100 for playing bingo at her church

The amount that Julia can claim as deductible monetary contributions is \$\_\_\_\_\_.

## What about casualty and theft losses?

The deduction for casualty and theft losses is complex, with many rules and exceptions. Taxpayers with deductible casualty and theft losses should be referred to a professional tax preparer.



## What are miscellaneous deductions?

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### What types of miscellaneous expenses are deductible?

Miscellaneous itemized deductions are expenses a taxpayer incurs to:

- Produce or collect income
- Manage, conserve, or maintain property held for producing income
- Determine, contest, pay, or claim a refund of any tax

For some miscellaneous deductions, only the portion that exceeds 2% of the taxpayer's AGI can be deducted. Other miscellaneous deductions are deductible regardless of AGI.

### Which deductions are subject to the 2% limit?

Examples of miscellaneous deductions include:

- Credit or debit card convenience fees incurred when paying income tax, charged by the card processor
- Union dues and fees
- Professional society dues
- Uniforms not adaptable to general use (See the Miscellaneous Deductions chapter in Publication 17 for more information.)
- Small tools and supplies used for business
- Professional books, magazines, and journals
- Employment-related educational expenses (Review Does Your Work-Related Education Qualify? in the Tax Benefits for Work-Related Education chapter in Publication 17.)
- Expenses of looking for a new job in your present occupation
- Investment counsel fees
- Investment expenses
- Safe deposit box rental for investment documents
- Tax counsel and assistance
- Trustee's administrative fees for IRA



**Tax Software Hint:** For software entries, go to the Volunteer Resource Guide, Deductions tab.

### Which deductions are exempt from the 2% limit?

Deductions that are *not* subject to the 2% limit include:

- Gambling losses to the extent of gambling winnings (taxpayers must have a record of their losses)
- Work-related expenses for disabled individuals that enables them to work, such as attendant care services at their workplace



**CAUTION** Gambling losses in excess of winnings are not deductible. The full amount of winnings must be reported as income and the losses (up to the amount of winnings) can be claimed as an itemized deduction.

## What types of miscellaneous expenses are not deductible?

The types of miscellaneous expenses that are not deductible include:

- Commuting expenses (mileage to and from a taxpayer's regular place of work)
- Political contributions
- The cost of entertaining friends
- Lost or misplaced cash or property
- Travel as a form of education



An attorney's fee for a will is considered a personal legal expense, so it is not deductible.



### EXERCISES (continued)

**Question 6:** Philip had the expenses shown below. What is the total of Philip's qualified miscellaneous itemized expenses? \$\_\_\_\_\_.

Expense	Amount	Deductible
Income tax preparation fee	\$100	?
Safe deposit box rental (to store bonds)	\$75	?
Life insurance premiums	\$300	?
Credit card convenience fee for income tax payment	\$70	?
Loss on sale of personal home	\$1,800	?
Investment journals and newsletters	\$250	?
Investment expenses	\$200	?
Attorney fees for preparation of a will	\$100	?
<b>Total</b>	<b>\$2,895</b>	<b>?</b>

## Summary

### Medical and Dental Expenses

Unreimbursed medical and dental expenses exceeding 10% of the taxpayer's AGI are deductible; they are reported on lines 1 through 4 of Schedule A.

Qualified medical and dental expenses are those paid during the tax year for the taxpayer, spouse, and dependents.

### Taxes

Deductible taxes are reported on lines 5 through 9 of Schedule A and include the following:

- State and local income taxes, or state and local general sales taxes
- State, local, or foreign real estate taxes
- Personal property taxes

## Interest

Deductible interest is reported on lines 10 through 15 of Schedule A.

Generally, the taxpayer receives Form 1098, Mortgage Interest Statement, which shows the total amount of interest paid. To be deductible, the interest must be paid by the taxpayer during the tax year. Only taxpayers who are legally liable for the debt can deduct the interest.

Only points paid as a form of interest (for the use of money) can be deducted on Schedule A. Generally, points must be spread over the life of the mortgage. However, if the loan is used to buy or build a taxpayer's main home, and certain other conditions are met, the taxpayer may be able to deduct the entire amount in the year paid.

## Gifts to Charity

Qualified charitable contributions are reported on lines 16 through 19 of Schedule A.

The contributions to **qualifying organizations** that taxpayers can deduct include:

- Monetary donations
- Dues, fees, and assessments paid to qualified organizations above the value of benefits received
- Fair market value of used clothing and furniture at the time of donation
- Cost and upkeep of uniforms that have no general use but must be worn while performing donated services for a charitable organization
- Unreimbursed transportation expenses or out of pocket expenses that relate directly to the services the taxpayer provided for the qualifying organization
- Part of a contribution above the fair market value for items received such as merchandise and tickets to charity balls or sporting events



Taxpayers are required to keep receipts and records of all their contributions.

## Miscellaneous Deductions

For some miscellaneous deductions, only the portion that exceeds 2% of the taxpayer's AGI can be deducted. Other miscellaneous deductions are deductible regardless of AGI.

### What situations are out of scope for the VITA/TCE programs?

The following is out of scope for this lesson. While this list may not be all inclusive, it is provided for your awareness only.

- Casualty and theft losses
- Investment interest
- Form 1098-C, Contributions of Motor Vehicles, Boats and Airplanes
- Taxpayers affected by limits on charitable deductions
- Taxpayers that file Form 8283 to report noncash contributions of more than \$500
- If the taxpayer is donating property that was previously depreciated
- If the taxpayer is donating capital gain property



## TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem or practice exercise(s) for your course of study in Publication 4491-W.

For practice using the tax preparation software, complete the scenarios using the Practice Lab on L&LT.



## EXERCISE ANSWERS

**Answer 1:** *The total of qualified medical and dental expenses is \$3,250, which does not include life insurance premiums, vitamins, or reimbursed hospital expenses.*

**Answer 2:** *B. State, local, foreign income tax, and real estate taxes are all deductible on Schedule A.*

**Answer 3:** *B, C, and D. Taxpayers cannot deduct a tax they did not owe, did not pay, or that they paid during another year. However, the tax may have been imposed in a prior year.*

**Answer 4:** *\$2,180. The only interest that is fully deductible for the tax year is Joe and Angela's home mortgage interest. The points they paid to refinance are not deductible because they were not paid to acquire or improve the main home, and the other interest paid was personal interest and is not deductible.*

**Answer 5:** *The amount that Julia can claim as deductible cash contributions is \$632 (donations to her church and to the Girl Scouts). Bingo, lottery tickets, and donations to individuals in need are not deductible.*

**Answer 6:** *\$695, which includes tax preparation fee, safe deposit box rental, credit card convenience fees, investment journals and newsletters, and investment expenses.*



# Military Employee Business Expenses



## Introduction

This lesson will help you determine and claim qualified employee business expenses for members of the Armed Forces, such as uniforms, education and travel. These expenses, with one exception, may be reported on Form 2106 or Form 2106-EZ or may be deducted on Schedule A as a Miscellaneous Itemized Deduction subject to the 2% limit or in certain cases as an adjustment to income.



Although Form 13614-C, Intake/Interview and Quality Review Sheet does not list military employee business expenses, service members should take advantage of deductions to which they are entitled. Ask taxpayers if they had any unreimbursed military work-related expenses.

## Objectives

At the end of this lesson, using your resource tools, you will be able to:

- Determine if the taxpayer has military business expenses that can be deducted
- Identify which form to use to report military business expenses

## What are military employee business expenses?

Military employee business expenses are necessary work-related expenses incurred by active and reserve members of the U.S. Armed Forces. The U.S. Armed Forces includes commissioned officers, warrant officers, and enlisted personnel in all regular and reserve units under the control of the Secretaries of the Defense, Army, Navy, Air Force, and Coast Guard. It does not include members of the Merchant Marines or the American Red Cross.

### What do I need?

- Form 13614-C
- Publication 4012
- Publication 3
- Publication 4491-W
- Form 2106
- Form 2106-EZ
- Schedule A

### Optional:

- Publication 463
- Publication 970
- Form 2106 Instructions

## What are qualified uniform expenses?

Qualified uniform expenses are the cost and upkeep of uniforms and certain articles that are:

- Specifically required as a condition of employment and
- Not adaptable to general use as regular clothing

Members of the Armed Forces are required to wear uniforms when they are on duty, and they are generally allowed to wear their uniforms in place of regular civilian clothing when they are off duty. In this case, members of the military cannot claim a deduction for the uniform cost and upkeep.

However, when military regulations *prohibit* off-duty wear of certain uniforms, service members can deduct the cost and upkeep of those uniforms. Service members must reduce the deductible expenses by any nontaxable uniform allowance or reimbursement they receive.

In addition, costs for required items, such as insignia of rank, corps devices, epaulets, aiguillettes, and swords, can be deducted.



The same rules apply for active duty personnel and reservists.

## Are professional dues deductible?

Dues paid to professional societies that are directly related to their trade or business can be deducted by service members.

However, service members cannot deduct amounts paid to an officers' club or a noncommissioned officers' club.

### example

Lt. Walker, an electrical engineer at Maxwell Air Force Base, can deduct professional dues paid to the American Society of Electrical Engineers.



## EXERCISES

Answers are after the lesson summary.

**Question 1:** Which of the following expenses can be deducted?

- A. The cost of a dress blue uniform (without shoulder boards or gold stripe on pants), including cape; off-duty wear allowed
- B. The cost of a full Army green uniform (without braid) that can be worn anytime
- C. The cost of battle dress uniforms and utility uniforms that can be worn only while on duty or while traveling to and from duty
- D. None of the above

**Question 2:** Which of the following expenses can be deducted?

- A. Cost of epaulets
- B. Cost and upkeep of a reservist's uniform that can be worn off duty (no uniform allowance received)
- C. All of the above

**Question 3:** Lt. Edwards is on active duty for the U.S. Navy. He specializes in the installation and maintenance of sonar detection systems on Navy ships. As a volunteer, he also draws illustrations and cartoons for his base's internal newsletter. He receives no compensation for his illustrations. Is the membership fee he pays to the Professional Illustrators' Society a deductible expense?  Yes  No

## Can service members claim work-related educational expenses?



This section relates only to expenses that may be deductible on Schedule A subject to the 2% AGI limitation. Service members can determine whether the expenses also qualify as an education credit, then claim them where they are most beneficial.

Service members can claim educational expenses as an employee business expense if the education:

- Is required by their employer, the law, or regulations to keep their current salary, status, or job if these requirements serve a business purpose of the employer or
- Maintains or improves the skills required in their present work

These expenses are deductible whether or not the education may lead to a degree.

However, service members cannot claim an employee business expense for education that is:

- Needed to meet the minimum educational requirements for their trade or business or
- Part of a program of study that will qualify them for a new trade or business

**example**

Col. Wilson, an Army pilot, incurred educational expenses to obtain an accounting degree. He cannot deduct his accounting degree expenses on Schedule A because the degree will qualify him for a new trade or business.



**EXERCISES** (continued)

**Question 4:** True or False? For educational expenses to be claimed as an employee business expense deduction, the education must help the service member qualify for a degree.

True  False

**Question 5:** Which of the following can be classified as a work-related education expense?

- A. Cost of a laptop and desk lamp for studying
- B. Expenses incurred by a flight operations officer to take an advanced piloting course
- C. Cost of civilian clothes to wear to a course taken off base
- D. Expenses incurred by a Navy disbursing clerk to learn television repair

**What about travel and transportation expenses incurred for educational expenses?**

Service members who have qualified deductible educational expenses may deduct the cost of travel and transportation for that education. This includes the cost of going from work to school, or travel expenses if the service member travels overnight mainly to obtain work-related education. Service members cannot deduct the round-trip cost of going from home to school unless they are regularly employed and go to school on a temporary basis (not reasonably expected to last more than one year) for work-related education.



**CAUTION** Service members cannot deduct the cost of travel that is itself a form of education, even if it is directly related to their duties.



**TIP** See Publication 970 for additional information regarding Educational Expenses.



**EXERCISES** (continued)

**Question 6:** Major Manchester is stationed in Manila. On weekends, she drives to Taal to take lessons in traditional Philippine dance. Can Major Manchester deduct these travel expenses?  Yes  No

## What are travel expenses?

Travel expenses are unreimbursed work-related expenses incurred while service members are traveling away from home. They must be ordinary and necessary expenses such as airfare, car rental, taxi fare, lodging, and meals. Expenses for personal travel, leave, or liberty cannot be deducted.

### When are travel expenses deductible?

For travel expenses to be deductible:

- There must be a work-related purpose for the travel
- They must be deemed as the “ordinary and necessary” costs of traveling away from home
- The expenses must be greater than the total of any advances, allowances, or reimbursements service members received



If Armed Forces members do not claim reimbursement for expenses they are entitled to, no deduction for those expenses may be claimed.

### What is meant by “away from home”?

“Away from home” has a slightly different meaning for military than for civilian taxpayers. For service members, “home” is the duty station to which they are permanently assigned, which can be a ship or a base. It includes the entire city or general area where the post of duty is located.

Service personnel are considered to be away from home if they are away from their permanent duty stations for a period substantially longer than an ordinary day’s work. Service members may deduct business-related travel expenses incurred while traveling away from home.



For Navy personnel assigned to permanent duty aboard a ship that has regular eating and living facilities, the ship is considered to be “home” for travel expense purposes.

Examples of work-related travel expenses for members of the Armed Forces include:

- Expenses incurred while on temporary duty (**TDY**) or temporary additional duty (**TAD**) if “away from home” (i.e., ship, base, or station)
- Expenses of a reservist away from home overnight to attend drills
- Meals and lodging of a reservist temporarily called to active duty
- Travel expenses, including meals and lodging, incurred in connection with deductible educational activities
- Travel expenses incurred when carrying on official business while on “no cost” (to the government) orders



### EXERCISES (continued)

**Question 7:** Which of the following individuals is entitled to deduct travel expenses?

- A. Sgt. Bullock, who commutes from his home to his permanent post of duty in the same city
- B. Capt. Hinds, who takes a taxi to work from his home to his permanent post of duty
- C. Major Forrest, a reservist who is called to temporary duty and must attend an overnight meeting away from home
- D. PFC Jenkins, who is assigned to permanent duty aboard a ship that provides meals and lodging



## What are temporary active duty reservists' expenses?

Military reservists temporarily called to active duty who must remain away from home to perform their duties may claim unreimbursed travel expenses such as meals and lodging. This applies:

- As long as the duty occurred under competent orders and
- Whether or not the reservist was compensated

To claim unreimbursed travel expenses, reservists must:

- Be stationed away from the general area of their job or business and
- Return to their regular jobs once released

Expenses are deductible only if the reservists pay for meals and lodging at their official military post and only to the extent the expenses exceed Basic Allowance for Housing (BAH) and Basic Allowance for Subsistence (BAS).

## What is the 100-mile rule for reservists?



Military reservists include members of the U.S. Armed Forces (i.e., Army, Navy, Marine Corps, Air Force, and Coast Guard Reserve), the U.S. Army National Guard, the U.S. Air National Guard, or the Reserve Corps of the U.S. Public Health Service.

Military reservists who must travel more than 100 miles away from home and stay overnight to attend a drill or reserve meeting may be able to deduct their travel expenses as an adjustment to income rather than as a miscellaneous itemized deduction. The amount of expenses that can be deducted is limited to the:

- Federal rate for per diem (for lodging, meals, and incidental expenses)
- Standard mileage rate (for car expenses) plus any parking fees, ferry fees, and/or tolls



The 100-mile rule is an exception to Form 2106 requirements and qualifies as an adjustment to income, which is an above-the-line deduction.

Any expense in excess of the standard mileage rate and expenses that do not qualify for the adjustment to gross income deduction can be claimed only as a miscellaneous itemized deduction subject to the 2% limit.

### example

Mary is in the Army Reserve. She lives in a town that is 120 miles from Base A, where she normally reports for Reserve drills or meetings. During the current tax year, she occasionally traveled to Base B, which was only 40 miles from her home.

Mary may claim the travel expenses she incurred going to Base A as an adjustment to income. Mary's remaining expenses for travel to Base B may qualify as an itemized deduction on Schedule A. This deduction will be subject to the 2% AGI limitation.



**Tax Software Hint:** For software entries, go to the Volunteer Resource Guide, Deductions tab.

## What is the deduction for meals?

U.S. service personnel can deduct the cost of meals and business-related entertainment incurred during business travel away from their permanent duty station.

Meals and entertainment expenses are figured separately from other business travel expenses. They are multiplied by a percentage: 50% for most taxpayers and 80% for those subject to Department of Transportation hours of service.

Taxpayers may report the actual amounts for meals, entertainment, and incidental expenses or they may use a standard amount to claim meals and incidental expenses. In either case, the service member must provide records to prove the time, place, and business purpose of the travel.

For service personnel who are fully reimbursed by the government for meals under an accountable plan that excludes reimbursement from gross income, there is no amount to deduct and, therefore, no amount subject to the 50% limit.



For information on using the standard meal allowance instead of actual expenses, see Publication 463, Travel, Entertainment, Gift, and Car Expenses.

## What are local transportation expenses?

Local transportation expenses are typically defined as the ordinary and necessary costs incurred in getting from one place to another to perform work-related duties while *not* traveling away from home. This can include traveling from one job to another. However, the expenses of getting to and from the taxpayer's regular place of work are not deductible.

Allowable local transportation expenses include:

- The cost of driving and maintaining one's own vehicle
- Travel by rental cars, bus, rail, or taxi

## Are car expenses deductible?

Service personnel who use their own vehicles to travel for work are entitled to deduct actual expenses or the standard mileage rate to figure the deductible costs of operating their vehicles for business purposes.



The standard mileage rate can be found on Form 2106, Part II, Section B, and Form 2106-EZ, Part II.

Actual expenses include the cost of gas, oil, repairs, insurance, and depreciation on the vehicle. If a taxpayer chooses to use actual expenses instead of the standard mileage rate, refer them to a professional tax preparer.



### EXERCISES (continued)

**Question 8:** Which of the following costs are considered to be a local transportation expense?

- A. Daily meals taken during a week-long training session while on duty
- B. Gasoline used to drive to and from one's regular place of work
- C. Taxi fare to travel while on duty to a local work-related convention
- D. Elaborate lunch to treat top-ranking military official visiting base

## Are expenses related to temporary work locations deductible?

Expenses incurred while commuting to work are not deductible. However, service members who are on temporary assignments in the same trade or business as their regular place of business can deduct the expenses of the daily round trip between their home and the temporary location, if not reimbursed by their employer.

Service members can deduct ordinary and necessary costs of traveling to temporary work assignments:

- Traveling from one workplace to another within the city or general area that is their tax home
- Visiting clients or customers
- Going to a business meeting away from their regular workplace

Expenses incurred while traveling away from home overnight are deductible as travel expenses, not local transportation expenses.

### example

Sgt. Purdue attended a meeting of an Armed Forces reserve unit. The meeting is considered to be a second place of business because it is held on one of Sgt. Purdue's regular work days. He can deduct the expense of traveling from his home and regular work location to the meeting location.

## Who needs to complete Form 2106?

If the service member has job-related travel, meals, or local transportation expenses, or other expenses that are greater than reimbursements, Form 2106 must be used to calculate the itemized deduction.

Form 2106 is not required if the taxpayer is claiming only job-related expenses for uniforms, professional dues, or education, and no reimbursement was received.



Form 2106-EZ can only be used by employees who received no reimbursement from their employer and who use the standard mileage rate. In most cases, military members with work-related travel expenses will have received reimbursement and will need to use Form 2106.

To determine whether service members need to complete Form 2106, consider the following factors:

- Did the service member have work-related travel, meals, or local transportation expenses?
- Did the service member receive an allowance or a reimbursement from the military?
- Did the amount of travel expenses exceed the amount of the reimbursement or allowance?

For service members who are not required to file Form 2106, enter miscellaneous deductions subject to 2% of AGI directly on Schedule A.

### example

Capt. Glendale traveled from his duty station in California to Washington, DC, for a conference. He was away for five days. The Army advanced \$700 to Capt. Glendale for the trip. His actual expenses were \$625. When he filed his travel voucher with the Army, he returned the extra \$75. He does not have to complete Form 2106.

## Taxpayer Interview and Tax Law Application

Let's see how a volunteer helps Mary, an Army Reservist, determine how to deduct her employee business expenses.

### SAMPLE INTERVIEW

#### VOLUNTEER SAYS...

*You were in the Reserves, as well as working your full-time civilian job. Did you have any expenses associated with that?*

*Oh, good. The expenses you have for traveling more than 100 miles away as a reservist can be deducted, even if you can't itemize. Did you have to pay for lodging or meals or parking? Did you get any reimbursement?*

*The most we'll be able to deduct on the meals is 50%, but you can take all of the lodging, plus your mileage.*

*It's different for the drills at the other base, since they're not as far from your home. I have two questions about these trips: when did you make them, and did you leave from your regular job to go to Baker, or was it on a day off?*

*Since you are driving from one job to another, that's deductible too. But only if you can itemize, and it's over 2% of your AGI. Did you have any other work-related expenses?*

*Did you get reimbursed for any part of that?*

*Then you'll be able to deduct the \$100 you paid out of pocket—but only if you can itemize and exceed that 2% limit.*

*All right, the expenses for traveling more than 100 miles for reserve duties adds up to \$1,284, along with the hotel rooms at \$720, and half the meals at \$100 totals \$2,104. We'll deduct that right on the front of the return.*

*The other mileage from trips to Baker add up to \$214, and the \$100 out of pocket for the class will give you a total of \$314 for your Schedule A if you can itemize. Now let me ask you some questions about your car so I can complete this form...*

[On Mary's intake and interview sheet, indicate that you've addressed these items.]

#### MARY RESPONDS...

Well, my unit usually meets at Anderson, which is about 120 miles from here. I had ten round trips during the year, plus we met at Baker five times. That's only 40 miles away. Here's my mileage record.

I paid \$72 for a hotel room each time, and I ate at the mess for about \$20 each trip.

No, I have to pay for it myself.

No, those were short meetings on week-nights, so I just drove straight from work.

I'm a trauma nurse, and I have to take continuing education courses each year to stay certified. The classes cost \$500 once I paid for the books.

The military gave me an allowance, but that only covered \$400.

## Summary

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This lesson explained business expense deductions of special interest to the military and how to claim them.

Travel expenses must be ordinary and necessary expenses of temporarily traveling away from home for a person's job and must be greater than the total of any advances, allowances, and reimbursements received for such expenses.

- Travel and transportation expenses can be taken as miscellaneous itemized deductions on Schedule A, subject to the 2% AGI limit.
- Travel expenses for meals, lodging, and incidentals are only deductible if they are incurred while temporarily away from home on business. Assignments that last, or are realistically expected to last, more than one year are not considered temporary.
- Commuting and other personal expenses are not deductible.
- Travel costs associated with deductible educational expenses are treated like other business travel costs.

Form 2106 and Schedule A are used to figure and claim the itemized deductions for employee business expenses that exceed reimbursement. Service members are required to file Form 2106 to claim job-related travel, transportation, meals, or entertainment expenses, or when they have been paid by their employer for any expenses being deducted on Schedule A.

National Guard and Reserve members who travel more than 100 miles away from home and stay overnight to attend drill or reserve meetings can deduct travel expenses as an adjustment to income. All other deductible miscellaneous itemized deductions discussed in this lesson are deducted on Schedule A as a Miscellaneous Itemized Deduction, subject to the 2% AGI limit.

To claim these expenses, a service member must itemize using Form 1040, Schedule A, Itemized Deductions.

### What situations are out of scope for the VITA/TCE programs?

The following is out of scope for this lesson. While this list may not be all inclusive, it is provided for your awareness only.

- Taxpayers who choose to use actual expenses instead of the standard mileage rate (vehicle-related deductions)



#### TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem or practice exercise(s) for your course of study in Publication 4491-W.

For practice using the tax preparation software, complete the scenarios using the Practice Lab on L&LT.



## EXERCISE ANSWERS

**Answer 1:** C. The cost of battle dress uniforms and utility uniforms that can be worn only while on duty or while traveling to and from duty.

**Answer 2:** A. The cost of items not replacing regular clothing such as insignia of rank and epaulets are deductible.

**Answer 3:** No. Lt. Edwards' illustrations are not part of his official duties and cannot be deducted as an employee business expense.

**Answer 4:** False. The education does not have to lead to a degree as long as it helps maintain or improve skills or knowledge needed for the taxpayer's current job.

**Answer 5:** B. Educational expenses may be claimed as miscellaneous itemized deductions if the education improves the skills used in the service member's current job.

**Answer 6:** No. Major Manchester cannot deduct the cost of traveling to Taal on weekends because the travel is not work-related.

**Answer 7:** C. Only Major Forrest can deduct the costs of traveling overnight to attend a reservists' meeting.

**Answer 8:** C. Taxi fare to travel on work-related business while not away from home is an allowable local transportation expense.



## Credit for Child and Dependent Care Expenses



### Introduction

This lesson covers the credit for child and dependent care expenses. Some taxpayers may not be aware of this credit. Your time and effort may result in a lower tax for the taxpayers.

Whether the taxpayer is filing Form 1040 or Form 1040A, calculate the credit using Form 2441.



Don't confuse this credit with the child tax credit!

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Determine if a taxpayer is eligible for the credit
- Calculate the amount of the credit

### What is a nonrefundable credit?

A nonrefundable credit is a dollar-for-dollar reduction of the tax liability. A nonrefundable credit can only reduce the tax liability to zero. The credit discussed in this lesson is a nonrefundable credit. Generally, nonrefundable credits are applied against federal tax in the order they are listed on Form 1040, page 2, in the Tax and Credits section.



**Tax Software Hint:** The software will calculate these credits, but the correct information must be input. The volunteer tax preparer must make the correct determinations by using the intake and interview sheet and resource materials.

#### What do I need?

- Form 13614-C
- Publication 4012
- Publication 17
- Publication 4491-W
- Form 2441 and instructions

#### **Optional:**

- Publication 503
- Form 1040 Instructions

### What is the child and dependent care credit?

This credit allows taxpayers to reduce their tax by a portion of their child and dependent care expenses. The credit may be claimed by taxpayers who, in order to work or look for work, pay someone to take care of their qualifying person. A qualifying person is a:

- Qualifying child under 13
- Spouse who is incapable of self-care
- Dependent who is incapable of self-care

The credit ranges from 20% to 35% of the taxpayer's expenses. The percentage is based on the taxpayer's earned income and adjusted gross income. The amount of the credit cannot be more than the amount of income tax on the return. It can reduce an individual's tax to \$0, but it will not give the taxpayer a refund.

Some taxpayers receive dependent care benefits from their employers, which may also be called "flexible spending accounts" or "reimbursement accounts." Taxpayers may be able to exclude these benefits from their income. Employer-provided dependent care benefits appear in the taxpayer's Form W-2, box 10.

Because the child and dependent care credit is a nonrefundable credit, only taxpayers with taxable income can claim the credit. However, all taxpayers who receive employer-provided dependent care benefits are required to complete Form 2441, Part III to determine if they can exclude all or part of these benefits from their taxable income.

## How do I determine if a taxpayer is eligible?

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The information gathered from the intake and interview sheet, along with the decision tree in the Volunteer Resource Guide, Nonrefundable Credits tab, will help you determine the taxpayer's eligibility. Be sure to ask whether the taxpayer has paid for *any* type of dependent care, for example, for a spouse or another dependent.

The Volunteer Resource Guide decision tree covers the five eligibility tests the taxpayer must meet to qualify for the credit:

- Qualifying person test
- Earned income test
- Work-related expense test
- Joint return test
- Provider identification test

Use the decision tree questions in the Volunteer Resource Guide, Nonrefundable Credits tab, as a guide for your interview with the taxpayer. Keep in mind that the taxpayer must pass all five of the tests to qualify for the credit.

## What is the qualifying person test?

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The taxpayer's child and dependent care expenses must be for the care of one or more qualifying people. Refer to the Volunteer Resource Guide, Nonrefundable Credits tab, Child and Dependent Care Credit Expenses, to determine who is a qualifying person. Any of the following are qualifying persons:

- A qualifying child who is the taxpayer's dependent and under age 13 when the care was provided. If the child is being claimed as a dependent by the noncustodial parent under the special rules for children of divorced and separated parents, only the custodial parent may treat the child as a qualifying person for this credit.
- Someone who was physically or mentally incapable of self-care who the taxpayer claims as a dependent or for whom the taxpayer could claim a dependency exemption, except that:
  - The person had income greater than the current year exemption amount
  - The person filed a joint return
  - The taxpayer or spouse, if Married Filing Jointly, could be claimed as a dependent on someone else's current year tax return
- Spouses who were physically or mentally unable to care for themselves and lived with the taxpayer more than half the year.

### example

Jim paid someone to care for his wife, Janet, so he could work. Janet is physically unable to care for herself. Jim also paid to have someone prepare meals for their 12-year-old daughter, Jill. Both Janet and Jill are qualifying persons for the credit.





See the rules for Qualifying Child and the special rules for children of divorced or separated parents or parents who live apart in Publication 17, Personal Exemptions and Dependents.

## What questions should I ask?

Ask the questions from the decision tree in the Volunteer Resource Guide, Nonrefundable Credits tab, and the intake and interview sheet. The sample interview shown uses these questions.

SAMPLE INTERVIEW	
VOLUNTEER SAYS...	DOROTHY RESPONDS...
<i>I see you indicated on your intake sheet that you had child and dependent care expenses.</i>	Yes, I did.
<i>You may qualify for the child and dependent care credit. Let me ask you a few questions about that. Which of your dependents received the care?</i>	My daughter.
<i>Now, she is 16 years old, correct?</i>	Yes, but she was diagnosed with a severe mental condition. She just can't take care of herself.

Even though Dorothy's daughter is over 13, she meets the qualifying person test because she cannot care for herself.

Once you've determined if the taxpayer had eligible expenses for the child and dependent care credit, confirm the appropriate box on the intake and interview sheet is checked.

## What is the earned income test?

The taxpayer (and spouse, if married) must both have earned income during the year. Earned income includes:

- Wages
- Salaries
- Tips
- Other taxable employee compensation
- Net earnings from self-employment
- Strike benefits
- Disability pay reported as wages



Earned income does not include amounts reported on Form 1040, line 7, that are excluded as foreign earned income on Form 2555, line 43, or Form 2555-EZ, line 18.

It does not include income earned while incarcerated or in a work release program.

Refer to the Volunteer Resource Guide, Earned Income Credits tab, Earned Income Table for the list of earned income.

### **What if spouses are full-time students or are unable to care for themselves?**

A taxpayer's spouse is treated as having earned income for any month the spouse is physically or mentally incapable of self-care, or is a full-time student. The spouse's income is considered to be \$250 for each month if there is one qualifying person in the home or \$500 each month if there are two or more qualifying people. A full-time student is defined as enrolled and attending a school for the number of hours or classes the school considers full time. The spouse must be a full-time student for some part of five calendar months during the year.

If, in the same month, both the taxpayer and the taxpayer's spouse are full-time students or are not able to care for themselves, only one spouse can be considered to have earned income of either \$250 for one qualifying person or \$500 for two qualifying persons for that month.



**Tax Software Hint:** To review information related to the software, go to the Volunteer Resource Guide, Nonrefundable Credits tab, Form 2441, Credit for Child and Dependent Care Expenses.

### **What questions should I ask?**

Ask the questions from the decision tree in the Volunteer Resource Guide, Nonrefundable Credits tab and the intake and interview sheet. Here is how a volunteer might interview a taxpayer about this test.

<b>SAMPLE INTERVIEW</b>	
<b>VOLUNTEER SAYS...</b>	<b>DOROTHY RESPONDS...</b>
<i>I believe you mentioned earlier that you and your husband both work, is that correct?</i>	Yes.
<i>Did you both work while your daughter was in day care?</i>	Yes and no. My husband just changed careers. He went to school the first half of the year, but he began working full time within a month of finishing his program in July.
<i>So, he was a full-time student for the first six months of the tax year?</i>	Yes. Does that disqualify us?
<i>No. That does not disqualify you.</i>	

Dorothy and her husband meet the earned income test because her husband was a full-time student for at least five months and is considered to have earned income for those months.

### **What is the work-related expense test?**

Expenses are considered work-related only if both of the following are true:

- The expenses allow the taxpayer (and spouse, if married) to work or look for work and
- The expenses are for a qualifying person's care, and to provide for that person's well-being and protection

For married taxpayers, generally both must work or be looking for work. Taxpayers' spouses are treated as working during any month the spouses were full-time students or were physically or mentally unable to take care of themselves.

There is a limit on the amount of work-related expenses that can be used to figure the credit. The limit is \$3,000 for one qualifying person and \$6,000 for two or more qualifying persons. This \$6,000 limit does not need to be divided equally among them.

### **What are examples of work-related expenses?**

The following expenses count as work-related:

- Cost of care outside the home for dependents under 13, for example, preschool or home day care, before- or after-school care for a child in kindergarten or higher grade
- Cost of care for any other qualifying person, for example, dependent care
- Household expenses that are at least partly for the well-being and protection of a qualifying person, for example, the services of a housekeeper or cook



If a taxpayer's qualifying child turned 13 during the tax year, their qualifying expenses include amounts incurred for the child while under age 13. For example, if the taxpayer's qualifying child turns 13 on September 16, count only those expenses through September 15.

#### **example**

Roger takes his 10-year-old child to a private school. In addition to paying for the cost of the education, Roger also pays an extra fee so that his child can attend a before- and after-school program while he is at work. Roger can count the cost of the before- and after-school program when figuring the credit, but not the cost of the education.

### **What expenses do not qualify as work-related?**

Expenses that do not qualify as work-related include amounts paid for food, clothing, education, or entertainment. However, small amounts paid for these items can be included if they are incident to and cannot be separated from the cost of care. Examples of childcare expenses that do **not** qualify as work-related include:

- Education, for example, expenses to attend kindergarten or a higher grade
- The cost of sending a child to an overnight camp
- The cost of transportation not provided by a care provider

#### **example**

Krista takes her 3-year-old child to a nursery school that provides lunch and educational activities as part of its preschool childcare service. She can count the total cost when she figures the credit.

### **What about taxes paid for household employees?**

Taxpayers who paid someone to come into their home to provide care for their dependent or spouse may be required to pay household employment taxes. These taxes may be considered a work-related expense. Refer to Publication 17, *Employment Taxes for Household Employers* section, for more information.

Generally, if the household employee earned less than a certain amount for the tax year, and the taxpayer did not withhold any income tax, the taxpayer is not required to pay employment taxes or provide the employee with Form W-2. Refer taxpayers who did not pay employment taxes for their household employees, and are unsure about these requirements, to Publication 926, *Household Employer's Tax Guide*, or to a professional tax preparer.

### What if the taxpayer makes payments to a relative?

Payments to relatives may qualify as work-related expenses if the taxpayer does not claim the relative as a dependent. Do not count amounts paid to:

- A dependent for whom the taxpayer (or spouse, if married) can claim an exemption
- The taxpayer's child who is under age 19 at the end of the year, even if the child is not the taxpayer's dependent
- A person who was the taxpayer's spouse at any time during the year
- The other parent of the taxpayer's qualifying child who is under age 13

### What questions should I ask?

Continue asking questions from the decision tree in the Volunteer Resource Guide, Nonrefundable Credits tab, and the intake and interview sheet. Here is how a volunteer might interview a taxpayer about the work-related test.

SAMPLE INTERVIEW	
VOLUNTEER SAYS...	DOROTHY RESPONDS...
<i>Did the caregivers assist your daughter only when you and your husband were at work?</i>	That's right. We couldn't afford any more help than that. All last year, they arrived just before we left for work and they left when my mother came at 2 p.m.
<i>Do you pay your mother to care for your daughter?</i>	No, we don't. She just does it because she loves her granddaughter.
<i>That's wonderful. You're all very fortunate. So all your expenses were only to allow you to work – or in your husband's case to go to school or look for work prior to becoming employed.</i>	Yes, exactly.

Dorothy passes the work-related expense test because the expenses are paid so that she and her husband can work and are not paid to a dependent relative.

### What is the joint return test?

Generally, *married couples* who wish to take the child and dependent care credit must file a joint return. However, taxpayers can be considered unmarried if they file a separate return and:

- Are legally separated on the last day of the tax year or
- Lived apart from their spouse for the last 6 months of the year and paid more than half of the cost of providing a home that was also the main home of the qualifying person for more than half the year



Generally, married persons who are considered unmarried will use the filing status, Head of Household.

A taxpayer whose spouse died during the tax year, and who has not remarried, must generally file a joint return to claim the credit.

At this point, you will have already determined the filing status and can rely on that to determine if the taxpayer passes the joint return test.

## What is the provider identification test?

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The provider identification test requires that taxpayers provide the name, address and Taxpayer Identification Number (TIN) of the person or organization who provided the care for their child or dependent.

If the care provider is an individual, the TIN is the same as the provider's Social Security number. If the provider is an organization, then it is the Employer Identification Number (EIN). Certain tax-exempt organizations are not required to have an EIN. See Publication 17 for more details.

Taxpayers who cannot provide all of the provider's information or who have incorrect information may still be able to take the credit if they can show that they used due diligence in trying to obtain the correct information. Refer to the sections titled Due Diligence and Provider Refusal in Publication 17, Child and Dependent Care chapter, for more information. Returns that do not include the provider information cannot be filed electronically.



### EXERCISES

Use the decision tree in the Volunteer Resource Guide, Nonrefundable Credits tab, to answer the following questions. The answers appear at the end of the lesson.

**Question 1:** Audrey is a stay-at-home mom. Her husband works and had earned income for the tax year. They have a young son with autism who must be supervised at all times. Audrey volunteers at a local autism information hotline 12 hours a week. She and her husband pay a caregiver to stay with their son during those hours.

Do they qualify for the child and dependent care credit?  Yes  No

**Question 2:** Why don't Audrey and her husband qualify for the credit? (Select all answers that apply.)

- A. The caregiver expense is not work-related
- B. Their son is not a qualifying person
- C. The caregiver's duties qualify as work-related
- D. They do not pass the earned income test

## Taxpayer Interview and Tax Law Application

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Bill, 61, and Helen, 62, are married and have lived together for twenty years. Earlier in the interview with Bill, you learned that Helen is too sick to work and needs 24-hour care. Bill is claiming his granddaughter as a dependent, as noted in the Marital Status and Household Information section of his intake and interview sheet. She is 18 and takes care of herself. You wonder whether Bill can take the child and dependent care credit.

Apply the questions from the credit for child and dependent care expenses decision tree in the Volunteer Resource Guide, Nonrefundable Credits tab, to find out whether Bill can take the credit, as shown in the sample interview to follow.

## SAMPLE INTERVIEW

### VOLUNTEER SAYS...

*For the credit for child and dependent care, I'd like to ask you some questions about the care provided for your wife, Helen. You may qualify for the credit.*

*Why don't you tell me about your wife's illness and care?*

*I'm sorry that she is so ill. That must be difficult for both of you.* [The volunteer has already determined earlier in the tax return preparation process that Bill has earned income from his full-time teaching job. So he skips these questions in the decision tree and moves ahead to the next relevant question.]

*Did you pay someone to take care of your wife so that you could go to work?*

*Oh, I see. Well unfortunately, you won't be able to take the credit for your wife because you are claiming Lucy as a dependent.*

*You're welcome. Just trying to help!*

[On the intake and interview sheet, indicate that the taxpayer doesn't qualify for this credit, and why.]

### BILL RESPONDS...

Oh, okay.

Well, she has chronic lung disease; she can't take care of herself at all. We need to have someone in the home 24 hours a day.

Yes, it is ... well, sometimes she has good days, and I'm thankful for that.

Yes, I pay my granddaughter Lucy, who just graduated from high school, to take care of Helen.

Oh, that's okay. Thanks for looking into it for me.

Bill does not pass the work-related expenses test because his expenses were paid to a dependent relative.

## How do I determine the amount of the credit?

To determine the amount of the credit, multiply the work-related expenses (after applying the earned income and dollar limits) by a percentage. It is possible a qualifying person could have no expenses and a second qualifying person have expenses that exceed \$3,000. List 0 for one person and the actual amount for the second person. The percentage depends on the taxpayer's adjusted gross income.



**Tax Software Hint:** The tax software performs much of the credit computation for you. To review information related to the software, go to the Volunteer Resource Guide, Nonrefundable Credits tab, Form 2441, Credit for Child and Dependent Care Expenses.

## How do I complete Form 2441?

Form 2441 is divided into three parts:

- Part I is for general information about the care provider
- Part II is where the child and dependent care credit is calculated
- Part III is where information is entered if the taxpayer reports employer-provided dependent care benefits

All taxpayers complete Part I first. Taxpayers who did not receive dependent care benefits from their employers then complete Part II. Taxpayers who did receive these benefits complete Part III and then Part II.

### ***What about employer-provided dependent care benefits?***

Some taxpayers receive dependent care benefits from their employers. Taxpayers may be able to exclude these benefits from their income. Dependent care benefits include amounts the employer pays either directly to the taxpayer or to the care provider. Employer-provided dependent care benefits appear in the taxpayer's Form W-2, box 10.

The taxpayer may still be able to claim a child and dependent care credit, but the amount of excluded benefits is not included in work-related expenses and also reduces the dollar limit for the credit. Taxpayers who receive dependent care benefits **must** complete Part III of Form 2441, even if they are not eligible for a child and dependent care credit.

#### **example**

Paula has one dependent child, Jenny, who is 6 years old. She paid \$2,900 in qualified expenses. Paula's Form W-2, box 10, shows she received \$1,400 during the year from her employer's dependent care assistance program. Because she received dependent care benefits, Form 2441, Part III, must be completed before completing Part II.



**Tax Software Hint:** To review information related to the software, go to the Volunteer Resource Guide, Nonrefundable Credits tab, Form 2441, Credit for Child and Dependent Care Expenses.

### ***What limits apply to this credit?***

The taxpayer's expenses are subject to an earned income limit. The amount of work-related expenses used to figure the credit cannot be more than:

- The taxpayer's earned income for the year or
- If Married Filing Jointly, the smaller of the taxpayer or spouse's earned income for the year

In addition to the earned income limit, there is a dollar limit on the amount of work-related expenses that can be used to figure the credit. This limit is \$3,000 for one qualifying person or \$6,000 for two or more qualifying persons. If the taxpayer received dependent care benefits from an employer, the amount of the benefits excluded from income must be subtracted from the dollar limit.

#### **example**

Mary has three qualifying children. She received \$4,800 in dependent care benefits through her employer. When Mary figures her credit, her work-related expenses will be limited to \$1,200 (\$6,000 – \$4,800).



**Tax Software Hint:** The tax software guides you through applying the limits and computing the credit. If the taxpayer received employer-paid benefits, enter the amounts in the Form W-2 section, and this amount is carried to Part III of Form 2441.

## How do I avoid common errors?

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When entering information into the software, double-check your entries for the provider's name, ID number, and amounts paid. Be sure that qualified expenses are entered in step 2 of the software. If the taxpayer had an amount in any Form W-2, box 10, the software will ask you to verify that the entry is correct, and to make sure Form 2441 is completed.

On the intake and interview sheet, make sure the box is checked to indicate that the taxpayer was eligible for the dependent care credit. Note anything unusual that the quality reviewer may need to know when reviewing this part of the tax return.

## Summary

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The credit for child and dependent care expenses is a nonrefundable credit that allows taxpayers to reduce their tax liability by a portion of the expenses.

The maximum expense amounts are \$3,000 for one qualifying person and \$6,000 for two or more qualifying persons. This \$6,000 limit does not need to be divided equally among them.

The maximum credit rate is 35% of the taxpayer's expenses. A taxpayer must satisfy the five eligibility tests to qualify for the credit. The tests are the:

- Qualifying person test
- Earned income test
- Work-related expense test
- Joint return test
- Provider identification test

The credit is calculated on Form 2441.

## What situations are out of scope for the VITA/TCE programs?

The following is out of scope for this lesson. While this list may not be all inclusive, it is provided for your awareness only.

- Taxpayers who need assistance in determining if employment taxes are owed for household employees



### TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem or practice exercise(s) for your course of study in Publication 4491-W.

For practice using the tax preparation software, complete the scenarios using the Practice Lab on L&LT.



### EXERCISE ANSWERS

**Answer 1:** No, they do not qualify.

**Answer 2:** A and D. Audrey is not using the caregiver's services to look for work or to perform work. In addition, both spouses must have earned income during the year to qualify. Only the husband had earned income for the tax year.





## Education Credits



### Introduction

This lesson covers tax credits available to help the taxpayer offset the costs of higher education by reducing the amount of income tax. This lesson suggests probing questions you can ask based on the intake and interview sheet, the Volunteer Resource Guide, Education Benefits tab, and on the rules for claiming education credits.

During the interview, ask taxpayers if they are aware of the education credits, and give a brief description. Next, gather information to determine if any credits can be claimed.

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Determine who qualifies for an education credit
- Determine which credit the taxpayer can claim

#### What do I need?

- Form 13614-C
- Publication 4012
- Publication 17
- Publication 970
- Publication 4491-W
- Form 1098-T
- Form 8863 and Instructions
- Optional:**
- Form 1040 Instructions

### What are education credits?

Education credits are amounts that will reduce the amount of tax due. The amount is based on qualified education expenses that the taxpayer paid during the tax year.

There are two different education credits: the American opportunity credit and the lifetime learning credit. The American opportunity credit allows 40% of the credit to be refundable. There are general rules that apply to these credits, as well as specific rules for each credit.

For an overview of the various education tax benefits, review the Volunteer Resource Guide, Education Benefits tab, Highlights of Education Tax Benefits.

### Who can take an education credit?

Taxpayers can take education credits for themselves, their spouse, and/or dependents (claimed on the tax return) who were enrolled at or attended an eligible postsecondary educational institution during the tax year. For tax years after 2016, the law requires that the student must generally receive a Form 1098-T in order for the taxpayers to claim the education credit.

### What basic requirements must the taxpayer meet?

To claim an education credit, verify that the following are true for the taxpayers:

- They cannot be claimed as a dependent on someone else's tax return
- They are not filing as Married Filing Separately
- Their adjusted gross income (AGI) is below the limitations for their filing status
- They were not nonresident aliens for any part of the tax year, or if they were, they elected to be treated as resident aliens



Taxpayers claiming the American opportunity credit must have a valid identification number (SSN or ITIN) by the due date of the tax return (including extensions). Further, the student claimed for the credit must also have a valid identification number (SSN, ATIN, or ITIN) by the due date (including extensions). Taxpayers cannot file an amended return to claim the credit for a year that the taxpayer and/or student did not originally have a required identification number by the return due date.

Refer to the Volunteer Resource Guide, Education Benefits tab, for the Education Credits Tips.

### How do I handle dependents?

The taxpayer must claim the student as a dependent to receive the credit for the student's qualified expenses. If the taxpayer claims the student as a dependent, all qualified education expenses of the student are treated as being paid by the taxpayer. Refer to the Education Credits Tips in the Volunteer Resource Guide, Education Benefits tab, demonstrated by the following example:

#### example

Carol Marshall has a grandson named Gary. He is claimed as a dependent on his parent's joint return. Carol paid Gary's tuition directly to the university. For purposes of claiming an education credit, Gary is treated as receiving the money as a gift and paying for the qualified tuition and related expenses. Since his parents are claiming him on their return, they may be able to use the expenses to claim an education credit. Alternatively, if he is claiming himself on his return, he might be able to claim the expenses as if he paid them to the school.

### What is an eligible institution?

An eligible institution is generally any accredited public, nonprofit, or private college, university, vocational school, or other postsecondary institution eligible to participate in a student aid program administered by the U.S. Department of Education. The school should be able to tell the student if it is an eligible education institution. A searchable database of all accredited schools is available at <http://ope.ed.gov/accreditation/>.



New legislation requires taxpayers claiming the American opportunity credit to report the EIN of the educational institution the student attended.

### What are qualifying expenses?

Qualified education expenses are tuition and certain related expenses required for enrollment or attendance at an eligible educational institution. Qualified education expenses include nonacademic fees, such as student activity fees, athletic fees, or other expenses unrelated to the academic course of institution that must be paid to the institution as a condition of enrollment or attendance. However, for the American opportunity credit, the definition for "certain related expenses" is different from the lifetime learning credit. This will be discussed later in the lesson.

Ask to see documentation, such as receipts or Form 1098-T, Tuition Statement, issued by the school. Identify the expenses that qualify for education credits.

#### example

When Janice enrolled for her freshman year of college, she had to pay a separate student activity fee in addition to her tuition. This activity fee is required of all students and is used solely to fund on-campus organizations and activities run by students, such as the student newspaper and the student government. No portion of the fee covers personal expenses. Although labeled as a student activity fee, the fee is required for Janice's college enrollment and attendance; therefore, it is a qualified expense.

## Which expenses do not qualify?

Do **not** include expenses such as:

- Room and board, insurance, medical expenses (including student health fees), transportation costs, or other similar personal, living, or family expenses
- Any course of instruction or other education involving sports, games, or hobbies, unless the course is part of the student's degree program or (for the lifetime learning credit) helps the student to acquire or improve job skills

### example

Jackie paid \$3,000 for tuition and \$5,000 for room and board at an eligible university. The \$5,000 paid for room and board is not a qualified expense for the education credits.

## Are any amounts excluded from qualified expenses?

Certain tax-free funds used to pay tuition cannot be used to figure the credit. Once you have identified each person claiming a credit and their qualified expenses, ask if the student received any of these untaxed educational benefits during the year:

- Pell grants.
- Employer-provided educational assistance.
- Veterans' educational assistance.
- Tax-free portions of scholarships and fellowships.
- Any other nontaxable payments received as educational assistance (other than gifts or inheritances). For example, distributions from a 529 plan reported on Form 1099-Q, Payments From Qualified Education Programs (Under Sections 529 and 530).
- Refunds of the year's qualified expenses paid on behalf of a student (e.g., the student dropped a class and received a refund of tuition).



**CAUTION** Do not reduce the qualified education expenses by any scholarship or fellowship reported as income on the student's tax return if the use of the scholarship is not restricted and used to pay education expenses that are not qualified (such as room and board). Some students may choose to pay non-qualifying expenses with scholarship/Pell grants funds, making the scholarship/Pell grants taxable. This is true even if the scholarship/grant was paid directly to the school.

Generally, any scholarship or fellowship grant is treated as tax-free educational assistance. However, a scholarship or fellowship grant is not treated as tax-free educational assistance to the extent the student includes it in gross income (the student may or may not be required to file a tax return) for the year the scholarship or fellowship grant is received.

Most students will receive Form 1098-T from the educational institution. The form should show the amounts the student paid for tuition and related expenses, the amounts of scholarships and grants received, and whether the student was at least a half-time student or a graduate student. Verify with the taxpayer that the amount in Form 1098-T, box 1 or 2, is actually the amount paid in the current tax year for qualified expenses.



**CAUTION** Form 1098-T may have incomplete information. Question the taxpayer to determine the amount of qualified expenses actually paid and adjust this amount by any non-taxable items, such as tax-free scholarships and tuition program distributions.

#### example

Joan Smith received Form 1098-T from the college she attends. It shows her tuition was \$9,500 and that she received a \$1,500 scholarship. She had no other scholarships or nontaxable payments. Her maximum qualifying expenses for the education credit would be \$8,000 (\$9,500 - \$1,500).

#### example

Brandon had \$5,000 of qualified education expenses and \$4,000 of room and board. He received a \$5,000 Pell grant and took out a \$2,750 student loan to pay these expenses. His parents paid the remaining \$1,250. By its terms, the Pell grant may be used for any of these expenses. Brandon and his parents opted to use \$4,000 of the Pell grant to cover room and board, and the other \$1,000 to cover the qualified education expenses. After reducing qualified education expenses by the tax-free grant, Brandon has \$4,000 (\$5,000 - \$1,000) of adjusted qualified education expenses available to figure the education credit. Brandon used the student loan of \$2,750 and his parents' payment of \$1,250 to cover the qualified education expenses.

### What about payments for the next academic year?

The taxpayers can claim payments prepaid for the academic period that begins in the first three months of the next calendar year. Refer to the Volunteer Resource Guide, Education Benefits tab, Education Credits.

#### example

Thomas pays \$1,500 in December for qualified tuition for the winter semester that begins in January. He can use the \$1,500 paid in December to compute his credit for the current tax year. He cannot count it again next tax year.

### What rules apply to each credit?

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#### How do the credits compare?

There are several differences between the two credits.

The American opportunity credit:

- Can be claimed based on the same student's expenses for no more than four tax years, including any years the Hope credit was claimed
- Available only if the student has not completed the first four years of post-secondary education before the beginning of the tax year
- Qualified tuition and related expenses include expenses for course materials – books, supplies, and equipment needed for a course of study, whether or not the materials are purchased from the educational institution as a condition of enrollment or attendance
- Generally, 40% of the credit is a refundable credit, which means taxpayers can receive up to \$1,000 even if they owe no taxes



**CAUTION** Taxpayers who claim the American opportunity credit even though they are not eligible can be banned from claiming the credit for 10 years.

Lifetime learning credit:

- There is no limit on the number of years the lifetime learning credit can be claimed for each student
- Available for all years of post-secondary education and for courses to acquire or improve job skills
- Course-related books, supplies, fees, and equipment are included in qualified education expenses only if they must be paid to the institution as a condition of enrollment or attendance
- No portion of the credit is refundable

## American Opportunity Tax Credit

Taxpayers can take the American opportunity credit for a student if they can answer all of these questions as indicated below:

- As of the beginning of the tax year, was the student still in the first four years of postsecondary education (generally, the freshman, sophomore, junior, and senior years)? *Yes*
- Was the student enrolled in a program that leads to a degree, certificate, or other credential? *Yes*
- Was the student taking at least one-half the normal full-time workload for the course of study, for at least one academic period beginning in the current tax year? *Yes*
- Has the student been convicted of a felony for possessing or distributing a controlled substance? *No*
- Did the taxpayer and student have a taxpayer identification number (TIN) by the due date of the return (including extensions)? *Yes*



If the student does not meet all of the conditions for the American opportunity credit, the taxpayer may be able to take other education benefits for part or all of the student's qualified expenses.

### example

Mindy's brother, Jim, started college in 2010. He was eligible for the American opportunity credit for 2010, 2011, 2012, and 2015. His parents claimed the American opportunity credit on their 2010, 2011, and 2012 returns. Jim claimed the credit on his 2015 tax return. Since the credit has been claimed for four years, the credit can't be claimed on any additional returns based on Jim's expenses.

The American opportunity credit can be up to \$2,500 per eligible student, depending on the amount of eligible expenses and the amount of tax on the return. The credit is 100% of the first \$2,000 and 25% of the second \$2,000 of eligible expenses per student, up to the amount of tax. Forty percent of the American opportunity credit is a refundable credit, which means the taxpayer can receive up to \$1,000 even if no taxes are owed. Taxpayers under age 24 cannot claim the refundable portion of the credit if certain conditions are met. Refer to Volunteer Resource Guide, Education Benefits tab, Student Under Age 24 Claiming American Opportunity Credit, for details.

The American opportunity credit is available for four years of college per eligible student (generally, freshman through senior years of college).

### example

Toby had receipts for books and supplies his first year at college. He spent \$1,291 for required books, lab supplies, and rock-hunting equipment he needed for his introductory chemistry and geology courses. The school has no policy requiring that these books and equipment be purchased from the college in order to enroll. These are qualified expenses for the American opportunity credit.

## Lifetime Learning Credit

The lifetime learning credit can be taken if the taxpayer and the expenses meet the requirements described under “What basic requirements must the taxpayer meet?” Refer to the Volunteer Resource Guide, Education Benefits tab, for the Education Credits Tips. The student need not be enrolled half-time or in a degree program, and a felony drug conviction does not disqualify the student.

The lifetime learning credit can be up to \$2,000 per tax return, depending on the amount of eligible expenses and the amount of tax on the return. The credit is 20% of the first \$10,000 of eligible expenses paid for all students, up to the amount of tax on the return. Taxpayers cannot claim the lifetime learning credit for any student for which they have already claimed the American opportunity credit in the same year.

### example

Jill attends Wanda’s School of Beauty, an eligible institution. She pays \$4,400 for the course of study, which includes tuition, equipment, and books required for the course. The school requires that students pay for the books and equipment when registering for the course. The entire \$4,400 would be an eligible educational expense.

### example

Jack attends a culinary school on Saturdays. He pays \$4,400 for the course of study and qualifies for the lifetime learning credit. The school provides a list of equipment that he needs to bring to class. The \$4,400 is an eligible educational expense, but the cost of the equipment and supplies is not.



## EXERCISES

Use the Volunteer Resource Guide, Education Benefits tab, and Publication 17, Comparison of Education Credits, to answer the following questions. Answers are at the end of the lesson summary.

**Question 1:** Bob was a full-time student and a fifth-year senior. He has only claimed the American opportunity and Hope credit in three earlier years. Does he qualify for the American opportunity credit?

Yes    No

**Question 2:** Janice works full time and takes one course a month at night school. Some of the courses are not for credit, but they are meant to advance her career. Which credit is appropriate for her?

American opportunity    Lifetime

**Question 3:** Clark is an older student who has gone back to college half time after serving 18 months in prison for felony drug possession. Which credit is appropriate for him?

American opportunity    Lifetime

## Can a taxpayer take multiple education benefits?

Education expenses can be taken in any of several areas on the tax return. They can be used toward one of these credits, as a work-related deduction on Schedule A, as a business expense on Schedule C or C-EZ, or to reduce the taxable portion of scholarships, fellowships, grants and distributions from education savings accounts. The definition of a qualifying expense varies among these different benefits, but in general, each expense can be used only once. For example, do **not**:

- Figure the education credits based on expenses that have already been taken on Schedule A or Schedules C and C-EZ
- Take both an American opportunity credit and a lifetime learning credit for the same student in the same year



Refer to the Legislative Extender's lesson contained in this publication for information regarding tuition and fees deductions.



A taxpayer who has taken an early distribution from an IRA may take an exception to the 10% additional tax based on expenses that are also used toward another education benefit.



**Tax Software Hint:** To review information related to software entries, go to the Volunteer Resource Guide, Education Benefits tab.



To determine the most beneficial way to claim education expenses, do not compare them until both federal and state tax returns have been otherwise completed.

## How do I determine the amount of the credit?

Here are the general steps in figuring the amount of education credits:

1. Review the list of qualifying students and expenses and decide if the American opportunity credit or lifetime learning credit is more suitable (see the requirements discussed earlier).
2. Form 8863, Part III, page 2, requests information about the student, the student's eligibility for the credit, and the educational institution(s). Taxpayers must complete Part III for each eligible student for whom they are claiming an education credit before completing Parts I and II.
3. Enter each student's qualified expenses. Be sure that these:
  - Include only qualified expenses
  - Are reduced by untaxed benefits
  - Do not exceed the limit for the credit
4. Find the totals for each section and apply the limits, then transfer the amounts to Parts I and II to determine the refundable and nonrefundable credits. Apply the income test and do the calculations. (Tax software does this step for you.)



To determine the amount of qualified expenses, please review Form 1098-T and have a discussion with the taxpayer to determine the qualified education expenses paid.



**Tax Software Hint:** When entering qualified expenses, the software allows you to choose which benefit. At this point, you can make changes to determine the most beneficial education benefit to claim for the taxpayer.



The software will not catch other errors, such as taking more than one benefit for the same taxpayer.



If you find taxpayers claimed an education credit in a prior year and they were refunded part or all of the expenses they used to claim the American opportunity or lifetime learning credit, they may have to repay (recapture) all or part of the credit. Information can be found in Publication 970, but this is beyond the scope of the VITA/TCE programs. Advise the taxpayer to consult a professional tax preparer.

## Taxpayer Interview and Tax Law Application

Here is how our volunteer helped taxpayer, Barbara Smith, determine which education credits applied to her family.

### SAMPLE INTERVIEW

VOLUNTEER SAYS...

BARBARA RESPONDS...

*Barbara, are you familiar with education credits?*

They have something to do with tuition.

*Yes, they apply to certain expenses for postsecondary education. Did anyone in the family attend college or vocational school during the tax year?*

My daughter, Carla, is a freshman, going to college full time, and I am taking classes at City College.

*There are two kinds of credits – here’s a chart comparing the two education credits. [Explains the differences.]*

Looks like American opportunity for Carla and lifetime for me!

*I think you’re right. You both meet the basic requirements, since you are both on the return and meet the income limits.*

Yes, these are for Carla’s tuition, fees, and books for the tax year. These are for extracurricular field hockey.

*Did you bring any receipts for education expenses?*

Only \$5,000 from her grandfather.

*The books will qualify but her field hockey costs will not. Did she receive any tax-free benefits from an employer, a scholarship, Pell grant, anything like that?*

*We don’t need to count the gift. The American opportunity credit is available for a student’s first four years of college, so that might be the best for you to claim. Now let’s look at your expenses.*

All I have are tuition and fees for two classes in accounting, spring and fall semesters.

*Are these to improve your job skills?*

Yes, but my boss doesn’t reimburse me.

*Are all of these required expenses?*

Yes.

*You’ll be eligible for the lifetime learning credit.*

I’m so glad you were here to help me!

[On the intake and interview sheet, indicate that you’ve addressed education benefits.]

## Which education benefit is better for the taxpayer?

Taxpayers have several options for using education expenses to reduce taxes. They are:

- American opportunity credit or lifetime learning credit
- Itemized deduction on Schedule A (employee-related expenses only)
- Business expenses on Schedules C and C-EZ



**CAUTION** Do not forget to check the Legislative Extenders section for tuition and fees deductions.

Generally, taxpayers will benefit the most from claiming the education credits. If taxpayers have a choice, the American opportunity credit will always be greater than the lifetime learning credit. However, you should compute any of the other benefits for which taxpayers are eligible to determine which gives them the lowest tax. Do not claim multiple benefits for the same education expense; use the benefit most advantageous to the taxpayer.

Refer to the Volunteer Resource Guide, Education Benefits tab, References – Highlights of Education Tax Benefits for a comparison chart of some of the tax benefits for education.



## How can I avoid common errors?

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Make sure that you have entered the names, SSNs, and education expense amounts correctly. Check that you have not claimed more than one tax benefit for the same taxpayer or taken a credit or deduction for expenses paid with a tax-free benefit like a scholarship.

On the intake and interview sheet, make sure that the appropriate box is checked to indicate that the taxpayer had education expenses. Note anything unusual that the quality reviewer may need to know when reviewing this part of the tax return. For example, you could note if some expenses were paid with a nontaxable scholarship.

## Summary

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You are now ready to help taxpayers determine which education tax benefits are best for them. When you get to this section of the return, always check the intake and interview sheet and ask probing questions based on the taxpayer's information and on the rules for claiming education credits.

There are two education credits that may reduce a taxpayer's tax:

- American opportunity credit
- Lifetime learning credit

Taxpayers and students must have a taxpayer identification number (TIN) by the due date of the return. Also, any taxpayer who claims the American opportunity credit and is not eligible can be banned up to 10 years from claiming the credit.

Education expenses can be applied to those credits, deducted on Schedules C and C-EZ, itemized on Schedule A, or used to reduce taxable portion of scholarships, grants, fellowships and distributions from education savings accounts. Choose the method that will give the taxpayer the lowest tax. The American opportunity credit can be claimed for students in their first four years of college and may be more beneficial than the lifetime learning credit. Remember, 40% of the American opportunity credit is a refundable credit, which means taxpayers can receive up to \$1,000 even if they have no tax liability.

One of your roles as a volunteer is to help taxpayers maximize the benefits that they are entitled to under the tax law. Stay alert to ways they can use their education expenses to lower their tax.

## What situations are out of scope for the VITA/TCE programs?

The following is out of scope for this lesson. While this list may not be all inclusive, it is provided for your awareness only.

- Taxpayers who must repay (recapture) part or all of an education credit claimed in a prior year.



### TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem or practice exercise(s) for your course of study in Publication 4491-W.

For practice using the tax preparation software, complete the scenarios using the Practice Lab on L&LT.





## Foreign Tax Credit



### Introduction

This lesson will show you how to help taxpayers claim the foreign tax credit. This credit applies to those who have paid or accrued taxes to a foreign country on foreign-sourced income and who are subject to U.S. tax on the same income.

To help these taxpayers, you must determine which taxes and types of foreign income are eligible for the foreign tax credit and accurately compute the credit using Form 1116.

If the foreign tax paid is reported on a Form 1099-INT or a Form 1099-DIV, completion of the entire Form 1116 may not be required.

If the foreign tax paid is a result of living and working outside the U.S., then all the questions on Form 1116 need to be addressed.

Although the foreign tax credit is not specifically listed on Form 13614-C, Intake/Interview & Quality Review Sheet, ask taxpayers if they paid any tax to a foreign country.

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Determine which taxes and types of foreign income are eligible for the foreign tax credit
- Accurately compute the credit using Form 1116
- Calculate and report the foreign tax credit as a nonrefundable credit

#### What do I need?

- Form 13614-C
- Publication 4012
- Publication 514
- Publication 4491-W
- Form 1116
- Form 1116 Instructions

### What is the foreign tax credit?

U.S. citizens and residents compute their U.S. taxes based on their worldwide income. This sometimes results in U.S. citizens having to pay tax twice on the same income — first to the government of the foreign country where the income was earned and again to the U.S. government.



Taxpayers can choose whether to take the amount of any qualified foreign taxes paid during the year as a foreign tax credit or as an itemized deduction. Taxpayers can change their choice for each year's taxes.

As a general rule, taxpayers must choose to take either a credit or a deduction for all qualified foreign taxes. For exceptions to this general rule, see Publication 514, Foreign Tax Credit for Individuals.

The foreign tax credit was created to help taxpayers avoid this double taxation. Taxpayers who paid income, war profits, or excess profits taxes to a foreign country or U.S. possession may be entitled to a credit on their U.S. taxes. Like other nonrefundable credits, the foreign tax credit allows taxpayers to take a dollar-for-dollar reduction in the amount of U.S. tax owed. However, in some cases, not all taxes paid to a foreign government on foreign-sourced income can be used in the computation of the credit.

Four tests must be met to qualify for the credit:

1. The tax must be imposed on the taxpayer
2. The taxpayer must have paid or accrued the tax
3. The tax must be a legal and actual foreign tax liability, and
4. The tax must be an income tax



Some foreign taxes are not income taxes. Taxpayers can deduct foreign real property taxes that are not trade or business expenses as an itemized deduction on Form 1040, Schedule A.

## What if the foreign tax credit is reported on Form 1099-INT or Form 1099-DIV?

Taxpayers who receive Form 1099-INT or Form 1099-DIV may have amounts indicating that foreign taxes have been paid on their behalf by the issuer of the document.

Taxpayers can elect to report foreign tax on Form 1040, page 2 without filing Form 1116 as long as the following conditions are met:

- All of the gross foreign source income was from interest and dividends and all of that income and the foreign tax paid on it were reported on Form 1099-INT, Form 1099-DIV, or Schedule K-1 (or substitute statement).
- If you had dividend income from shares of stock, you must have held those shares for at least 16 days.
- You are not filing Form 4563, Exclusion of Income for Bona Fide Residents of American Samoa, or excluding income from sources within Puerto Rico.
- The total of your foreign taxes was not more than \$300 (not more than \$600 if married filing jointly).
- All of your foreign taxes were:
  - Legally owed and not eligible for a refund, and
  - Paid to countries that are recognized by the United States and do not support terrorism.

Refer taxpayers who must complete Form 1116 because they cannot qualify for the election to a volunteer with an International certification or a professional tax preparer.



A credit for foreign taxes can be claimed only for foreign tax imposed by a foreign country or U.S. possession.

Additional information can be found in the Form 1040 Instructions, Form 1116 Instructions, Publication 17, and Publication 514.



**Tax Software Hint:** To review information related to the software, go to the Volunteer Resource Guide, Nonrefundable Credits tab.

### example

Ryan, who is single, received Form 1099-DIV showing \$29 of foreign taxes paid. According to Ryan, he received no other foreign source of income and paid no other foreign taxes. The dividends were paid on shares of a mutual fund that he owned all year. He is eligible to claim the foreign tax credit on Form 1040, page 2, and does not have to complete Form 1116.



## EXERCISES

Answers are after the lesson summary.

**Question 1:** To claim the foreign tax credit without filing Form 1116, a taxpayer who is filing Single must have paid foreign taxes listed in Box 6 of 1099-DIV or 1099 INT that are equal to or less than \$300.

True  False

**Question 2:** Clyde comes to your site seeking help with his foreign tax credit. He is single and his Forms 1099-DIV show a total of \$324 of foreign tax paid. Can Clyde make the election?

Yes  No

**Question 3:** Judy and Mark are married and will file a joint return. Their Forms 1099-DIV show a foreign tax paid of \$590. Can they make the election?  Yes  No

The remaining sections of this lesson are directed at volunteers seeking an International certification. All others may proceed to the next lesson.



## What are the rules for claiming the foreign tax credit on Form 1116?

If the foreign tax paid is more than \$300 (\$600 for Married Filing Jointly) or they do not meet the other conditions to make the election, taxpayers must file Form 1116 to claim the foreign tax credit.

In most cases, it is better to take a credit for qualified foreign taxes than to deduct them as an itemized deduction. In general, if the credit is chosen, you must take the credit for all qualified foreign taxes. However, taxpayers may be able to deduct a foreign income tax that is not allowed as a credit in certain circumstances. See Publication 514 for details. In these rare situations, refer taxpayers to a professional tax preparer.



The foreign earned income exclusion differs from the foreign tax credit; try both methods for taxpayers and choose the approach that results in the lowest tax.

- The exclusion allows a portion of the foreign earned income to be excluded from taxable income.
- The credit adds the foreign income to the taxable income and then reduces the U.S. tax due by some portion of taxes paid to the foreign government(s).

## What qualifies taxpayers for the credit?

To qualify for the credit, the following requirements must be met. A taxpayer must:

- Have income from a foreign country
- Have paid taxes on that income to the same foreign country
- Not have claimed the foreign earned income exclusion on the same income (see the foreign earned income exclusion section of the Income – Other Income lesson)

In addition, the foreign tax must:

- Be paid to a foreign country on income derived from that country
- Be similar to the U.S. income tax
- Provide no economic benefit to the taxpayer paying the tax

Foreign taxes that qualify for the foreign tax credit generally include taxes on:

- Wages
- Dividends
- Interest
- Royalties
- Annuities

Foreign taxes for which an individual may *not* take a credit include taxes:

- On excluded income
- On foreign mineral income
- On combined foreign oil and gas income
- For which the taxpayer can take only an itemized deduction
- From international boycott operations
- Of U.S. persons controlling foreign corporations and partnerships
- Taxes paid to a foreign country that a taxpayer does not legally owe, including amounts eligible for refund by the foreign country



**CAUTION** Taxpayers cannot take the foreign tax credit for foreign income taxes paid on income excluded under the foreign earned income exclusion.



For more detailed information, see Publication 514 and the Form 1116 Instructions.

#### example

Robb and his wife are U.S. citizens who reside in France. Their Form 1040, Schedule B, Interest and Ordinary Dividends, lists \$2,000 interest from a U.S. bank and \$600 interest from a French bank. They paid income taxes on both amounts to both countries. On their U.S. tax return, they can compute a foreign tax credit to offset the taxes they owe to the U.S. on the interest received from the French bank. They would need to check with the French taxing authorities to determine if they can claim a similar tax credit on their French tax return to offset the taxes paid to the U.S. on the interest income earned in the U.S.

#### example

Eva is a U.S. citizen who lives in Hong Kong. Eva owns her home in Hong Kong and paid \$2,000 in real estate taxes and \$1,000 in personal property taxes. She also paid \$3,000 in income taxes to the government of Hong Kong. She cannot claim a foreign tax credit for either the real estate taxes or the personal property taxes because they are not income taxes. Eva can compute a foreign tax credit on the \$3,000 in income taxes paid to Hong Kong.

However, Eva can deduct the real estate taxes that she paid as an itemized deduction on her U.S. tax return. She can itemize the foreign personal property tax only if it is based on the value of the personal property.



## EXERCISES (continued)

**Question 4:** Anne is a U.S. citizen living in Japan. She listed wages, interest income, and dividend income on her U.S. tax return. She paid taxes on each of these types of income to Japan. Anne can claim a foreign tax credit for taxes paid on which of the following sources of income?

- A. Wages from her job in the U.S.
- B. Interest income from a U.S. bank
- C. Interest income from a Japanese bank
- D. Dividend income from a U.S. corporation

**Question 5:** Jean, a U.S. citizen, received an inheritance upon the death of an uncle in Spain and paid an inheritance tax to the Spanish government. Can Jean claim a foreign tax credit to offset the inheritance tax she paid in Spain?  Yes  No

### What is “economic benefit”?

As mentioned earlier, the foreign tax paid cannot provide a specific economic benefit for the taxpayer and be included in the foreign tax credit computation. This means that the tax cannot be a payment that results in an individual receiving:

- Goods
- Services
- Fees or other payments
- The right to use, acquire, or extract resources, patents, or other property that the foreign country owns or controls
- Discharges of contractual obligations



**TIP** Taxpayers are considered to receive a specific economic benefit if they conduct a business transaction with a person who receives an economic benefit from a foreign country, and under the terms and conditions of the transaction, the taxpayer directly or indirectly receives some part of the benefit.

#### example

Lawrence is a business owner who lives in China, which has a two-tier income tax system:

- Everyone is taxed according to their income
- Business owners pay additional tax on their profits

The second tier entitles business owners to certain reduced fees and other benefits, such as ability to rent space in a government building. Because of the specific economic benefits Lawrence receives, he cannot use the second-tier tax payments to compute a foreign tax credit on his U.S. tax return. However, the first-tier income taxes are similar to U.S. income taxes and can be used to figure his foreign tax credit.

## What are Sanctioned Country Restrictions and Section 901(j) Income?

Taxes paid to or accrued by certain countries do not qualify for the foreign tax credit. These are countries:

- That have been designated by the Secretary of State as repeatedly providing support for acts of international terrorism,
- With which the U.S. has severed or does not conduct diplomatic relations, or
- Whose government the U.S. does not recognize, unless that government is eligible to purchase defense articles or services under the Arms Export Control Act

See Publication 514 or visit [www.irs.gov](http://www.irs.gov) for the current list of sanctioned countries.



Foreign income earned in sanctioned countries is subject to U.S. tax. A separate Form 1116 must be completed for foreign income from a sanctioned country, using the “Section 901(j) income” category. This is beyond the scope of the VITA/TCE programs; refer taxpayers to a professional tax preparer.



### EXERCISES (continued)

**Question 6:** Adele lived and worked in a sanctioned country until August of this tax year, when she was transferred to Italy. She paid taxes to each country on the income earned in that country. Can Adele take a foreign tax credit on her U.S. tax return for the taxes paid on income she earned in the sanctioned country?  Yes  No

**Question 7:** Write “Q” next to each tax that qualifies for the foreign tax credit or “NQ” next to those that do not. Assume the taxpayer is a U.S. citizen or resident living in a nonsanctioned foreign country and that the tax is being paid to a foreign government on foreign-sourced income.

- \_\_\_ Dividend taxes
- \_\_\_ Foreign oil related income tax
- \_\_\_ Interest income tax
- \_\_\_ Real estate taxes
- \_\_\_ Income tax on wages from a foreign country
- \_\_\_ Taxes paid on income earned in a sanctioned country

## What categories of income qualify for the credit?

At the top of Form 1116, Part I, taxpayers are asked to indicate the type of foreign income they received. Two of these income categories fall within the scope of the VITA/TCE programs:

- Passive category income
- General category income



A separate Form 1116 must be completed for each type of income; each Form 1116 can include income earned in as many as three foreign countries.



## Passive Category Income

This category includes passive income and specified passive category income. Passive income generally includes the following:

- Dividends
- Interest
- Royalties
- Rents
- Annuities
- Net gain from the sale of property that produces such income, or non-income-producing investment property

For example, a taxpayer who lives in a foreign country and pays taxes on interest income could claim the foreign tax credit and check the Passive category income box on Form 1116.



Wages and salaries are considered to be general category income, which is discussed later in this topic. Passive category income may qualify as general category income if the foreign government taxes it at a rate higher than the highest U.S. tax rate; see “High-Taxed Income” later in this lesson.

For additional information on passive income and specified passive category income, see Publication 514.

## General Category Income

General category income consists of wages earned in a foreign country that an individual does not exclude, or excludes only part of, under the foreign earned income exclusion. Additionally, foreign income that does not come under any of the other categories on Form 1116 can typically be included as general category income.

### example

Robert paid taxes to Spain for earned income and did not claim the foreign earned income exclusion. He can claim a foreign tax credit for the taxes paid to Spain.

## What is high-taxed income?

Some passive category income can be included in general category income if it is taxed by a foreign government at a rate higher than the highest U.S. income tax rate. Therefore, if taxpayers pay more than the highest U.S. income tax rate on the foreign-sourced passive income for which they claimed the credit, the credit is computed under general category income.

### example

Brenda is a U.S. citizen who lives in a foreign country and pays 45% income tax on her interest income in that country. She lists this as “General Category Income” on Form 1116, since the tax rate paid on this passive income is higher than the highest U.S. income tax rate.



## EXERCISES (continued)

**Question 8:** Regina lives in a foreign country and is a U.S. citizen. She has both dividend income and interest income from foreign countries. Her foreign bank withholds 15% of her interest income for income taxes. She also pays foreign income taxes on her dividend income, at a rate of 45%. For the purposes of Form 1116, how should the following types of income be classified?

Interest Income: \_\_\_\_ Dividend Income: \_\_\_\_

- A. Passive category income
- B. General category income

**Question 9:** Bernard is a U.S. citizen who lives in Barbados. This year, he paid 17% income tax on interest income from his bank account in Barbados. For the purposes of Form 1116, Bernard's foreign interest income should be classified as:

- A. Passive category income
- B. General category income

## Tax Law Application

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There are several factors to consider when determining if taxes paid to a foreign government are eligible for the foreign tax credit. Ask the taxpayer:

- Was the income foreign-sourced?
- What type of tax was paid to the foreign government?
- Will the taxpayer receive some kind of specific economic benefit from the payment of this tax?

## How do I complete Form 1116?

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If the taxpayer does not qualify for the election to report foreign tax directly on Form 1040, page 2, Form 1116 must be completed. The amount of the foreign tax credit is the portion of U.S. income tax liability based on gross taxable foreign income. Certain expenses can be deducted to reduce foreign gross income. Some of these situations are complicated and beyond the scope of the VITA/TCE programs, such as:

- Expenses directly related to the foreign income, such as employee business expenses
- Investment interest expense
- Foreign losses, such as those from selling foreign assets or a loss from a business or partnership

If the taxpayers have any of these types of deductions, refer them to a professional tax preparer.

For step-by-step instructions on completing Form 1116, go to the Volunteer Resource Guide, Nonrefundable Credits tab.

## Summary

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Taxpayers who paid taxes to a foreign country or U.S. possession may be able to take a nonrefundable foreign tax credit. Generally, to claim the credit, taxpayers are required to file Form 1116, Foreign Tax Credit.

Taxpayers do not have to file Form 1116 if they meet certain requirements and can elect to claim the foreign tax credit directly on Form 1040, page 2. This election is in scope for the Advanced certification. VITA/TCE volunteers must have International certification to help taxpayers who are required to file Form 1116.

To qualify for the foreign tax credit, the taxpayer, income, and taxes must all meet specific requirements. The credit is computed and reported on Form 1116. A separate Form 1116 must be completed for each category of income.

The foreign tax credit is different from the foreign earned income exclusion. If the taxpayer uses the foreign earned income exclusion, foreign tax paid on the excluded income cannot be used to claim the foreign tax credit. Taxpayers can choose the approach that results in the lowest tax.

### What situations are out of scope for the VITA/TCE programs?

The following are out of scope for this lesson. While this list may not be all inclusive, it is provided for your awareness only.

- Taxpayers who must complete Form 1116 because they cannot elect to report foreign tax on Form 1040, unless your site has a volunteer with an International certification
- Taxpayers who may deduct a foreign income tax that is not allowed as a credit in certain circumstances
- Certain expenses deducted to reduce foreign gross income
- Taxpayers who must report a carryback or carryover on Form 1116
- Taxpayers who must file a separate Form 1116 required for foreign income from a sanctioned country, using the "Section 901(j) income" category



### TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem or practice exercise(s) for your course of study in Publication 4491-W.

For practice using the tax preparation software, complete the scenarios using the Practice Lab on L&LT.



## EXERCISE ANSWERS

**Answer 1:** True. Form 1116 is not required if the total foreign taxes paid are less than or equal to \$300 (\$600 if Married Filing Jointly).

**Answer 2:** No. Clyde needs to complete Form 1116 because his foreign taxes exceed \$300. Clyde will need to be referred to a volunteer with an International certification or seek the assistance of a professional tax preparer.

**Answer 3:** Yes. Judy and Mark do not have to complete Form 1116 because they file jointly and their foreign taxes are less than \$600.

**Answer 4:** C. On Anne's tax return, she can claim a foreign tax credit to offset taxes she paid to Japan on interest received from the Japanese bank.

**Answer 5:** No. An inheritance does not qualify as income from a foreign country. Under U.S. tax law, inheritances are not taxable to the beneficiaries. Jean is not eligible to claim a foreign tax credit for the inheritance taxes she pays to the Spanish government.

**Answer 6:** No. Adele cannot take a foreign tax credit for the taxes paid on income she earned in the sanctioned country. However, this income is taxable in the U.S., since she is a U.S. citizen.

**Answer 7:**

Q – Dividend taxes

NQ – Foreign oil-related income tax

Q – Interest income tax

NQ – Real estate taxes

Q – Income tax on wages from a foreign country

NQ – Taxes paid on income earned in a sanctioned country

**Answer 8:** Interest Income – A; Dividend Income – B (High-taxed income is considered general category income.)

**Answer 9:** A. Since 17% (the tax rate Bernard paid) is not more than the highest U.S. income tax rate, Bernard's income falls under "Passive Category Income."



# Child Tax Credit



## Introduction

The child tax credit is unique because if a taxpayer cannot benefit from the nonrefundable credit, the taxpayer may be able to qualify for the refundable additional child tax credit on Schedule 8812. In this chapter, we will learn about both credits and their relationship to each other. Some taxpayers may not be aware of these credits. Your time, effort, and understanding of this credit may result in a lower tax for the taxpayer.

The child tax credit is entered in the Nonrefundable Credits section of the tax return; the additional child tax credit is entered in the Payments section. Form 1040EZ filers cannot take the credit.

The intake and interview sheet, along with the interview tips in the Volunteer Resource Guide, Nonrefundable Credits tab are critical tools needed to determine eligibility for the credit.



Don't confuse these credits with the child and dependent care credit!

## Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Determine the taxpayer's eligibility for the credit(s)
- Determine which taxpayer can claim the additional credits

### What do I need?

- Form 13614-C
- Publication 4012
- Publication 17
- Publication 972
- Publication 4491-W
- Schedule 8812

#### Optional:

- Form 1040 Instructions

## What is the child tax credit?

The child tax credit is a nonrefundable credit that allows taxpayers to claim a tax credit of up to \$1,000 per qualifying child, which reduces their tax liability.

## What is the additional child tax credit?

Taxpayers who are not able to claim the full amount of the child tax credit may be able to take the refundable additional child tax credit. Completing Schedule 8812, Child Tax Credit, may result in a refund even if the taxpayer doesn't owe any tax.

## Who can claim the child tax credit?

To be eligible to claim the child tax credit, the taxpayer must have at least one qualifying child. If taxpayers claim the child tax credit or additional child tax credit but are not eligible for the credit, they can be banned from claiming the credit for either two or ten years. Refer to the Volunteer Resource Guide, Nonrefundable Credits tab for additional information.

### example

Ed's son, Jeff, turned 17 on December 30, and has a valid SSN. He is a citizen of the United States. According to the child tax credit rules, he is not a qualifying child for the child tax credit because he was not under the age of 17 at the end of the tax year.

## Does the child have to be the taxpayer's dependent?

To be a qualifying child for the child tax credit, the child must be claimed as the taxpayer's dependent.

## Are there special rules for children of divorced or separated parents or parents who live apart?

There are special rules for children of divorced or separated parents, as well as for children of parents who live apart. The custodial parent is the parent with whom the child lived for the greater number of nights during the year. The other parent is the noncustodial parent. In most cases the custodial parent may claim the dependency exemption for the qualifying child. The noncustodial parent, however, may be entitled to claim the dependency exemption for a child and thus the child tax credit and additional child tax credit. Review the Child Tax Credit Interview Tips in the Volunteer Resource Guide, Nonrefundable Credits tab for additional information.



Taxpayers with divorce decrees or divorce agreements executed after 2008 must use Form 8332 or similar statement whose only purpose is to release the custodial parent's claim to the exemption; they cannot simply substitute pages from the divorce decree.

Remember, a custodial parent's release of the dependency exemption will also release the child tax credit and the additional child tax credit, if either applies, to the noncustodial parent. Noncustodial parents must attach Form 8332 or a similar statement to their return each year the exemption is claimed.

### example

Mary and Ralph got a divorce in 2007. They have one child together, Amy, who lives with Mary. All are U.S. citizens and have SSNs. Mary and Ralph provide more than half of Amy's support. Mary's AGI is \$31,000, and Ralph's AGI is \$39,000. Amy is 12. The divorce decree does not state who can claim the child.

Ralph, the noncustodial parent, can claim the dependency exemption and child tax credit only if Mary signs Form 8332. Mary can still claim the earned income credit, Head of Household, and child and dependent care credit for Amy assuming she qualifies for them.

## What is the amount of the credit?

The maximum amount taxpayers can claim for the child tax credit is \$1,000 for each qualifying child. The amount actually claimed on Form 1040 depends on the taxpayer's tax liability, modified adjusted gross income (MAGI), and filing status. The amount of the credit may be reduced if the taxpayer's:

- Tax liability less the majority of the nonrefundable credits is less than the maximum child tax credit, or
- MAGI is above the limit for the taxpayer's filing status; review Publication 17, Child Tax Credit chapter for the limits on the credit or the Volunteer Resource Guide, Nonrefundable Credits tab.

Review the Child Tax Credit Interview Tips, steps 6 and 7, in the Volunteer Resource Guide, Nonrefundable Credits tab to determine which worksheet must be used to figure the credit. If the taxpayer answers yes to steps 6 and 7, then the worksheet in Publication 972 must be used to figure the credit.

example

Stan files as Head of Household and has three children who qualify for purposes of the child tax credit. Stan's MAGI is \$54,000 and his tax liability is \$4,680. Stan is eligible to take the full \$1,000 per child (\$3,000) because his MAGI is less than the ceiling limit and his tax liability is greater than \$3,000.

example

May and Bob file as Married Filing Jointly and have two children who qualify for the child tax credit. Their MAGI is \$86,000 and their tax liability is \$954. Even though their AGI is less than the threshold limit, they can only claim \$954, reducing their tax to zero. As they could not claim the maximum child tax credit, May and Bob may also be eligible for the additional child tax credit.

## What is MAGI?

Typically, the taxpayers' MAGI (Modified Adjusted Gross Income) is the same as their AGI from Form 1040, page 2. For more information on MAGI as it applies to the child tax credit, refer to Publication 17.



If the taxpayers' tax liability is zero, they cannot take the credit because there is no tax to reduce. However, the taxpayers may be able to take the additional child tax credit, discussed later in this lesson.



## EXERCISES

Use the Child Tax Credit interview tips from the Volunteer Resource Guide, Nonrefundable Credits tab and Publication 17 to complete the exercises. Answers are at the end of the lesson summary.

**Question 1:** Paul and Marie are married with two dependent children. They will file a joint Form 1040 for the year. The children are qualifying children for purposes of the child tax credit. Paul and Marie's MAGI is above the threshold limit, and their tax liability is \$6,200. Based on this information, Paul and Marie:

- A. Are not eligible for the maximum credit and can use the Child Tax Credit Worksheet in the Form 1040 Instructions to figure their child tax credit
- B. Will have to use Publication 972 to figure their child tax credit
- C. Are eligible to claim a full child tax credit
- D. Are not eligible to claim any amount for the child tax credit

**Question 2:** Laura's adopted son Jack is 12. He is a citizen of the United States and lived with Laura for the entire tax year, during which time Laura provided full financial support. Is Jack a qualifying child for the child tax credit?  Yes  No

**Question 3:** Which one of the following individuals (all of whom have two qualifying children for the purposes of the child tax credit) are eligible to claim the maximum \$1,000 per child for the child tax credit on their tax return?

- A. Fiona, who is Married Filing Separately with a MAGI of \$78,000
- B. Ken, a Qualifying Widower with a MAGI of \$30,000 and tax liability of \$490
- C. Nick, who is Single with a MAGI of \$70,000 and a tax liability of \$5,000
- D. Julie, who is Married Filing Jointly with a MAGI of \$122,000

## How do I determine taxpayer eligibility for the credit?

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To determine whether a child meets the criteria of qualifying child for the child tax credit or additional child tax credit, use the interview techniques and tools discussed in earlier lessons. Begin by reviewing the Marital Status and Household Information section of the taxpayer's intake and interview sheet. Verify that the child:

- Is under 17 on December 31 of the tax year
- Lived with the taxpayer for more than six months of the year (remember the special rules for divorced or separated parents or parents who live apart)
- Did not provide over half of his or her own support
- Meets the relationship criteria
- Is a U.S. citizen, U.S. national, or resident of the United States

If the Marital Status and Household Information section is incomplete or the taxpayer is unsure of how to respond, you may want to use the Child Tax Credit Interview Tips in the Volunteer Resource Guide, Nonrefundable Credits tab. It provides helpful probing questions to ask the taxpayer.



**Tax Software Hint:** The entries for each qualifying child in the Basic Information section will help the software determine if the child is eligible for the child tax credit.

## How do I calculate the child tax credit?

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To calculate the credit, you must first determine which worksheet to use. Review the Child Tax Credit interview tips in the Volunteer Resource Guide, Nonrefundable Credits tab to determine which worksheet the taxpayer must use.



**CAUTION** Taxpayers claiming the child tax credit must have a valid identification number (SSN or ITIN) by the due date of the tax return, including extensions. In addition, the dependent claimed must have a valid identification number (SSN, ATIN, or ITIN) by the due date of the return. Taxpayers cannot subsequently file amended returns to claim the credit for a year that they did not originally have a valid identification number by the return due date.



**Tax Software Hint:** If you are using tax software, the system will automatically calculate the credit, provided you have correctly completed the:

- Taxpayer's return through the retirement savings contribution credit line
- Part I of Form 5695, and Schedule R

If you have a question about the amount that appears as the child tax credit, the taxpayer's completed Child Tax Credit Worksheet may help you understand the determination.



## What is the additional child tax credit?

This credit is for certain individuals who get less than the full amount of the child tax credit. The additional child tax credit may give taxpayers a refund even if they do not owe any tax.

### What is the amount of the credit?

Like the child tax credit, the additional child tax credit allows eligible taxpayers to claim up to \$1,000 for each qualifying child after subtracting the allowable amount of child tax credit. For taxpayers with earned income over \$3,000, the credit is based on the lesser of:

- 15% of the taxpayer's taxable earned income that is over \$3,000 or
- The amount of unused child tax credit (caused when tax liability is less than allowed credit)



The refund or credit for taxpayers claiming the additional credit will not be issued prior to February 15.

### Who can take the additional child tax credit?

Taxpayers who do not get the full \$1,000 of the child tax credit may qualify for the additional child tax credit. Review the Additional Child Tax Credit Tip in the Volunteer Resource Guide, Nonrefundable Credits tab to see the requirements to claim the credit.

#### example

Remember May and Bob who have two qualifying children, a MAGI of \$86,000, and a tax liability of \$954? Because their tax liability is less than the full amount of the credit (in their case \$2,000), they may be able to take the additional child tax credit of up to \$1,046 (\$2,000 – \$954).

There is another method to compute the additional child tax credit for taxpayers with three or more qualifying children. These taxpayers may benefit if they:

- Had Social Security or Medicare taxes withheld from their pay
- Were self-employed and paid self-employment tax
- Paid tax on tips not reported to their employer
- Did not receive the maximum available child tax credit

The amount of the taxpayer's earned income credit is a factor in this calculation on Schedule 8812.



The child tax credit is not refundable for taxpayers electing to exclude foreign earned income from tax.

### How do I calculate the additional child tax credit?

Schedule 8812, Child Tax Credit, is used to calculate the credit, which is entered on the additional child tax credit line of the Payment section of Form 1040.



Taxpayers must use Part I to document each child for whom an IRS Individual Taxpayer Identification Number (ITIN) was entered on the return.



**Tax Software Hint:** If you are using the tax software, the system will automatically calculate the credit and place that entry on the appropriate line of the payment section.



## EXERCISES (continued)

**Question 4:** Jose and Yolanda Alameda are Married Filing Jointly and have five dependent children under the age of 17. Jose and Yolanda both have valid SSNs. Their children have Individual Taxpayer Identification Numbers (ITINs). The children are qualifying children for purposes of the child tax credit but not the earned income credit. Jose and Yolanda's earned income is \$8,850, and their tax liability is \$0. Are they eligible to take the additional child tax credit?  Yes  No

### How do I avoid common errors?

When considering the child tax credit, it is critical to interview the taxpayer thoroughly to correctly identify eligible children.

### Summary

The child tax credit is a nonrefundable credit that allows qualifying taxpayers to reduce their tax liability to the lesser of the amount of the credit or their adjusted tax liability.

If a taxpayer is not able to benefit from the maximum \$1,000 per qualifying child, the taxpayer may be eligible for the additional child tax credit, which is a refundable tax credit.

Taxpayers claiming the child tax credit must have a valid identification number (SSN or ITIN) by the due date of the return, including extensions.

If taxpayers claim the child tax credit or additional child tax credit but are not eligible for the credit, they can be banned from claiming the credit for either two or ten years.



## TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem or practice exercise(s) for your course of study in Publication 4491-W.

For practice using the tax preparation software, complete the scenarios using the Practice Lab on L&LT.



## EXERCISE ANSWERS

**Answer 1:** A. Paul and Marie's MAGI is over the threshold limit for their filing status. They are not eligible to claim a full child tax credit. They can use the Child Tax Credit Worksheet in the Form 1040 Instructions to calculate the credit.

**Answer 2:** Yes. Jack is a qualifying child for the child tax credit because he was under the age of 17 at the end of the current tax year; he meets the relationship requirement, lived with Laura for at least six months of the year; and he did not provide more than half of his support.

**Answer 3:** C. Nick may be able to take the full \$1,000 credit for each of his qualifying children because his MAGI is not affected by the threshold limit for his single filing status. In addition, his tax liability of \$5,000 is more than the amount of \$1,000 per child for the credit.

**Answer 4:** Yes. Jose and Yolanda qualified for the initial child tax credit. However, they could not benefit from it because their tax liability (0) was less than their allowable child tax credit (\$5,000). Since their earned income is more than \$3,000, they are eligible for the additional child tax credit.



## Miscellaneous Credits



### Introduction

This lesson provides the information you need to be able to prepare a return with certain nonrefundable credits. The Basic Course includes retirement savings contribution credit and credit for the elderly or the disabled. The other miscellaneous credits covered in this lesson are part of the Advanced Course.

These credits are reported in the Tax and Credits section of Form 1040.

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Determine if a taxpayer qualifies for the retirement savings contributions credit and accurately complete Form 8880, Credit for Qualified Retirement Savings Contributions
- Calculate the credit for the elderly or the disabled by completing Form 1040, Schedule R, Credit for the Elderly or the Disabled

Use the information from the intake and interview sheet, along with the documents provided by the taxpayer to determine eligibility for these credits.

#### What do I need?

- Form 13614-C
- Publication 4012
- Publication 17
- Publication 4491-W
- Form 1040
- Schedule R
- Form 8880

#### Optional:

- Form 1040 Instructions
- Form W-2 Instructions

### What is a nonrefundable credit?

In an earlier lesson, you learned the difference between a nonrefundable credit and a refundable credit. A nonrefundable credit can only reduce the tax liability to zero. All the credits discussed in this lesson are nonrefundable credits.

Generally, nonrefundable credits are applied against federal tax in the order they are listed on Form 1040, page 2, in the Tax and Credits section.



**Tax Software Hint:** The software will calculate these credits, but the correct information must be entered. The volunteer tax preparer must make the correct determinations by using the intake and interview sheet and resource materials.



For information about the residential energy credits, see the Legislative Extenders lesson.

### What is the retirement savings contributions credit?

The retirement savings contributions credit is a nonrefundable credit eligible taxpayers may claim if they made a qualifying contribution to a retirement plan.

If the contribution is tax deductible (such as a traditional IRA), the taxpayer receives the benefit of the tax deduction and a tax credit. This is considered a *double benefit* and is rarely allowed. Contributions to non-tax-deductible accounts (such as Roth IRAs) can qualify the taxpayer for the credit as well. The credit is calculated on Form 8880, Credit for Qualified Retirement Savings Contributions, and reported in the Tax and Credits section of Form 1040.

## Who is eligible for the retirement savings contributions credit?

Go to the Volunteer Resource Guide, Nonrefundable Credits tab, and review the Retirement Savings Contribution Credit – Decision Tree for the qualifications.

## What are eligible contributions for the purpose of the retirement savings contributions credit?

To be eligible for the credit, taxpayers' contributions are elective or voluntary. For purposes of this credit, an employee contribution will be voluntary as long as it is not required as a condition of employment. Eligible contributions include:

- Traditional or Roth IRA contributions (other than rollover contributions)
- Elective deferrals to a 401(k) or 403(b) plan (including designated Roth contributions), a governmental 457 plan, SEP, or SIMPLE plan
- Voluntary employee contributions to a qualified retirement plan as defined in section 4974(c) (including the federal Thrift Savings Plan), or
- Contributions to a 501(c)(18)(D) plan

## Important myRA Program Update

Following a review, the U.S. Department of the Treasury has decided to phase out the myRA® program and the program is no longer accepting new enrollments. Savings in existing accounts remain safely in the investment issued by Treasury.



**CAUTION** Contributions designated under Internal Revenue Code Section 414(h)(2) (government pick-up plans) are treated as employer contributions, not voluntary contributions made by the employee. They do not qualify for the credit and should not be included on Form 8880, line 2. This information is stated in the Form 8880 Instructions.

## How do I know if the taxpayer made an eligible contribution?

In most cases, eligible contributions will be listed on the taxpayer's Form W-2, box 12 and preceded by one of the following codes: D, E, F, G, H, S, AA, or BB. These are the codes most frequently seen. For a complete list of box 12 codes, refer to the Form W-2 Instructions.

Contributions to traditional or Roth IRAs may not appear on any tax document. When reviewing the Expenses section on page 2 of the intake and interview sheet, be sure to ask if the taxpayer made a contribution to an IRA or other retirement account.



**Tax Software Hint:** If Form W-2 is entered into the software correctly and completely, the program will carry the appropriate information to Form 8880. Review the Volunteer Resource Guide, Income tab, Form W-2 Instructions, for the software entries.



**TIP** Some employers allow employees to contribute after-tax money to a Roth plan. These after-tax contributions are listed on Form W-2, box 12 with code AA for a Roth 401(k) or BB for a Roth 403(b).



**Tax Software Hint:** If the taxpayer contributed to a Roth or a traditional IRA, whether it is deductible or not, enter the amounts on the Retirement Savings Contributions Credits screen. The software will carry the appropriate contributions to Form 8880. Review the Volunteer Resource Guide, Nonrefundable Credits tab, for the software entries.

### **What may reduce an eligible contribution for purposes of the credit?**

Eligible contributions are reduced by the following distributions received during the testing period:

- Traditional or Roth IRAs (including myRAs)
- 401(k), 403(b), governmental 457, 501(c)(18)(D), SEP, or SIMPLE plans
- Qualified retirement plans as defined in section 4974(c) (including the federal Thrift Savings Plan)

The testing period includes:

- The tax year
- The two preceding tax years, and
- The period between the end of the tax year and the due date of the return, including extensions

Question the taxpayer to determine if they received any distributions in the testing period. Do not reduce eligible contributions by distributions received from military retirement plans. Also, do not include distributions that were not taxable because they were rolled over or transferred to another qualified plan. See Publication 4012, Nonrefundable Credits tab, for additional exceptions that do not need to be included in total distributions.



**Tax Software Hint:** The software automatically reduces contributions by any taxable distributions from current tax year Forms 1099-R. Any other distributions that reduce the amount of contributions must be manually input on the appropriate line of the Retirement Savings Contributions Credits screen.

### **What is the maximum contribution amount for married taxpayers?**

For married taxpayers filing a joint return, both spouses may be eligible for a credit on a maximum annual contribution of \$2,000 each. If either spouse has received a distribution during the testing period, *both* spouses must reduce their eligible contribution by that amount.

#### **example**

Jose and Lucy are married and will file a joint return. Their adjusted gross income was below the retirement savings contributions limit. They each contributed \$3,000 to a 401(k) plan. They did not receive any distributions during the three-year period and cannot claim any other credits. Jose and Lucy are eligible for a credit based on the maximum eligible annual contribution amount of \$2,000 each.

#### **example**

Joe and Mary have been married for five years and always file a joint return. In the previous tax year, Mary changed jobs and cashed in a small 401(k) from her former employer.

In the current tax year, both Joe and Mary made eligible contributions to their IRAs and otherwise qualify for the retirement savings credit. They both must reduce the amount of their eligible contributions by the amount of the distribution that Mary received last year. This calculation is completed on Form 8880.

### **How do I determine the amount of the credit?**

Form 8880 is used to figure the credit. The credit can be as low as 10% or as high as 50% of a maximum annual contribution of \$2,000 per person depending on filing status and adjusted gross income.



**Tax Software Hint:** Review the Volunteer Resource Guide, Nonrefundable Credits tab, Retirement Savings Contributions Credit, for the software entries.



## EXERCISES

**Question 1:** All of these taxpayers contributed to their employers' 401(k) plan. Who qualifies for the retirement savings credit based on adjusted gross income?

- A. Ed, who is single and has an AGI of \$49,000
- B. Sybil, who is married, files jointly, and has an AGI of \$52,500
- C. Megan, who is head of household and has an AGI of \$65,400
- D. Carl, who is a qualifying widower with a dependent child, and has a modified AGI of \$59,250

## Taxpayer Interview and Tax Law Application

Our volunteer is working with Ryan. She has already determined that Ryan's filing status is Single, no one can claim him as a dependent, his AGI is \$25,000, and he is 28 years old. Using the Volunteer Resource Guide, Retirement Savings Contributions Credit – Decision Tree, follow along with our volunteer as she determines Ryan's eligibility for the credit.

### SAMPLE INTERVIEW

VOLUNTEER SAYS...

*Ryan, I see from your Form W-2 that you contributed \$1,500 to your employer's 401(k) plan. Did you make contributions to any other qualified plans, such as an IRA?*

*That's a great benefit. Were you a full-time student during the tax year?*

*Well, it looks like you qualify for the credit. I will complete Form 8880 to see how much the credit will be.*

*Did you receive any distributions from your retirement plan at any time this tax year or the last two years, or do you plan to take any distributions before the tax filing deadline?*

*No, your loan isn't considered a distribution, so you'll get to use the full \$1,500 contribution in the calculation of your credit. The credit will be a percentage of your contribution. It will reduce your amount of total tax, so you'll end up with a bigger refund.*

RYAN RESPONDS...

No, I put all my savings into the 401(k) because my employer matches it.

No, I've been out of school for several years.

Great!

Well, last year I took out a loan against my 401(k) to use as a down payment on a car. I've already paid it back through payroll deductions. Does that count?

I'll take every penny!

## How do I handle the credit for the elderly or the disabled?

The credit for the elderly or the disabled is calculated on Schedule R and reported in the Tax and Credits section of Form 1040.

## Who qualifies for the credit for the elderly or the disabled?

Individuals who qualify for the elderly or the disabled credit are:

- Age 65 or older or
- Under age 65, retired on permanent and total disability, receiving taxable disability income, and under the mandatory retirement age their company has set



A taxpayer with a permanent and total disability is unable to engage in “substantial, gainful activity,” or in other words, paid employment. Taxpayers who can do such work are not considered disabled. Working in a sheltered work-shop setting, however, is not considered substantial, gainful activity.

*Mandatory retirement age* is the age set by a taxpayer’s employer at which the taxpayer would have been required to retire, had the taxpayer not become disabled.

Generally, disability income comes from an employer’s disability insurance, health plan, or pension plan. The payments replace wages for the time the taxpayer missed work because of the disability. The plan must provide for disability retirement for the payments to be considered disability income.

In addition to being a qualified individual, the taxpayer’s total income must be within certain limits. The income limits can be found in the Volunteer Resource Guide, Nonrefundable Credits tab, Credit for the Elderly or the Disabled, Figure B, Income Limits.

Few taxpayers qualify for this credit because the credit calculation includes the taxpayers’ nontaxable Social Security, veterans’ benefits, or other excludable pension, annuity, or disability benefits. Most taxpayers’ Social Security benefits alone exceed the limit.

#### example

John is unmarried and filing a single return. He is 67 years old and received \$12,000 in nontaxable Social Security benefits in the tax year. His AGI is \$9,000. Even though John is a qualified individual, he is not eligible to claim the credit since his nontaxable Social Security benefits exceed \$5,000.

### How do I determine the amount of the credit?

Schedule R is used to calculate the credit, and has three parts:

- Part I, Filing Status and Age
- Part II, Statement of Permanent and Total Disability which ensures that taxpayers who are under 65 have obtained a completed physician’s statement that proves they are permanently and totally disabled
- Part III, Figure Your Credit

If the taxpayer is 65 or over, or under 65 and retired on permanent and total disability, complete Schedule R to determine the amount of the credit, if any.



All Social Security and railroad retirement benefits must be entered on the Social Security benefits screen, even if no Social Security is taxable, so the tax software can correctly calculate this credit.



**Tax Software Hint:** Go to the Volunteer Resource Guide, Nonrefundable Credits tab, for details about qualifying income limits for this credit. If a taxpayer appears to qualify, follow the directions in the Volunteer Resource Guide to complete a Schedule R. The taxpayer will not get the benefit of the credit unless the Schedule R is completed.



## EXERCISES (continued)

**Question 2:** Taxpayers may be able to take the credit for the elderly or disabled if they are:

- Under age 65 at the end of the tax year
- Retired on permanent and total disability
- Under the mandatory retirement age on January 1, of the tax year, and
- Receiving taxable disability income

True  False

## Taxpayer Interview and Tax Law Application

### Determining Albert's Eligibility

Albert arrives at the tax center with his Form 1040 nearly complete, but he wants to know if he can claim the credit for the elderly or the disabled. Follow along in the conversation.

#### SAMPLE INTERVIEW

VOLUNTEER SAYS...

ALBERT RESPONDS...

*Are you either a U.S. citizen or a resident alien?*

Yes, I'm a U.S. citizen.

*Are you over 65?*

No, I'm only 54, not even old enough for retirement. But I had to stop working last year because of my disability.

*Are you retired on permanent and total disability?*

Yes. In fact, I started receiving disability retirement benefits last August.

*Sounds like you may qualify. What is your adjusted gross income?*

\$15,430.

*How much did you receive in Social Security?*

I got \$4,430 in Social Security benefits.

*Did you receive any other pension benefits that might not be taxable?*

No, I just get my Social Security and disability checks from the place I retired.

*And your filing status is Single, so it looks like you might be able to claim the credit. If you would like for me to do your return, I will go back through it step-by-step to make sure.*

### What is the mortgage interest credit?

This topic is out of scope for the VITA/TCE programs and is included for informational purposes only. Taxpayers who hold mortgage credit certificates (MCCs) under a qualified state or local government program may claim a nonrefundable credit for mortgage interest paid. The taxpayer must have a document titled, "Mortgage Credit Certificate (MCC)." The amount of the credit is listed on the certificate. Refer taxpayers who choose to claim this credit to a professional tax preparer.

### How are the total nonrefundable credits reported?

The total of all nonrefundable credits is reported on the applicable line in the Tax and Credits section of Form 1040.





**Tax Software Hint:** Based on your entries for all the credits, the software calculates the total of the taxpayer's credits and enters the amount on the Total Credits line. Remember, the nonrefundable credits cannot exceed the taxpayer's federal income tax.

## Summary

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### Retirement Savings Contributions Credit

Taxpayers who contributed to certain retirement plans or IRAs may be eligible for a nonrefundable qualified retirement savings contributions credit.

Be sure to ask the taxpayer if IRA contributions were made. Carefully review the taxpayer's Form(s) W-2 for pretax retirement plan contributions and accurately input the amounts into the tax software. The software calculates the retirement savings credit based on the information entered.

The amount of the credit is determined by the taxpayer's filing status, adjusted gross income, and the taxpayer's qualified retirement contributions.

Form 8880 is used to calculate the credit.



**CAUTION** Taxpayers' IRA contributions are often overlooked. Ask taxpayers if they made traditional or Roth IRA contributions that may qualify for the retirement savings contributions credit.

### Credit for the Elderly or the Disabled

Taxpayers age 65 or older, or under age 65 who retired on permanent and total disability, may be able to claim a special nonrefundable credit if they are U.S. citizens or resident aliens. Few qualify for this credit because most taxpayers' Social Security benefits exceed the income limits.

The Volunteer Resource Guide provides a flowchart for determining basic eligibility and a quick reference table of income and Social Security limits. Schedule R, Credit for the Elderly or the Disabled, is used to calculate the credit.

### What situations are out of scope for the VITA/TCE programs?

The following is out of scope for this lesson. While this list may not be all inclusive, it is provided for your awareness only.

- Mortgage interest credit



#### TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem or practice exercise(s) for your course of study in Publication 4491-W.

For practice using the tax preparation software, complete the scenarios using the Practice Lab on L&LT.





## Other Taxes



### Introduction

This lesson covers the Other Taxes section of the return. You will determine if taxpayers owe additional taxes, and determine their total tax.

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Identify the different types of other taxes on a return
- Determine if a taxpayer is liable for other taxes that are within scope of the volunteer program
- Determine how to report these additional taxes on the tax return and complete the applicable forms or schedules

### What are other taxes?

“Other taxes” are different from the income tax from the tax tables or figured using the Tax Computation Worksheet. They include:

- Self-employment tax
- Social Security and Medicare taxes on tip income
- Additional taxes on IRAs and other qualified retirement plans
- Repayment of first-time homebuyer credit

These amounts are usually calculated on their own form or schedule. The taxes are added after the nonrefundable credits are calculated; the nonrefundable credits do not reduce the other taxes.

Household employment taxes are also included in the Other Taxes section. However, this topic is beyond the scope of the VITA/TCE programs. Taxpayers who must file household employment taxes should be referred to a professional tax preparer.

Two additional taxes may apply to taxpayers with higher income. These are the additional Medicare tax on wages (Form 8959) and the net investment income tax (Form 8960). Taxpayers with income levels large enough to incur these taxes should be referred to a paid professional preparer.



**CAUTION** Social Security and Medicare taxes on tip income is covered under the Advanced course. Self-employment tax, additional tax on IRAs and other qualified retirement plans, and repayment of first-time homebuyer credit are Advanced-level topics. If an issue related to an Advanced-level topic arises at a volunteer site, be sure that a volunteer with required certification provides assistance.



**TIP** Refer to the Affordable Care Act (ACA) lesson contained in this publication for information on the advance premium tax credit, the premium tax credit, and the shared responsibility payment.



**Tax Software Hint:** The software makes most of the calculations and displays the resulting tax on Form 1040.

#### What do I need?

- Form 13614-C
- Publication 4012
- Publication 17
- Publication 4491-W

#### Optional:

- Publication 1244
- Form 1040 Instructions
- Form 4137
- Form 5329 and Instructions
- Form 5405 and Instructions
- Form W-2
- Schedule SE



## What is self-employment tax?

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Self-employment (SE) tax is Social Security and Medicare taxes collected primarily from individuals who work for themselves, similar to the Social Security and Medicare taxes withheld from the pay of most wage earners. Payments of SE tax contribute to the taxpayer's coverage under the Social Security system. Social Security coverage provides the taxpayer with retirement, disability, survivor, and hospital insurance (Medicare) benefits.

### Who must pay self-employment tax?

SE tax must be paid if either of the following applies:

- The taxpayer had income as a church employee of \$108.28 or more.
- The taxpayer receives net earnings from self-employment income in the amount of \$400 or more (excluding church employee income).



The VITA/TCE programs' scope includes Schedule C, with limits. The Schedule C criteria is the same as Schedule C-EZ, although expenses up to \$25,000 are allowed.

Generally, taxpayers who are independent contractors and receive Form 1099-MISC must file Schedule C/C-EZ and Schedule SE. Since taxes are not withheld from independent contractors' pay, it is the taxpayer's responsibility to pay income and SE tax.



Self-employed taxpayers who receive tips should include the tips in gross receipts on Schedule C/C-EZ.

Schedule SE contains two ways to compute the tax: the long version and the short version. The instructions on the form guide you in deciding which version the taxpayer needs. The short version is used more often in the VITA/TCE programs, but you should understand both versions.

### How do I figure and report this tax?

As a volunteer, you may be qualified to assist self-employed taxpayers who need to complete Schedule C (with limits) or Schedule C-EZ, Net Profit from Business (covered in an earlier lesson). When assisting a taxpayer with self-employment income, first complete Schedule C or C-EZ. Schedule SE is used to calculate the self-employment tax. The deductible part of the self-employment tax is reflected as an adjustment to income on Form 1040, page 1. This amount is from line 6 of Schedule SE, the deduction for employer-equivalent portion of self-employment tax. The adjustment to income is similar to the benefit that employees receive because their employers pay a portion of the Social Security and Medicare taxes.



**Tax Software Hint:** The software automatically transfers the appropriate information from Schedule C or C-EZ to Schedule SE and calculates the self-employment tax and the adjustment of the deductible part of the self-employment tax.

### What about taxes on unreported tip income?

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All tip income is subject to federal income tax. However, tips of less than \$20 per month that are not reported to the employer are not subject to Social Security and Medicare taxes.

Individuals who receive \$20 or more per month in tips from any one job must report their tip income to their employer. The employer reports these tips as part of the wages on Form W-2, box 1. The employer withholds Social Security and Medicare taxes and federal income tax on that income.

### What about allocated tips?

An employer may “allocate” tips to an employee if the employee worked in a restaurant, cocktail lounge, or similar business and reported tips that were less than the employee’s share of 8% of food and drink sales. If the employer allocates tips to employees, the amount is reported on Form W-2, box 8, and included in income on Form 1040. Social Security and Medicare taxes are not withheld on allocated tips. The employee pays the Social Security and Medicare taxes by completing Form 4137, Social Security and Medicare Tax on Unreported Tip Income.

If the employee can show, using Publication 1244, Employee’s Daily Record of Tips and Report to Employer, or some similar daily tip record, that the actual tips received are different from the allocated amount, then the actual amount is reported on Form 1040. The actual tips received are also reported on Form 4137 to calculate Social Security and Medicare taxes.

### What about tips that the employee did not report to the employer?

If the employee received \$20 or more in unreported cash and charge tips in any month from any job, the employee must report that income on Form 1040 and pay the Social Security and Medicare taxes on that income. But, if the employee received less than \$20 in tips in any month from any job, they are not required to report them to the employer. However, these amounts *do* need to be included on Form 1040. They will not be subject to Social Security or Medicare taxes.



**Tax Software Hint:** See Volunteer Resource Guide, Income tab for instructions on reporting tip income. The software calculates Social Security and Medicare taxes only on the applicable tips. The software will also add unreported tips to Form 1040, line 7.

#### example

Carla waits tables at a café. Her employer reports all tips that customers add to their credit card tabs, but she leaves it up to Carla to keep track of her cash tips. Carla receives more than \$20 per month in cash tips. Carla keeps a record but, because she doesn’t report her cash tips to her employer, they are not included on her Form W-2. Carla includes the unreported tips as income on Form 1040, line 7. Carla also uses Form 4137 to calculate and pay the Social Security and Medicare taxes on those tips.

### How do I figure and report these taxes?



As part of your interview, explain to taxpayers that sometimes people do not realize they owe taxes on tips they do not report to their employer. Also explain the taxes paid on those tips actually boost the taxpayer’s future Social Security benefits.

To figure the tax, determine if during any month the taxpayer received \$20 or more in cash and charge tips that were not reported to the employer. Unreported tips are entered on the W-2 screen.

Report the tax amount on the applicable line on Form 1040.



**Tax Software Hint:** The tax software will compute the correct tax on allocated and unreported tip income. Go to the Volunteer Resource Guide, Income tab, for software entries.



## EXERCISES

Answers follow the lesson summary.

**Question 1:** Nancy had a summer job at a coffee hut. She made \$18 in tips in May, \$755 in June, \$600 in July, and \$45 in August. Until a co-worker told her, she didn't realize she had to report her tips to their employer. She then reported \$1,000 in tips to her boss.

What amount of tips will Nancy have to add to her Form 1040, line 7?

- A. \$1,418
- B. \$1,000
- C. \$418
- D. \$18

**Question 2:** What amount of unreported tips does Nancy have to pay Social Security and Medicare taxes on when she files her tax return?

- A. \$1,418
- B. \$400
- C. \$45
- D. \$18



## What about taxes on IRAs and other qualified retirement plans?

Traditional IRAs and other qualified plans allow individuals to defer paying taxes on contributions and earnings until the funds are distributed.

If the rules for contributions and distributions are not followed, additional penalty taxes may be due. For example, the taxpayer must pay income tax plus an additional tax if any of the following apply:

- A distribution is taken before the individual reaches the age of 59½ and is not rolled over into another qualified plan or IRA and no other exception applies (in scope)
- Minimum distributions are not withdrawn when required (out of scope)
- Excess contributions are not removed by the due date of the return including extensions (out of scope)



If the taxpayer is under the age of 59½, earnings on excess contributions withdrawn *by the due date* of the return are early distributions and subject to the 10% additional tax. Refer to the Adjustments to Income lesson for more information.

The additional tax for each situation is outlined on Form 5329, Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts.

Only Part I of Form 5329 is in scope. This part provides for the exceptions to the additional tax on part or all of the early distributions from IRAs or qualified pension plans. The other parts of Form 5329 are out of scope; refer taxpayers with these issues to a professional tax preparer.



Some exceptions apply only to IRA distributions, some apply only to distributions from a qualified retirement plan, and some exceptions apply to both IRA and retirement plan distributions. Refer to Publication 17 chapters Retirement Plans, Pensions, and Annuities or Individual Retirement Arrangements for the list of exceptions

Refer to the intake and interview sheet, Part III – Income, for the question regarding pension or IRA distributions. If the answer is “yes,” ask for any Form 1099-R that reports these payments to determine if the taxpayer is subject to the additional tax or qualifies for an exception.

If Form 1099-R correctly shows code 1 in box 7 indicating an early distribution, the additional tax applies unless the taxpayer qualifies for an exception. Guidelines permit entering 10% of the taxable amount directly on Form 1040, on the applicable line for additional tax on IRAs or other qualified retirement plans. “No” is entered to the left of this line to indicate Form 5329 is not required. Tax software does this automatically based on entries on Form 1099-R.

### **New early distribution exceptions**

Public Laws 114-26 and 114-113 added federal law enforcement officers, federal customs and border protection officers, federal firefighters, air traffic controllers, nuclear materials couriers, members of the United States Capitol Police or Supreme Court Police, and diplomatic security special agents of the Department of State to the definition of qualified public safety employees under 72(t)(10(B)) eligible for an early distribution exception for distributions made after separation from service in or after the year the employee has reached age 50. These changes are effective for distributions made after December 31, 2015.

Frequently, taxpayers who receive Form 1099-R with code 1 in box 7 *are* subject to the 10% additional tax for early distribution because the money was spent for items that are not on the list of exceptions, for example, no exception applies on household expenses or bills. This situation does not require completion of Form 5329.

#### **example**

John is 39 years old and received Form 1099-R with code 1 in box 7. John has qualified education expenses that he paid during the year, which are on the list of exceptions. He can reduce the amount of the early distribution that is subject to the additional tax by the amount of qualified education expenses. Note that John can also use the qualified education expenses for another education benefit if he meets those requirements. See the Education Credits lesson.



### **How do you complete Form 5329, Part I?**

If an exception to the additional tax on early distributions applies, Form 5329, Part I, must be completed.

- Form 5329, line 1, is the amount of the distribution included in income.
- Line 2 is the amount that qualifies for the exception. The applicable code is also entered. Refer to the Volunteer Resource Guide, Other Taxes and Payments tab, for a screen shot of Form 5329, Part I, and the exceptions. For additional information, see Form 5329 Instructions.
- For line 3 the amount from line 2 is subtracted from line 1. This is the amount subject to the additional tax.
- Line 4 is the additional tax that is carried over to the Other Taxes section of the return.



When the early distribution is from a SEP IRA and it is made within two years from when participation in the plan began, the addition to tax is computed using a rate of 25% instead of 10%. Such a distribution is designated by Code S in box 7 of Form 1099-R.



**Tax Software Hint:** The software doesn't use code numbers. Select from the drop down box on the 3rd line of the software.

#### example

Laura is 41 years old and received an early distribution from her 401(k) account. The volunteer determines that Laura paid for unreimbursed qualified medical expenses, and she meets the requirements for exception code 05. In this case Form 5329, Part I, would be completed. Laura would not have to pay the additional tax on this distribution.

IRA distributions, pensions, and annuities are covered in the Retirement Income lesson. Tax preparers certified at the Basic level may prepare returns having retirement income with taxable amount determined. If the taxable amount has not been determined or if one of the exceptions to the additional tax on early distributions applies, refer the taxpayer to a volunteer with Advanced certification.

## What about repayment of the first-time homebuyer credit?

Certain situations may require the credit to be repaid and reported in the Other Taxes section of Form 1040.



The 2008 homebuyer credit had different rules. The credit functions like a no-interest loan and must be paid back. Taxpayers who received the credit in 2008 continue to repay the credit over a 15-year period that began with the 2010 tax return.

Review the Life Events section of the intake and interview sheet to determine if the taxpayer claimed the 2008 homebuyer credit and must pay back a portion of the credit each year.

References to homes purchased in any years other than 2008 have been eliminated from the Form 5405. Beginning in tax year 2017, the repayments only apply to homes purchased in 2008.

If the taxpayer received the first-time homebuyer credit for a home purchased in 2008, generally they must repay the credit over a 15-year period in 15 equal installments. The repayment period began in 2010. However, if the home ceases to be the taxpayer's main home before the 15-year period is up, the taxpayer must repay all remaining annual installments.

The home ceases to be the main home if the taxpayer sells the home; converts the entire home to business or rental property; the home is destroyed, condemned, or disposed of under threat of condemnation; or the lender forecloses on the mortgage. There are certain exceptions to the repayment rule. See the general instructions for Form 5405, First-Time Homebuyer Credit and Repayment of the Credit, for details.



If the taxpayer dies, they do not have to repay the balance of the credit.

Taxpayers who filed a joint return for 2008 and claimed the first-time homebuyer credit may have special rules apply. If the home is transferred to a spouse (or ex-spouse as part of a divorce), the spouse receiving the home is responsible for repaying the credit, unless an exception applies. Or if one of the spouses dies, their half of the remaining credit is forgiven and does not need to be paid back.



The credit is repaid by including it as additional tax on the return for the year the home ceases to be the taxpayer's main home. If the taxpayer is required to repay the credit, it is calculated on Form 5405 and reported on the applicable line in the Other Taxes section of Form 1040. Certain taxpayers who are repaying an installment of the credit claimed for homes purchased in 2008 are not required to file Form 5405. See Form 5405 Instructions for more information.



## How do I figure total tax?

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The Other Taxes section provides a total of income tax and other taxes that may apply to the taxpayer. Adding the amounts on these lines gives the total tax. This amount reflects the tax on all income, adjustments to income, deductions, nonrefundable tax credits, and other taxes. The next step is entering tax payments and refundable credits. Then calculate the taxes owed or the amount overpaid that will result in a refund.



**Tax Software Hint:** The tax software will calculate the total tax automatically. Go to the Volunteer Resource Guide, Other Taxes and Payments tab, for software entries.

## Summary

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This lesson explained how to complete the Other Taxes section of the return. Other taxes are not calculated using the income tax tables or the Tax Computation Worksheet. They include:

- Self-employment tax
- Social Security and Medicare taxes on unreported tip income
- Additional taxes on IRAs and other qualified retirement plans
- Repayment of first-time homebuyer credit



**Tax Software Hint:** These amounts are calculated on separate forms or schedules. The tax software provides all of the forms and performs most of the calculations.

## What situations are out of scope for the VITA/TCE programs?

The following are out of scope for this lesson. While this list may not be all inclusive, it is provided for your awareness only.

- Household employment taxes
- IRA minimum distributions not withdrawn when required
- Excess contributions to an IRA that are not removed by the due date of the return including extensions
- Parts II through VIII of Form 5329 (only Part I is in scope)
- Distribution from an ABLE account that exceeds the qualified disability expenses
- Individuals subject to the additional Medicare tax on Form 8959
- Individuals subject to the net investment income tax on Form 8960





# Payments



## Introduction

This is one of several lessons that cover the Payments section of the return, which includes payments, additional child tax credit, the refundable education credit, and earned income credit. After finishing these lessons, you will be able to complete the Payments section of the taxpayer's return. This lesson covers income tax withholding, estimated tax payments, certain refundable credits, and other payments made by the taxpayer.

Additional child tax credit and the refundable education credit have already been covered. Earned income credit will be covered in the next lesson.

## Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Identify the following types of payments and credits that are applicable for most low- and moderate-income taxpayers:
  - Federal income tax withheld from Forms W-2, Wage and Tax Statement
  - Federal income tax withheld from Forms 1099
  - Estimated tax payments and amounts applied from the prior year's return
  - Amount paid with a request for an extension to file
  - Excess Social Security and tier 1 RRTA tax withheld
- Report these payments and credits correctly on the taxpayer's return

The information you obtain from the taxpayer's Intake/Interview & Quality Review Sheet will help you determine the payments and credits that should be reported. Refer to the Volunteer Resource Guide, Other Taxes and Payments section, to identify and review the Payments section of the return.

## How do I report federal income tax withheld?

The federal income tax system is a "pay as you go" system. That means tax is paid as income is earned or received during the year and is referred to as withholding credit.

### What do I need?

- Form 13614-C
- Publication 4012
- Publication 17
- Publication 4491-W
- Form W-2
- Form 1040

### **Optional:**

- Publication 505
- Form 1040 Instructions
- Form 1040-ES
- Forms 1099
- Form 4868
- Form 5405

Income tax is generally withheld from the following types of income:

- Salaries and wages
- Tips
- Taxable fringe benefits
- Sick pay
- Pensions and annuities
- 401(k) and IRA distributions
- Gambling winnings
- Unemployment compensation
- Certain federal payments such as Social Security benefits

If taxpayers have income tax withheld during the tax year, they will receive one of the following forms showing the amount withheld:

- Form W-2, Wage and Tax Statement
- Form W-2G, Certain Gambling Winnings
- One of several different types of Forms 1099

The total amount withheld is entered on Form 1040, Payments section, on the line for federal income tax withheld.



The total amount withheld from income is included on the return. If a paper return must be filed, attach all Forms W-2 and any Forms W-2G and Forms 1099 if tax was withheld.

#### example

Freda worked as a clerk and received a Form W-2 that reported federal income tax withholding of \$1,000. She also received Form 1099-INT from her bank, which reflected federal income tax withholding of \$50. The correct total withholding reported on her return would be \$1,050 (\$1,000 + \$50).



Refer to the Affordable Care Act (ACA) lesson in this publication for information on the advanced premium tax credit, the premium tax credit, and the shared responsibility payment.



**Tax Software Hint:** By the time you reach the Payments section, you have already entered information from the taxpayer's Form(s) W-2 and Form(s) 1099, including the federal income tax withheld. The tax software calculates the total and displays it on the Payments section of the return.

## What about estimated taxes and amounts applied from the prior year's return?

### What are estimated tax payments?

Many taxpayers have income from self-employment, dividends, interest, capital gains, rent, and royalties. The "pay as you go" system also applies to this income. If the tax due on this income exceeds certain limits, estimated tax must be paid quarterly by the taxpayer. If estimated tax payments are not paid when they are required, a penalty could be imposed. This also applies if taxpayers do not have enough income tax withheld from their salary or wages. See the Refund and Amount of Tax Owed lesson for more information on estimated taxes.



Estimated tax includes the taxpayer's income tax and self-employment tax, which is equivalent to the Social Security and Medicare taxes withheld from employee's pay.

### Where do I get this information?

Review the taxpayer's Intake/Interview & Quality Review Sheet to determine if they had income from sources such as self-employment or investments for which taxes may not have been withheld. If so, ask, "Did you pay estimated taxes to the IRS?" If the answer is "yes," ask to see the taxpayer's record of payments, such as Form 1040-ES, Estimated Tax for Individuals.

If taxpayers need more information about estimated taxes, refer them to Form 1040-ES, which includes instructions and a worksheet for computing the amount of estimated taxes they should pay. Forms can be obtained on [www.irs.gov](http://www.irs.gov).



If a taxpayer paid substantially more or less than required in estimated tax, encourage them to recalculate it. They can adjust their estimated tax payments by following the instructions and worksheet on Form 1040-ES.

### What about tax payments applied from a previous year?

Taxpayers who overpay their income taxes in one year can apply all or part of their overpayment to the next year's estimated tax by indicating the amount they want to apply.

### Where do I get this information?

This information should be included in the intake and interview sheet, but confirm by asking the taxpayer:

- Did last year's return show an overpayment?
- Did you apply any part of the overpayment to this tax year?

If the answer is "yes" to both questions, ask to see last year's tax return to document the amount of tax applied to this year's tax return. Add this amount to the estimated tax payments and enter the total on the applicable line.



**Tax Software Hint:** For software entries to record current year estimated tax payments, go to the Volunteer Resource Guide, Finishing the Return tab.

## Taxpayer Interview and Tax Law Application

Let's see how our volunteer helped a taxpayer, Ernie, with this part of the Payments section.

### SAMPLE INTERVIEW

VOLUNTEER SAYS...

ERNIE RESPONDS...

*Let's complete the Payments section of your return. The tax software added up all the income tax withheld from your Forms W-2 we entered earlier. I know you had a little self-employment income and I see you responded "yes" to the question on estimated tax payments on the intake and interview sheet. Is that correct?*

Yes, I did.

*Do you have a record of your payments, perhaps on a Form 1040-ES?*

Yeah, here it is.

*Good, you paid each quarter. We'll enter those payments. While we're here, did last year's return show an overpayment?*

Yes, here it is: \$150.

*Did you apply any of that overpayment to this year's tax return?*

Yes, all of it.

*Okay, we'll enter that too. Now we show the total of the withholding from your Forms W-2, your estimated tax paid and the refund amount from last year's return applied to this year.*

Good!

## What about amounts paid with an extension to file?

Taxpayers can get an automatic six-month extension of time to file by submitting Form 4868, Application for Automatic Extension of Time To File U.S. Individual Income Tax Return. This form extends the time to file until October 15. This is only an extension to *file*, not an extension to *pay*. If taxpayers do not pay their taxes by April 15, they will owe interest and may be charged penalties.



If the April 15 deadline falls on a Saturday, Sunday, or legal holiday, the deadline is the next business day.

Later, when taxpayers file their return, they report the payment made with Form 4868 on the applicable line on Form 1040, Payments section.

### example

One of Bernice's Forms W-2 was lost in the mail. She requested a copy from her former employer, but it did not arrive by April 15. She filed for an extension, calculated the amount of taxes owed based on her final pay stub from that employer, and paid the \$243 that was due. When she finally received her Form W-2, she filed her return and reported the \$243 on the applicable line on Form 1040, Payments section.

## How can taxpayers file the extension?

Taxpayers may file the extension electronically or on paper. The extension must be transmitted or mailed by the due date of the return. You can help taxpayers file for an extension using the tax software.



**Tax Software Hint:** Go to the Volunteer Resource Guide, Other Returns tab, to review the step-by-step procedures for filing for an extension.

## What is excess Social Security and tier 1 RRTA tax withholding?

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A taxpayer may have more than one employer and a combined income over the amount for the Social Security wage base. This means the taxpayer may have paid more in Social Security tax than is required. This excess amount is entered on the applicable line on Form 1040, Payment section, and is a refundable credit.



**Tax Software Hint:** The software will calculate this automatically based on the amount entered for each Form W-2. Therefore, be sure the information from each Form W-2 is accurately entered.

## How do I find the total payments?

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Figuring the total tax payments is easy. Add the lines in the Payments section, and enter the total on Form 1040, total payments line.



**Tax Software Hint:** The software totals all payments automatically.

## Summary

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Completion of the Payments section is critical to an accurate tax return. It lists all the payments the taxpayer made during the year, and the taxpayer's refundable credits. You must be able to identify the types of payments and credits that apply to individuals who qualify for volunteer return preparation assistance.

## What situations are out of scope for the VITA/TCE programs?

The following is out of scope for this lesson. While this list may not be all inclusive, it is provided for your awareness only.

- Taxpayers who choose to claim any of the following credits:
  - Form 4136, Credit for Federal Tax Paid on Fuels
  - Form 2439, Notice to Shareholder of Undistributed Long-Term Capital Gains
  - Form 8839, Qualified Adoption Expenses
  - Form 8885, Health Coverage Tax Credit



### TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem or practice exercise(s) for your course of study in Publication 4491-W.

For practice using the tax preparation software, complete the scenarios using the Practice Lab on L&LT.







## Earned Income Credit (EIC)



### Introduction

This lesson covers the earned income credit (EIC). There are several common errors associated with claiming this credit on the return. Publication 4012, Volunteer Resource Guide, and the intake and interview sheet are critical tools in avoiding these mistakes.

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Determine if a taxpayer is eligible for the earned income credit
- Calculate the earned income credit

#### What do I need?

- Form 13614-C
  - Publication 4012
  - Publication 17
  - Publication 4491-W
  - Form 1040 and Instructions
- Optional:**
- Publication 596
  - Schedule EIC

### What is the EIC?

The earned income credit (EIC) is a refundable tax credit for most people who work but do not earn high incomes. The purpose of the EIC is to reduce their tax burden and to supplement the wages of working families whose earnings are less than the maximums for their filing status. Eligible taxpayers can receive a refund with this credit, even if they have no filing requirement, owe no tax, and had no income tax withheld. All taxpayers and dependents must have valid Social Security numbers by the due date of the return (including extensions) to claim the credit. Due to recent tax law changes, returns filed claiming EIC cannot be released before February 15th.

The EIC can be a very valuable credit. The EIC was permanently expanded to allow families to claim credit for three or more children. The EIC amounts are adjusted for inflation every year.

The EIC is reported in the Payments section of the tax return.

### How does a taxpayer qualify for the EIC?

There are general sets of rules for claiming the earned income credit:

- Rules for everyone
- Rules for taxpayers with a qualifying child
- Rules for taxpayers who do not have a qualifying child

### What rules apply to everyone?

The taxpayer must meet all the rules to qualify for the earned income credit. Turn to the chart titled Summary of EIC Eligibility Requirements in the Volunteer Resource Guide, Earned Income Credit tab. Review Part A, Rules for Everyone, and Part D, Earned Income and AGI Limitations.



Both earned income and adjusted gross income must be below the limits in order for the taxpayer to qualify for the EIC. These amounts are adjusted for inflation every year.



Individual Taxpayer Identification Numbers (ITINs) and Adoption Taxpayer Identification Numbers (ATINs) cannot be used when claiming the EIC. If a couple is filing a joint return, both spouses and all qualifying children must have a valid SSN for work by the due date of the return. Taxpayers cannot file an amended return retroactively for any year in which they did not have a valid Social Security number by the due date of the return (including extensions).



There is a limit to the amount of investment income a person can receive and still qualify for the EIC. See Publication 4012, Earned Income Credit tab, Summary of EIC Eligibility Requirements for the investment income limit. Investment income includes such items as taxable interest and dividends, tax-exempt interest, capital gain net income, and income from residential rental property.

## What is “earned” income for EIC purposes?

Earned income is wages, salaries, tips, and other taxable employee pay. Turn to the Earned Income Table in the Volunteer Resource Guide, Earned Income Credit tab, for examples of earned income.

One type of payment considered earned income is “taxable long-term disability benefits received prior to minimum retirement age.” Taxpayers with disabilities can sometimes receive a disability pension from their employer even though they are younger than the minimum retirement age. Minimum retirement age is generally the age at which taxpayers can first receive a pension or annuity from their employer if they are not disabled. Taxpayers usually receive Form 1099-R reporting the pension.

Turn to the Volunteer Resource Guide, Income tab, Form 1099-R. Find the page showing Form 1099-R with Code G or 6, Rollovers. A distribution code of “3” in box 7 indicates this is a disability pension. If the taxpayer is under the plan’s minimum retirement age, this income is reported on line 7 of Form 1040. If the taxpayer is at or above the company’s minimum retirement age, this would be reported as a regular pension. Sometimes the employer does not change the code in box 7 to indicate it is now regular pension income. If this is the case, the taxpayer should request a corrected Form 1099-R from the employer.



**Tax Software Hint:** Volunteers using software must check the box in the Rollover or Disability section of the Form 1099-R input screen to report disability as wages. To review information on reporting disability income for a person under retirement age, go to the Volunteer Resource Guide, Income tab.

## What about combat pay?

Combat pay is never taxable to most soldiers. Members of the U.S. Armed Forces who served in a combat zone may elect to include their nontaxable combat pay in their earned income for the purposes of computing this credit. Doing this may increase or decrease the taxpayer’s EIC. Figure the EIC amount with and without the pay before making the election. If the election is made, *all* of the nontaxable combat pay must be included. If both spouses filing a joint return have combat pay, they can individually choose to make the election on the tax return.



**Tax Software Hint:** If a taxpayer has combat pay listed in box 12 of Form W-2 marked with code Q, the software will determine if the combat pay should or should not be added to your taxpayer’s income.

## What about self-employment income?

Net earnings from self-employment are considered earned income. For most taxpayers within the scope of the VITA/TCE programs, “net earnings” for EIC purposes will be the amount reported on line 12 of Form 1040, minus the deductible portion of the self-employment tax that is reported in the Adjusted Gross Income section of the tax return.

### example

Jeff's self-employment income reported on Form 1040, line 12 is \$2,000. The deductible portion of his self-employment tax, which is recorded in the adjustments section of Form 1040, is \$142.

His income for EIC purposes is  $\$2,000 - \$142 = \$1,858$ .

**Reminder:** Nonwage income received for doing work (such as for side jobs or contract labor) is self-employment income, even for taxpayers who do not think of themselves as "self-employed." **All self-employment income and expenses are required** to be reported on Schedule C-EZ, Net Profit from Business, or Schedule C, Profit or Loss from Business. Taxpayers not meeting the VITA/TCE programs' requirements for filing Schedules C and C-EZ will need to seek the assistance of a professional tax preparer.



**TIP** An IRS certified volunteer tax preparer must exercise due diligence when preparing or assisting in the preparation of, approving, and filing tax returns. Although a volunteer tax preparer may rely in good faith without requiring certain documents from the taxpayer, the tax preparer must ask questions if the information furnished appears to be incorrect, inconsistent, or incomplete.

### What about household employee income?

Domestic employees such as housekeepers, are only issued Form W-2 if their earnings are more than a certain amount. Refer to Publication 926, Household Employer's Guide, for other tax year amounts. The income should be added to line 7 on Form 1040. This income should also be included when calculating the EIC.

### Earned income not qualifying for the EIC

One income item that is reported on Form W-2, but does not qualify as earned income for EIC purposes, is income received for work while an inmate is in a penal institution (including work performed while in a work release program or while in a halfway house). Also, Medicaid waiver payments must be excluded if they qualify. Excluded income is not included as earned income for EIC purposes. Refer to the Volunteer Resource Guide, Earned Income Credit tab, to find this listed in the Earned Income Table.



**Tax Software Hint:** Income received for work while an inmate is in a penal institution must be entered in the Other Income section, Other Compensation, then Prisoner Earned Income line.



### EXERCISES

Use the Summary of EIC Eligibility Requirements Chart in the Volunteer Resource Guide, Earned Income Credit tab, to answer the following questions. Answers follow the lesson summary.

**Question 1:** A taxpayer is filing as Married Filing Separately. Does this taxpayer qualify for the EIC?

Yes  No

**Question 2:** A taxpayer has interest income of \$4,500. His earned income is only \$7,000. He is single, has a valid Social Security number and is not the qualifying child of anyone else. Does he qualify for the EIC?  Yes  No

## What are the rules for taxpayers with qualifying children?

The taxpayer can file Form 1040 to claim the EIC with a qualifying child. The taxpayer has a qualifying child for EIC purposes if the child meets **all** the tests outlined in the Volunteer Resource Guide, Earned Income Credit tab. A short version of the rules is shown in Part B, Rules If You Have a Qualifying Child. A detailed version is on the next page of the Volunteer Resource Guide.

### example

Jane, 31, and Todd, 33, have an 8-year-old daughter, Amanda. All are U.S. citizens and have valid SSNs. Jane and Todd have never been married. Jane and Amanda lived together all year in an apartment. Todd lived alone. Jane earned \$15,000 working as a clerk in a clothing store. Todd is an assistant manager of a hardware store and earned \$48,000. He paid over half Jane's rent and utilities, and also gave Jane extra money for groceries.

Todd does not pay any expenses or support for any other family member. Although Todd provided over half the cost of a home for Jane and Amanda, he cannot file Head of Household and he cannot claim the child for EIC, since Amanda did not live with him more than half the year. Jane cannot file as Head of Household either. Review the Filing Status for Head of Household rules in the Volunteer Resource Guide, Filing Status tab.

Jane is the only one who can claim Amanda as a qualifying child for EIC. Review the Earned Income Credit rules in the Volunteer Resource Guide, Earned Income Credit tab.



For EIC purposes, a qualifying child does *not* have to be the taxpayer's dependent (unless the child is married). In the case of divorced or separated parents, the custodial parent (with whom the child lived for more than half the year) can qualify for the EIC regardless of whether or not they claim the dependency exemption for the child. The noncustodial parent cannot qualify for EIC because the child did not live with them for more than half the year.

## What are the rules for a qualifying child of more than one person?

A child who meets the conditions to be a qualifying child of more than one person can only be claimed by one taxpayer for the EIC.

Using the Interview Tips (EIC with a Qualifying Child) from the Volunteer Resource Guide, Earned Income Credit tab, based on what we have learned so far about Robyn and her family:

### example

Robyn is 25 years old. She and her 2-year-old son, Aiden, lived with Robyn's mother all year. Aiden has a valid Social Security number.

Step 1 is YES

Step 2 is YES

Step 3 is YES

Step 4 is NO

Step 5 is YES



Taxpayers have the option to choose which taxpayer will claim the child. Tiebreaker rules apply when the child is claimed by multiple taxpayers.

For step 6, check to see if Aiden can be anyone else's qualifying child, for EIC purposes.

Who else lived in the house that is related to Aiden? Robyn's mother also lives with them. Go through the steps to see if Aiden can be a qualifying child for Robyn's mother.

If the taxpayer can't claim the EIC because the qualifying child is treated under the tiebreaker rules as the qualifying child of another person, the taxpayer may be able to take the EIC using a different qualifying child, or take the EIC if they qualify using the rules for people who don't have a qualifying child. See the Qualifying Child of More than One Person rules in the Volunteer Resource Guide, Earned Income Credit Tab.

## What are the rules for taxpayers without qualifying children?

Taxpayers can claim the EIC without a qualifying child. Confirm that the taxpayer and spouse cannot be claimed as dependents by their parents or anyone else. Review the rules in the Volunteer Resource Guide, Earned Income Credit tab, under Part C, Rules If You Do Not Have a Qualifying Child.



Taxpayers turning 25 on January 1 are considered to be of age as of December 31. Taxpayers reaching the age of 65 on January 1 are still considered 64 as of December 31. Taxpayers in either of these situations whose return is rejected may need to file a paper return.



For a couple filing a joint return, only one taxpayer has to meet the age requirement.

### example

Tom and Martha are a married couple. Tom is 66 and Martha is 58 years old. If all other rules are met, they would qualify for the EIC.



### EXERCISES (continued)

Using the interview tips in the Volunteer Resource Guide, determine if each of these taxpayers has a qualifying child or can claim the EIC. Each child has a valid Social Security number.

**Question 3:** Maureen's 20-year-old daughter, Angie, lived with her for eight months of the year. Angie is not married and is a full-time college student. Is Angie a qualifying child for the EIC?  Yes  No

**Question 4:** Starting in February of the tax year, Sam has cared for Lisa, the 10-year-old daughter of his stepson. Does Lisa meet the EIC requirements for a qualifying child?  Yes  No

**Question 5:** Three children live with Mira, who cares for them as her own: Twila, the 3-year-old daughter of Mira's cousin; Chez, Mira's newly adopted 2-year-old son from Europe, who has lived with Mira since November of the tax year; and Dwight, Mira's 20-year-old son, who attends community college part time. Which of them are qualifying children?  Twila  Chez  Dwight  None

**Question 6:** Margie's daughter, Aimee, turned 23 early in the tax year while attending college full time. Margie is filing as Head of Household. Margie has an AGI of \$31,000. Assuming that she and her daughter pass all other tests, can Margie claim the EIC?  Yes  No

**Question 7:** Rob and Laura are divorced. Laura is the custodial parent for Dawn, who lived with her all year. Laura signed Form 8332, allowing Rob to claim the dependency exemption for Dawn until she turns 18. Can Rob claim Dawn for the EIC?  Yes  No

**Question 8:** Jewel and her daughter lived with Jewel's brother, Emmitt all year. Jewel earns \$20,000 and claims her daughter as the qualifying child for the EIC. Emmitt is 25 years old and earned \$8,500. Is Emmitt able to claim the EIC for a taxpayer without a qualifying child?  Yes  No

### ***How should I handle a taxpayer whose EIC was disallowed in a prior year?***

The intake and interview sheet asks if the taxpayer was previously disallowed EIC in a prior year because special rules apply. If the taxpayer answers “yes” to this question, refer to the Volunteer Resource Guide, Earned Income Credits tab, Disallowance of the Earned Income Credit.

### **How is the correct EIC amount calculated?**

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The credit is determined using worksheets and the Earned Income Credit tables. The EIC worksheets can be found in Publication 596 or Form 1040 Instructions. The software will determine the amount of EIC.



Double-check that the heading on your page says “Earned Income Credit (EIC) Table.” It is common to mistake the Tax Tables for the EIC tables.

### ***Class Exercise***

A taxpayer is filing Head of Household and has one qualifying child. The earned income and AGI is \$19,000. How much EIC is the taxpayer entitled to?

Turn to the first page of the EIC tables. Find the amount in the “At least - But less than” column. Find the correct filing status column: Single, head of household and qualifying widow(er), or in a separate column, married filing jointly. There are subcolumns for the number of qualifying children.

The EIC amount is entered on the Earned Income Credit line in the Payments section of the return.



**Tax Software Hint:** To review information related to the software, go to the Volunteer Resource Guide, Beginning the Return tab. The software automatically calculates the credit based on the information entered in the Filing Status, Personal Information, Dependent Information, and Income sections.

### **Summary**

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The earned income credit computation is based on filing status, number of qualifying children, earned income, and adjusted gross income. Certain individuals with no children may also qualify.

By using the intake and interview sheet, the interview tips in the Volunteer Resource Guide and correctly filling out the EIC worksheets, most of the errors that arrive from incorrectly computing the EIC can be avoided.

The EIC is entered in the Payments section of the return.



#### **TAX LAW APPLICATION USING THE WORKBOOK**

To gain a better understanding of the tax law, complete the comprehensive problem or practice exercise(s) for your course of study in Publication 4491-W.

For practice using the tax preparation software, complete the scenarios using the Practice Lab on L&LT.



## EXERCISE ANSWERS

**Answer 1:** No. Married Filing Separately does not qualify for the EIC.

**Answer 2:** No. His investment income exceeds the limit.

**Answer 3:** Yes. Daughter Angie meets all the eligibility tests to be a qualifying child.

**Answer 4:** Yes. Lisa is a descendent of Sam's stepson and meets the other eligibility requirements.

**Answer 5:** None of the children under Mira's care are qualifying children for the EIC. Twila does not meet the relationship test, Chez does not meet the residency test, and Dwight does not meet the age test.

**Answer 6:** Yes. Margie meets the general eligibility requirements and Aimee meets the Qualifying Child rules.

**Answer 7:** No. While Rob can claim his daughter as a dependent, the daughter did not live with him for more than half the year, so she fails the residency test. Dawn is the qualifying child of Laura.

**Answer 8:** Yes. Jewel's daughter is not the qualifying child of Emmitt, but he can claim the EIC for a taxpayer without a qualifying child.







## Refund and Amount of Tax Owed



### Introduction

This lesson covers the Refund and Amount You Owe sections of the taxpayer's return. After completing this lesson, you will determine if taxpayers have overpaid (a refund is due) or have underpaid (balance is due to the government) their tax. This part of the return is a summary of the tax, credits, and payments.

Taxpayers may be entitled to a refund or owe tax. In either case, they have several choices on how to get their refund or pay the amount they owe. It is important that volunteers are familiar with those choices to better help taxpayers understand their refund and payment options. This is especially true because of the increase in the number of taxpayers coming in to VITA/TCE sites who owe tax for the first time and need guidance.



Feedback results indicate volunteers are less familiar with the procedures for payment options than the procedures for refund options. Be sure to identify the payment options available to taxpayers that are outlined in this lesson and in the Volunteer Resource Guide, Finishing the Return tab.

To complete these sections of the taxpayer's return, you will need to confirm answers provided on the Intake/Interview & Quality Review Sheet, regarding direct deposit and direct debit. Also, review the Volunteer Resource Guide, Finishing the Return tab, which provides guidance on refunds and balance due returns.

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Identify the applicable section and lines of Form 1040 for the refund or amount owed
- Report the correct amount of refund or amount owed
- Identify the refund options available, including the purchase of savings bonds
- Describe the different payment options for the amount owed
- Revise the amount of tax withheld or make estimated tax payments to avoid underpayment of taxes
- Identify the purpose of and determine how to complete the Third Party Designee portion of the tax return

#### What do I need?

- Form 13614-C
  - Publication 4012
  - Publication 17
  - Publication 4491-W
  - Form 1040
  - Form 1040-ES
  - Form 8888
  - Form W-4
  - Form W-4P
  - Form W-4V
- Optional:**
- Publication 505
  - Publication 594
  - Publication 4541
  - Form 2210 and Instructions
  - Form 9465

## How do I know if the taxpayer is due a refund?

If the amount of the tax liability exceeds the payments made, the amount owed appears in the Amount You Owe section of the Form 1040. This is the amount the taxpayer must pay to the IRS. The taxpayer's total tax appears on the applicable line in Form 1040, Other Taxes section.

The taxpayer's total tax payments already made, which includes refundable credits, appears on the applicable line in Form 1040, Payments section.

If the payments made exceed the amount of tax liability, the amount of the overpayment is shown on the applicable line in the Refund section of the Form 1040. This is the amount the taxpayer has overpaid.



For taxpayers who are due a refund:

- Advise taxpayers to check Where's My Refund? on [www.irs.gov](http://www.irs.gov)
- Inform taxpayers of the split refund and saving bond options

## What are the options for an overpayment?

Taxpayers can choose to:

- Apply any portion of their overpayment to the following tax year
- Receive all or part of their refund using direct deposit
- Receive all or part of their refund as a check
- Purchase Series I Savings Bonds



**RALs, RACs, and Other Financial Products:** You may be asked about Refund Anticipation Loans (RALs). A RAL is money borrowed by a taxpayer from a lender based on the taxpayer's anticipated income tax refund. A variation of a RAL is a Refund Anticipation Check (RAC). Financial Institutions also offer a variety of other financial products to taxpayers based on their refunds. Providers that assist taxpayers in applying for a RAL or other financial products have additional responsibilities and may be sanctioned by the IRS if they fail to adhere to the requirements.

## How do I apply part of the overpayment to the following year?

For taxpayers who want to apply a portion of the overpayment to next year's taxes, enter the amount to be applied to the following year on the applicable line. By entering an amount on this line, the taxpayer is electing to apply all or a portion of the current year's overpayment to next year's estimated tax.



**Tax Software Hint:** The software shows the remaining amount to be refunded to the taxpayer on the amount to be refunded line.

## How do I indicate that the entire refund should be sent to the taxpayer?

For taxpayers who want the entire refund sent to them, leave the line for amount applied to estimated tax blank or enter 0.



A field in the signature section at the bottom of Form 1040 labeled Identity Protection PIN is designed to help prevent refunds from being issued to an identity thief. See Form 1040 Instructions for more information.



**Tax Software Hint:** The tax software shows the entire refund amount on the amount to be refunded line.

### ***What are a taxpayer's refund options?***

Taxpayers may choose to have their refund deposited directly into their account at a bank, credit union, or other financial institution, or to an IRA. Direct deposits are usually received within three weeks of return acceptance. Taxpayers may choose to have a refund check mailed to them. Refund checks are usually mailed within 6 to 8 weeks after the return is filed. In addition, taxpayers can request that their refund be deposited directly into a TreasuryDirect online account to buy U.S. Treasury marketable securities and savings bonds. Details can be found at [www.treasurydirect.gov](http://www.treasurydirect.gov).



The taxpayer may decide toward the end of the return preparation process to allocate some or all of the refund to their IRA. Be sure to go back into the return and enter the contribution amount – the taxpayer may get additional benefit from the contribution through a deduction and/or the retirement savings credit.

Taxpayers who do not have a TreasuryDirect online account also have the option to purchase savings bonds with their federal income tax refunds. Additional details will be covered later in the lesson.

### ***What are the benefits of direct deposit?***

Encourage taxpayers to use direct deposit; direct deposit refunds are received faster than checks (usually within 10 to 21 days) and eliminate the possibility of a check being lost or stolen. Direct deposit is more convenient for the taxpayer.

Direct deposit saves tax dollars because it costs the government less.

### ***How do I enter the information for direct deposit?***

Make sure taxpayers show you proof of their bank account and routing information, such as a check. Bank deposit slips are not a reliable source for routing and account numbers for direct deposit. Enter the account number from left to right, but omit spaces and symbols. The Volunteer Resource Guide, Finishing the Return tab, Pointers for Direct Deposit of Refunds, includes a diagram showing where to find the Routing Transit Number (RTN) and Depositor Account Number (DAN) information on a check.



Direct deposit of a taxpayer's refund is to be made to an account (or accounts) only in the taxpayer's name. Advise taxpayers their refunds may only be deposited directly into their own accounts.



**Tax Software Hint:** For software entries, go to the Volunteer Resource Guide, Finishing the Return tab, for software entries on direct deposit.



If the routing and account numbers are not valid, the refund will be delayed 4–6 weeks. If the direct deposit is rejected, a check will automatically be mailed to the address on the return.

### ***Can the refund be deposited into more than one account?***

Taxpayers may choose to have their refund deposited in up to three accounts. For example, a person expecting a refund of \$600 could choose to deposit \$200 into a checking account, \$300 into a savings account, and \$100 into an IRA account.



**Tax Software Hint:** Use Form 8888, Allocation of Refund (Including Savings Bond Purchases), to list the RTN and account number for each deposit. Form 8888 is not required if the refund is to be deposited into a single account. Go to the Volunteer Resource Guide, Finishing the Return tab, for the software entries.



Publication 4541, available for download on [www.irs.gov](http://www.irs.gov), provides information about split refunds.

### **What if the taxpayer makes a mistake on the return that increases the amount of the refund?**

The IRS recommends using electronic filing to avoid math errors and other common problems that can require adjustments to a return after it is filed. If an adjustment results in a larger refund than expected, the IRS adds the difference to the last account designated for direct deposit.



When an adjustment is made to a tax refund, the IRS sends a letter explaining any errors that resulted in the adjustment, as well as any changes made to the refund amount and the amount of each direct deposit.

### **What if the taxpayer makes a mistake on the return that decreases the amount of the refund?**

If an adjustment results in a smaller than expected refund, the IRS uses a bottom-up rule and deducts the difference from the direct deposit amount designated for the last account shown on Form 8888. If the difference exceeds the amount designated for the last account, the IRS deducts the remainder from the amount designated to the next account, until the amount due is paid.

#### **example**

Joan's return shows a refund of \$300 and she asks the IRS to split her refund among three accounts with \$100 to each account. Due to an error, her refund is decreased by \$150. The IRS will adjust her direct deposits as follows:

	Requested Direct Deposits	Actual Direct Deposits
Account 1	\$100	\$100
Account 2	\$100	\$50
Account 3	\$100	0

The IRS will apply this same bottom-up rule to adjust direct deposits for refund offsets for *unpaid federal taxes* or if the *Earned Income Credit (EIC) portion of the taxpayer's refund* is withheld pending further review. After the EIC review, if a refund is allowed, it will be direct-deposited in the account listed first on Form 8888.

#### **example**

Bill asks that his refund of \$780 be deposited into three different accounts: \$300 into Account 1, \$300 into Account 2, and \$180 into Account 3. However, Bill owes federal taxes of \$290 on an earlier tax year, and after this is offset, only \$490 remains to be direct deposited. Account 3 will receive \$0, Account 2 will receive \$190, and Account 1 will receive \$300.

#### **example**

Melanie is due a refund of \$1,000; \$700 of the refund is an earned income credit (EIC). She asks that her refund be split into three different accounts: \$500 into Account 1, \$300 into Account 2, and \$200 into Account 3. Melanie's EIC amount of \$700 was held pending a review. So, \$300 went to Account 1 and \$0 went to Accounts 2 and 3. Later, when the IRS allowed her EIC refund amount, it was deposited into Account 1.

### **What happens if the taxpayer owes other debts like student loans or child support?**

If the refund is decreased due to an offset to pay state income tax, child support, or certain federal nontax debts, such as student loans, then the decrease will be taken first from the account that appears first on the payment file received from the IRS. The IRS payment file orders accounts from the lowest to the highest routing number. If the debt exceeds the payment designated for the account that appears first on the payment file, the Treasury Department's Financial Management Service (FMS) will reduce the payment designated for the account that appears next.

### **What should I watch out for?**

Double-check the RTN of the financial institution before the return is transmitted if:

- You are unfamiliar with the financial institution.
- The RTN is for a credit union that is payable through another financial institution. Taxpayers should contact their credit union for the correct RTN.
- If more than one account is selected for direct deposit, be sure that the amounts on Form 8888 equal the refund amount on Form 1040.



Financial institutions generally do not allow a joint refund to be deposited into an individual account. The IRS is not responsible if a financial institution refuses a direct deposit.



### **EXERCISES**

Answers follow the lesson summary.

**Question 1:** Using direct deposit is one way to reduce the chance that a refund will be lost or stolen.

True  False

**Question 2:** When entering an account number for direct deposit, make sure to include all spaces and hyphens.  True  False

## **What do I need to know about the option to buy U.S. savings bonds with a federal tax refund?**

IRS will provide taxpayers with an opportunity to purchase U.S. savings bonds with their tax refunds. Volunteers should review these guidelines to promote this asset-building opportunity as part of the filing season.

Taxpayers now have more choices, including the purchase of bonds for co-owners, such as children or grandchildren.

### **What are U.S. savings bonds?**

U.S. savings bonds are savings instruments for individual savers issued by the U.S. Department of the Treasury. For purposes of this program, only Series I Savings Bonds will be offered.

Series I Savings Bonds are sold at face value (a \$50 bond costs \$50), and grow in value for up to 30 years. The bonds can be purchased in denominations of \$50, \$100, \$200, \$500, \$1,000. In any single calendar year, taxpayers can purchase up to \$5,000 of savings bonds of any denominations.

Series I Savings Bonds pay interest based on a combination of a fixed rate (which remains the same throughout the life of the savings bond) and a semiannual inflation rate, which is updated each May and November. Savings bonds accrue interest until redeemed or until they reach their final maturity in 30 years.

Savings bonds can be redeemed for principal and accrued earnings anytime after the first 12 months after date of purchase (unless the taxpayer lives in an area affected by natural disaster.) Also, if a savings bond is redeemed within the first five years, the three most recent months' interest will be forfeited. After five years, no penalty will apply.

## How can purchases be made at VITA/TCE sites?

Taxpayers can choose to save part or all of their refunds by requesting savings bonds on Form 8888. The specific details on how to purchase savings bonds with a federal tax refund are included in the Form 8888 Instructions.

In addition to the three direct deposits, taxpayers can allocate their refund to request up to three different savings bond registrations and receive a check. Form 8888 is divided into separate parts to reflect this.

- Part I: Complete this part for direct deposit of a portion of a refund to one or more accounts.
- Part II: Complete this part to buy paper bonds with part of a refund. In addition to making bond purchases for themselves, taxpayers can make bond purchases and add beneficiaries or co-owners, and make bond purchases for someone other than themselves.
- Part III: Complete this part if taxpayers wish to receive part of their refund by check.
- Part IV: Total allocation of refund. Add the amounts for each part together; they must equal the total refund amount.

The Form 8888 Instructions provide directions for the specific information to include on the form for the purchase of savings bonds.

### example

Mary's tax return shows she is due a refund of \$548.00. She wants to buy a \$500 savings bond. Using Form 8888, Mary can purchase the savings bond and elect to deposit the remaining \$48 into her checking account.

## How does the taxpayer receive the savings bonds?

Taxpayers will receive the amount they designated by mail in the form of U.S. Series I Savings Bonds. However, if taxpayers make an error in figuring their refund, the bond request is not a multiple of \$50, or the refund is offset for any reason, this option will not apply and the entire amount of the refund will be sent to taxpayers in the form of a check.

## When will requested bonds not be issued?

Bonds will not be issued if any of the following apply:

- The bond request is not a multiple of \$50.
- More than one name is entered on line 5b, 5c, 6b, or 6c.
- The refund is decreased because of a math error.
- The refund is offset for any reason.

Instead, the **entire** refund will be sent to the taxpayer in the form of a check.

If an error is made on the return and the amount of the refund is increased, the additional amount will be sent to the taxpayer in the form of a check.

## Whom does the taxpayer contact if the savings bonds are not received?

The first step is to check the status of the refund by going to the "Where's My Refund" feature on [www.irs.gov](http://www.irs.gov), or calling 1-800-829-1954. Taxpayers can generally get information about their refund 72 hours after the IRS acknowledges receipt of their e-filed return, or three to four weeks after mailing a paper return. If the IRS has processed the refund and placed the order for their savings bonds, taxpayers will need to contact the Treasury Retail Securities office at 1-800-245-2804 to inquire about the status of the savings bonds.

For additional information, refer to Form 8888 or go to [www.irs.gov](http://www.irs.gov).

## How do I know if an amount is owed?

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Taxpayers who owe money on their returns are often afraid and do not know what to do next. This is a good opportunity to advise the taxpayers of the various options for payment.



To avoid a penalty, taxpayers with an amount owed must file their return by the due date even if they cannot pay the full amount with the return.



**Tax Software Hint:** The software automatically calculates the amount that is owed when the payment total is less than the amount of tax. Refer to the Volunteer Resource Guide, Other Taxes and Payments tab.

Explain to taxpayers that the tax return will be filed now and that they should submit their payment of taxes due no later than April 15 (or the next business day if April 15 falls on Saturday, Sunday, or a legal holiday). Remind taxpayers that filing an extension of time to file does not extend the time for payment.

## What forms of payment are acceptable?

The payment options are:

- Check or money order submitted with Form 1040-V, Payment Voucher
- Electronic funds withdrawal
- Credit card (fees may apply)
- Electronic Federal Tax Payment System (EFTPS)
- IRS Direct Pay
- Cash at a retail partner



Taxpayers who pay their income tax (including estimated tax) by credit or debit card can deduct the convenience fee charged by the card processor as a miscellaneous itemized deduction (subject to the 2 percent AGI floor).



Taxpayers should not mail cash with their returns.



Form 1040-V includes instructions and a table of IRS addresses.



**Tax Software Hint:** Go to the Volunteer Resource Guide, Finishing the Return, to review the information on balance due returns. Be sure to read this reference and refer to it when preparing a return that has an amount owed; it provides more information on EFTPS.

## What if the taxpayer cannot pay?

If taxpayers state that they cannot pay, first advise them to file the return and pay as much as they can with the return. This will reduce penalty and interest charges. Once they receive a notice, they can pay the remaining amount in full or choose another payment option if more time is needed.

Taxpayers who cannot pay the full amount owed, shown on Form 1040 in the Amount You Owe section, may request one of the following agreements:

- Pay in full within 120 days using the Online Payment Agreement Application (OPA) or calling. No fee is charged, but interest and penalties are charged on payments after the April due date.
- Monthly installment payments (established online using OPA or file Form 9465, Installment Agreement Request). A fee is charged for this option, in addition to interest and penalties.



Any amount of tax owed that is not paid by the April due date is subject to penalties and interest. Taxpayers who cannot pay should choose the option that is the least costly. For example, the 120-day pay-in-full option has no user fee. Print extra vouchers for taxpayers who need to send in multiple payments.



Taxpayers who can show they will have a substantial financial difficulty if they pay their tax on the due date are considered to have an *undue hardship*. Such taxpayers can request an extension of time to pay by filing Form 1127, Application for Extension of Time for Payment of Tax Due to Undue Hardship, by the due date of the return. Remember, undue hardship is more than an inconvenience.

## How do I handle Form 9465, Installment Agreement Request?

The following outlines key information related to an installment agreement.

- Taxpayers who owe can immediately establish an installment agreement online, using the Online Payment Agreement Application (OPA) on [irs.gov](http://irs.gov). Taxpayers can also use OPA to agree to pay in full in up to 120 days. With OPA, there is no need to complete Form 9465. For more information, go to [www.irs.gov](http://www.irs.gov) and search for the term "OPA" or, on the "I need to" list, select "Set Up a Payment Agreement."
- If the return is being filed electronically, Form 9465 can also be included with the e-filed return.
- When filing a paper return, Form 9465 should be completed and attached to the front of the return before mailing.
- If taxpayers already have an installment agreement with the IRS, they may be able to add the current year's amount owed to the same agreement. Taxpayers in this situation should contact the IRS directly at 1-800-829-1040.
- If the request is granted, the taxpayers must also pay a fee of \$120, or \$52 if payments are made by electronic funds withdrawal. If the taxpayers' income is below certain limits, they may qualify for a reduced fee of \$43. Taxpayers can also request a reduced user fee of \$43 by completing Form 13844, Application for Reduced User Fee for Installment Agreement. Taxpayers can obtain Form 13844 at [www.irs.gov](http://www.irs.gov) or by calling the IRS forms number at 1-800-829-3676.
- If the IRS approves the agreement, a notice is issued that provides details of the agreement and requests the user fee at that time.
- If the total amount due is more than \$25,000, there are additional requirements. Refer to Form 9465 instructions.





**Tax Software Hint:** If the taxpayer chooses to apply for an installment agreement using Form 9465, the form can be e-filed. Refer to the Volunteer Resource Guide, Finishing the Return tab.



### EXERCISES (continued)

**Question 3:** For which of the following will the taxpayer be charged a convenience fee?

- A. Direct deposit of a refund
- B. Electronic funds withdrawal of a tax payment
- C. Using a credit card to make a tax payment
- D. Using a personal check to make a tax payment

## Taxpayer Interview and Tax Law Application

Seymour's Form 1040 shows his total tax is \$450. His tax payments come to just \$200. Therefore, Seymour owes \$250.

### SAMPLE INTERVIEW

VOLUNTEER SAYS...

*The amount of tax you owe is \$250. You can either mail in a check or money order with the payment voucher, use electronic funds withdrawal, IRS Direct Pay, use cash at a retail partner, or call in a credit card payment. You'll have to pay an additional convenience fee for using a credit card.*

*No, we can designate the date that the debit will occur, any time up to April 15. I would just need to see proof of account to verify your bank account information so I can include the routing and account numbers in your electronic return.*

*Right. And it saves you the trouble of mailing in the voucher with your payment.*

*You can do that too. Here's Form 1040-V, which has been completed for you. Make your check or money order payable to "United States Treasury." If it's not already printed on the check, make sure it shows your name, address and daytime phone number. Also, print your Social Security number and "Form 1040" with the applicable tax year on the front of your check. Then mail the payment with the voucher. I'll get the mailing address for you.*

*Just make sure it gets postmarked by the due date. I can e-file your tax return right now, but it's up to you to make sure you send in your payment on time.*

SEYMOUR RESPONDS...

Hmm. How does electronic funds withdrawal work? Does it come out of my account right away?

And there's no charge?

Sounds good to me. But I don't have my checking account information with me. Maybe I should just mail in my payment.

That doesn't seem too hard.

Thank you for your help. I will make sure the payment is made on time.

## How is the estimated tax penalty calculated?

The estimated tax penalty is calculated on Form 2210, Underpayment of Estimated Tax by Individuals, Estates, and Trusts, and reported on the applicable line in Form 1040, Amount You Owe section. While completion of Form 2210 is out of the scope of the VITA/TCE programs, it is important for volunteers to have an awareness of the estimated tax penalty provisions.

### What is the Estimated Tax Penalty?

Generally, taxpayers may owe a penalty for underpayment of estimated tax if they did not pay enough tax, either through withholding or by making estimated tax payments.

In most cases, taxpayers must make estimated tax payments if they expect to owe at least \$1,000 in tax (after subtracting withholding and credits) and their withholding and credits will be less than the smaller of:

- 90 percent of the tax shown on the current tax return or
- 100 percent of the tax shown on the prior year's tax return (110 percent for certain higher-income taxpayers; see Form 1040-ES)

An estimated tax penalty may apply if the taxpayer does not make estimated tax payments as required.

There are special situations when a taxpayer will not have to pay a penalty. See Form 2210 Instructions or Publication 17 for more information.

#### example

Mark's total tax is \$1,657 for the current tax year. His withholding is \$417. He owes \$1,240. His prior year's tax was \$2,000. Mark will probably be charged an estimated tax penalty because the amount he owes is over \$1,000 and his withholding and credits are less than 90 percent of his current year tax or 100 percent of his prior year tax.

### Do I have to calculate the estimated tax penalty?

Because Form 2210 is complicated, leave the estimated tax penalty line blank on Form 1040. This will not prevent the IRS from calculating the penalty if it is due. Let the taxpayer know that a penalty may be owed, and if so, the IRS will send a notice.



Form 2210 is no longer included with the estimated tax penalty notice. Refer taxpayers who need assistance with Form 2210 to a professional tax preparer.



#### EXERCISES (continued)

**Question 4:** Dion's total tax liability is \$1,044. After withholding, she owes \$640. This means Dion might have to pay a penalty for underpayment of estimated tax.  True  False

## How can taxpayers make sure the correct amount of tax is withheld?

There are several ways to pay taxes during the year to avoid having a balance due when the return is filed. Depending on the taxpayer's situation, here are some suggestions:

- Taxpayers whose income is mostly from wages, pensions, unemployment, or some investment income (such as interest on U.S. bonds) can adjust their withholding

- Taxpayers whose income is mostly from self-employment or investments can make or increase their estimated tax payments
- A combination of increased withholding and estimated tax payments may work best for some taxpayers

Recipients of annuity, pension, or certain other deferred compensation payments use these forms to tell payers the correct amount of federal income tax to withhold: Form W-4, Employee's Withholding Allowance Certificate, and if applicable, Form W-4P, Withholding Certificate for Pension or Annuity Payments, and Form W-4V, Voluntary Withholding Request. Each form includes the following types of information the employer uses to figure the taxpayer's correct withholding:

- Marital status (married taxpayers may request the employer to withhold at the higher single rate)
- Withholding allowances the taxpayer claims
- Any additional amount to be withheld
- Qualification of exempt status

The amount of tax the employer withholds from the taxpayer's wages depends on:

- The amount of pay the taxpayer earns
- How often the taxpayer is paid
- The taxpayer's information entered on Form W-4

### **When should taxpayers submit a revised Form W-4 to their employer?**

The taxpayers may submit a new Form W-4 whenever they want to increase or decrease the withholding amount.

Life events such as a change in marital status, birth of a child, or purchase of a home will change exemptions, adjustments, deductions, and credits on the tax return. These taxpayers should submit a revised Form W-4 to their employer.



Refer to Form W-4 instructions to see the applicable lines a taxpayer must complete to revise Form W-4.

In some situations, getting the right amount withheld is difficult if:

- The taxpayers are married and both work
- The taxpayers have more than one job
- The tax law regarding deductions or credits changes

Publication 17, Tax Withholding and Estimated Tax chapter, has more information on this topic. Taxpayers can go to the withholding calculator on [www.irs.gov](http://www.irs.gov) to help calculate the correct withholding.

#### **example**

Mary was claiming an allowance for her son on her Form W-4. Mary will not be able to claim her son as a dependent on next year's return. Mary will change her Form W-4 to reduce the number of allowances and submit it to her employer.

#### **example**

John works two full-time jobs. He reviews his withholding and realizes he will not have enough tax withheld. He gives his employer a revised Form W-4 to increase his withholding so he will not owe money when he files his return.

## How do taxpayers request an increase or decrease in withholding for other income payments?

Taxpayers can use the following withholding forms to request a change in their withholding on other types of income.

- Form W-4P, Withholding Certificate for Pension or Annuity Payments
- Form W-4S, Request for Federal Income Tax Withholding from Sick Pay
- Form W-4V, Voluntary Withholding Request (generally used for certain government payments)



Refer to the Volunteer Resource Guide, Finishing the Return tab, for guidance on helping taxpayers avoid a balance due. Advise taxpayers to use the withholding calculator on [www.irs.gov](http://www.irs.gov) to check their withholding for next year. If they need to adjust the amount withheld, suggest they submit a revised Form W-4, and if appropriate, help them complete the revised Form W-4.

## When should the taxpayer make estimated tax payments?

Estimated tax is the amount a taxpayer expects to owe for the tax year after deducting any tax credits or federal withholding. Taxpayers with significant income that is not subject to withholding (such as interest, dividends, capital gains, or self-employment income) will often find they need to make estimated tax payments.

The decision tree in Publication 17, Your Federal Income Tax for Individuals, and Publication 505, Tax Withholding and Estimated Taxes, can help determine if the taxpayer should make estimated tax payments. See the Payments lesson for more information.

### example

Maria is retired, and her only income is from a pension and some investments. She had no withholding and is not eligible for any tax credits. When you complete her return this year, she has a balance due of \$1,300. Maria should begin making estimated payments, since her balance due next year will be more than \$1,000, and she has no withholding. If Maria does not want to make estimated payments, she could submit Form W-4P to request withholding from her pension instead.

## How is estimated tax figured?

Use Form 1040-ES, Estimated Tax for Individuals, to compute the amount of estimated tax that should be paid over the year. This form includes worksheets to help taxpayers estimate their income and tax liability for the year. The current year's tax return can be used as a starting point, but any anticipated changes should also be taken into account. Taxpayers may also have to adjust their payments during the tax year if a change in income or the tax law will affect their tax liability.

For additional information on estimated tax payments, refer to the Volunteer Resource Guide, Finishing the Return tab.

## What is the Third Party Designee?

For taxpayers who want to allow a friend, a family member, or another person to discuss their tax return with the IRS, the "Yes" box of the Third Party Designee area of the return can be checked. You may see this situation in the case of an individual going overseas, a personal representative (executor) filing a return for a deceased taxpayer, or elderly parents who wish to have their adult child handle their affairs. You will also need to enter the name, phone number, and any five numbers the designees choose as their Personal Identification Number (PIN).



Volunteer preparers must *never* be designated as a third party designee.



See Publication 17 for information on what the taxpayer is authorizing when designating a third party designee.

## How can I avoid common errors?

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Double- and triple-check the routing number and account number for direct deposit and electronic funds withdrawal. Have the taxpayers compare the numbers entered on the return to their checks or other account information. If an error is made in the bank information, taxpayers must work with the bank to resolve any misdirected funds.

## Summary

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### Refunds

If the payments made exceed the amount of tax, then the amount of the overpayment is entered on the overpaid line in the Refund section of Form 1040.

Taxpayers can choose to apply any portion of their overpayment to the following tax year or receive their refund as a check or direct deposit. Direct deposits can be split among as many as three different accounts by using Form 8888.

For direct deposit of the refund, select Direct Deposit as the Federal Return type on the e-File page. Enter the Routing Transit Number (RTN) and Depositor Account Number (DAN) in the Taxpayer Bank Account Information section of the e-File page. Use a check as proof of account.

Taxpayers can use their federal tax refund to buy U.S. savings bonds for themselves or others, such as children or grandchildren. They do not need to have a bank account or an existing account with Treasury.

Review Form 8888 for more information about splitting a refund and the purchase of savings bonds. Form 8888 can be downloaded from [www.irs.gov](http://www.irs.gov).

### Amount Owed

If the payment total is less than the amount of tax owed, then tax software shows the balance due amount on the applicable line in the Amount You Owe section of Form 1040 and generates a copy of Form 1040-V, which is used for mail-in tax payments.

Taxpayers are often very anxious if they owe tax on their return. Take the time to provide the various payment options to taxpayers in this situation.

Explain to taxpayers that the tax return can be electronically filed now but that they should submit their payment of taxes by the due date of the return. They can pay with a check or money order, with Form 1040-V, electronic funds withdrawal, credit card, Direct Pay, or cash at a retail partner.

Taxpayers who are unable to pay may request an additional 120 days to pay, or complete Form 9465 for an installment agreement. This request can be made with an e-filed return, or by using the Online Payment Agreement feature on [www.irs.gov](http://www.irs.gov).

Interest and penalties are charged on amounts not paid by the due date. There are fees associated with certain payment options.

## Estimated Tax Penalty

If it appears taxpayers may owe an estimated tax penalty, let them know the IRS will calculate the penalty and send a bill. Completion of Form 2210 is out of scope. Refer taxpayers who need assistance with Form 2210 to a professional tax preparer.

## Adjusting Tax Withholding

Advise taxpayers who did not have enough tax withheld to submit a revised Form W-4 (to their employer), Form W-4P (to a pension or IRA payer), Form W-4S (to a sick-pay payer), or Form W-4V (to certain governmental payers). Use the withholding calculator on [www.irs.gov](http://www.irs.gov) to calculate the correct withholding amount.

Taxpayers with significant income that is not subject to withholding (such as interest, dividends, capital gains, or self-employment income) may find they need to make estimated tax payments. Use Form 1040-ES, Estimated Tax for Individuals, to compute the amount of estimated tax that should be paid over the year.

## Third Party Designee

Taxpayers can authorize a friend, a family member, or another person to discuss their return with the IRS. Volunteers should *never* designate themselves as a third party designee.

## What situations are out of scope for the VITA/TCE programs?

The following is out of scope for this lesson. While this list may not be all inclusive, it is provided for your awareness only.

- Form 2210, Underpayment of Estimated Tax by Individuals, Estates, and Trusts



### TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem or practice exercise(s) for your course of study in Publication 4491-W.

For practice using the tax preparation software, complete the scenarios using the Practice Lab on L&LT.



### EXERCISE ANSWERS

**Answer 1:** True. Direct deposit is safer since there is no check to be lost or stolen.

**Answer 2:** False. Enter the account number from left to right, leaving out all spaces and special characters.

**Answer 3:** C. The credit card processor covers its costs by assessing a “convenience fee” to taxpayers using this system. Taxpayers will be advised of the amount of this fee when they call the interactive voice response system.

**Answer 4:** False. The tax Dion owes is less than \$1,000, so she does not have to pay a penalty.



## Completing the Return



### Introduction

In this lesson, you will receive insights and information for concluding your interview with the taxpayer and completing the return.

Using the tools discussed in the Volunteer Resource Guide, Finishing the Return tab, share the following with the taxpayers:

- Which records/documents they should keep and why
- What documentation is maintained at the site – why, how long, etc.
- What they need to know and do if they overpaid their taxes (e.g., refund cycle dates, increasing the number of exemptions on Form W-4 to avoid overpayments). See the Refund and Amount of Tax Owed lesson for additional information.
- What they need to know and do if they owe additional taxes (e.g., payment due date, estimated tax payments, and reducing the number of exemptions on Form W-4 to increase withholding). See the Payments lesson for additional information.

These are important tasks to accomplish after the tax return is completed, quality reviewed, and ready to be filed. The way that you conclude the interview can impact taxpayers' attitudes toward the taxpaying experience and their satisfaction with the volunteer tax return assistance program. It can also make next year's tax preparation easier for taxpayers and the volunteer who assists them.

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Assemble the taxpayer's copy of the tax return
- Identify the records the site maintains
- Explain to taxpayers which records they should maintain
- End the interview

#### What do I need?

- Publication 4012
- Publication 17
- Publication 4491-W
- Publication 730
- Form 1040-V

#### **Optional:**

- Form 8332
- Form 8879
- Form 9465

### How do I prepare the e-filing packet?

Volunteer tax assistance sites use tax software to create and e-file tax returns. Even so, taxpayers must retain paper copies of their returns. Follow the steps in the Volunteer Resource Guide, Finishing the Return tab, to prepare the packet. In general:

1. Use tax software to print the entire return, including all forms, schedules, and attachments
2. Make sure the taxpayer names and Social Security numbers are correct
3. Assemble the packet:
  - Start with Form 1040 on top
  - Place each form, schedule, and attachment in the proper sequence, based on the sequence number shown in the upper right corner of the form

4. Show the taxpayers the printed copy of the tax return, verifying once more the name, SSN, ITIN, address, filing status, dependents, income, expenses, deductions, credits, payments, and tax refund or balance due

## Who keeps the records?

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### What forms should taxpayers keep?

Taxpayers must keep records to prove their income and expenses. If they own a home or investments, their records should contain information needed to calculate the basis of the property.

Advise taxpayers to keep a copy of the following documents for at least three years:

- Form 1040 with all forms, schedules, and attachments.
- All other tax-related documents, including Forms W-2 and 1099.
- If applicable:
  - Form 8332, Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent
  - Power of Attorney
- For e-file returns, taxpayers must also keep a copy of the signed Form 8879, IRS e-file Signature Authorization.

If Publication 730, Important Tax Records Envelope, or an alternative is available, place the return and supporting documents into that envelope.



Advise taxpayers to bring the envelope to the site next year.

### What tax return data will the site keep?

The site will keep the following data confidential and in a secure location until December 31 of the current year:

- A master backup disk containing all electronically transmitted returns unless the site is using an internet-based software.
- Signed copies of IRC 7216, Consent to Disclose and Consent to Use Notices, are recommended to be retained for three years.



The site is no longer required by IRS to retain signed copies of Form 8879.

## How do I close the contact?

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Before seeing taxpayers off:

- Ask taxpayers, “Do you have any questions before you leave?”
- If the taxpayer is expecting a refund, provide instructions about how to check on the refund status at [irs.gov](http://irs.gov) “Where’s my Refund?”
- If the taxpayer has a balance due on the current or prior year return, provide information about various payment options.
- Advise taxpayers how to get answers to questions that may come up later.



- Encourage taxpayers to consider volunteering if they seem interested in learning more about tax preparation. Provide them with contact information or take their contact information, depending on your site's procedures.
- Ensure that you have the contact information needed to reach taxpayers in case there are any problems with e-filing the return.
- Thank taxpayers for using the service.

## Does the taxpayer have to do anything else?

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Give taxpayers a brief explanation of how the e-file process works:

- The Site Coordinator or designee transmits all the e-file returns.
- The Site Coordinator or designee receives an acknowledgment for each successful e-file, or a reject notice if there was a problem with the electronic file. The most common problem is a name or Social Security number that does not match IRS records.
- If the e-file is rejected, the Site Coordinator or designee will contact the taxpayer to resolve the problem, if necessary.
- If the return is not being e-filed, taxpayers must mail the signed copy of the tax return, along with copy B of all Forms W-2 and any Forms 1099 with withholding. Taxpayers who are filing a state return may need another copy of the return and Forms W-2. Make sure taxpayers know the correct address for mailing the return(s). Advise taxpayers that the return must be postmarked by the April filing due date.

## Summary

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Concluding the interview properly ensures that taxpayers have a complete record of the return, understand what will happen next, and know how to get answers to questions that come up later. If you handle the interview well, it can help taxpayers develop a more positive attitude toward the tax experience, which can foster greater accuracy in returns and timeliness in filing.

You should know how to assemble the tax packet and how to end the interview. The taxpayers should leave with instructions on:

- Which records the site is maintaining
- Which tax records they should maintain



### TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem or practice exercise(s) for your course of study in Publication 4491-W.

For practice using the tax preparation software, complete the scenarios using the Practice Lab on L&LT.





## Military Finishing and Filing the Return



### Introduction

This lesson will help you address special filing concerns of members of the U.S. Armed Forces. To do this you need to determine where and when to file a federal tax return, who qualifies for a deadline extension, and who qualifies for special tax benefits.

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Identify the special tax filing concerns of members of the Armed Forces
- Describe the extensions to file that are available for members of the Armed Forces
- Determine the effect on taxes of being in a combat zone
- Identify the tax forgiveness provisions related to military or terrorist actions

#### What do I need?

- Form 13614-C
- Publication 4012
- Publication 3
- Publication 17
- Publication 4491-W
- Form 1040
- Form 2848
- Form 4868
- Form 8822

#### **Optional:**

- Form 1040 Instructions

### Where and when should members of the Armed Forces file their returns?

#### Where should the taxpayer file the return?

Members of the Armed Forces should send their federal returns to the service center for where they currently live. Refer to the Form 1040 Instructions for the appropriate address.

The address may be different depending on if the taxpayer encloses a payment or if the military member is stationed overseas with an APO or FPO address.



Many military facilities have a Volunteer Income Tax Assistance center that will e-file tax returns.

#### example

Sergeant Kane, who is stationed in Maine but whose permanent home address is in California, should send her federal return to the service center for Maine.

#### When should the taxpayer file the return?

Most individual tax returns cover a calendar year, January through December.

Calendar-year taxpayers who live in the United States or Puerto Rico should file their individual tax returns by the April due date of the following year.

Taxpayers who have a balance due can pay by check, money order, electronic funds withdrawal, or credit card.



If April 15 falls on a weekend or holiday, then the due date is the next business day.



If the postal service does not deliver to the taxpayer's street address and the taxpayer has a post office box, enter the post office box number on the line for the present home address.

## What action should be taken when a member of the Armed Forces moves?

Taxpayers who changed their mailing address during the year should notify the IRS of the change on Form 8822, Change of Address.

Taxpayers who move after filing a tax return should fill out and mail Form 8822 to the IRS service center for the state where their returns were previously filed. The service centers' addresses are listed on page 2 of the form.



### EXERCISES

Answers are after the lesson summary.

**Question 1:** Tony, who is due a refund, filed his tax return from his home address in Florida on March 12. On March 30 he was transferred to Puerto Rico. Where should Tony submit his Form 8822, Change of Address?

- A. To the IRS service center for Florida
- B. To the IRS service center for Puerto Rico
- C. Either of the above

## What do members of the Armed Forces need to know about getting a refund or having an amount of tax owed on their returns?

Members of the Armed Forces who you assist may be entitled to a refund or owe tax. In either case they have several choices on how to get their refund or pay the amount they owe. It is important that volunteers are familiar with those choices to better help taxpayers understand their refund and payment options. This information was covered in the Refund and Amount of Tax Owed lesson. Refer to this lesson to review these options.

## What are the extension requirements for taxpayers within the U. S.?

Taxpayers can receive extensions of time to file their returns. Different rules apply to taxpayers who live in the U.S. and those who live outside the U.S.

The IRS will charge interest on taxes not paid by the due date, even if an extension of time to file is granted. The only exception is when the combat zone extension applies.



See Publication 3, Armed Forces Tax Guide which is a helpful resource for those assisting members of the Armed Forces.

## How does a taxpayer get an automatic extension?

Taxpayers living in the United States can receive an automatic six-month extension of time to file their federal tax returns.

To get the automatic extension, taxpayers must file Form 4868, Application for Automatic Extension of Time To File U.S. Individual Income Tax Return, by the due date for their tax return (usually April 15). Calendar-year taxpayers who take the extension will have until October 15 to file their tax return.



There are three ways to request an automatic extension of time to file a U.S. individual income tax return:

- e-File Form 4868.
- Pay all or part of the estimated income tax due using a credit or debit card. See “How to Make a Payment” on page 3 of Form 4868.
- File a paper Form 4868.

See Form 4868 for details.

Taxpayers *cannot* use the automatic six-month extension if they:

- Choose to have the IRS figure their tax or
- Are under a court order to file their returns by the regular due date

### Will the taxpayer owe interest and/or penalties?

Although taxpayers are not required to pay the amount they estimate as due, Form 4868 does not extend the time to pay their taxes. *If taxpayers do not pay the amount due by the regular due date, they will owe interest.*

In addition, taxpayers may be charged a late-payment penalty if the amount of tax paid before the due date (from withheld taxes or estimated tax payments) is less than 90% of the actual tax owed.

If Form 4868 is filed late, the IRS will inform the taxpayer that the request was denied.



For more details on penalties, refer to filing information in Publication 17.



### EXERCISES (continued)

**Question 2:** True or False? Interest is charged on the balance remaining after the due date of the return.  True  False

**Question 3:** Which of the following calendar-year taxpayers can receive an automatic six-month extension?

- A. Avery, who filed Form 4868 in February and chose to have the IRS figure his taxes
- B. Benton, who filed Form 4868 on April 15 and did not include any tax payments
- C. Calvin, who filed Form 4868 on April 20 and included a tax payment that was over 90% of what he owed
- D. None of the above

### How does the taxpayer file the return after obtaining a filing extension?

When the tax return is actually filed, any payment that was submitted with Form 4868 should be entered on the applicable line for amounts paid with extension on Form 1040. This line is located on Form 1040, Payments section.



**Tax Software Hint:** For instructions on filing an extension using the tax software, go to the Volunteer Resource Guide, Other Returns tab.

## What are the extension requirements for taxpayers outside the U.S. and Puerto Rico?

Extension requirements for taxpayers who live outside the United States and Puerto Rico differ from those who live inside the U.S.

### Who qualifies for an automatic two-month extension?

U.S. citizens and resident aliens are allowed an automatic two-month extension to file their return if they are:

- Living outside the U.S. and Puerto Rico on the due date of the return, and their main place of business or assigned post of duty is outside the U.S. and Puerto Rico
- Members of the Armed Forces on duty outside of the U.S. and Puerto Rico on the due date of the tax return

Although calendar-year taxpayers in this situation don't have to file or pay until June 15, they will owe interest charged from the April due date to the date the tax is paid. Form 4868 is not required to obtain this automatic two-month extension to file.



Traveling outside the United States and Puerto Rico on the due date does not qualify the taxpayer for an automatic two-month extension.

### What must taxpayers attach to their return?

Taxpayers using the automatic two-month extension must attach a statement to their return stating that they meet the requirements previously discussed in the section "Who qualifies for an automatic two-month extension" above.

### What is the extension rule for married taxpayers?

For married taxpayers who file jointly, only one spouse needs to meet the requirements to take advantage of the automatic extension to June 15.

For married taxpayers who file separately, only the spouse who meets the requirements qualifies for the automatic extension. If both spouses meet the requirements, each may take advantage of the extension.

### How can a taxpayer request an additional extension?

Taxpayers who live outside the U.S. and Puerto Rico and whose main place of business or assigned tour of duty is outside the U.S. and Puerto Rico can also request an additional extension by filing Form 4868 by the automatic extension date of June 15 and checking the "out of the country" and a U.S. citizen or resident box.

The due date will then be extended to **October 15**.



### EXERCISES (continued)

**Question 4:** Which of the following calendar-year taxpayers has until June 15 to file a tax return? (Select all that apply.)

- A. Weston, who files a joint return with his wife, Sheila. She was stationed in the Philippines from January through May, and they paid their taxes by credit card on April 2.
- B. Lilly, who lives in Mexico from January through April working for a company, returning to her main business in Texas on May 1.
- C. Dwayne, who was stationed in South Korea from July 1 through January 31.
- D. None of the above.



## EXERCISES (continued)

**Question 5:** Pvt. Franklin, a U.S. citizen, is a calendar-year taxpayer. What would the due date be for him to file a return if his assigned tour is in Puerto Rico?

- A. April 15
- B. June 15
- C. June 16

### How should the IRS be notified about combat zone service?

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The IRS works with the Department of Defense to identify taxpayers who are serving in a combat zone, so the IRS may suspend compliance actions, such as audits or enforced collections, until 180 days after the taxpayer has left the zone.

Taxpayers qualifying for such combat zone relief may also notify the IRS directly of their status through a special e-mail address: [combatzone@irs.gov](mailto:combatzone@irs.gov). They should provide name, stateside address, date of birth, and date of deployment to the combat zone. They should not include any Social Security numbers in an e-mail. This notification may be made by the taxpayer, spouse, or authorized agent or representative.

The IRS cannot provide tax account information by e-mail. The IRS will send responses to any questions about the taxpayer's account by regular mail to the address on record for the person, within two business days. The IRS may provide general answers to questions regarding the status of individual combat zone updates via e-mail.

### What are the tax options for combat zone participants?

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For members of the Armed Forces serving in a combat zone or qualified hazardous duty area, the deadline for filing tax returns, paying taxes, filing claims for refunds, and taking other actions with the IRS is automatically extended.

The deadline for taking action with the IRS is extended 180 days after the later of:

- The last day in a combat zone/qualified hazardous duty area
- The last day of any continuous hospitalization for injury from service in a combat zone or qualified hazardous duty area

In addition to the 180-day extension, the deadline is also extended by the number of days that were left to take the action with the IRS when the taxpayer entered a combat zone (or began performing qualifying service outside the combat zone). If a taxpayer entered the combat zone or qualified hazardous duty area before the period of time to take action began, the deadline is extended by the entire period of the time to take action.

Generally, spouses of individuals who served in a combat zone are entitled to the same deadline extension. There are two exceptions:

- Any tax year beginning more than two years after the date the area ceases to be a combat zone
- Any period the qualifying individual is hospitalized in the U.S. for injuries incurred in a combat zone

In these instances, the extension does not apply to a spouse.

### example

Captain Kristina Jones entered a combat zone on December 1, 2012. She remained there through March 31, 2014, when she departed for the U.S. She was not injured and did not return to the combat zone. Her deadlines for filing 2012, 2013, and 2014 returns are:

- 2012 tax return deadline is January 10, 2015. This deadline is extended by 285 days (180 plus 105) after the Captain's last day in the combat zone. The 105 additional days are the number of days in the 3½ month filing period that were left when she entered the combat zone (January 1–April 15, 2013).
- 2013 tax return deadline is January 10, 2015; the deadline is extended by 285 days (180 plus 105).
- 2014 tax return deadline is not extended because the 180-day extension period after March 31, 2014, ends on September 27, 2014 (which is before the start of the next filing period, January 1–April 15, 2015).

Publication 3 will provide additional information for combat zone extension of deadlines.



### EXERCISES (continued)

**Question 6:** If a member of the Armed Forces served in a combat zone from December 30, 2012 through May 31, 2014 and was not injured, the deadline for filing a 2012 tax return would be extended by how many days?



Request Publication 3 if you prepare returns at a military site. There are many special provisions that apply to service personnel and this publication is a valuable reference.

## What are other tax options for combat zone participants?

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Other situations that count as time served in a combat zone or qualified hazardous duty area are:

- Missing status such as missing in action or prisoner of war time counts as time served
- Support personnel including Red Cross, accredited correspondents, and civilian personnel acting under the direction of the Armed Forces
- Hospitalization outside the U.S. and up to five years of hospitalization in the U.S. as a result of an injury while serving in a combat zone or a contingency operation

## When can taxes be deferred?

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Reservists called to active duty and enlistees in the Armed Forces might qualify for a deferral of taxes owed if they can show that their ability to pay taxes was affected by their military service. The Service Members Civil Relief Act provides this benefit. The act covers active duty members of the military services and commissioned officers of the uniformed services.



## What are rules for deferment?

The deferral is not automatic; a taxpayer must apply for it. A taxpayer must have received a notice of tax due, or have an installment agreement with the IRS, before applying for the deferral. When applying, the taxpayer must:

- Be performing military service, and
- Show how the member's ability to pay the income tax has been materially affected by military service

The IRS will review each request and advise the taxpayer in writing of its decision. The service member will then be allowed up to 180 days after termination or release from military service to pay the tax. If the tax is paid in full by the end of the deferral period, no interest or penalty will be charged for that period.

## Can other parties assist with a tax return?

If a taxpayer wants a third party designee to discuss a tax return with the IRS, the "Yes" box in the Third Party Designee area of the return must be checked. Also, the taxpayer must provide the designee's name, phone number, and any five numbers the designee chooses as a personal identification number.

**Volunteers may not be named as a "Third Party Designee."**

The image shows a portion of a tax return form. At the top, it says "You Owe 77 Estimated tax penalty (see instructions) 77". Below that is the "Third Party Designee" section. It asks "Do you want to allow another person to discuss this return with the IRS (see instructions)?" with a checked "Yes. Complete below." box and an unchecked "No" box. Below the question are three fields: "Designee's name", "Phone no.", and "Personal identification number (PIN)". The PIN field is a five-digit grid.

Form 2848, Power of Attorney and Declaration of Representative, may also be used to grant authority to an individual to represent the taxpayer before the IRS and to receive tax information. If the return is e-filed, a copy of Form 2848 must be attached to Form 8453, U.S. Individual Income Tax Transmittal Form for an IRS e-file Return, and mailed to the IRS.

Use caution when allowing a representative to sign for someone. See Signatures in the Filing Information chapter in Publication 17 for more information.

If it is not possible to obtain a signature for a joint return from a spouse serving in a combat zone, a signed authorization to act on the taxpayer's behalf can be accepted. The IRS also accepts a written statement explaining that the spouse is serving in a combat zone. The statement must be signed by the spouse who is not serving in a combat zone and attached to the return.

## What are the tax forgiveness provisions for decedents?

Special tax-forgiveness provisions apply to individuals who die:

- While serving in a combat zone, or from wounds, disease, or other injury incurred while serving in a combat zone
- As a result of wounds or injuries incurred in a terrorist or military action while working for the U.S. government



Only the decedent's part of the joint income tax liability is eligible for the refund or tax forgiveness.

The forgiveness applies to:

- The tax year death occurred and
- Any earlier tax year in the period beginning with the year before the year in which the wounds or injury occurred

Any forgiven tax liability that has already been paid, will be refunded.

In addition, any unpaid taxes for years ending before the member began service in a combat zone will be forgiven, and any of those taxes that are paid after the date of death will be refunded.

The tax forgiveness provision also applies to those taxpayers serving outside the combat zone if the service:

- Was in direct support of military operations in the zone and
- Qualified the member for special military pay for duty subject to hostile fire, imminent danger, and/or terrorist actions



## EXERCISES (continued)

**Question 7:** Mr. Morris, a civilian employee of the United States, died in 2013 as a result of injuries he suffered during a terrorist attack in 2011. What years are Mr. Morris' income liabilities forgiven?

- A. 2012 through 2013
- B. 2012 through 2014
- C. 2011 through 2014

## What are the rules for filing a return for decedents?

The personal representative must file the final income tax return for the year of death and any returns not filed for preceding years. A surviving spouse may have to file the returns for the decedent.

To make a claim, the decedent's representative must file:

- A tax return for each year a tax return has not yet been filed
- Form 1040X for each year an income tax return has already been filed

If an individual died after the tax year, but before the return for that year was filed, the return for the tax year is not the final return; it is a regular return. The return for the year the taxpayer died will be the final tax return.

### example

Bob died in February 2014. His 2013 tax return – due on April 15, 2014 – is not the final tax return. The final tax return would be the 2014 Form 1040, filed in 2015.

The final tax return is due at the same time the decedent's return would have been due had the death not occurred.



**Tax Software Hint:** For software entries related to filing a decedent's return, go to the Volunteer Resource Guide, Finishing the Return tab.

For information on signing a joint return if one spouse has died or cannot sign the return, see Publication 17 Index, keyword: Signatures.

## Summary

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This lesson will help you determine special filing concerns for members of the U.S. Armed Forces.

- Members of the Armed Forces should send their federal returns to the service center for where they currently live.
- Most taxpayers who live in the U.S. or Puerto Rico should file their individual tax returns by April 15, unless that date falls on a weekend or holiday.
- Taxpayers who changed their mailing address should notify the IRS of the change on Form 8822, Change of Address.
- Taxpayers have options for receiving their refund or for paying a balance due. Be sure to review the Refund or Amount of Tax Owed lesson.
- The extension rules vary depending on whether the taxpayer lives in the U.S. or outside the U.S.
- The taxpayer, spouse, authorized agent, or representative can notify the IRS about combat zone service by sending an email to [combatzone@irs.gov](mailto:combatzone@irs.gov). Social Security numbers should not be included in the email.
- For members of the Armed Forces serving in a combat zone or Qualified Hazardous Duty Area, deadlines for taking action with the IRS are automatically extended until 180 days (plus any time remaining to take action) from the time the member leaves the combat zone/qualified hazardous duty area.
- The income tax liability of a member of the Armed Forces is forgiven if a member dies as a result of service in a combat zone or from a terrorist or military action outside the U.S.
- The terrorist or military action forgiveness also applies to an individual who is a U.S. employee at death and dies from wounds or injuries incurred in a terrorist or military action regardless of where the action occurred.



### TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem or practice exercise(s) for your course of study in Publication 4491-W.

For practice using the tax preparation software, complete the scenarios using the Practice Lab on L&LT.



## EXERCISE ANSWERS

**Answer 1:** A. Because he already filed his return from his previous address, Tony should submit Form 8822 to the service center for his previous address.

**Answer 2:** True. If the tax is paid after the regular due date, interest is charged from the regular due date to the date the tax is paid.

**Answer 3:** B. To get the extension, taxpayers must file Form 4868 by the return's due date. They do not have to pay their tax when submitting Form 4868, but they will owe interest on any tax not paid by the due date.

**Answer 4:** A. For Weston and Sheila, who file jointly, only one spouse needs to meet the requirements to take advantage of the automatic extension. In scenario B, Lilly does not qualify for the two-month automatic extension since her main place of business is Texas. In scenario C, Dwayne does not qualify for the automatic two-month extension because he was back in the U.S. on the due date.

**Answer 5:** A. April 15. Taxpayers who live and/or assigned in the U.S. or Puerto Rico should file their individual tax returns by April 15, unless that date falls on a weekend or holiday.

**Answer 6:** The deadline for filing the 2012 tax return is 180 days plus the number of days remaining for the Armed Forces member to take action after entering the combat zone. The deadline for 2012 is extended 285 days (180 plus 105) after leaving the combat zone, to March 12, 2014. The 105 additional days are the number of days in the 3½ month filing period that were left when the taxpayer entered the combat zone on December 30 (January–April 15, 2013).

**Answer 7:** C. 2011, 2012, 2013, 2014.



## Amended and Prior Year Returns



### Introduction

This lesson will help you determine how to amend a federal income tax return regardless of where the original return was prepared. In addition, this lesson provides guidance on preparing prior year returns for the previous three years provided the taxpayer has the applicable required materials. The site may prepare returns beyond the three previous years if taxpayers have the required materials for those years, including software.

If a taxpayer requests your help in filing an amended return, first confirm the original return is within the scope of the VITA/TCE programs regarding amendments. Ask the taxpayer what errors or omissions they wish to correct, and examine the return carefully to determine if the original return is, in fact, incorrect. To amend a return, tax preparation software must be used to complete Form 1040X, Amended U.S. Individual Income Tax.

### Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Identify when it is appropriate to prepare an amended return, Form 1040X
- Determine the time limits for filing Form 1040X
- Identify how to assemble and submit Form 1040X
- Provide guidance when preparing prior year returns
- Identify when it is appropriate to file a prior year return

#### What do I need?

- Form 13614-C
- Publication 4012
- Publication 17
- Publication 4491-W
- Form 1040X
- Form 1040X Instructions

#### **Optional:**

- Form 1040 Instructions
- Form 8379

### When is an amended return required?

Taxpayers should file amended returns using Form 1040X to correct any errors or omissions on a return they have already filed.

An amended return is not always required when the original return has an error. For example, the IRS will usually correct a math error on a return, or they will write the taxpayer and request a missing schedule or form. In these cases, do not amend the return. If taxpayers receive a notice from the IRS, refer them to the contact person and telephone number on the notice.

File an amended return if taxpayers:

- Received another Form W-2, a corrected Form W-2, or another income statement that was not reported on the original return
- Received an additional Form 1099 (such as unemployment compensation) or a corrected Form 1099 that was not reported on the original return
- Claimed their own personal exemption on the return when someone else was entitled to claim it
- Claimed deductions or credits they should not have claimed
- Did not claim deductions or credits they could have claimed, or
- Should have used a different filing status



If the federal return has to be amended, often the state return must also be amended.



Under the PATH Act, a wrongfully incarcerated individual does not include in income any civil damages, restitution, or other monetary award received that relates to his or her incarceration. Eligible taxpayers must file Form 1040X for each year these payments were reported and write “Incarceration Exclusion PATH Act” at the top. See the What’s New lesson for additional information.

#### example

Two weeks after Bernard’s current-year tax return was filed, he received another Form W-2 in the mail. The volunteer tax preparer reviews Bernard’s file to be sure the Form W-2 wasn’t included on the original return. The volunteer then helps Bernard prepare Form 1040X to include the additional Form W-2 on the current-year return.



After the due date of the original return, a taxpayer can change from Married Filing Separately to Married Filing Jointly, but cannot change from Married Filing Jointly to Married Filing Separately. However, an executor may be able to make this change for a deceased spouse. Refer to Publication 17 for more information.

### Is an amended return needed for injured spouse situations?

When a joint return is filed and only one spouse owes a past due amount such as child support, an education loan, or prior year’s taxes, the spouse who is not obligated for the debt can be considered an “injured spouse.” The couple should have filed Form 8379, Injured Spouse Allocation, with their original return. If they did not file Form 8379, and one of them qualifies as an injured spouse, file Form 8379 by itself. Do not attach the form to Form 1040X.

However, if the couple is filing Form 1040X for an additional refund not associated with the original injured spouse claim, and they do not want the injured spouse’s portion of the overpayment to be applied to the offset against the spouse, then complete and attach another Form 8379 to Form 1040X. See Publication 17, Form 8379, and Form 1040X Instructions for further information.

### How do I start?

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To file an amended return, you need a copy of the original return and the information that needs to be changed.

- Begin by researching and verifying the change requested by the taxpayer. Review the Intake/Interview & Quality Review Sheet with the taxpayer **and** use the Volunteer Resource Guide and Publication 17 to make sure that what the taxpayer wants to change is correct.
- Ask probing questions, using the interview techniques and tools discussed in the Volunteer Resource Guide, to get all the facts before preparing Form 1040X. Ask taxpayers if they have received any correspondence from the IRS making changes to the original return, or if they want to amend the return for another reason. For example, the parents of a college student correctly claimed their child as a dependent. However, their child also filed a return and incorrectly claimed the personal exemption. The child’s return was processed first. In this situation, the IRS would adjust the parents’ return by removing the exemption for the child. You will need this information to correctly amend the parents’ and child’s returns.

## What is Form 1040X?

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Look at the format of Form 1040X, page 1; there are three columns:

- Column A is used to show the **original** or **IRS adjusted figures** from the original return or previous amendment
- Column C is used to show the entries that would have been made on the original return if it had been done correctly
- The differences between the figures in columns A and C are shown in column B (Net change)



Amended returns can be prepared using tax software. However, they cannot be filed electronically. They must be mailed to the IRS.

Part I, Exemptions (on page 2), is used only if the taxpayer is increasing or decreasing the number of exemptions (personal and dependents) claimed on line 6d of the return being amended.

Part II, Presidential Election Campaign Fund, is used to make a \$3 donation to the fund for you (or your spouse) if you did not do so on your original return.

Part III, Explanation of Changes, must be used to explain specific changes being made on the return and the reasons for each change.

Explanations should be easily understood and clearly point out that the taxpayer qualifies for the change. For example, "taxpayer received another W-2 after they filed original return," or "taxpayer qualifies to claim child care expenses of \$600 for their 10-year-old dependent child, Form 2441 attached," or "taxpayer meets the qualifications to file as Head of Household instead of Married Filing Separately."



Taxpayers can easily find out the status of a Form 1040X, Amended U.S. Individual Income Tax Return, using the Where's My Amended Return? tool on [www.irs.gov](http://www.irs.gov). It's available in English and Spanish, and tracks the status of the amended return for the current year and up to three prior years.



Taxpayers can obtain a free transcript of their original or amended return from the last three years using the IRS2Go phone app or completing Form 4506T or Form 4506T-EZ, Request for Transcript of Tax Return. For a free copy of the original return, complete and mail Form 4506, Request for a Copy of Tax Return, to the appropriate IRS office listed on the form.

## What are the time limits to file amended returns for refunds?

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There is a statute of limitations on refunds being claimed on amended returns. In general, if a refund is expected on an amended return, taxpayers must file the return within three years of the due date of the original return, or within two years after the date they paid the tax, whichever is later. Returns filed before the due date (without regard to extensions) are considered filed on the due date.

### example

Robert's 2014 tax return was due April 15, 2015. He filed it on March 20, 2015. He amends the 2014 return, expecting the correction to result in a refund. If he gets it postmarked on or before April 15, 2018, it will be within the three-year limit, and the return will be accepted. But if the amended 2014 return is postmarked after April 15, 2018, it will fall outside the three-year period and he will not receive the refund.

Time periods for claiming a refund are suspended for a period when a taxpayer is financially disabled due to a medically determined physical or mental impairment. It is, however, very rare that a taxpayer qualifies for that status. Read the definition of financial disability in Publication 17, Filing Information chapter.

There are a few exceptions to the three-year limit. For example, a taxpayer has a longer period of time to claim a loss on a bad debt or worthless security, or for a foreign tax credit or deduction. The exceptions are explained in more detail in Publication 17 and the Form 1040X Instructions. If you think the taxpayer may qualify for an exception to the three-year time limit, refer them to a professional tax preparer.

## What if taxpayers are due a refund on their amended return?

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If the amended return indicates the taxpayer is due a refund, be sure to advise that:

- Before mailing the amended return, the taxpayer must wait until the original return is processed.
- The taxpayer can cash the original refund check, if any, while waiting for any additional refund.
- Interest will be paid for a refund on an amended return from the due date or filing date of the original return, whichever is later, to the date the amended return is filed. (This interest will be taxable in the year it is received.)
- Generally, it takes 8-16 weeks to process an amended tax return.

## What if the taxpayer owes money on the amended return?

---

If the amended current year return indicates the taxpayer owes money, file Form 1040X and instruct the taxpayer to pay the amount by the April due date to avoid interest and penalties.

Taxpayers who cannot pay the balance in full by the April due date should file the return on time anyway. Encourage taxpayers to pay as much as they can on time, because the IRS will calculate and bill for interest on the amount of tax owed. Refer to the Volunteer Resource Guide, Finishing the Return tab, for more information on payment options.



Refer taxpayers to the Form 1040X Instructions for information they must include on their check or money order.



### EXERCISES

Answers are after the lesson summary.

**Question 1:** John e-filed his 2014 Form 1040 on March 29, 2015. John found an error on the 2014 return and mailed an amended 2014 return on April 15, 2018. Is this too late to qualify for the refund?

Yes    No

**Question 2:** Brenda discovers an error on her timely-filed 2014 tax return. Correction of this error would result in a refund. She mails an amended return on May 6, 2018. Is this too late for Brenda to claim a refund?  Yes    No



## How do I complete the amended return using tax software?

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Volunteer tax preparers can amend returns regardless of where the original return was prepared, using tax software. Remember to follow the interview process and use the research tools to prepare an accurate return.



**Tax Software Hint:** For software entries, go to Volunteer Resource Guide, Other Returns tab, to review the step-by-step procedures for preparing Form 1040X.



A refund on an amended return cannot be direct deposited. A paper check will be mailed to the taxpayer.

## How do I assemble and submit Form 1040X?

---

### What should be attached?

Remember, Form 1040X should be prepared using tax software but it cannot be e-filed. Once the amended return is complete, follow these steps to assemble the return for mailing and for the taxpayers' records:

1. Print two copies of the federal amended return from the tax software, and if there is a state return, two copies of that form: one for the taxpayers' records and one to mail.
2. Have the taxpayer (and spouse if Married Filing Jointly) sign and date Form 1040X and the state return.
3. Attach all additional or corrected Form(s) W-2 or Form(s) 1099 that the taxpayers received after filing their original return. Be sure you have included any additional federal income tax withheld in the Payments section of Form 1040X.
4. Attach any forms or schedules needed to support the changes. Make sure the reason for amending the return is explained on Form 1040X, Part III.



Attach all affected forms and schedules when amending a return, otherwise IRS will send the amended return back to the taxpayer unprocessed.

Explain that normal processing time for an amended return is generally 8-16 weeks. Also tell the taxpayers that, if they owe money and are not paying the balance due by the original due date of the return, the IRS will send a bill that will include any interest or penalty amounts.

## Who can prepare prior year returns?

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A volunteer may prepare a prior year return if it is within scope and if the tax topics are within the volunteer's **current** year's certification level. Taxpayers seeking assistance outside the scope of VITA/TCE should be referred to a professional tax preparer.



SPEC may be able to support sites that have the resources, motivation and ability to go back as many years as needed, while maintaining quality standards.



VITA/TCE sites are encouraged, but not required to prepare prior year returns.



If a taxpayer requests return preparation assistance for returns older than three years or if the site is unable to prepare prior year returns, refer the taxpayer to a paid preparer to complete the prior year returns.

## What technical resources are required?

If your site chooses to prepare prior year returns, the Site Coordinator should be aware of the requirements. The SPEC Relationship Managers and [www.irs.gov](http://www.irs.gov) (keyword search: prior year returns) are critical resources for administrative and technical resources.



The Partner and Volunteer Resource Page on [www.irs.gov](http://www.irs.gov) (keyword search: Partner and Volunteer Resource Center) includes hot topics for partners and volunteers.

At a minimum, the following tools are required:

- Prior year tax preparation software
- Reference material, including Publications 17 and 4012 (available in the tax software) and volunteer quality alerts/volunteer tax alerts (available on [www.irs.gov](http://www.irs.gov))
- A current year Form 13614-C must be completed for each prior year return and will be used to determine the scope and certification level of each return.

Prior year tax form instructions and publications are also available on [www.irs.gov](http://www.irs.gov) for reference. If your site does not have the necessary tools to prepare prior year returns, seek guidance from your Site Coordinator.



The Interactive Tax Assistant (ITA) is an online tool that provides consistent answers to many current and prior year tax law questions using a probe and response process. ITA is available on [www.irs.gov](http://www.irs.gov).

## How do I file a prior year return?

Tax returns for the two most current prior years can be filed electronically. Other prior year returns must be mailed by taxpayers to the appropriate IRS address listed in the Volunteer Resource Guide, Partner Resources tab. Also, see the information about balance due returns in the Finishing the Return tab of the same guide.

## Summary

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In the VITA/TCE programs, you can help taxpayers prepare amended or prior year tax returns provided the site offers this service. Use the interview process and research tools to prepare accurate amended returns.

Amended returns should be filed to correct any error or omission that is within scope.

Additional notes:

- Amended returns for any year and prior year returns before 2014 cannot be e-filed.
- A refund on an amended or prior year return cannot be direct deposited; a check is mailed to the taxpayer.
- If you are amending the federal return, you usually have to amend the state return.
- Volunteers may only prepare returns within the scope of VITA/TCE programs and only if the tax issues come within the volunteer's current level of training and certification.
- If a taxpayer requests return preparation assistance for returns older than three years or if the site is unable to prepare prior year returns, refer the taxpayer to a paid preparer to complete the prior year returns.

## What situations are out of scope for the VITA/TCE programs?

The following is out of scope for this lesson. While this list may not be all inclusive, it is provided for your awareness only.

- Taxpayers who may qualify for an exception to the three-year time limit for filing an amended return for a refund



### TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem or practice exercise(s) for your course of study in Publication 4491-W.

For practice using the tax preparation software, complete the scenarios using the Practice Lab on L&LT.



### EXERCISE ANSWERS

**Answer 1:** *No, it is not too late. Returns filed before the due date are considered filed on the due date of the return. Therefore, John's amended return was filed within the three-year period allowed for refunds.*

**Answer 2:** *Yes, it is too late. The postmark must be three years from the due date of the return. The IRS will disallow Brenda's amended return requesting a refund because it was filed more than three years after the due date of the original return.*





## Appendix: Affordable Care Act (ACA) Exercises



### Instructions

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The purpose of the following examples is to give volunteers an opportunity to practice completing forms and worksheets associated with the Affordable Care Act (ACA) tax provisions. Adequate information is provided to prepare simple tax returns with various health insurance coverage scenarios that you may encounter. Following each scenario are screen shots from the tax preparation software that will allow you to check your work. Note: This publication is posted before software and most tax forms are finalized.

### Reminders

- All taxpayer names, addresses and Social Security numbers provided in the scenarios are fictitious.
- When entering Social Security numbers (SSNs), replace the Xs as directed, or with any four digits of your choice.
- Use employer identification number (EIN) 622-00-XXXX for all W-2s.
- Complete tax return and intake sheet information is not provided. For the purposes of these exercises, you can ignore incomplete or missing information, or enter sample information of your choice.
- Use your city, state, and ZIP code when completing any forms, unless the notes state otherwise.
- For the purposes of the premium tax credit calculations on Form 8962, use “Other 48 states and DC” so your calculations will match the provided answers.
- For all scenarios, assume that the identity and Social Security cards were checked for all individuals on the intake sheet.

### Example 1 – Taxpayer with Partial Year Minimum Essential Coverage (MEC) and Coverage Exemption

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#### Interview Notes

- Greg Clayton is single with no dependents. No one can claim him as a dependent.
- His SSN is 621-00-XXXX
- Greg left his old job on March 15. He was covered under his previous employer through the end of March. He began a new job on June 15th, and immediately became eligible for, and enrolled in, his employer sponsored health care coverage. Both employers withheld Greg’s share of the insurance premium pretax from his paycheck each week.
- Greg was uninsured from April 1 through June 14 of the tax year.
- Greg’s first W-2 shows the following:
  - Box 1 = \$15,200
  - Box 2 = \$1,520
  - Box 12 = \$1,456 with code DD

- Greg's second W-2 shows:
  - Box 1 = \$22,800
  - Box 2 = \$2,280
  - Box 12 = \$2,184 with code DD

**Directions**

Review the interview notes, complete the volunteer sections of the intake sheet, and start a new return using Practice Lab or TaxSlayer software. Enter the SSN, filing status, personal information, and income. Then complete the following steps:

1. Select the Health Insurance section and answer all the questions pertaining to Greg.
2. Compare your result to the screen shots on the following pages.

Greg's intake sheet, page 1:

Form <b>13614-C</b> (October 2017)		Department of the Treasury - Internal Revenue Service <b>Intake/Interview &amp; Quality Review Sheet</b>				OMB Number 1545-1964	
<b>You will need:</b> <ul style="list-style-type: none"> <li>• Tax Information such as Forms W-2, 1099, 1098, 1095.</li> <li>• Social security cards or ITIN letters for all persons on your tax return.</li> <li>• Picture ID (such as valid driver's license) for you and your spouse.</li> </ul>				<ul style="list-style-type: none"> <li>• Please complete pages 1-3 of this form.</li> <li>• You are responsible for the information on your return. Please provide complete and accurate information.</li> <li>• If you have questions, please ask the IRS-certified volunteer preparer.</li> </ul>			
Volunteers are trained to provide high quality service and uphold the highest ethical standards. To report unethical behavior to the IRS, email us at <a href="mailto:wi.voltax@irs.gov">wi.voltax@irs.gov</a>							
<b>Part I – Your Personal Information</b> (If you are filing a joint return, enter your names in the same order as last year's return)							
1. Your first name <b>GREG</b>		M.I.	Last name <b>CLAYTON</b>		Telephone number <b>YOUR PHONE #</b>		Are you a U.S. citizen? <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No
2. Your spouse's first name		M.I.	Last name		Telephone number		Is your spouse a U.S. citizen? <input type="checkbox"/> Yes <input type="checkbox"/> No
3. Mailing address <b>55 CONCORD COURT</b>				Apt #	City <b>YOUR CITY</b>		State <b>YS</b> ZIP code <b>YOUR ZIP</b>
4. Your Date of Birth <b>7/22/1987</b>		5. Your job title <b>SALES REP</b>		6. Last year, were you:		a. Full-time student <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	
				b. Totally and permanently disabled <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No		c. Legally blind <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	
7. Your spouse's Date of Birth		8. Your spouse's job title		9. Last year, was your spouse:		a. Full-time student <input type="checkbox"/> Yes <input type="checkbox"/> No	
				b. Totally and permanently disabled <input type="checkbox"/> Yes <input type="checkbox"/> No		c. Legally blind <input type="checkbox"/> Yes <input type="checkbox"/> No	
10. Can anyone claim you or your spouse on their tax return? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No <input type="checkbox"/> Unsure							
11. Have you or your spouse: a. Been a victim of identity theft? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No b. Adopted a child? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No							
<b>Part II – Marital Status and Household Information</b>							
1. As of December 31, 2017, were you: <input checked="" type="checkbox"/> Unmarried (This includes registered domestic partnerships, civil unions, or other formal relationships under state law) <input type="checkbox"/> Married a. If Yes. Did you get married in 2017? <input type="checkbox"/> Yes <input type="checkbox"/> No							

Greg's intake sheet, page 3:

Check appropriate box for each question in each section				Page 3														
Yes	No	Unsure	<b>Part VI - Health Care Coverage - Last year, did you, your spouse, or dependent(s)</b>															
<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	1. (B) Have health care coverage?															
<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	2. (B) Receive one or more of these forms? (Check the box) <input checked="" type="checkbox"/> Form 1095-B <input type="checkbox"/> Form 1095-C															
<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	3. (A) Have coverage through the Marketplace (Exchange)? [Provide Form 1095-A]															
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	3a. (A) If yes, were advance credit payments made to help you pay your health care premiums?															
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	3b. (A) If yes, is everyone listed on your Form 1095-A being claimed on this tax return?															
<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	4. (B) Have an exemption granted by the Marketplace?															
<a href="http://www.irs.gov">http://www.irs.gov</a> or call 1-800-318-2596 for more information on health insurance options and assistance.																		

Greg's Form 1095-B from Employer A:

<b>Part IV Covered Individuals</b> (Enter the information for each covered individual(s).)																
(a) Name of covered individual(s)	(b) SSN	(c) DOB (if SSN is not available)	(d) Covered all 12 months	(e) Months of coverage												
				Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	
23 GREG CLAYTON	621-00-XXXX	7/22/1987	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
24			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Greg's Form 1095-B from Employer B:

Part IV Covered Individuals (Enter the information for each covered individual(s).)																
(a) Name of covered individual(s)	(b) SSN	(c) DOB (if SSN is not available)	(d) Covered all 12 months	(e) Months of coverage												
				Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	
23 GREG CLAYTON	621-00-XXXX	7/22/1987	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
24			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

### Results – Approaching the ACA

Confirm with Greg the months that he had MEC, and indicate this on Part VI of his intake sheet:

To be Completed by a Certified Volunteer Preparer (Use Publication 4012 and check the appropriate box(es) indicating Minimum Essential Coverage (MEC) for everyone listed on the return.)						
Name (List dependents in the same order as in Part II)	MEC Entire Year	No MEC	Part Year MEC (mark months with coverage)	Exemption (mark months exemptions applies)	Exemption All Year	Notes
Taxpayer			J F M A M J J A S O N D	J F M A M J J A S O N D		Short coverage gap
Spouse			J F M A M J J A S O N D	J F M A M J J A S O N D		
Dependent			J F M A M J J A S O N D	J F M A M J J A S O N D		
Dependent			J F M A M J J A S O N D	J F M A M J J A S O N D		

### Results – TaxSlayer ACA Responses

Greg's completed TaxSlayer health insurance input screens are shown below.

## Health Insurance Questionnaire

Did you or your family have health insurance at any time in 2016?

Yes

No

## Health Insurance Questionnaire

Did you purchase health insurance via HealthCare.gov or a State Marketplace? \*

Yes

No

## Months Insured

Was your entire household insured for all 12 months of 2016? \*

Yes

No

Please enter the number of months insured for each household member.

Name	Months Insured
Greg Clayton	10

Enter the months that Greg had health insurance coverage. Remember that MEC coverage for one day during the month counts for the entire month. He has MEC for January through March and June through December.

## Months Insured - Greg Clayton

Specify the 10 months that Greg Clayton had minimum essential coverage

<input checked="" type="checkbox"/> January	<input checked="" type="checkbox"/> February	<input checked="" type="checkbox"/> March
<input type="checkbox"/> April	<input type="checkbox"/> May	<input checked="" type="checkbox"/> June
<input checked="" type="checkbox"/> July	<input checked="" type="checkbox"/> August	<input checked="" type="checkbox"/> September
<input checked="" type="checkbox"/> October	<input checked="" type="checkbox"/> November	<input checked="" type="checkbox"/> December

[← Back](#) [Continue](#)

Only complete this screen if the taxpayer is claiming the coverage is unaffordable exemption.

## Do you qualify for Health Care Exemptions?

To determine if you can claim the "Coverage is Unaffordable" exemption, you must enter the following premium values from your Form 8965 Worksheet. Use the link below to determine the premium amounts. If you already know this return would not qualify to claim the "Coverage is Unaffordable" exemption, please select continue below to continue through the Health Insurance menu.

**Monthly Premium for the Lowest Cost Bronze Plan Premium (worksheet line 1)**

\$|

**Monthly Premium for the Second Lowest Cost Silver Plan Premium (worksheet line 10)**

\$

[Click here to obtain the LCBP and SLCSP premium amounts to enter above.](#)  
[Click here to determine if you can claim a health coverage exemption.](#)

[← Back](#) [Continue](#)

Greg qualifies for a short coverage gap exemption for April and May.

## Health Care Exemption Certificates

**!** You do not qualify to claim the coverage exemption for household or gross income below the filing threshold, but if you received exemption certificates or can claim another coverage exemption, answer Yes below and then continue.

**Did you receive an exemption certificate from a marketplace or qualify to claim a coverage exemption on your return? \***

Yes  
 No

[Click here to determine if you can claim a health coverage exemption.](#)

[← Back](#) [Continue](#)



Check the box for each month that the exemption applies.

## Health Insurance/Exemption

**Name of Individual \***

**Do you have a marketplace-issued certificate for this exemption or going to apply for an exemption from the marketplace? \***

Yes  
 No

**Exemption Type on the return**

Indicate full year or specify months for which you qualify to take the exemption.

Full Year

January       February       March       April  
 May       June       July       August  
 September       October       November       December

## Health Coverage Exemptions

Name of Individual	Type	Edit	Delete
Greg Clayton	B		
<input type="button" value="Add another exemption"/>			

### Results – Form 1040, page 2

Greg will not be required to pay any shared responsibility payment. Greg's Form 1040, page 2 will not have the "Full-year coverage" box marked and will also not show an amount on the individual responsibility line.

<b>60a</b>	Household employment taxes. Schedule H	0
	<b>b</b> First-time homebuyer credit repayment. Form 5405	0
<b>61</b>	Health care: individual responsibility <span style="float: right;">Full-year coverage: <input type="checkbox"/></span>	0
<b>62</b>	Taxes from <input type="checkbox"/> Form 8959 <input type="checkbox"/> Form 8960 <input type="checkbox"/>	
	UT: 0      MSA: 0      ZPMF: 0	

## Example 2 – Coverage Exemptions

---

### Interview Notes

- Jerome and Judy Baxter are married and file a joint return.
- They have one child, Jana, who they claim as a dependent on their return.
- Jerome’s Form W-2 shows the following:
  - Box 1 = \$26,000
  - Box 2 = \$2,000
- Jerome, Judy, and Jana do not have any other income.
- Their Social Security numbers are:
  - Jerome: 623-00-XXXX
  - Judy: 624-00-XXXX
  - Jana: 625-00-XXXX
- Jerome’s small employer offered health insurance for the tax year, but Jerome and Judy thought the premium was too expensive. The insurance Jerome was offered met the ACA’s definition of an affordable employer coverage offer.
- Jerome and Judy were uninsured for all of 2017.
- They live in a state that did not expand Medicaid coverage to low-income adults.
- Jana was enrolled in Medicaid all year. All children in their state who are under the age of 18 are eligible for Medicaid with household income under 138% of FPL.

### Directions

Review the interview notes, complete the volunteer sections of the intake sheet, and start a new return using Practice Lab or TaxSlayer software. Enter the SSNs, filing status, personal information, dependents, and income. Then complete the following steps:

1. Select the Health Insurance section and answer all the questions pertaining to Jerome and his family.
2. Compare your result to the screen shots on the following pages.

Form <b>13614-C</b> (October 2017)	Department of the Treasury - Internal Revenue Service <b>Intake/Interview &amp; Quality Review Sheet</b>	OMB Number 1545-1964
<p><b>You will need:</b></p> <ul style="list-style-type: none"> <li>Tax Information such as Forms W-2, 1099, 1098, 1095.</li> <li>Social security cards or ITIN letters for all persons on your tax return.</li> <li>Picture ID (such as valid driver's license) for you and your spouse.</li> </ul>		
<p><b>Please complete pages 1-3 of this form.</b></p> <ul style="list-style-type: none"> <li>You are responsible for the information on your return. Please provide complete and accurate information.</li> <li>If you have questions, please ask the IRS-certified volunteer preparer.</li> </ul>		
<p>Volunteers are trained to provide high quality service and uphold the highest ethical standards. To report unethical behavior to the IRS, email us at <a href="mailto:wi.voltax@irs.gov">wi.voltax@irs.gov</a></p>		
<p><b>Part I – Your Personal Information</b> (If you are filing a joint return, enter your names in the same order as last year's return)</p>		
1. Your first name <b>JEROME</b>	M.I. <b>BAXTER</b>	Last name <b>BAXTER</b>
2. Your spouse's first name <b>JUDY</b>	M.I. <b>BAXTER</b>	Last name <b>BAXTER</b>
3. Mailing address <b>33 APACHE WAY</b>		Apt # <b>YOUR CITY</b>
4. Your Date of Birth <b>07/09/1979</b>	5. Your job title <b>SALES</b>	6. Last year, were you: a. Full-time student <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No b. Totally and permanently disabled <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No c. Legally blind <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
7. Your spouse's Date of Birth <b>12/01/1983</b>	8. Your spouse's job title <b>HOMEMAKER</b>	9. Last year, was your spouse: a. Full-time student <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No b. Totally and permanently disabled <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No c. Legally blind <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
10. Can anyone claim you or your spouse on their tax return? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No <input type="checkbox"/> Unsure		
11. Have you or your spouse: a. Been a victim of identity theft? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No b. Adopted a child? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No		
<p><b>Part II – Marital Status and Household Information</b></p>		
1. As of December 31, 2017, were you: <input type="checkbox"/> Unmarried (This includes registered domestic partnerships, civil unions, or other formal relationships under state law) <input checked="" type="checkbox"/> Married a. If Yes, Did you get married in 2017? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No <input type="checkbox"/> Divorced b. Did you live with your spouse during any part of the last six months of 2017? <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No Date of final decree _____ <input type="checkbox"/> Legally Separated Date of separate maintenance agreement _____ <input type="checkbox"/> Widowed Year of spouse's death _____		
2. List the names below of: • everyone who lived with you last year (other than your spouse) • anyone you supported but did not live with you last year		
If additional space is needed check here <input type="checkbox"/> and list on page 3		
<b>To be completed by a Certified Volunteer Preparer</b>		
Name (first, last) Do not enter your name or spouse's name below	Date of Birth (mm/dd/yy)	Relationship to you (for example: son, daughter, parent, none, etc)
(a)	(b)	(c)
<b>JANA BAXTER</b>	<b>02/04/2015</b>	<b>DAUGHTER</b>
Number of months lived in your home last year	US Citizen (yes/no)	Resident of US, Canada, or Mexico last year (yes/no)
(d)	(e)	(f)
<b>12</b>	<b>YES</b>	<b>YES</b>
Single or Married as of 12/31/16 (S/M)	Full-time Student last year (yes/no)	Totally and Permanently Disabled (yes/no)
(g)	(h)	(i)
<b>S</b>	<b>NO</b>	<b>NO</b>
Is this person a qualifying child/relative of any other person? (yes/no)	Did this person provide more than 50% of his/her own support? (yes/no)	Did this person have less than \$4,050 of income? (yes/no)
(j)	(k)	(l)
<b>NO</b>	<b>NO</b>	<b>YES</b>
Did the taxpayer(s) provide more than 50% of support for this person? (yes/no/N/A)	Did the taxpayer(s) pay more than half the cost of maintaining a home for this person? (yes/no)	
(m)	(n)	
<b>YES</b>	<b>YES</b>	

Page 3		
Check appropriate box for each question in each section		
Yes	No	Unsure
<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<p>Part VI - Health Care Coverage - Last year, did you, your spouse, or dependent(s)</p>		
1. (B) Have health care coverage?		
2. (B) Receive one or more of these forms? (Check the box) <input type="checkbox"/> Form 1095-B <input type="checkbox"/> Form 1095-C		
3. (A) Have coverage through the Marketplace (Exchange)? [Provide Form 1095-A]		
3a. (A) If yes, were advance credit payments made to help you pay your health care premiums?		
3b. (A) If yes, Is everyone listed on your Form 1095-A being claimed on this tax return?		
4. (B) Have an exemption granted by the Marketplace?		
Visit <a href="http://www.healthcare.gov/">http://www.healthcare.gov/</a> or call 1-800-318-2596 for more information on health insurance options and assistance.		

## Results – Approaching the ACA

Complete the volunteer section of the Baxters' intake sheet, Part II:

<input type="checkbox"/> widowed Year of spouse's death: _____		
2. List the names below of: • everyone who lived with you last year (other than your spouse) • anyone you supported but did not live with you last year		
If additional space is needed check here <input type="checkbox"/> and list on page 3		
<b>To be completed by a Certified Volunteer Preparer</b>		
Name (first, last) Do not enter your name or spouse's name below	Date of Birth (mm/dd/yy)	Relationship to you (for example: son, daughter, parent, none, etc)
(a)	(b)	(c)
<b>JANA BAXTER</b>	<b>02/04/2015</b>	<b>DAUGHTER</b>
Number of months lived in your home last year	US Citizen (yes/no)	Resident of US, Canada, or Mexico last year (yes/no)
(d)	(e)	(f)
<b>12</b>	<b>YES</b>	<b>YES</b>
Single or Married as of 12/31/16 (S/M)	Full-time Student last year (yes/no)	Totally and Permanently Disabled (yes/no)
(g)	(h)	(i)
<b>S</b>	<b>NO</b>	<b>NO</b>
Is this person a qualifying child/relative of any other person? (yes/no)	Did this person provide more than 50% of his/her own support? (yes/no)	Did this person have less than \$4,050 of income? (yes/no)
(j)	(k)	(l)
<b>NO</b>	<b>NO</b>	<b>YES</b>
Did the taxpayer(s) provide more than 50% of support for this person? (yes/no/N/A)	Did the taxpayer(s) pay more than half the cost of maintaining a home for this person? (yes/no)	
(m)	(n)	
<b>YES</b>	<b>YES</b>	

## Results – Exemption; Medicaid Coverage Gap

Consider the income-based exemptions Jerome and Judy may be eligible to claim. At \$26,000, their income is above the filing threshold, so they cannot claim the exemption on Line 7 of Form 8965.

Because they live in a state that did not expand Medicaid coverage, the Code G exemption will apply if their income is less than 138% of the federal poverty line (FPL). Use the table in Publication 4012, ACA tab, to find the income amount for a family of three at 138% FPL (\$27,821). Jerome and Judy's income (\$26,000) is less than 138% FPL, so they are eligible to claim Code G. Eligibility for affordable employer-sponsored coverage or coverage in the marketplace does not disqualify them from this exemption.

Complete the volunteer section of the Baxter' intake sheet, Part VI:

as, income, marital status or family size changes, to your Marketplace. Reporting changes will help to make sure you are getting the proper amount of advance payments.

**To be Completed by a Certified Volunteer Preparer** (Use Publication 4012 and check the appropriate box(es) indicating Minimum Essential Coverage (MEC) for everyone listed on the return.)

Name (List dependents in the same order as in Part II)	MEC Entire Year	No MEC	Part Year MEC (mark months with coverage)	Exemption (mark months exemptions applies)	Exemption All Year	Notes
Taxpayer		X	J F M A M J J A S O N D	J F M A M J J A S O N D	Yes	Medicaid coverage gap
Spouse		X	J F M A M J J A S O N D	J F M A M J J A S O N D	Yes	Medicaid coverage gap
Dependent	X		J F M A M J J A S O N D	J F M A M J J A S O N D		Covered by Medicaid
Dependent			J F M A M J J A S O N D	J F M A M J J A S O N D		
Dependent			J F M A M J J A S O N D	J F M A M J J A S O N D		
Dependent			J F M A M J J A S O N D	J F M A M J J A S O N D		

**Part VII – Additional Information and Questions Related to the Preparation of Your Return**

1. Presidential Election Campaign Fund (If you check a box, your tax or refund will not change)

## Results – TaxSlayer ACA Responses

Indicate that Jana was covered by Medicaid for the entire year and Jerome and Judy did not have health insurance coverage for any month during the year:

### Health Insurance Questionnaire

Did you or your family have health insurance at any time in 2016?

Yes

No

### Health Insurance Questionnaire

Did you purchase health insurance via HealthCare.gov or a State Marketplace? \*

Yes

No

## Months Insured

Was your entire household insured for all 12 months of 2016? \*

- Yes  
 No

Please enter the number of months insured for each household member.

Name	Months Insured
Jerome Baxter	0
Judy Baxter	0
Jana Baxter	12

Continue past this screen. Jana did not have a filing requirement.

## Dependents' Modified AGI (if filing requirement)

Enter the AGI for your dependents from Form 1040, line 38; Form 1040A, line 22; Form 1040EZ, line 4; and Form 1040NR, line 37

\$|

Enter any tax-exempt interest for your dependents from Form 1040, line 8b; Form 1040A, line 8b; Form 1040EZ, the amount written to the left of the line 2 entry space; and Form 1040NR, line 9b

\$

Enter any amounts for your dependents from Form 2555, lines 45 and 50, and Form 2555-EZ, line 18

\$

Enter for each of your dependents the difference, if any, between Form 1040, lines 20a and 20b; and Form 1040A, lines 14a and 14b

\$

Do not enter anything on this screen for the Baxters.

## Do you qualify for Health Care Exemptions?

To determine if you can claim the "Coverage is Unaffordable" exemption, you must enter the following premium values from your Form 8965 Worksheet. Use the link below to determine the premium amounts. If you already know this return would not qualify to claim the "Coverage is Unaffordable" exemption, please select continue below to continue through the Health Insurance menu.

Monthly Premium for the Lowest Cost Bronze Plan Premium (worksheet line 1)

\$|

Monthly Premium for the Second Lowest Cost Silver Plan Premium (worksheet line 10)

\$

[Click here to obtain the LCBP and SLCSP premium amounts to enter above.](#)

[Click here to determine if you can claim a health coverage exemption.](#)

You have determined that Jerome and Judy qualify for a coverage exemption. Complete the remaining questions to claim the exemption for Jerome and Judy on the tax return.

## Health Care Exemption Certificates



You do not qualify to claim the coverage exemption for household or gross income below the filing threshold, but if you received exemption certificates or can claim another coverage exemption, answer Yes below and then continue.

Did you receive an exemption certificate from a marketplace or qualify to claim a coverage exemption on your return? \*

- Yes  
 No

[Click here to determine if you can claim a health coverage exemption.](#)

Indicate that Jerome can claim a coverage exemption because his income is below 138% of FPL and he was a resident of a state that did not expand Medicaid. Make the same entries for Judy.

## Health Insurance/Exemption

Name of Individual \*

Jerome Baxter ▼

Do you have a marketplace-issued certificate for this exemption or going to apply for an exemption from the marketplace? \*

- Yes  
 No

Exemption Type on the return

Resident of a state that did not expand Medicaid ▼

Indicate full year or specify months for which you qualify to take the exemption.

- Full Year

## Health Coverage Exemptions

[+ Add another exemption](#)

Name of Individual	Type		
Jerome Baxter	G		
Judy Baxter	G		

### Results – Form 8965 Part III

<b>Part III</b> Coverage Exemptions Claimed on Your Return for Individuals. If you and/or a member of your tax household are claiming an exemption on your return, complete Part III.																
	(a) Name of Individual	(b) SSN	(c) Exemption Type	(d) Full Year	(e) Jan	(f) Feb	(g) Mar	(h) Apr	(i) May	(j) June	(k) July	(l) Aug	(m) Sept	(n) Oct	(o) Nov	(p) Dec
8	JEROME BAXTER	623-00-XXXX	G	X												
9	JUDY BAXTER	624-00-XXXX	G	X												

### Results – Form 1040 Page 2

On Form 1040, the “Full-year coverage” box is not checked:

60a	Household employment taxes from Schedule H	0.00
b	First-time homebuyer credit repayment. Attach Form 5405 if required	0.00
61	Health care: individual responsibility (see instructions) Full-year coverage <input type="checkbox"/>	0.00
62	Taxes from: a <input type="checkbox"/> Form 8959 b <input type="checkbox"/> Form 8960 c <input type="checkbox"/> Instructions; enter code(s)	0.00
63	Add lines 56 through 62. This is your <b>total tax</b>	\$0.00
64	Federal income tax withheld from wages, etc.	0.00

In this case, each member of the tax household had either coverage or a coverage exemption for each month so there is no individual shared responsibility payment required.

## Example 3 – Coverage Exemptions

---

### Interview Notes

- Susan and Lee Parks are married and file a joint return.
- They have two children, Elisabeth and Emilee, whom they claim as dependents on their return.
- Susan's Form W-2 shows the following:
  - Box 1 = \$30,000
  - Box 2 = \$2,000
- Lee's Form W-2 shows the following:
  - Box 1 = \$27,000
  - Box 2 is \$2,700.
- Neither Susan, Lee, nor their children have any other income.
- Their Social Security numbers are:
  - Lee: 613-00-XXXX
  - Susan: 614-00-XXXX
  - Elisabeth: 615-00-XXXX
  - Emilee: 616-00-XXXX
- Lee's employer did not offer health insurance coverage for the tax year.
- Susan purchased self-only coverage under a plan offered by her employer.
- Susan had the option to purchase family coverage under an insurance plan offered by her employer which would have covered Susan, Lee, Elisabeth, and Emilee, at a cost of \$13,140. Susan and Lee could not afford this plan. Lee, Elisabeth and Emilee did not have health insurance coverage all year.
- The Parks don't qualify for any non-income-based coverage exemptions.

### Directions

Review the interview notes, complete the volunteer sections of the intake sheet, and start a new return using Practice Lab or TaxSlayer software. Enter the SSN, filing status, dependents, personal information, and income. Then complete the following steps:

1. Determine if this couple is eligible for the affordability exemption. No other exemptions apply.
2. Select the Health Insurance section and answer all the questions pertaining to Susan, Lee, Elisabeth, and Emilee.
3. Compare your result to the screen shots on the following pages.



Form <b>13614-C</b> (October 2017)	Department of the Treasury - Internal Revenue Service <b>Intake/Interview &amp; Quality Review Sheet</b>	OMB Number 1545-1964											
<b>You will need:</b> <ul style="list-style-type: none"> <li>• Tax Information such as Forms W-2, 1099, 1098, 1095.</li> <li>• Social security cards or ITIN letters for all persons on your tax return.</li> <li>• Picture ID (such as valid driver's license) for you and your spouse.</li> </ul>													
<ul style="list-style-type: none"> <li>• Please complete pages 1-3 of this form.</li> <li>• You are responsible for the information on your return. Please provide complete and accurate information.</li> <li>• If you have questions, please ask the IRS-certified volunteer preparer.</li> </ul>													
Volunteers are trained to provide high quality service and uphold the highest ethical standards. To report unethical behavior to the IRS, email us at <a href="mailto:wi.voltax@irs.gov">wi.voltax@irs.gov</a>													
<b>Part I – Your Personal Information</b> (If you are filing a joint return, enter your names in the same order as last year's return)													
1. Your first name <b>LEE</b>	M.I.	Last name <b>PARKS</b>	Telephone number <b>YOUR PHONE #</b>	Are you a U.S. citizen? <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No									
2. Your spouse's first name <b>SUSAN</b>	M.I.	Last name <b>PARKS</b>	Telephone number	Is your spouse a U.S. citizen? <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No									
3. Mailing address <b>87 HASTINGS BLVD</b>			Apt #	City <b>YOUR CITY</b>									
4. Your Date of Birth <b>06/01/1968</b>		5. Your job title <b>CONSTRUCTION</b>		6. Last year, were you:									
7. Your spouse's Date of Birth <b>04/05/1970</b>		8. Your spouse's job title <b>SALES</b>		9. Last year, was your spouse:									
10. Can anyone claim you or your spouse on their tax return? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No <input type="checkbox"/> Unsure													
11. Have you or your spouse:													
a. Been a victim of identity theft? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No													
b. Adopted a child? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No													
<b>Part II – Marital Status and Household Information</b>													
1. As of December 31, 2017, were you:													
<input type="checkbox"/> Unmarried (This includes registered domestic partnerships, civil unions, or other formal relationships under state law)													
<input checked="" type="checkbox"/> Married													
a. If Yes, Did you get married in 2017? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No													
b. Did you live with your spouse during any part of the last six months of 2017? <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No													
Date of final decree _____													
Date of separate maintenance agreement _____													
Year of spouse's death _____													
2. List the names below of:													
• everyone who lived with you last year (other than your spouse)													
• anyone you supported but did not live with you last year													
If additional space is needed check here <input type="checkbox"/> and list on page 3													
<b>To be completed by a Certified Volunteer Preparer</b>													
Name (first, last) Do not enter your name or spouse's name below	Date of Birth (mm/dd/yy)	Relationship to you (for example: son, daughter, parent, none, etc)	Number of months lived in your home last year	US Citizen (yes/no)	Resident of US, Canada, or Mexico last year (yes/no)	Single or Married as of 12/31/16 (S/M)	Full-time Student last year (yes/no)	Totally and Permanently Disabled (yes/no)	Is this person a qualifying child/relative of any other person? (yes/no)	Did this person provide more than 50% of his/her own support? (yes/no)	Did this person have less than \$4,050 of income? (yes/no)	Did the taxpayer(s) provide more than 50% of support for this person? (yes/no/N/A)	Did the taxpayer(s) pay more than half the cost of maintaining a home for this person? (yes/no)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)					
<b>ELISABETH PARKS</b>	<b>03/02/2012</b>	<b>DAUGHTER</b>	<b>12</b>	<b>YES</b>	<b>YES</b>	<b>S</b>	<b>YES</b>	<b>NO</b>	<b>NO</b>	<b>NO</b>	<b>YES</b>	<b>YES</b>	<b>YES</b>
<b>EMILEE PARKS</b>	<b>09/07/2007</b>	<b>DAUGHTER</b>	<b>12</b>	<b>YES</b>	<b>YES</b>	<b>S</b>	<b>YES</b>	<b>NO</b>	<b>NO</b>	<b>NO</b>	<b>YES</b>	<b>YES</b>	<b>YES</b>

Page 3			
<b>Check appropriate box for each question in each section</b>			
<b>Yes</b>	<b>No</b>	<b>Unsure</b>	<b>Part VI - Health Care Coverage - Last year, did you, your spouse, or dependent(s)</b>
<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	1. (B) Have health care coverage? <b>SUSAN</b>
<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	2. (B) Receive one or more of these forms? (Check the box) <input checked="" type="checkbox"/> Form 1095-B <input checked="" type="checkbox"/> Form 1095-C
<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	3. (A) Have coverage through the Marketplace (Exchange)? [Provide Form 1095-A]
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	3a. (A) If yes, were advance credit payments made to help you pay your health care premiums?
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	3b. (A) If yes, Is everyone listed on your Form 1095-A being claimed on this tax return?
<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	4. (B) Have an exemption granted by the Marketplace?

**Results – Exemptions; Insurance is Unaffordable**

Complete the volunteer section on page 1 of the intake sheet:

<input type="checkbox"/> Widowed					Year of spouse's death _____								
2. List the names below of:													
• everyone who lived with you last year (other than your spouse)													
• anyone you supported but did not live with you last year													
If additional space is needed check here <input type="checkbox"/> and list on page 3													
<b>To be completed by a Certified Volunteer Preparer</b>													
Name (first, last) Do not enter your name or spouse's name below	Date of Birth (mm/dd/yy)	Relationship to you (for example: son, daughter, parent, none, etc)	Number of months lived in your home last year	US Citizen (yes/no)	Resident of US, Canada, or Mexico last year (yes/no)	Single or Married as of 12/31/16 (S/M)	Full-time Student last year (yes/no)	Totally and Permanently Disabled (yes/no)	Is this person a qualifying child/relative of any other person? (yes/no)	Did this person provide more than 50% of his/her own support? (yes/no)	Did this person have less than \$4,050 of income? (yes/no)	Did the taxpayer(s) provide more than 50% of support for this person? (yes/no/N/A)	Did the taxpayer(s) pay more than half the cost of maintaining a home for this person? (yes/no)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)					
<b>ELISABETH PARKS</b>	<b>03/02/2012</b>	<b>DAUGHTER</b>	<b>12</b>	<b>YES</b>	<b>YES</b>	<b>S</b>	<b>YES</b>	<b>NO</b>	<b>NO</b>	<b>NO</b>	<b>YES</b>	<b>YES</b>	<b>YES</b>
<b>EMILEE PARKS</b>	<b>09/07/2007</b>	<b>DAUGHTER</b>	<b>12</b>	<b>YES</b>	<b>YES</b>	<b>S</b>	<b>YES</b>	<b>NO</b>	<b>NO</b>	<b>NO</b>	<b>YES</b>	<b>YES</b>	<b>YES</b>

Form 1095-B for Susan Parks:

Part IV Covered Individuals (Enter the information for each covered individual.)																					
(a) Name of covered individual(s)	(b) SSN	(c) DOB (if SSN is not available)	(d) Covered all 12 months	(e) Months of coverage																	
				Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec						
23 SUSAN PARKS	614-00-XXXX	04/05/1970	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Form 1095-C for Susan Parks:

Form <b>1095-C</b> Department of the Treasury Internal Revenue Service	<b>Employer-Provided Health Insurance Offer and Coverage</b>		<input type="checkbox"/> VOID <input type="checkbox"/> CORRECTED		600116 OMB No. 1545-2251 <b>2017</b>																
Part I Employee				Applicable Large Employer Member (Employer)																	
1 Name of employee SUSAN PARKS		2 Social security number (SSN) 614-00-XXXX		7 Name of employer EMPLOYER A		8 Employer identification number (EIN) 62-200XXXX															
3 Street address (including apartment no.) 87 HASTINGS BLVD				9 Street address (including room or suite no.) 1 FIRST AVENUE																	
4 City or town YOUR CITY		5 State or province YS		6 Country and ZIP or foreign postal code YOUR ZIP		10 Contact telephone number YOUR PHONE															
11 City or town YOUR CITY				12 State or province YS		13 Country and ZIP or foreign postal code YOUR ZIP															
Part II Employee Offer and Coverage				Plan Start Month (Enter 2-digit number):																	
14 Offer of Coverage (enter required code)	All 12 Months	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec								
	1E																				
15 Employee Share of Lowest Cost Monthly Premium, for Self-Only Minimum Value Coverage		\$ 260	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$								
16 Applicable Section 4980H Safe Harbor (enter code, if applicable)		2C																			
Part III Covered Individuals				If Employer provided self-insured coverage, check the box and enter the information for each covered individual. <input type="checkbox"/>																	
(a) Name of covered individual(s)	(b) SSN	(c) DOB (if SSN is not available)	(d) Covered all 12 months	(e) Months of Coverage																	
				Jan	Feb	Mar	Apr	May	June	July	Aug	Sep	Oct	Nov	Dec						
17 SUSAN PARKS	614-00-XXXX	04/05/1970	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Susan had coverage all year so you do not need to determine if it was affordable. Next, determine if the coverage available to Lee, Elisabeth and Emilee is considered unaffordable.

The required contribution for Lee, Elisabeth, and Emilee is Susan's share of the cost for family coverage (\$13,140), which is more than 8.16% of their household income (\$57,000 x .0816 = \$4,651). As a result, Lee, Elisabeth, and Emilee are eligible for the exemption for unaffordable coverage for the tax year. Their Affordability Worksheet is completed below:

**(A) Affordability Threshold**  
 Enter 8.16% of your household income (see *Household Income*). For this purpose, increase household income by the amount of any premium that is paid through a salary reduction arrangement and excluded from gross income. \$4651

**(B) Required Contribution Amount**  
 For each member of your tax household, enter in the columns provided the annual premium for the first option below that applies to that person. If the premium is the same for the whole year, enter the same value for each month. If the premium covers only part of the year, use the *Annualized Premium Worksheet* to determine what the annualized premium would be for each month.

Options (use the first that applies to each member of your tax household, including you, for each month):

1. The lowest cost self-only policy offered to each member of your tax household by his or her employer.
2. The lowest cost family policy\* offered by your employer or your spouse's employer (if you are filing a joint return).
3. The amount from the Marketplace Coverage Affordability Worksheet.

For each individual, coverage is unaffordable and the individual is exempt if (B), the Required Contribution Amount, is greater than (A), the Affordability Threshold.

Members of your tax household (enter one name per column):	Lee	Elisabeth	Emilee			
Premium for:						
January	13,140	13,140	13,140			
February	13,140	13,140	13,140			
March	13,140	13,140	13,140			
April	13,140	13,140	13,140			
May	13,140	13,140	13,140			
June	13,140	13,140	13,140			
July	13,140	13,140	13,140			
August	13,140	13,140	13,140			
September	13,140	13,140	13,140			
October	13,140	13,140	13,140			
November	13,140	13,140	13,140			
December	13,140	13,140	13,140			

\*The policy must cover everyone in your tax household:

- for whom a personal exemption deduction is claimed on your tax return,
- who is not eligible for employer coverage, and
- who does not qualify for another coverage exemption.

After you determine that the taxpayers are eligible for a coverage exemption, complete the volunteer section of the Part VI on the intake sheet:

If advance payments of the premium tax credit were paid on your behalf to help pay your health insurance premiums, you should report life changes, such as, income, marital status or family size changes, to your Marketplace. Reporting changes will help to make sure you are getting the proper amount of advance payments.

To be Completed by a Certified Volunteer Preparer (Use Publication 4012 and check the appropriate box(es) indicating Minimum Essential Coverage (MEC) for everyone listed on the return.)

Name (List dependents in the same order as in Part II)	MEC Entire Year	No MEC	Part Year MEC (mark months with coverage)	Exemption (mark months exemptions applies)	Exemption All Year	Notes
Taxpayer Lee		X	J F M A M J J A S O N D	J F M A M J J A S O N D	Yes	Coverage unaffordable
Spouse Susan	X		J F M A M J J A S O N D	J F M A M J J A S O N D		Employer coverage
Dependent Elisabeth		X	J F M A M J J A S O N D	J F M A M J J A S O N D	Yes	Coverage unaffordable
Dependent Emilee		X	J F M A M J J A S O N D	J F M A M J J A S O N D	Yes	Coverage unaffordable
Dependent			J F M A M J J A S O N D	J F M A M J J A S O N D		

**Results – TaxSlayer ACA Responses**

Answer the ACA questions for Susan and Lee as shown below.

## Health Insurance Questionnaire

Did you or your family have health insurance at any time in 2016?

Yes

No

# Health Insurance Questionnaire

Did you purchase health insurance via HealthCare.gov or a State Marketplace? \*

- Yes  
 No

Because Susan had minimum essential coverage all year, indicate that she was insured for 12 months. Because Lee, Elisabeth and Emilee had no insurance all year, indicate zero months for each.

## Months Insured

Was your entire household insured for all 12 months of 2016? \*

- Yes  
 No

Please enter the number of months insured for each household member.

Name	Months Insured
Lee Parks	0
Susan Parks	12
Elisabeth Parks	0
Emilee Parks	0

The children do not have a filing requirement. Leave this screen blank.

## Dependents' Modified AGI (if filing requirement)

Enter the AGI for your dependents from Form 1040, line 38; Form 1040A, line 22; Form 1040EZ, line 4; and Form 1040NR, line 37

\$|

Enter any tax-exempt interest for your dependents from Form 1040, line 8b; Form 1040A, line 8b; Form 1040EZ, the amount written to the left of the line 2 entry space; and Form 1040NR, line 9b

\$

Enter any amounts for your dependents from Form 2555, lines 45 and 50, and Form 2555-EZ, line 18

\$

Enter for each of your dependents the difference, if any, between Form 1040, lines 20a and 20b; and Form 1040A, lines 14a and 14b

\$

Follow the steps in Publication 4012, tab H, Coverage is Unaffordable page. Leave this screen blank for Susan and Lee.

## Do you qualify for Health Care Exemptions?

To determine if you can claim the "Coverage is Unaffordable" exemption, you must enter the following premium values from your Form 8965 Worksheet. Use the link below to determine the premium amounts. If you already know this return would not qualify to claim the "Coverage is Unaffordable" exemption, please select continue below to continue through the Health Insurance menu.

**Monthly Premium for the Lowest Cost Bronze Plan Premium (worksheet line 1)**

\$|

**Monthly Premium for the Second Lowest Cost Silver Plan Premium (worksheet line 10)**

\$

[Click here to obtain the LCBP and SLCSPP premium amounts to enter above.](#)

[Click here to determine if you can claim a health coverage exemption.](#)

Complete this section to claim coverage exemptions for Lee, Elisabeth and Emilee on the tax return.

## Health Care Exemption Certificates



You do not qualify to claim the coverage exemption for household or gross income below the filing threshold, but if you received exemption certificates or can claim another coverage exemption, answer Yes below and then continue.

Did you receive an exemption certificate from a marketplace or qualify to claim a coverage exemption on your return? \*

Yes

No

[Click here to determine if you can claim a health coverage exemption.](#)

First enter the information for Lee.

## Health Insurance/Exemption

**Name of Individual \***

Lee Parks ▾

**Do you have a marketplace-issued certificate for this exemption or going to apply for an exemption from the marketplace? \***

Yes

No

**Exemption Type on the return**

Coverage is unaffordable ▾



Indicate full year or specify months for which you qualify to take the exemption.

Full Year

Then add additional exemptions for Elisabeth and Emilee.

## Health Coverage Exemptions

+ Add another exemption







Name of Individual	Type		
Lee Parks	A		

+ Add another exemption

### Results – Health Coverage Exemptions

## Health Coverage Exemptions

+ Add another exemption

Name of Individual	Type		
Lee Parks	A		
Elisabeth Parks	A		
Emilee Parks	A		

+ Add another exemption

### Results – Form 8965 Part III

<b>Part III</b> Coverage Exemptions Claimed on Your Return for Individuals. If you and/or a member of your tax household are claiming an exemption on your return, complete Part III.																
	(a) Name of Individual	(b) SSN	(c) Exemption Type	(d) Full Year	(e) Jan	(f) Feb	(g) Mar	(h) Apr	(i) May	(j) June	(k) July	(l) Aug	(m) Sept	(n) Oct	(o) Nov	(p) Dec
8	LEE PARKS	613-00-XXXX	A	X												
9	ELISABETH PARKS	615-00-XXXX	A	X												
10	EMILEE PARKS	616-00-XXXX	A	X												

### Results – Form 1040 Page 2

On Form 1040, the “Full-year coverage” box is not checked:

<b>60a</b>	Household employment taxes from Schedule H	<b>60a</b>	0 00
<b>b</b>	First-time homebuyer credit repayment. Attach Form 5405 if required	<b>60b</b>	0 00
<b>61</b>	Health care: individual responsibility (see instructions) Full-year coverage <input type="checkbox"/>	<b>61</b>	0 00
<b>62</b>	Taxes from: <b>a</b> <input type="checkbox"/> Form 8959 <b>b</b> <input type="checkbox"/> Form 8960 <b>c</b> <input type="checkbox"/> Instructions; enter code(s)	<b>62</b>	0 00

In this case, each member of the tax household had either coverage or a coverage exemption for every month so there is no individual shared responsibility payment required.

## Example 4 – Affordability Exemptions – Marketplace Coverage

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### Interview Notes

- Edward and Julia Fulton are married and file a joint return. Their SSNs are:
  - Edward: 617-00-XXXX
  - Julia: 618-00-XXXX
- The Fultons have a dependent son, Sam. Sam worked part-time and earned enough that he was required to file a tax return this year. Sam’s MAGI is \$6,900. Sam’s SSN is 619-00-XXXX.
- Julia and Edward did not have minimum essential coverage for any month during the tax year. Edward and Julia mention that they looked into purchasing coverage through the Marketplace, but felt that the premiums were too expensive.
- Sam was covered all year by a government-sponsored Children’s Health Plan.
- Edward’s Form W-2 shows:
  - Box 1 = \$16,280
  - Box 2 = \$1,628
- Julia’s W-2 shows:
  - Box 1 = \$17,000
  - Box 2 = \$0
- Edward and Julia had no other income.

### Directions

Explain that if their premium costs for Marketplace coverage is more than a certain percentage of their income, they would be eligible for an exemption from the SRP. Complete the worksheets in the Form 8965 Instructions to see if Edward and Julia qualify for the affordability exemption. Edward and Julia were not offered insurance coverage through their employers, so you’ll need to complete two worksheets:

1. The Affordability Worksheet
2. The Marketplace Coverage Affordability Worksheet



Form <b>13614-C</b> (October 2017)	Department of the Treasury - Internal Revenue Service <b>Intake/Interview &amp; Quality Review Sheet</b>	OMB Number 1545-1964											
<b>You will need:</b> <ul style="list-style-type: none"> <li>Tax Information such as Forms W-2, 1099, 1098, 1095.</li> <li>Social security cards or ITIN letters for all persons on your tax return.</li> <li>Picture ID (such as valid driver's license) for you and your spouse.</li> </ul>													
<b>Please complete pages 1-3 of this form.</b> <b>You are responsible for the information on your return. Please provide complete and accurate information.</b> <b>If you have questions, please ask the IRS-certified volunteer preparer.</b>													
<b>Volunteers are trained to provide high quality service and uphold the highest ethical standards.</b> <b>To report unethical behavior to the IRS, email us at <a href="mailto:wi.voltax@irs.gov">wi.voltax@irs.gov</a></b>													
<b>Part I – Your Personal Information</b> (If you are filing a joint return, enter your names in the same order as last year's return)													
1. Your first name <b>EDWARD</b>	M.I.	Last name <b>FULTON</b>	Telephone number <b>YOUR PHONE #</b>	Are you a U.S. citizen? <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No									
2. Your spouse's first name <b>JULIA</b>	M.I.	Last name <b>FULTON</b>	Telephone number	Is your spouse a U.S. citizen? <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No									
3. Mailing address <b>456 STONEHILL RD</b>			Apt #	City <b>SAVANNAH</b>									
State <b>GA</b>		ZIP code <b>31405</b>											
4. Your Date of Birth <b>06/01/1978</b>	5. Your job title <b>MANAGER</b>	6. Last year, were you:		a. Full-time student <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No									
		b. Totally and permanently disabled <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No		c. Legally blind <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No									
7. Your spouse's Date of Birth <b>01/06/1979</b>	8. Your spouse's job title <b>CUSTOMER SERVICE REP</b>	9. Last year, was your spouse:		a. Full-time student <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No									
		b. Totally and permanently disabled <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No		c. Legally blind <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No									
10. Can anyone claim you or your spouse on their tax return? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No <input type="checkbox"/> Unsure													
11. Have you or your spouse:													
a. Been a victim of identity theft? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No		b. Adopted a child? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No											
<b>Part II – Marital Status and Household Information</b>													
1. As of December 31, 2017, were you:													
<input type="checkbox"/> Unmarried		(This includes registered domestic partnerships, civil unions, or other formal relationships under state law)											
<input checked="" type="checkbox"/> Married		a. If Yes, Did you get married in 2017? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No											
<input type="checkbox"/> Divorced		b. Did you live with your spouse during any part of the last six months of 2017? <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No											
<input type="checkbox"/> Legally Separated		Date of final decree _____											
<input type="checkbox"/> Widowed		Date of separate maintenance agreement _____											
		Year of spouse's death _____											
2. List the names below of:													
<ul style="list-style-type: none"> <li>everyone who lived with you last year (other than your spouse)</li> <li>anyone you supported but did not live with you last year</li> </ul>													
If additional space is needed check here <input type="checkbox"/> and list on page 3													
<b>To be completed by a Certified Volunteer Preparer</b>													
Name (first, last) Do not enter your name or spouse's name below	Date of Birth (mm/dd/yy)	Relationship to you (for example: son, daughter, parent, none, etc)	Number of months lived in your home last year	US Citizen (yes/no)	Resident of US, Canada, or Mexico last year (yes/no)	Single or Married as of 12/31/16 (S/M)	Full-time Student last year (yes/no)	Totally and Permanently Disabled (yes/no)	Is this person a qualifying child/relative of any other person? (yes/no)	Did this person provide more than 50% of his/her own support? (yes/no)	Did this person have less than \$4,050 of support for this person? (yes/no/N/A)	Did the taxpayer(s) provide more than 50% of support for this person? (yes/no/N/A)	Did the taxpayer(s) pay more than half the cost of maintaining a home for this person? (yes/no)
(a) <b>SAM FULTON</b>	(b) <b>05/19/2000</b>	(c) <b>SON</b>	(d) <b>12</b>	(e) <b>YES</b>	(f) <b>YES</b>	(g) <b>S</b>	(h) <b>YES</b>	(i) <b>NO</b>					

Page 3

Check appropriate box for each question in each section

Yes	No	Unsure	Part VI - Health Care Coverage - Last year, did you, your spouse, or dependent(s)
<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	1. (B) Have health care coverage?
<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	2. (B) Receive one or more of these forms? (Check the box) <input type="checkbox"/> Form 1095-B <input type="checkbox"/> Form 1095-C
<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	3. (A) Have coverage through the Marketplace (Exchange)? [Provide Form 1095-A]
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	3a. (A) If yes, were advance credit payments made to help you pay your health care premiums?
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	3b. (A) If yes, Is everyone listed on your Form 1095-A being claimed on this tax return?
<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	4. (B) Have an exemption granted by the Marketplace?

<http://www.irs.gov> or call 1-800-318-2596 for more information on health insurance options and assistance.

## Results – Affordability Worksheet

Complete the top of the Affordability Worksheet to determine the Affordability Threshold of the Household Income. Include the MAGI for a dependent, such as Sam, whose income exceeds the filing threshold.

The calculation is:  $\$40,180 \times .0816$  (affordability threshold for 2017) =  $\$3,279$ .

**Affordability Worksheet**

Use this worksheet to determine whether coverage for each individual in your tax household is unaffordable. If you or another member of your tax household isn't eligible for employer-sponsored coverage, use the [Marketplace Coverage Affordability Worksheet](#) to figure the required contribution for that individual. An individual is exempt for any month in which (B), the Required Contribution, is more than (A), the Affordability Threshold.

<p><b>(A) Affordability Threshold</b> Enter 8.16% of your household income (see <a href="#">Household income</a>). For this purpose, increase household income by the amount of any premium that is paid through a salary reduction arrangement and excluded from gross income.</p>	<div style="border: 1px solid black; padding: 5px; display: inline-block;"> <b>\$3,279</b> </div>
<p><b>(B) Required Contribution Amount</b></p>	

Since Edward and Julia are not eligible for employer-sponsored coverage, they need to use the Marketplace Coverage Affordability Worksheet. Visit [www.healthcare.gov/tax-tool](http://www.healthcare.gov/tax-tool) to find the figures they will need to complete this worksheet:

- Remember to use their ages at the start of the tax year, since the first month they did not have coverage was January.
- Assume they live in zip code 31405 (Chatham County, GA) and do not use tobacco.
- Look up the lowest cost bronze plan for Edward, Julia and Sam. For this example, Sam is included in the calculation for the lowest cost bronze plan since he does not have an offer of employer coverage. Enter this amount on line 1 of the worksheet.
- Then look up the second lowest cost silver plan (SCLSP) for Edward and Julia. Do not include Sam in this quote because he has government-sponsored coverage. Enter this figure on line 10.

EDWARD FULTON

### Marketplace Coverage Affordability Worksheet

Use this worksheet to figure an individual's required contribution for any month in which the individual is not eligible for employer-sponsored coverage. Complete a separate worksheet for each part of the year in which either the individual resided in different geographic rating areas served by the Marketplace or for which the number of people in your tax household who are neither exempt nor eligible for employer-sponsored coverage was different.



*Do not complete this worksheet unless you were instructed to do so in the Affordability Worksheet.*

1. Enter the monthly premium for the lowest cost bronze plan that covers everyone in your tax household for whom a personal exemption deduction is claimed, who is not eligible for employer coverage, and who does not qualify for another coverage exemption for the month. To find the lowest cost bronze plan go to the Marketplace for your area	\$439
2. Enter your household income (see <i>Household income</i> )	\$40,180
3. Enter the total of all nontaxable social security benefits received by you, your spouse, and each claimed dependent who must file a tax return*	
4. Add lines 2 and 3	\$40,180
5. Enter the federal poverty line for the number of individuals in your tax household less any dependents not claimed. See the instructions for Form 8962, line 4	\$20,160
6. Divide line 4 by line 5. If the result (without rounding) is less than 1.0 or more than 4.0, skip lines 7 through 10 and enter -0- on line 11.	1.993
7. Multiply line 6 by 100 and round to the nearest whole number. Enter the applicable figure for the result from the table in the instructions for Form 8962, line 7	0.0638
8. Multiply line 4 by line 7	\$2,563
9. Divide line 8 by 12.0	\$214
10. Enter the monthly premium for the second lowest cost silver plan premium that covers everyone in your tax household for whom a personal exemption deduction is claimed, who is not eligible for minimum essential coverage (other than coverage in the individual market), and who does not qualify for another coverage exemption for the month. To find the second lowest cost silver plan go to the Marketplace for your area	\$495
11. Subtract line 9 from line 10	\$281
12. Subtract line 11 from line 1. If zero or less, enter -0-. This is the individual's required contribution for the month	\$158
13. Is the individual eligible for this coverage for every month of the year?	
<input checked="" type="checkbox"/> <b>Yes.</b> Multiply line 12 by 12.0. This is the annualized premium. Enter this amount in the space for every month on the <i>Affordability Worksheet</i>	\$1,896
<input type="checkbox"/> <b>No.</b> Use the Annualized Premium Worksheet to determine what the annualized premium would be for each month the individual was eligible for the coverage being tested. Enter the annualized premium in the space for the appropriate months on the <i>Affordability Worksheet</i>	

Compare the annualized premium from line 13 of the Marketplace Coverage Affordability Worksheet to the Affordability Threshold. Because the annualized premium is lower than the 8.16% threshold, Edward and Julia can't claim the affordability exemption.

**(B) Required Contribution Amount**  
 For each member of your tax household, enter in the columns provided the annual premium for the first option below that applies to that person. If the premium is the same for the whole year, enter the same value for each month. If the premiums covers only part of the year, use the Annualized Premium Worksheet to determine what the annualized premium would be for each month.

Options (use the first that applies to each member of your tax household, including you, for each month):

1. The lowest cost self-only policy offered to each member of your tax household by his or her employer.
2. The lowest cost family policy\* offered by your employer or your spouse's employer (if you are filing a joint return).
3. The amount from the Marketplace Coverage Affordability Worksheet.

For each individual, coverage is unaffordable and the individual is exempt if (B), the Required Contribution Amount, is greater than (A), the Affordability Threshold.

Members of your tax household (enter one name per column):	Edward	Julia				
Premium for:						
January	\$1,896	\$1,896				
February	\$1,896	\$1,896				
March	\$1,896	\$1,896				
April	\$1,896	\$1,896				
May	\$1,896	\$1,896				
June	\$1,896	\$1,896				
July	\$1,896	\$1,896				
August	\$1,896	\$1,896				
September	\$1,896	\$1,896				
October	\$1,896	\$1,896				
November	\$1,896	\$1,896				
December	\$1,896	\$1,896				

\*The policy must cover everyone in your tax household:

- for whom a personal exemption deduction is claimed on your tax return,
- who is not eligible for employer coverage, and
- who does not qualify for another coverage exemption.

Complete Part VI of their intake sheet, indicating that Edward and Julia are not eligible for a coverage exemption.

If advance payments of the premium tax credit were paid on your behalf to help pay your health insurance premiums, you should report life changes, such as, income, marital status or family size changes, to your Marketplace. Reporting changes will help to make sure you are getting the proper amount of advance payments.

To be Completed by a Certified Volunteer Preparer (Use Publication 4012 and check the appropriate box(es) indicating Minimum Essential Coverage (MEC) for everyone listed on the return.)

Name (List dependents in the same order as in Part II)	MEC Entire Year	No MEC	Part Year MEC (mark months with coverage)	Exemption (mark months exemptions applies)	Exemption All Year	Notes
Taxpayer <b>Edward</b>		X	J F M A M J J A S O N D	J F M A M J J A S O N D		No exemption
Spouse <b>Julia</b>		X	J F M A M J J A S O N D	J F M A M J J A S O N D		No exemption
Dependent <b>Sam</b>	X		J F M A M J J A S O N D	J F M A M J J A S O N D		Covered by CHP
Dependent			J F M A M J J A S O N D	J F M A M J J A S O N D		

Because Edward and Julia did not have MEC were not eligible for an exemption, they must make an individual shared responsibility payment (SRP). Complete their return in the next example.

## Example 5 – Shared Responsibility Payment

For this scenario, use the same facts as Example 4.

Since Edward and Julia didn't have health insurance coverage for any month of the year and weren't eligible for an exemption, they must make a shared responsibility payment.

### Directions

Review the interview notes, complete the volunteer sections of the intake sheet, and start a new return using Practice Lab or TaxSlayer software. Enter the SSN, filing status, dependents, personal information, and income. Then complete the following steps:

1. Complete the Health Insurance section of Edward and Julia's tax return.
2. Find the shared responsibility payment on the tax return and compare your results with the screen shots below.

### Results – TaxSlayer ACA Responses

Edward and Julia's completed Health Insurance section is shown below. Neither spouse had minimum essential coverage for any month, so you will indicate zero months insured for both taxpayer and spouse. Sam had full coverage all year, so you will indicate 12 months of coverage for him.

### Health Insurance Questionnaire

Did you or your family have health insurance at any time in 2016?

Yes

No

### Health Insurance Questionnaire

Did you purchase health insurance via HealthCare.gov or a State Marketplace? \*

Yes

No

### Months Insured

Was your entire household insured for all 12 months of 2016? \*

- Yes
- No

Please enter the number of months insured for each household member.

Name	Months Insured
Edward Fulton	0
Julia Fulton	0
Sam Fulton	12

Because Sam's income exceeded the filing threshold, his MAGI is included in household income when calculating Edward and Julia's shared responsibility payment.

## Dependents' Modified AGI (if filing requirement)

Enter the AGI for your dependents from Form 1040, line 38; Form 1040A, line 22; Form 1040EZ, line 4; and Form 1040NR, line 37

\$ 6900

Enter any tax-exempt interest for your dependents from Form 1040, line 8b; Form 1040A, line 8b; Form 1040EZ, the amount written to the left of the line 2 entry space; and Form 1040NR, line 9b

\$

Enter any amounts for your dependents from Form 2555, lines 45 and 50, and Form 2555-EZ, line 18

\$

Enter for each of your dependents the difference, if any, between Form 1040, lines 20a and 20b; and Form 1040A, lines 14a and 14b

\$

Enter the amount of the lowest cost bronze level plan and second lowest cost silver level plan.

## Do you qualify for Health Care Exemptions?

To determine if you can claim the "Coverage is Unaffordable" exemption, you must enter the following premium values from your Form 8965 Worksheet. Use the link below to determine the premium amounts. If you already know this return would not qualify to claim the "Coverage is Unaffordable" exemption, please select continue below to continue through the Health Insurance menu.

**Monthly Premium for the Lowest Cost Bronze Plan Premium (worksheet line 1)**

\$ 443.54

**Monthly Premium for the Second Lowest Cost Silver Plan Premium (worksheet line 10)**

\$ 499.48

[Click here to obtain the LCBP and SLCSPP premium amounts to enter above.](#)

[Click here to determine if you can claim a health coverage exemption.](#)

Edward and Julia were not eligible for the affordability exemption or any other exemption.

## Health Care Exemption Certificates



You do not qualify to claim the coverage exemption for household or gross income below the filing threshold, but if you received exemption certificates or can claim another coverage exemption, answer Yes below and then continue.

Did you receive an exemption certificate from a marketplace or qualify to claim a coverage exemption on your return? \*

Yes

No

[Click here to determine if you can claim a health coverage exemption.](#)

## Results – Form 1040 Page 2

The shared responsibility payment will carry over to Edward and Julia's Form 1040, page 2, shown below:

<b>60a</b> Additional employment taxes from Schedule H	<b>60a</b>	0 00
<b>b</b> First-time homebuyer credit repayment. Attach Form 5405 if required	<b>60b</b>	0 00
<b>61</b> Health care: individual responsibility (see instructions) Full-year coverage <input type="checkbox"/>	<b>61</b>	1,390 00
<b>62</b> Taxes from: <b>a</b> <input type="checkbox"/> Form 8959 <b>b</b> <input type="checkbox"/> Form 8960 <b>c</b> <input type="checkbox"/> Instructions; enter code(s)	<b>62</b>	0 00



## Example 6 – Premium Tax Credit with Advance Credit Payments

---

### Interview Notes

- Sheryl Graves has two children she claims as dependents, Trina and Travis, who live with her all year. She divorced in 2010. Sheryl pays all the costs of keeping up the home. Their SSNs are:
  - Sheryl: 605-00-XXXX
  - Trina: 606-00-XXXX
  - Travis: 607-00-XXXX
- Sheryl's mother, Monique Floyd, also lives with her. Sheryl provides over half of Monique's support and claims her as a dependent. Monique's SSN is 608-00-XXXX. Her only income for the tax year is \$4,500 received from Social Security and she was covered by Medicare all year.
- Sheryl's Form W-2 shows:
  - Box 1 = \$36,429
  - Box 2 = \$1,026
- Sheryl had no other income or deductions.
- Sheryl's employer does not offer health insurance coverage. She purchased minimum essential coverage for herself and her children through the Marketplace. They were covered for the entire year. Sheryl received the benefit of advance payments of the premium tax credit to help with the cost of her insurance premiums.

### Directions

Review the interview notes, complete the volunteer sections of the intake sheet, and start a new return using Practice Lab or TaxSlayer software. Enter the SSN, filing status, personal information, dependents, and income. Then complete the following steps:

1. Select the Health Insurance section and answer all the questions pertaining to Sheryl and her family.
2. Compare your result to the screen shots on the following pages.

Form <b>13614-C</b> (October 2017)	Department of the Treasury - Internal Revenue Service <b>Intake/Interview &amp; Quality Review Sheet</b>	OMB Number 1545-1964																																																									
<p><b>You will need:</b></p> <ul style="list-style-type: none"> <li>• Tax Information such as Forms W-2, 1099, 1098, 1095.</li> <li>• Social security cards or ITIN letters for all persons on your tax return.</li> <li>• Picture ID (such as valid driver's license) for you and your spouse.</li> </ul>																																																											
<p style="text-align: center;">Volunteers are trained to provide high quality service and uphold the highest ethical standards. To report unethical behavior to the IRS, email us at <a href="mailto:wi.voltax@irs.gov">wi.voltax@irs.gov</a></p>																																																											
<b>Part I – Your Personal Information</b> (If you are filing a joint return, enter your names in the same order as last year's return)																																																											
1. Your first name <b>SHERYL</b>	M.I. <b>GRAVES</b>	Last name <b>GRAVES</b>																																																									
2. Your spouse's first name	M.I.	Last name																																																									
3. Mailing address <b>321 MARTIN ROAD</b>	Apt #	City <b>YOUR CITY</b>																																																									
4. Your Date of Birth <b>06/17/1979</b>	5. Your job title <b>CLERK</b>	6. Last year, were you:																																																									
7. Your spouse's Date of Birth	8. Your spouse's job title	9. Last year, was your spouse:																																																									
10. Can anyone claim you or your spouse on their tax return? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No <input type="checkbox"/> Unsure		11. Have you or your spouse:																																																									
<b>Part II – Marital Status and Household Information</b>																																																											
1. As of December 31, 2017, were you: <input type="checkbox"/> Unmarried <input type="checkbox"/> Married <input checked="" type="checkbox"/> Divorced <input type="checkbox"/> Legally Separated <input type="checkbox"/> Widowed																																																											
2. List the names below of: • everyone who lived with you last year (other than your spouse) • anyone you supported but did not live with you last year																																																											
<table border="1" style="width:100%; border-collapse: collapse;"> <thead> <tr> <th rowspan="2">Name (first, last) Do not enter your name or spouse's name below</th> <th rowspan="2">Date of Birth (mm/dd/yy)</th> <th rowspan="2">Relationship to you (for example: son, daughter, parent, none, etc)</th> <th rowspan="2">Number of months lived in your home last year</th> <th rowspan="2">US Citizen (yes/no)</th> <th rowspan="2">Resident of US, Canada, or Mexico last year (yes/no)</th> <th rowspan="2">Single or Married as of 12/31/16 (S/M)</th> <th rowspan="2">Full-time Student last year (yes/no)</th> <th rowspan="2">Totally and Permanently Disabled (yes/no)</th> <th colspan="4">To be completed by a Certified Volunteer Preparer</th> </tr> <tr> <th>Is this person a qualifying child/relative of any other person? (yes/no)</th> <th>Did this person provide more than 50% of his/her own support? (yes/no)</th> <th>Did this person have less than \$4,050 of income? (yes/no)</th> <th>Did the taxpayer(s) provide more than 50% of support for this person? (yes/no/N/A)</th> <th>Did the taxpayer(s) pay more than half the cost of maintaining a home for this person? (yes/no)</th> </tr> </thead> <tbody> <tr> <td>TRINA GRAVES</td> <td>03/01/2001</td> <td>DAUGHTER</td> <td>12</td> <td>YES</td> <td>YES</td> <td>S</td> <td>YES</td> <td>NO</td> <td></td> <td></td> <td></td> <td></td> </tr> <tr> <td>TRAVIS GRAVES</td> <td>12/25/2002</td> <td>SON</td> <td>12</td> <td>YES</td> <td>YES</td> <td>S</td> <td>YES</td> <td>NO</td> <td></td> <td></td> <td></td> <td></td> </tr> <tr> <td>MONIQUE FLOYD</td> <td>05/05/1944</td> <td>MOTHER</td> <td>12</td> <td>YES</td> <td>YES</td> <td>S</td> <td>NO</td> <td>NO</td> <td></td> <td></td> <td></td> <td></td> </tr> </tbody> </table>			Name (first, last) Do not enter your name or spouse's name below	Date of Birth (mm/dd/yy)	Relationship to you (for example: son, daughter, parent, none, etc)	Number of months lived in your home last year	US Citizen (yes/no)	Resident of US, Canada, or Mexico last year (yes/no)	Single or Married as of 12/31/16 (S/M)	Full-time Student last year (yes/no)	Totally and Permanently Disabled (yes/no)	To be completed by a Certified Volunteer Preparer				Is this person a qualifying child/relative of any other person? (yes/no)	Did this person provide more than 50% of his/her own support? (yes/no)	Did this person have less than \$4,050 of income? (yes/no)	Did the taxpayer(s) provide more than 50% of support for this person? (yes/no/N/A)	Did the taxpayer(s) pay more than half the cost of maintaining a home for this person? (yes/no)	TRINA GRAVES	03/01/2001	DAUGHTER	12	YES	YES	S	YES	NO					TRAVIS GRAVES	12/25/2002	SON	12	YES	YES	S	YES	NO					MONIQUE FLOYD	05/05/1944	MOTHER	12	YES	YES	S	NO	NO				
Name (first, last) Do not enter your name or spouse's name below	Date of Birth (mm/dd/yy)	Relationship to you (for example: son, daughter, parent, none, etc)										Number of months lived in your home last year	US Citizen (yes/no)	Resident of US, Canada, or Mexico last year (yes/no)	Single or Married as of 12/31/16 (S/M)	Full-time Student last year (yes/no)	Totally and Permanently Disabled (yes/no)	To be completed by a Certified Volunteer Preparer																																									
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MONIQUE FLOYD	05/05/1944	MOTHER	12	YES	YES	S	NO	NO																																																			

Page 3			
<b>Check appropriate box for each question in each section</b>			
Yes	No	Unsure	<b>Part VI - Health Care Coverage - Last year, did you, your spouse, or dependent(s)</b>
<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	1. (B) Have health care coverage?
<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	2. (B) Receive one or more of these forms? (Check the box) <input checked="" type="checkbox"/> Form 1095-B <input type="checkbox"/> Form 1095-C
<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	3. (A) Have coverage through the Marketplace (Exchange)? [Provide Form 1095-A]
<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	3a. (A) If yes, were advance credit payments made to help you pay your health care premiums?
<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	3b. (A) If yes, Is everyone listed on your Form 1095-A being claimed on this tax return?
<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	4. (B) Have an exemption granted by the Marketplace?

Part IV Covered Individuals (Enter the information for each covered individual(s).)															
(a) Name of covered individual(s)	(b) SSN	(c) DOB (if SSN is not available)	(d) Covered all 12 months	(e) Months of coverage											
				Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
23 Monique Floyd	608-00-XXXX	05/05/1944	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>



Form **1095-A****Health Insurance Marketplace Statement** 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](http://www.irs.gov/Form1095A) for instructions and the latest information. CORRECTED**2017****Part I Recipient Information**

1 Marketplace identifier <b>XXXXX</b>	2 Marketplace-assigned policy number <b>XXXXXX</b>	3 Policy issuer's name <b>XXXXXXXXXXXX</b>
4 Recipient's name <b>SHERYL GRAVES</b>	5 Recipient's SSN <b>605-00-XXXX</b>	6 Recipient's date of birth <b>05/17/1979</b>
7 Recipient's spouse's name	8 Recipient's spouse's SSN	9 Recipient's spouse's date of birth
10 Policy start date <b>01/01/2017</b>	11 Policy termination date <b>12/31/2017</b>	12 Street address (including apartment no.) <b>321 MARTIN ROAD</b>
13 City or town <b>YOUR CITY</b>	14 State or province <b>YOUR STATE</b>	15 Country and ZIP or foreign postal code <b>YOUR ZIP</b>

**Part II Covered Individuals**

	A. Covered individual name	B. Covered individual SSN	C. Covered individual date of birth	D. Coverage start date	E. Coverage termination date
16	<b>SHERYL GRAVES</b>	<b>605-00-XXXX</b>	<b>05/17/1979</b>	<b>01/01/2017</b>	<b>12/31/2017</b>
17	<b>TRINA GRAVES</b>	<b>606-00-XXXX</b>	<b>03/01/2001</b>	<b>01/01/2017</b>	<b>12/31/2017</b>
18	<b>TRAVIS GRAVES</b>	<b>607-00-XXXX</b>	<b>12/25/2002</b>	<b>01/01/2017</b>	<b>12/31/2017</b>
19					
20					

**Part III Coverage Information**

Month	A. Monthly enrollment premiums	B. Monthly second lowest cost silver plan (SLCSP) premium	C. Monthly advance payment of premium tax credit
21 January	<b>\$587.00</b>	<b>\$774.00</b>	<b>\$492.00</b>
22 February	<b>\$587.00</b>	<b>\$774.00</b>	<b>\$492.00</b>
23 March	<b>\$587.00</b>	<b>\$774.00</b>	<b>\$492.00</b>
24 April	<b>\$587.00</b>	<b>\$774.00</b>	<b>\$492.00</b>
25 May	<b>\$587.00</b>	<b>\$774.00</b>	<b>\$492.00</b>
26 June	<b>\$587.00</b>	<b>\$774.00</b>	<b>\$492.00</b>
27 July	<b>\$587.00</b>	<b>\$774.00</b>	<b>\$492.00</b>
28 August	<b>\$587.00</b>	<b>\$774.00</b>	<b>\$492.00</b>
29 September	<b>\$587.00</b>	<b>\$774.00</b>	<b>\$492.00</b>
30 October	<b>\$587.00</b>	<b>\$774.00</b>	<b>\$492.00</b>
31 November	<b>\$587.00</b>	<b>\$774.00</b>	<b>\$492.00</b>
32 December	<b>\$587.00</b>	<b>\$774.00</b>	<b>\$492.00</b>
33 Annual Totals	<b>\$7,044.00</b>	<b>\$9,288.00</b>	<b>\$5,904.00</b>

For Privacy Act and Paperwork Reduction Act Notice, see separate instructions.

Cat. No. 60703Q

Form **1095-A** (2017)

## Results – Approaching the ACA

Complete the volunteer section of Sheryl's intake sheet on page 1:

widowed      Year of spouse's death: \_\_\_\_\_

2. List the names below of:  
 • **everyone** who lived with you last year (other than your spouse)  
 • **anyone** you supported but did not live with you last year

If additional space is needed check here  and list on page 3

									To be completed by a Certified Volunteer Preparer				
Name (first, last) Do not enter your name or spouse's name below	Date of Birth (mm/dd/yy)	Relationship to you (for example: son, daughter, parent, none, etc)	Number of months lived in your home last year	US Citizen (yes/no)	Resident of US, Canada, or Mexico last year (yes/no)	Single or Married as of 12/31/16 (S/M)	Full-time Student last year (yes/no)	Totally and Permanently Disabled (yes/no)	Is this person a qualifying child/relative of any other person? (yes/no)	Did this person provide more than 50% of his/her own support? (yes/no)	Did this person have less than \$4,050 of income? (yes/no)	Did the taxpayer(s) provide more than 50% of support for this person? (yes/no/N/A)	Did the taxpayer(s) pay more than half the cost of maintaining a home for this person? (yes/no)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)					
TRINA GRAVES	03/01/2001	DAUGHTER	12	YES	YES	S	YES	NO	NO	NO	YES	YES	YES
TRAVIS GRAVES	12/25/2002	SON	12	YES	YES	S	YES	NO	NO	NO	YES	YES	YES
MONIQUE FLOYD	05/05/1944	MOTHER	12	YES	YES	S	NO	NO	NO	NO	YES	YES	YES

Catalog Number 52121E      www.irs.gov      Form **13614-C** (Rev. 10-2017)

Complete Part VI of Sheryl's intake sheet after confirming her insurance coverage:

If advance payments of the premium tax credit were paid on your behalf to help pay your health insurance premiums, you should report life changes, such as, income, marital status or family size changes, to your Marketplace. Reporting changes will help to make sure you are getting the proper amount of advance payments.

To be Completed by a Certified Volunteer Preparer (Use Publication 4012 and check the appropriate box(es) indicating Minimum Essential Coverage (MEC) for everyone listed on the return.)

Name (List dependents in the same order as in Part II)	MEC Entire Year	No MEC	Part Year MEC (mark months with coverage)	Exemption (mark months exemptions applies)	Exemption All Year	Notes
Taxpayer <b>SHERYL</b>	X		J F M A M J J A S O N D	J F M A M J J A S O N D		MARKETPLACE
Spouse			J F M A M J J A S O N D	J F M A M J J A S O N D		
Dependent <b>TRINA</b>	X		J F M A M J J A S O N D	J F M A M J J A S O N D		MARKETPLACE
Dependent <b>TRAVIS</b>	X		J F M A M J J A S O N D	J F M A M J J A S O N D		MARKETPLACE
Dependent <b>MONIQUE</b>	X		J F M A M J J A S O N D	J F M A M J J A S O N D		MEDICARE
Dependent			J F M A M J J A S O N D	J F M A M J J A S O N D		

Sheryl's completed Health Insurance section is shown below. Because Sheryl, Trina, and Travis all had minimum essential coverage all year purchased through the Marketplace, select yes to the following question:

### Health Insurance Questionnaire

Did you purchase health insurance via HealthCare.gov or a State Marketplace? \*

Yes

No

Because Sheryl, Trina, Travis all had minimum essential coverage all year purchased through the Marketplace and Monique was covered by Medicare all year, indicate the entire household was insured for all 12 months:

### Months Insured

Was your entire household insured for all 12 months of 2016? \*

Yes

No

Enter the information from Sheryl's Form 1095-A:

## Advanced Premium Tax Credit (1095-A)

Did you receive a 1095-A statement or any Premium Tax Credits to assist you in paying for your health care for 2016? \*

- Yes  
 No

Are you required to repay all of the APTC received? In most cases, the answer is NO. ONLY answer YES if you were not considered lawfully present in the U.S. or you meet the Health Coverage Tax Credit criteria. Note: We will automatically calculate a full repayment of APTC when MAGI is greater than 400 percent of Federal Poverty Line.

- Yes  
 No

Is your household income below 100% of the Federal poverty line, and do you meet all of the requirements under either "Estimated household income at least 100% of the Federal poverty line" or "Alien lawfully present in the United States"?

- Yes  
 No

Do all Forms 1095-A include coverage for January through December, with no changes in monthly amounts?

- Yes  
 No

Please enter your annual Advance Premium Tax Credit information

Premium Amount (Form 1095-A, line 33A)

\$7044

Annual Premium Amount of SLCSP (Form 1095-A, line 33B)

\$9288

Annual Advance Payment of PTC (Form 1095-A, line 33C)

\$5904

You do not need to enter an amount for the dependents' modified AGI because none of Sheryl's dependents were required to file a return.

### Dependents' Modified AGI (if filing requirement)

---

Enter the AGI for your dependents from Form 1040, line 38; Form 1040A, line 22; Form 1040EZ, line 4; and Form 1040NR, line 37

\$ 0

Enter any tax-exempt interest for your dependents from Form 1040, line 8b; Form 1040A, line 8b; Form 1040EZ, the amount written to the left of the line 2 entry space; and Form 1040NR, line 9b

\$ 0

Enter any amounts for your dependents from Form 2555, lines 45 and 50, and Form 2555-EZ, line 18

\$ 0

Enter for each of your dependents the difference, if any, between Form 1040, lines 20a and 20b; and Form 1040A, lines 14a and 14b

\$ 0

### Results – Form 1040, page 2

The software will check the “Full-year coverage” box to indicate that everyone listed on the ACA worksheet had insurance all year.

<b>60 a</b>	Household employment taxes. Schedule H	0
<b>b</b>	First-time homebuyer credit repayment. Form 5405	0
<b>61</b>	Health care: individual responsibility <span style="float: right;">Full-year coverage: <input checked="" type="checkbox"/></span>	0
<b>62</b>	Taxes from <input type="checkbox"/> Form 8959 <input type="checkbox"/> Form 8960 <input type="checkbox"/>	

There is no amount on the individual responsibility line because all members of the tax household had full year coverage.

Results – Premium Tax Credit Form 8962

Form <b>8962</b> Department of the Treasury Internal Revenue Service Name shown on your return <b>Sheryl Graves</b>	<b>Premium Tax Credit (PTC)</b> ▶ Attach to Form 1040, 1040A, or 1040NR. ▶ Go to <a href="http://www.irs.gov/Form8962">www.irs.gov/Form8962</a> for instructions and the latest information.	OMB No. 1545-0074 <b>2017</b> Attachment Sequence No. <b>73</b>					
Your social security number		<b>605-00-XXXX</b>					
You cannot take the PTC if your filing status is married filing separately unless you qualify for an exception (see instructions). If you qualify, check the box <input type="checkbox"/>							
<b>Part I Annual and Monthly Contribution Amount</b>							
1 Tax family size. Enter the number of exemptions from Form 1040 or Form 1040A, line 6d, or Form 1040NR, line 7d	<b>1</b>	<b>4</b>					
2a Modified AGI. Enter your modified AGI (see instructions)	<b>2a</b>	<b>36429</b>					
b Enter the total of your dependents' modified AGI (see instructions)	<b>2b</b>	<b>0</b>					
3 Household income. Add the amounts on lines 2a and 2b (see instructions)	<b>3</b>	<b>36429</b>					
4 Federal poverty line. Enter the federal poverty line amount from Table 1-1, 1-2, or 1-3 (see instructions). Check the appropriate box for the federal poverty table used. a <input type="checkbox"/> Alaska b <input type="checkbox"/> Hawaii c <input checked="" type="checkbox"/> Other 48 states and DC	<b>4</b>	<b>24300</b>					
5 Household income as a percentage of federal poverty line (see instructions)	<b>5</b>	<b>150 %</b>					
6 Did you enter 401% on line 5? (See instructions if you entered less than 100%. <input checked="" type="checkbox"/> No. Continue to line 7. <input type="checkbox"/> Yes. You are not eligible to take the PTC. If advance payment of the PTC was made, see the instructions for how to report your excess advance PTC repayment amount.							
7 Applicable Figure. Using your line 5 percentage, locate your "applicable figure" on the table in the instructions	<b>7</b>	<b>.0408</b>					
8a Annual contribution amount. Multiply line 3 by line 7. Round to nearest whole dollar amount	<b>8a</b>	<b>1486</b>					
b Monthly contribution amount. Divide line 8a by 12. Round to nearest whole dollar amount	<b>8b</b>	<b>124</b>					
<b>Part II Premium Tax Credit Claim and Reconciliation of Advance Payment of Premium Tax Credit</b>							
9 Are you allocating policy amounts with another taxpayer or do you want to use the alternative calculation for year of marriage (see instructions)? <input type="checkbox"/> Yes. Skip to Part IV, Allocation of Policy Amounts, or Part V, Alternative Calculation for Year of Marriage. <input checked="" type="checkbox"/> No. Continue to line 10.							
10 See the instructions to determine if you can use line 11 or must complete lines 12 through 23. <input checked="" type="checkbox"/> Yes. Continue to line 11. Compute your annual PTC. Then skip lines 12–23 <input type="checkbox"/> No. Continue to lines 12–23. Compute your monthly PTC and continue to line 24.							
	(a) Annual enrollment premiums (Form(s) 1095-A, line 33A)	(b) Annual applicable SLCSP premium (Form(s) 1095-A, line 33B)	(c) Annual contribution amount (line 8a)	(d) Annual maximum premium assistance (subtract (c) from (b), if zero or less, enter -0-)	(e) Annual premium tax credit allowed (smaller of (a) or (d))	(f) Annual advance payment of PTC (Form(s) 1095-A, line 33C)	
11 Annual Totals	<b>7044</b>	<b>9288</b>	<b>1486</b>	<b>7802</b>	<b>7044</b>	<b>5904</b>	
	(a) Monthly enrollment premiums (Form(s) 1095-A, lines 21–32, column A)	(b) Monthly applicable SLCSP premium (Form(s) 1095-A, lines 21–32, column B)	(c) Monthly contribution amount (amount from line 8b or alternative marriage amount)	(d) Monthly maximum premium assistance (subtract (c) from (b), if zero or less, enter -0-)	(e) Monthly premium tax credit allowed (smaller of (a) or (d))	(f) Monthly advance payment of PTC (Form(s) 1095-A, lines 21–32, column C)	
22 November							
23 December							
24 Total premium tax credit. Enter the amount from line 11(e) or add lines 12(e) through 23(e) and enter the total here						<b>24</b>	<b>7044</b>
25 Advance payment of PTC. Enter the amount from line 11(f) or add lines 12(f) through 23(f) and enter the total here						<b>25</b>	<b>5904</b>
26 Net premium tax credit. If line 24 is greater than line 25, subtract line 25 from line 24. Enter the difference here and on Form 1040, line 69; Form 1040A, line 45; or Form 1040NR, line 65. If line 24 equals line 25, enter -0-. Stop here. If line 25 is greater than line 24, leave this line blank and continue to line 27						<b>26</b>	<b>1140</b>
<b>Part III Repayment of Excess Advance Payment of the Premium Tax Credit</b>							



Column C of the 1095-A is entered in Column F of Form 8962.

Results – Form 1040, page 2

68 American opportunity credit. Form 8863	0	
69 Net premium tax credit. Form 8962	1140	
70 Amount paid with request for extension of time to file	0	

## Example 7 – Premium Tax Credit with Advance Payments for Part-Year Coverage

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### Interview Notes

- Charles and Shay Baldwin are married with two dependent children, Nathaniel and Karly, who live with them all year. Their SSNs are:
  - Charles: 609-00-XXXX
  - Shay: 610-00-XXXX
  - Nathaniel: 611-00-XXXX
  - Karly: 612-00-XXXX
- Charles' Form W-2 shows:
  - Box 1 = \$33,500
  - Box 2 = \$1,820
- Shay's W-2 shows:
  - Box 1 = \$17,750
  - Box 2 = \$1,153
- Charles' and Shay's employers do not offer health insurance coverage. In early March, Charles enrolled in a plan through the Marketplace that covered him, Shay, and both children with an effective date of April 1. He selected the second lowest cost silver plan. They received the benefit of advance payments of the premium tax credit for their coverage. During the year, Charles received an unexpected raise in pay. They did not notify the Marketplace. The family has no other income or deductions.
- They received a marketplace exemption for January, February, and March.
  - Charles' ECN is A23BC56
  - Shay's ECN is A34BC67
  - Nathaniel's ECN is A45BC78
  - Karly's ECN is A56BC89

### Directions

Review the interview notes, complete the volunteer sections of the intake sheet, and start a new return using Practice Lab or TaxSlayer software. Enter the SSNs, filing status, personal information, dependents, and income. Then complete the following steps:

1. Select the Health Insurance section and answer all the questions pertaining to Charles, Shay, and their family.
2. Compare your result to the screen shots on the following pages.

Form <b>13614-C</b> (October 2017)	Department of the Treasury - Internal Revenue Service <b>Intake/Interview &amp; Quality Review Sheet</b>	OMB Number 1545-1964											
<b>You will need:</b> <ul style="list-style-type: none"> <li>• Tax Information such as Forms W-2, 1099, 1098, 1095.</li> <li>• Social security cards or ITIN letters for all persons on your tax return.</li> <li>• Picture ID (such as valid driver's license) for you and your spouse.</li> </ul>													
<ul style="list-style-type: none"> <li>• Please complete pages 1-3 of this form.</li> <li>• You are responsible for the information on your return. Please provide complete and accurate information.</li> <li>• If you have questions, please ask the IRS-certified volunteer preparer.</li> </ul>													
Volunteers are trained to provide high quality service and uphold the highest ethical standards. To report unethical behavior to the IRS, email us at <a href="mailto:wi.voltax@irs.gov">wi.voltax@irs.gov</a>													
<b>Part I – Your Personal Information</b> (If you are filing a joint return, enter your names in the same order as last year's return)													
1. Your first name <b>CHARLES</b>	M.I.	Last name <b>BALDWIN</b>	Telephone number <b>YOUR PHONE #</b>	Are you a U.S. citizen? <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No									
2. Your spouse's first name <b>SHAY</b>	M.I.	Last name <b>BALDWIN</b>	Telephone number	Is your spouse a U.S. citizen? <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No									
3. Mailing address <b>775 BANKS ST</b>			Apt #	City <b>YOUR CITY</b>									
			State <b>YS</b>	ZIP code <b>YOUR ZIP</b>									
4. Your Date of Birth <b>12/03/1981</b>	5. Your job title <b>CUSTOMER SERVICE REP</b>		6. Last year, were you:										
		b. Totally and permanently disabled <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No		a. Full-time student <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No									
				c. Legally blind <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No									
7. Your spouse's Date of Birth <b>06/10/1985</b>	8. Your spouse's job title <b>CASHIER</b>		9. Last year, was your spouse:										
		b. Totally and permanently disabled <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No		a. Full-time student <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No									
				c. Legally blind <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No									
10. Can anyone claim you or your spouse on their tax return? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No <input type="checkbox"/> Unsure													
11. Have you or your spouse:													
a. Been a victim of identity theft? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No													
b. Adopted a child? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No													
<b>Part II – Marital Status and Household Information</b>													
1. As of December 31, 2017, were you:													
<input type="checkbox"/> Unmarried (This includes registered domestic partnerships, civil unions, or other formal relationships under state law)													
<input checked="" type="checkbox"/> Married a. If Yes, Did you get married in 2017? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No													
b. Did you live with your spouse during any part of the last six months of 2017? <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No													
<input type="checkbox"/> Divorced Date of final decree _____													
<input type="checkbox"/> Legally Separated Date of separate maintenance agreement _____													
<input type="checkbox"/> Widowed Year of spouse's death _____													
2. List the names below of:													
• everyone who lived with you last year (other than your spouse)													
• anyone you supported but did not live with you last year													
If additional space is needed check here <input type="checkbox"/> and list on page 3													
<b>To be completed by a Certified Volunteer Preparer</b>													
Name (first, last) Do not enter your name or spouse's name below	Date of Birth (mm/dd/yy)	Relationship to you (for example: son, daughter, parent, none, etc)	Number of months lived in your home last year	US Citizen (yes/no)	Resident of US, Canada, or Mexico last year (yes/no)	Single or Married as of 12/31/16 (S/M)	Full-time Student last year (yes/no)	Totally and Permanently Disabled (yes/no)	Is this person a qualifying child/relative of any other person? (yes/no)	Did this person provide more than 50% of his/her own support? (yes/no)	Did this person have less than \$4,050 of income? (yes/no)	Did the taxpayer(s) provide more than 50% of support for this person? (yes/no/N/A)	Did the taxpayer(s) pay more than half the cost of maintaining a home for this person? (yes/no)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)					
<b>NATHANIEL BALDWIN</b>	<b>04/04/2004</b>	<b>SON</b>	<b>12</b>	<b>YES</b>	<b>YES</b>	<b>S</b>	<b>YES</b>	<b>NO</b>					
<b>KARLY BALDWIN</b>	<b>04/29/2006</b>	<b>DAUGHTER</b>	<b>12</b>	<b>YES</b>	<b>YES</b>	<b>S</b>	<b>YES</b>	<b>NO</b>					

Check appropriate box for each question in each section			Page 3
<b>Yes</b>	<b>No</b>	<b>Unsure</b>	<b>Part VI - Health Care Coverage - Last year, did you, your spouse, or dependent(s)</b>
<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	1. (B) Have health care coverage?
<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	2. (B) Receive one or more of these forms? (Check the box) <input type="checkbox"/> Form 1095-B <input type="checkbox"/> Form 1095-C
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	3. (A) Have coverage through the Marketplace (Exchange)? [Provide Form 1095-A]
<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	3a. (A) If yes, were advance credit payments made to help you pay your health care premiums?
<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	3b. (A) If yes, Is everyone listed on your Form 1095-A being claimed on this tax return?
<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	4. (B) Have an exemption granted by the Marketplace?

**Part I Recipient Information**

1 Marketplace identifier <b>XXXXX</b>	2 Marketplace-assigned policy number <b>XXXXX</b>	3 Policy issuer's name <b>XXXXXXXXXXXX</b>
4 Recipient's name <b>CHARLES BALDWIN</b>	5 Recipient's SSN <b>609-00-XXXX</b>	6 Recipient's date of birth <b>12/03/1981</b>
7 Recipient's spouse's name <b>SHAY BALDWIN</b>	8 Recipient's spouse's SSN <b>610-00-XXXX</b>	9 Recipient's spouse's date of birth <b>06/10/1985</b>
10 Policy start date <b>04/01/2017</b>	11 Policy termination date <b>12/31/2017</b>	12 Street address (including apartment no.) <b>775 BANKS ST</b>
13 City or town <b>YOUR CITY</b>	14 State or province <b>YOUR STATE</b>	15 Country and ZIP or foreign postal code <b>YOUR ZIP</b>

**Part II Covered Individuals**

	A. Covered individual name	B. Covered individual SSN	C. Covered individual date of birth	D. Coverage start date	E. Coverage termination date
16	<b>CHARLES BALDWIN</b>	<b>609-00-XXXX</b>	<b>12/03/1981</b>	<b>04/01/2017</b>	<b>12/31/2017</b>
17	<b>SHAY BALDWIN</b>	<b>610-00-XXXX</b>	<b>06/10/1985</b>	<b>04/01/2017</b>	<b>12/31/2017</b>
18	<b>NATHANIEL BALDWIN</b>	<b>611-00-XXXX</b>	<b>04/04/2004</b>	<b>04/01/2017</b>	<b>12/31/2017</b>
19	<b>KARLY BALDWIN</b>	<b>612-00-XXXX</b>	<b>04/29/2006</b>	<b>04/01/2017</b>	<b>12/31/2017</b>
20					

**Part III Coverage Information**

Month	A. Monthly enrollment premiums	B. Monthly second lowest cost silver plan (SLCSP) premium	C. Monthly advance payment of premium tax credit
21 January			
22 February			
23 March			
24 April	<b>\$789.00</b>	<b>\$789.00</b>	<b>\$607.00</b>
25 May	<b>\$789.00</b>	<b>\$789.00</b>	<b>\$607.00</b>
26 June	<b>\$789.00</b>	<b>\$789.00</b>	<b>\$607.00</b>
27 July	<b>\$789.00</b>	<b>\$789.00</b>	<b>\$607.00</b>
28 August	<b>\$789.00</b>	<b>\$789.00</b>	<b>\$607.00</b>
29 September	<b>\$789.00</b>	<b>\$789.00</b>	<b>\$607.00</b>
30 October	<b>\$789.00</b>	<b>\$789.00</b>	<b>\$607.00</b>
31 November	<b>\$789.00</b>	<b>\$789.00</b>	<b>\$607.00</b>
32 December	<b>\$789.00</b>	<b>\$789.00</b>	<b>\$607.00</b>
33 Annual Totals	<b>\$7,101.00</b>	<b>\$7,101.00</b>	<b>\$5,463.00</b>

For Privacy Act and Paperwork Reduction Act Notice, see separate instructions.

Cat. No. 60703Q

Form **1095-A** (2017)



## Results – Approaching the ACA

Complete the volunteer section of the Baldwins' intake sheet, Part II:

everyone who lived with you last year (other than you or your spouse)  
 anyone you supported but did not live with you last year

If additional space is needed, check here  and use page 3

										To be completed by a Certified Volunteer Preparer				
Name (first, last) Do not enter your name or spouse's name below	Date of Birth (mm/dd/yy)	Relationship to you (for example: son, daughter, parent, none, etc)	Number of months lived in your home last year	US Citizen (yes/no)	Resident of US, Canada, or Mexico last year (yes/no)	Single or Married as of 12/31/15 (S/M)	Full-time Student last year (yes/no)	Totally and Permanently Disabled (yes/no)	Is this person a qualifying child/relative of any other person? (yes/no)	Did this person provide more than 50% of his/her own support? (yes/no)	Did this person have less than \$4,000 of income? (yes/no)	Did the taxpayer(s) provide more than 50% of support for this person? (yes/no/N/A)	Did the taxpayer(s) pay more than half the cost of maintaining a home for this person? (yes/no)	
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)						
NATHANIEL BALDWIN	04/04/2004	SON	12	YES	YES	S	YES	NO	NO	NO	YES	YES	YES	
KARLY BALDWIN	04/29/2006	DAUGHTER	12	YES	YES	S	YES	NO	NO	NO	YES	YES	YES	

Volunteers are trained to provide high quality service and uphold the highest ethical standards.  
 To report unethical behavior to the IRS, email us at [wi.voltax@irs.gov](mailto:wi.voltax@irs.gov) or call toll free

Catalog Number 52121E www.irs.gov Form 13614-C (Rev. 10-2015)

Complete the volunteer section of the Baldwins' intake sheet, Part VI:

To be Completed by a Certified Volunteer Preparer (Use Publication 4012 and check the appropriate box(es) indicating minimum Essential Coverage (MEC) for everyone listed on the return.)

Name (List dependents in the same order as in Part II)	MEC Entire Year	No MEC	Part Year MEC (mark months with coverage)	Exemption (mark months exemptions applies)	Exemption All Year	Notes
Taxpayer CHARLES			J F M <u>A</u> M J J A S O N D	J F M <u>A</u> M J J A S O N D		Marketplace
Spouse SHAY			J F M <u>A</u> M J J A S O N D	J F M <u>A</u> M J J A S O N D		Marketplace
Dependent NATHANIEL			J F M <u>A</u> M J J A S O N D	J F M <u>A</u> M J J A S O N D		Marketplace
Dependent KARLY			J F M <u>A</u> M J J A S O N D	J F M <u>A</u> M J J A S O N D		Marketplace
Dependent			J F M A M J J A S O N D	J F M A M J J A S O N D		
Dependent			J F M A M J J A S O N D	J F M A M J J A S O N D		

Charles and Shay's completed Health Insurance section is shown below. Indicate that Charles, Shay, Nathaniel and Karly all had minimum essential coverage purchased through the Marketplace from April through December:

## Health Insurance Questionnaire

Did you purchase health insurance via HealthCare.gov or a State Marketplace? \*

Yes

No

## Months Insured

Was your entire household insured for all 12 months of 2016? \*

- Yes  
 No

Please enter the number of months insured for each household member.

Name	Months Insured
Charles Baldwin	9
Shay Baldwin	9
Nathaniel Baldwin	9
Karly Baldwin	9

Indicate the months Charles had health insurance coverage. Do the same for Shay, Nathaniel, and Karly.

## Months Insured - Charles Baldwin

Specify the 9 months that Charles Baldwin had minimum essential coverage

- |   |  |   |
|---|--|---|
| <input type="checkbox"/> January            | <input type="checkbox"/> February            | <input type="checkbox"/> March                |
| <input checked="" type="checkbox"/> April   | <input checked="" type="checkbox"/> May      | <input checked="" type="checkbox"/> June      |
| <input checked="" type="checkbox"/> July    | <input checked="" type="checkbox"/> August   | <input checked="" type="checkbox"/> September |
| <input checked="" type="checkbox"/> October | <input checked="" type="checkbox"/> November | <input checked="" type="checkbox"/> December  |

Enter the information from Form 1095-A:

## Advanced Premium Tax Credit (1095-A)

Did you receive a 1095-A statement or any Premium Tax Credits to assist you in paying for your health care for 2016? \*

- Yes
- No

Are you required to repay all of the APTC received? In most cases, the answer is NO. ONLY answer YES if you were not considered lawfully present in the U.S. or you meet the Health Coverage Tax Credit criteria. Note: We will automatically calculate a full repayment of APTC when MAGI is greater than 400 percent of Federal Poverty Line.

- Yes
- No

Is your household income below 100% of the Federal poverty line, and do you meet all of the requirements under either "Estimated household income at least 100% of the Federal poverty line" or "Alien lawfully present in the United States"?

- Yes
- No

Do all Forms 1095-A include coverage for January through December, with no changes in monthly amounts?

- Yes
- No

Please enter your monthly Advance Premium Tax Credit information

Month	Monthly Premium Amount (Form 1095-A, Part III, Column A)	Monthly Premium Amount of SLCSP (Form 1095-A, Part III, Column B)	Monthly Advance Payment of PTC (Form 1095-A, Part III, Column C)
January	\$ <input type="text"/>	\$ <input type="text"/>	\$ <input type="text"/>
February	\$ <input type="text"/>	\$ <input type="text"/>	\$ <input type="text"/>
March	\$ <input type="text"/>	\$ <input type="text"/>	\$ <input type="text"/>
April	\$789 <input type="text"/>	\$789 <input type="text"/>	\$607 <input type="text"/>
May	\$789 <input type="text"/>	\$789 <input type="text"/>	\$607 <input type="text"/>
June	\$789 <input type="text"/>	\$789 <input type="text"/>	\$607 <input type="text"/>
July	\$789 <input type="text"/>	\$789 <input type="text"/>	\$607 <input type="text"/>
August	\$789 <input type="text"/>	\$789 <input type="text"/>	\$607 <input type="text"/>
September	\$789 <input type="text"/>	\$789 <input type="text"/>	\$607 <input type="text"/>
October	\$789 <input type="text"/>	\$789 <input type="text"/>	\$607 <input type="text"/>
November	\$789 <input type="text"/>	\$789 <input type="text"/>	\$607 <input type="text"/>
December	\$789 <input type="text"/>	\$789 <input type="text"/>	\$607 <input type="text"/>

The dependents did not have any income or filing requirement.

## Dependents' Modified AGI (if filing requirement)

Enter the AGI for your dependents from Form 1040, line 38; Form 1040A, line 22; Form 1040EZ, line 4; and Form 1040NR, line 37

\$ 0

Enter any tax-exempt interest for your dependents from Form 1040, line 8b; Form 1040A, line 8b; Form 1040EZ, the amount written to the left of the line 2 entry space; and Form 1040NR, line 9b

\$ 0

Enter any amounts for your dependents from Form 2555, lines 45 and 50, and Form 2555-EZ, line 18

\$ 0

Enter for each of your dependents the difference, if any, between Form 1040, lines 20a and 20b; and Form 1040A, lines 14a and 14b

\$ 0

Each family member received an exemption from the Marketplace for the months when they did not have health coverage:

## Health Care Exemption Certificates



You do not qualify to claim the coverage exemption for household or gross income below the filing threshold, but if you received exemption certificates or can claim another coverage exemption, answer Yes below and then continue.

Did you receive an exemption certificate from a marketplace or qualify to claim a coverage exemption on your return? \*

Yes

No

[Click here to determine if you can claim a health coverage exemption.](#)

Complete the exemption information for Charles, then add the information for Shay and both children:

## Health Insurance/Exemption

**Name of Individual \***

Charles Baldwin ▾

**Do you have a marketplace-issued certificate for this exemption or going to apply for an exemption from the marketplace? \***

Yes

No

**Exemption Certificate Number (enter PENDING if applying or applied for)**

A23BC56


Indicate full year or specify months for which you qualify to take the exemption.

Full Year

January     
  February     
  March     
  April  
 May     
  June     
  July     
  August  
 September     
  October     
  November     
  December

## Health Coverage Exemptions









[+ Add another exemption](#)

Name of Individual	Type	
Charles Baldwin	Certificate A23BC56	 

[+ Add another exemption](#)

## Health Coverage Exemptions

[+ Add another exemption](#)

Name of Individual	Type	
Charles Baldwin	Certificate A23BC56	 
Nathaniel Baldwin	Certificate A45BC78	 
Karly Baldwin	Certificate A56BC89	 
Shay Baldwin	Certificate A34BC67	 

[+ Add another exemption](#)

## Results – Exemptions, Form 8965

Each member of the family received a coverage exemption from the Marketplace for the months of January, February, and March. See Part I of the Baldwin’s completed Form 8965:

Form <b>8965</b> Department of the Treasury Internal Revenue Service	<b>Health Coverage Exemptions</b> ▶ Attach to Form 1040, Form 1040A, or Form 1040EZ. ▶ Go to <a href="http://www.irs.gov/Form8965">www.irs.gov/Form8965</a> for instructions and the latest information.	OMB No. 1545-0074 <b>2017</b> Attachment Sequence No. 75	
Name as shown on return <b>Charles Baldwin</b>		Your social security number <b>609-00-XXXX</b>	
Complete this form if you have a Marketplace-granted coverage exemption or you are claiming a coverage exemption on your return.			
<b>Part I</b> <b>Marketplace-Granted Coverage Exemptions for Individuals.</b> If you and/or a member of your tax household have an exemption granted by the Marketplace, complete Part I.			
	(a) Name of Individual	(b) SSN	(c) Exemption Certificate Number
1	CHARLES BALDWIN	609-00-XXXX	A23BC456
2	SHAY BALDWIN	610-00-XXXX	A34BC567
3	NATHANIEL BALDWIN	611-00-XXXX	A45BC678
4	KARLY BALDWIN	612-00-XXXX	A56BC789

## Results – Premium Tax Credit, Form 8962

See Parts 1, 2, and 3 of Charles and Shay’s completed Form 8962 below. Part 3 of Form 8962 reconciles advance payments of the premium tax credit.

In this case, Charles failed to report an increase in pay to the Marketplace. This resulted in an excess advance premium tax credit repayment. This excess will decrease their refund or increase their balance due. Charles should have reported his change in income to the Marketplace so they could have adjusted his advance credit payments for the remainder of the coverage year.

**Premium Tax Credit (PTC)**

Department of the Treasury  
Internal Revenue Service

▶ Attach to Form 1040, 1040A, or 1040NR.  
▶ Go to [www.irs.gov/Form8962](http://www.irs.gov/Form8962) for instructions and the latest information.

Name shown on your return

Your social security number

**Charles Baldwin**

**609-00-XXXX**

You cannot take the PTC if your filing status is married filing separately unless you qualify for an exception (see instructions). If you qualify, check the box

**Part I Annual and Monthly Contribution Amount**

<b>1</b>	Tax family size. Enter the number of exemptions from Form 1040 or Form 1040A, line 6d, or Form 1040NR, line 7d	<b>1</b>	<b>4</b>
<b>2a</b>	Modified AGI. Enter your modified AGI (see instructions)	<b>2a</b>	<b>51250</b>
<b>b</b>	Enter the total of your dependents' modified AGI (see instructions)	<b>2b</b>	<b>0</b>
<b>3</b>	Household income. Add the amounts on lines 2a and 2b (see instructions)	<b>3</b>	<b>51250</b>
<b>4</b>	Federal poverty line. Enter the federal poverty line amount from Table 1-1, 1-2, or 1-3 (see instructions). Check the appropriate box for the federal poverty table used. <b>a</b> <input type="checkbox"/> Alaska <b>b</b> <input type="checkbox"/> Hawaii <b>c</b> <input checked="" type="checkbox"/> Other 48 states and DC	<b>4</b>	<b>24300</b>
<b>5</b>	Household income as a percentage of federal poverty line (see instructions)	<b>5</b>	<b>210 %</b>
<b>6</b>	Did you enter 401% on line 5? (See instructions if you entered less than 100%.) <input checked="" type="checkbox"/> <b>No.</b> Continue to line 7. <input type="checkbox"/> <b>Yes.</b> You are not eligible to take the PTC. If advance payment of the PTC was made, see the instructions for how to report your excess advance PTC repayment amount.		
<b>7</b>	Applicable Figure. Using your line 5 percentage, locate your "applicable figure" on the table in the instructions	<b>7</b>	<b>.0679</b>
<b>8a</b>	Annual contribution amount. Multiply line 3 by line 7. Round to nearest whole dollar amount	<b>8a</b>	<b>3480</b>
<b>b</b>	Monthly contribution amount. Divide line 8a by 12. Round to nearest whole dollar amount	<b>8b</b>	<b>290</b>

**Part II Premium Tax Credit Claim and Reconciliation of Advance Payment of Premium Tax Credit**

- 9** Are you allocating policy amounts with another taxpayer or do you want to use the alternative calculation for year of marriage (see instructions)?  
 **Yes.** Skip to Part IV, Allocation of Policy Amounts, or Part V, Alternative Calculation for Year of Marriage.  **No.** Continue to line 10.
- 10** See the instructions to determine if you can use line 11 or must complete lines 12 through 23.  
 **Yes.** Continue to line 11. Compute your annual PTC. Then skip lines 12–23 and continue to line 24.  **No.** Continue to lines 12–23. Compute your monthly PTC and continue to line 24.

Annual Calculation	(a) Annual enrollment premiums (Form(s) 1095-A, line 33A)	(b) Annual applicable SLCSP premium (Form(s) 1095-A, line 33B)	(c) Annual contribution amount (line 8a)	(d) Annual maximum premium assistance (subtract (c) from (b), if zero or less, enter -0-)	(e) Annual premium tax credit allowed (smaller of (a) or (d))	(f) Annual advance payment of PTC (Form(s) 1095-A, line 33C)	
<b>11 Annual Totals</b>							
Monthly Calculation	(a) Monthly enrollment premiums (Form(s) 1095-A, lines 21–32, column A)	(b) Monthly applicable SLCSP premium (Form(s) 1095-A, lines 21–32, column B)	(c) Monthly contribution amount (amount from line 8b or alternative marriage monthly calculation)	(d) Monthly maximum premium assistance (subtract (c) from (b), if zero or less, enter -0-)	(e) Monthly premium tax credit allowed (smaller of (a) or (d))	(f) Monthly advance payment of PTC (Form(s) 1095-A, lines 21–32, column C)	
<b>12 January</b>							
<b>13 February</b>							
<b>14 March</b>							
<b>15 April</b>	<b>789</b>	<b>789</b>	<b>290</b>	<b>499</b>	<b>499</b>	<b>607</b>	
<b>16 May</b>	<b>789</b>	<b>789</b>	<b>290</b>	<b>499</b>	<b>499</b>	<b>607</b>	
<b>17 June</b>	<b>789</b>	<b>789</b>	<b>290</b>	<b>499</b>	<b>499</b>	<b>607</b>	
<b>18 July</b>	<b>789</b>	<b>789</b>	<b>290</b>	<b>499</b>	<b>499</b>	<b>607</b>	
<b>19 August</b>	<b>789</b>	<b>789</b>	<b>290</b>	<b>499</b>	<b>499</b>	<b>607</b>	
<b>20 September</b>	<b>789</b>	<b>789</b>	<b>290</b>	<b>499</b>	<b>499</b>	<b>607</b>	
<b>21 October</b>	<b>789</b>	<b>789</b>	<b>290</b>	<b>499</b>	<b>499</b>	<b>607</b>	
<b>22 November</b>	<b>789</b>	<b>789</b>	<b>290</b>	<b>499</b>	<b>499</b>	<b>607</b>	
<b>23 December</b>	<b>789</b>	<b>789</b>	<b>290</b>	<b>499</b>	<b>499</b>	<b>607</b>	
<b>24</b>	Total premium tax credit. Enter the amount from line 11(e) or add lines 12(e) through 23(e) and enter the total here					<b>24</b>	<b>4491</b>
<b>25</b>	Advance payment of PTC. Enter the amount from line 11(f) or add lines 12(f) through 23(f) and enter the total here					<b>25</b>	<b>5463</b>
<b>26</b>	Net premium tax credit. If line 24 is greater than line 25, subtract line 25 from line 24. Enter the difference here and on Form 1040, line 69; Form 1040A, line 45; or Form 1040NR, line 65. If line 24 equals line 25, enter -0-. Stop here. If line 25 is greater than line 24, leave this line blank and continue to line 27					<b>26</b>	

**Part III Repayment of Excess Advance Payment of the Premium Tax Credit**

<b>27</b>	Excess advance payment of PTC. If line 25 is greater than line 24, subtract line 24 from line 25. Enter the difference here	<b>27</b>	<b>972</b>
<b>28</b>	Repayment limitation (see instructions)	<b>28</b>	<b>1500</b>
<b>29</b>	Excess advance premium tax credit repayment. Enter the smaller of line 27 or line 28 here and on Form 1040, line 46; Form 1040A, line 29; or Form 1040NR, line 44	<b>29</b>	<b>972</b>

For Paperwork Reduction Act Notice, see your tax return instructions.

Cat. No. 37784Z

Form **8962** (2017)

**Results – Form 1040, page 2**

<b>45</b> Alternative minimum tax. Attach Form 6251	0
<b>46</b> Excess advance premium tax credit repayment. Form 8962	972

The "Full-year coverage" box is not checked.

<b>61</b> Health care: individual responsibility	Full-year coverage: <input type="checkbox"/>	0
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## Index

### A

Accrued interest 9-8  
Additional child tax credit 26-1, 26-5, 29-1  
Additional taxes 28-1, 28-4, 28-7, 32-1  
Address changes 33-2  
Adjusted basis 11-1, 11-2, 11-3, 13-8, 11-14, 11-6  
Adjusted gross income 18-1, 18-13  
Adjustments to income 18-1  
Adopted child 7-3, 7-11, 8-8  
Affordable Care Act 3-1  
Alimony 9-12, 16-8, 16-14, 18-1, 18-6  
Allocated tips 9-4, 28-3  
Allocation of refund 31-3, 31-6  
Amended return 34-1  
American opportunity tax credit 24-4  
Amount owed 31-2, 31-7, 31-13  
Amount realized 11-14, 11-16, 11-18  
Annuity 12-1, 12-9, 31-11  
Applicable taxpayer 3-10, 3-21  
Asset write-off 10-4  
ATIN 4-5, 4-6, 8-8

### B

Basic Allowance for Housing (BAH) 17-1, 22-5  
Basic Allowance for Subsistence (BAS) 22-5  
Basis 11-2, 11-14, 12-3, 13-8  
Bitcoin 11-2  
Bona fide 16-11, 16-13  
Bond 9-6, 18-11, 31-2, 31-5  
Bronze level health plan 3-9  
Business expenses 10-3, 10-5, 22-1  
Business income 10-1

### C

Capital gain distributions 9-10, 11-6, 11-8  
Capital gain or loss 11-1  
Carryover losses 11-9, 11-10  
Cash for keys program 16-2  
Cash method of accounting , 10-4  
Casualty losses 11-2, 11-14, 11-19, 21-10  
Certificate of Deposit (CD) 9-6  
Charitable contributions 20-2, 20-4, 21-7  
Children of divorced/separated parents 7-2, 7-9, 26-2  
Child tax credit (CTC) 26-1

Combat pay 17-4, 18-7, 30-2  
Combat zone 17-1, 17-3, 17-5, 33-5, 33-6  
Combat zone participants 33-5, 33-6  
Community property 5-3, 17-6  
Completing the return 32-1  
Concluding the interview 32-1  
Corporate distributions (dividends) 9-10  
Cost basis 11-3, 12-3, 12-9  
Course introduction 1-1  
Coverage Family 3-21  
Coverdell ESA 16-3, 18-11  
Credit for child and dependent care 23-1  
Credit for retirement savings contributions 27-1  
Credit for the elderly or disabled 27-1, 27-4  
CTC – Qualifying child 26-1, 26-4  
CTC – Worksheet 26-3, 26-4, 26-6  
Custodial parent 7-10, 26-2

### D

Death of a spouse 5-4, 5-7, 6-2, 6-3, 33-8  
Decedents 4-5, 33-7  
Deductible business expenses 10-7, 22-1  
Deductible IRA contributions 18-8  
Dependency Exemptions 7-1, 8-7  
Dependency tests 7-1, 7-2  
Dependent care expenses 23-1  
Dependents of more than one taxpayer 3-21  
Depositor account number (DAN) 31-3  
Depreciation 13-7, 10-4, 13-6  
Direct deposit 4-8, 31-2, 31-3  
Disability pension income 12-10  
Disabled permanently and totally (defined) 27-5  
Distributions 11-8, 12-3, 12-6, 12-11, 12-12, 28-4  
Dividend reinvestment plan (DRIP) 11-3  
Dividends 9-9, 11-3, 25-4, 25-7  
Divorced/separated parents – qualifying child 7-2, 7-9, 23-3  
Domestic abuse 3-21  
Dual enrollment 3-21  
Dual-status aliens 20-2, 21-1  
Duplicate/mismatched SSN/ITIN 4-7  
Duty station 11-17, 16-11, 17-4, 22-4

## E

---

Early withdrawal of savings 18-4  
Earned income 9-2, 30-2, 30-3  
Earned income credit (EIC) 30-1  
Educational institution 18-11, 24-2  
Education credits 24-1  
Education expenses 18-10, 24-2  
E-file 4-8, 32-3  
EIC – Disallowance 30-6  
EIC – Eligibility requirements 30-1  
EIC – Qualifying child rules 30-4, 30-5  
EIC – Tables 30-6  
EIC – Worksheet 30-6  
Electronic federal tax payment system (EFTPS) 31-7  
Eligibility requirements 16-11, 18-6, 30-1  
Emancipated child 7-10  
Employee business expense 22-1  
Employee safe harbor 3-21  
Employer retirement plans 12-1  
Equivalent railroad retirement benefit 15-1  
Estimated tax payments 29-3  
Estimated tax penalty 31-10  
Exchange rates 16-8, 16-9  
Exempt income 9-2  
Exempt individual (substantial presence test) 8-3  
Exemption Certificate Number (ECN) 3-21  
Exemption – Dependency 7-1  
Exemption – Foreign Spouse 8-1  
Exemption – Personal 6-1  
Extensions 29-4, 33-2, 33-4

## F

---

Family coverage 3-22  
Family size 3-22  
Federal Poverty Line (FPL) 3-10  
Filing Basics 4-1  
Filing Status 5-1, 8-4, 18-8  
First-time homebuyer credit 28-6  
Foreign coverage 3-22  
Foreign earned income 16-8, 16-14, 16-15,  
Foreign earned income exclusion 16-10, 16-14  
Foreign exchange rate 16-8  
Foreign tax credit 25-1  
Form 1040 4-8  
Form 1040A 4-8  
Form 1040-ES 31-10  
Form 1040EZ 4-8  
Form 1040NR-EZ 8-3

Form 1040 (Schedule A) 21-1  
Form 1040 (Schedule C, Schedule C-EZ) 10-1  
Form 1040 (Schedule D) 11-1  
Form 1040 (Schedule E) 13-1  
Form 1040 (Schedule R) 27-1  
Form 1040 (Schedule SE) 10-3, 10-15, 28-2  
Form 1040-V 31-7  
Form 1041 (Schedule K-1) 13-1  
Form 1065 (Schedule K-1) 13-1  
Form 1098-T 9-5, 24-2  
Form 1099-B 11-2, 11-4, 11-6  
Form 1099-DIV 9-9, 9-10, 11-5, 11-8, 25-2  
Form 1099-G 9-11, 14-1  
Form 1099-INT 9-6, 25-1  
Form 1099-K 10-1  
Form 1099-MISC 10-1  
Form 1099-OID 9-6, 18-4  
Form 1099-R 9-8, 12-2, 18-9, 28-5, 30-2  
Form 1099-S 11-2, 11-11, 11-14, 11-16  
Form 1116 25-1  
Form 1120S (Schedule K-1) 13-1  
Form 1127 31-8  
Form 2120 7-9  
Form 2210 31-10  
Form 2441 23-1, 23-8  
Form 2555/2555-EZ 16-1  
Form 3903 19-1  
Form 4137 28-3  
Form 4852 9-3  
Form 5329 12-11, 28-4, 28-7  
Form 5405 28-6  
Form 8332 7-10  
Form 8582 13-12, 13-13  
Form 8606 12-4, 18-8  
Form 8822 33-2  
Form 8863 24-7  
Form 8880 27-1, 27-3  
Form 8888 31-3, 31-4, 31-6  
Form 8949 11-8, 11-9, 11-10, 11-11, 11-16  
Form 8962 3-10  
Form 9465 31-8  
Form 13614-C 1-1, 1-3  
Form 13615 1-3, 1-7  
Form 14509 1-4  
Form RRB-1099 15-1, 15-2, 15-3  
Forms 1095-A, B, and C 3-14, 3-22  
Form SSA-1099 4-6, 15-1, 15-2, 15-3  
Form W-2 4-2, 4-6, 9-3

Form W-2G 16-2, 29-2  
Form W-4 31-11, 32-1  
Form W-4P 12-14, 31-12  
Form W-4S 31-12  
Form W-4V 12-14, 31-12  
Form W-7 4-6  
Foster child 5-7, 7-3, 7-7  
Fraudulent activity 4-9

## G

---

Gambling winnings 16-1, 16-2, 21-11, 29-2  
Gifts to charity 20-4, 21-2, 21-7  
Green card test 8-2  
Gross income 4-1, 4-2, 7-6, 7-8, 9-2, 17-1

## H

---

Head of Household filing status 5-5, 8-5  
Head of Household rules 5-5  
Health coverage tax credit 4-3  
Health Savings Account (HSA) 16-2, 18-2  
Help from the IRS 1-11  
Holding period 11-1  
Home mortgage interest 13-4, 13-8  
Hope credit 24-4  
Household employees/employment 9-4, 23-5, 28-1  
Household income 3-22

## I

---

Identity protection PIN 31-2  
Identity theft 1-5, 4-5  
Incarceration 3-22  
Income 9-1  
Independent contractor 10-1, 28-2  
Individual Market 3-22  
Individual Retirement Arrangements (IRAs) 9-8, 12-1, 18-5, 18-8, 28-4  
Individual TIN (ITIN) 4-5, 4-7, 8-4  
Inherited property 11-2, 11-3  
Injured spouse 5-4, 34-2  
Inmate's Income 16-2  
Innocent spouse relief 5-3, 5-4  
Installment agreement 31-8  
Insurance premiums 13-5  
Intake/Interview & Quality Review Sheet (Form 13614-C) 1-1, 7-1  
Interest deduction 13-4, 18-10, 18-12, 21-5  
Interest income - nontaxable 9-2, 9-7  
Interest income - taxable 9-6  
Interview Tips – Itemized Deductions 21-1

Inventory 10-3, 10-12  
Investment interest 21-5  
Investment property 11-5, 25-7  
IRA contributions 12-5, 12-13, 18-5, 18-7, 18-8, 27-7, 28-4  
IRA Deduction Worksheet 18-8  
Itemized deductions 21-1  
ITIN 4-5

## J

---

Jury duty 16-1, 18-13

## L

---

LCBP 3-22  
Legislative Extenders 2-1  
Lifetime learning credit 24-1, 24-6, 24-7, 24-8  
Link & Learn Taxes 1-3, 1-4, 1-11  
Loan Repayment Assistance Programs (LRAP) 9-6  
Lowest cost bronze plan 3-22  
Lump-sum benefit payments 15-3

## M

---

MACRS 13-7, 13-10  
MAGI 3-22  
Mailing the return 32-3  
Main home 11-11, 11-12, 11-13, 11-15  
Marketplace 3-22  
Married Filing Jointly filing status 5-2, 8-4  
Married Filing Separately filing status 5-3, 5-4, 8-4  
Married taxpayers 3-23  
Medicaid Expansion 3-23  
Medicaid waiver payments 10-2, 16-2  
Medical separation pay 17-1  
Military filing status – exemptions 8-1  
Military finishing and filing the return 33-1  
Military income 17-1  
Military moving expenses 19-1  
Minimum essential coverage (MEC) 3-23  
Miscellaneous credits 27-1  
Modified Adjusted Gross Income (MAGI) 3-23  
Mortgage interest 13-4, 20-2, 21-1, 21-5, 27-6  
Mortgage interest credit 27-6  
Moving expenses 16-15, 19-1  
Multiple support agreement 7-9  
Mutual funds 9-10, 11-5  
myRA 27-2

## N

---

National Average Bronze Plan Premium (NABPP) 3-23  
Nonbusiness credit card debt cancellation 16-4  
Noncustodial parent 7-9, 7-10, 26-2  
Nonqualified distributions 12-5  
Nonrefundable credits (defined) 23-1, 27-1  
Nonresident aliens 8-1, 21-1, 24-1  
Nontaxable income 9-2

## O

---

Original issue discount (OID) 9-6, 9-13, 18-4  
Other income 16-1  
Other taxes 28-1  
Overpayment 31-2

## P

---

Partnerships 13-3  
Passive income , 13-11  
Payment options 31-1, 31-7, 33-2, 34-4  
Payments 29-1  
Payment voucher 31-7  
Pell grants 24-3  
Penalty for early withdrawal 18-4  
Pension income 12-9, 12-10  
Permanently and totally disabled (defined) 7-3, 7-8, 27-5  
Personal exemptions 6-1, 8-6  
Personal identification number (PIN) 31-12  
Personally Procured Move 19-2  
Points, mortgage 21-6  
Practice Lab 1-3  
Premium tax credit 3-1  
Principal business code 10-10, 10-11  
Prior year returns 34-5, 34-6  
Provider identification, child care 23-7  
Publication 4012, Volunteer Resource Guide 1-3

## Q

---

Qualified dividends 9-9, 9-10  
Qualified education expenses 18-11, 24-1, 24-2  
Qualified health plan 3-23  
Qualified Medicaid waiver payments 10-2, 16-2  
Qualifying child (child and dependent care credit) 23-2  
Qualifying child (child tax credit) 26-1  
Qualifying child (dependency exemption) 7-3, 7-9  
Qualifying child (EIC) 30-4  
Qualifying relative 5-5, 7-1, 7-6  
Qualifying Widow(er) filing status 5-7

## R

---

Railroad retirement 15-1, 15-2  
Real estate taxes 20-4, 21-4  
Reconstructing records 10-14  
Recordkeeping 10-13  
Refund/amount of tax owed 31-1  
Refund information 31-1  
Regular place of abode 16-11  
Release of claim to exemption 7-10, 32-2  
Rental income and expenses 13-1  
Required contribution 3-24  
Reservists expenses 22-5  
Residency status 8-1  
Resident alien 8-1  
Retirement income 12-1  
Retirement plan distributions 12-2, 12-3, 12-12  
Retirement savings contribution credit 27-1  
Rollover 12-7  
Roth IRA 12-4, 12-6  
Routing transit number (RTN) 31-3  
Royalty income 13-13,

## S

---

Sale of home 11-11, 11-13, 11-15  
Sale of investment property 11-1, 11-5  
Sale of stock 11-1, 11-6  
Sales taxes 9-12  
Savings accounts 9-6  
Savings bond 9-6, 18-11, 31-2, 31-5  
Schedule C 10-1, 10-3  
Schedule C-EZ 10-1, 10-3  
Schedule E 13-1  
Schedule K-1 13-1  
Scholarships 9-5, 18-11, 24-3  
Second Lowest Cost Silver Plan (SLCSP) 3-24  
Self-employment income 10-1, 16-15, 30-2  
Self-employment income, foreign earned 16-10, 16-11, 16-15  
Self-employment tax 10-3, 10-11, 10-12, 10-15, 18-4, 28-2  
Shared responsibility payment (SRP) 3-9  
Signatures 33-7, 33-8  
Single filing status 5-2  
Site identification number (SIDN) 1-5  
Social security benefits 15-1  
Social security number (SSN) 4-5, 4-6, 4-7  
Social security taxes 15-1, 28-2, 29-5  
Software practice lab 1-3  
Sources of support 7-8

Split refunds 31-3  
Spousal abandonment 3-24  
Standard deduction and tax computation 20-1  
Standard deduction charts 20-3  
Standard mileage rate 19-4  
Standard mileage rate (business) 10-7, 10-11, 22-5, 22-6  
Standard mileage rate (charitable) 21-8  
Standard mileage rate (medical and move) 21-2  
State and local income taxes 20-4, 21-4  
State and local real estate taxes 20-4, 21-4  
Student loan interest deduction 18-10  
Substantial presence test 8-2, 8-4  
Supplemental security income (SSI) 15-1  
Support test 7-4, 7-8

## **T**

---

Taxable income 9-2, 20-5  
Taxable interest 9-6  
Taxable pensions 12-9  
Taxable retirement income 12-1  
Taxation of distribution 12-1  
Tax-exempt interest 9-7  
Tax family 3-24  
Tax forgiveness 33-7  
Tax home 16-11  
Tax household 3-24  
Tax payments 29-1  
Temporary absences 5-5, 11-12  
Temporary work location 22-7  
Testing and certification 1-4  
Theft losses 21-2, 21-10, 21-13  
Third party designee 31-12, 31-14  
Tie-breaker rule 7-5  
TINs (taxpayer identification numbers) 4-5  
Tip income 9-4, 9-3, 9-5  
Travel expenses 10-9, 13-6, 22-3, 22-4, 22-6  
Treasury Department's Financial Management Service (FMS) 31-4  
Trust 13-2  
Tuition statement (Form 1098-T) 9-6, 24-2, 24-3

## **U**

---

Unaffordable coverage 3-24

Undue hardship 31-8  
Unearned income 9-2  
Unemployment compensation 14-1  
Uniforms 22-1

## **V**

---

Valid taxpayer identification 4-5  
Vehicle expenses 10-7, 10-11, 13-6  
Volunteer hotline 1-11  
Volunteer ID Insert 1-4  
Volunteer Income Tax Assistance (VITA) 1-1  
Volunteer Protection Act 1-5  
Volunteer Resource Guide (Publication 4012) 1-3  
Volunteer standards of conduct 1-4

## **W**

---

Wages and salaries 9-3, 16-10, 25-7  
Wash sales 11-4  
Where's My Refund? 31-6  
Which form to file 4-8  
Who must file 4-1  
Who should file 4-3  
Withholding 29-1, 31-10  
Worldwide income 5-2, 16-7, 25-1



# Link & Learn Taxes

**Link & Learn Taxes** is web-based training designed specifically for VITA/TCE volunteers. Each volunteer's ability to prepare complete and accurate returns is vital to the credibility and integrity of the program. Link & Learn Taxes, as part of the complete volunteer training kit, provides the path to achieving this high level of quality service.

Link & Learn Taxes and the printed technical training kit, Publication 4480, work together to help volunteers learn and practice.

## Link & Learn Taxes for 2017 includes:

- Access to all VITA/TCE courses
- Easy identification of the VITA/TCE courses with the course icons
  - As you progress through a lesson, the content for Basic, Advanced, Military, or International will display, depending on the level of certification you selected
- PowerPoint presentations that can be customized to fit your classroom needs
- VITA/TCE Central to provide centralized access for training materials and reference links
- The Practice Lab
  - Gives volunteers practice with an early version of the IRS-provided tax preparation software
  - Lets volunteers complete workbook problems from Publication 4491W
  - Lets volunteers prepare test scenario returns for the test/retest



Go to [www.irs.gov](http://www.irs.gov), type “Link & Learn” in the Keyword field and click Search. You’ll find a detailed overview and links to the courses.

**FSA (Facilitated Self Assistance)** empowers taxpayers to prepare their own returns with the assistance of a certified volunteer. Taxpayers complete their own returns using interview-based software supplied by leaders in the tax preparation industry. Volunteers assist taxpayers with tax law and software questions.

**Virtual VITA** allows partners to initiate the intake process for taxpayers in one location, while utilizing a certified volunteer to prepare the return in an entirely different location. By incorporating this flexibility, partners can provide taxpayers with more convenient locations to file their taxes.

**For more information contact your SPEC Relationship Manager to see if you should start a FSA or Virtual VITA site in your community.**



**www.irs.gov**

## Your online resource for volunteer and taxpayer assistance

### Partner and Volunteer Resource Center

<https://www.irs.gov/Individuals/Partner-and-Volunteer-Resource-Center>

- What's Hot!
- Site Coordinator's Corner

### Quality and Tax Alerts for IRS Volunteer Programs

<https://www.irs.gov/Individuals/Quality-and-Tax-Alerts-for-IRS-Volunteer-Programs>

- Volunteer Tax Alerts

### Volunteer Training Resources

<https://www.irs.gov/Individuals/Volunteer-Training-Resources>

### Outreach Corner

<https://www.irs.gov/Individuals/Outreach-Corner>

### Tax Trails for Answers to Common Tax Questions

<https://www.irs.gov/Individuals/Tax-Trails-Main-Menu>

### Online Services and Tax Information for Individuals

<https://www.irs.gov/Individuals>

#### File Your Return

- Direct Deposit your refund

#### Make a Payment

- Direct Pay
- Other ways you can pay  
(Electronic funds withdrawal, debit and credit card, and IRS2Go)

#### Manage Your Tax Info

- Withholding Calculator
- Answers about the Health Care Law
- Protect your identity

#### After You File

- Where's My Refund?
- Get Transcript

### eBooks

Want to view our training products on your mobile or tablet devices? Click here to access our eBooks: <https://www.irs.gov/Individuals/Site-Coordinator-Corner>.

### Mobile App

Another device to use for additional information is IRS2Go. Click here to download IRS2Go mobile app: <https://www.irs.gov/uac/irs2goapp>.

## and much more!

Your direct link to tax information 24/7:

[www.irs.gov](https://www.irs.gov)