2009 Publication 4555

Instructor Guide

For Use in Preparing Tax Year 2009 Returns

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

Process Based Training

"Another Step Toward Quality"

IRS

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tax products and
information.

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Technical Updates

Publication 4491-X conveys tax law updates and other revisions to the VITA/TCE training products that occur after the products are published. The publication is normally available for downloading in mid-December via IRS.gov.

Volunteer Tax Alerts are issued during filing season (as needed) and may include additional technical updates. They are accessible via IRS.gov (keyword: Community Network). Also, consult your course instructor and/or site coordinator for guidance.

Department of the Treasury – Internal Revenue Service

Volunteer Agreement

Standards of Conduct – VITA/TCE Programs

The mission of the VITA/TCE Program is to provide free basic tax return preparation for eligible taxpayers. Volunteers are the program's most valuable resource. To establish the greatest degree of public trust, Volunteers have a responsibility to provide high quality service and uphold the highest of ethical standards.

As a participant in the VITA/TCE Program, I agree to the following standards of conduct:

- I will treat all taxpayers professionally, with courtesy and respect.
- I will safeguard the confidentiality of taxpayer information.
- I will apply the tax laws equitably and accurately to the best of my ability.
- I will only prepare returns for which I am certified. (Basic, Advanced, etc.)
- I will exercise reasonable care in the use and protection of equipment and supplies.
- I will not solicit business from taxpayers I assist or use the knowledge I have gained about them for any direct or indirect personal benefit for me or any other specific individual.
- I will not accept payment from taxpayers for the services I provide. I may receive compensation as an employee of a program sponsor.
- I will ensure the returns I prepare, follow the Intake/Interview and Quality Review Processes.

The Tax Software Hints in this product are for sites using TaxWise© software to prepare tax returns. This software is copyrighted and owned by CCH Small Firm Services© (CCH). It is issued to VITA/TCE sites by the IRS. Consult your instructor and/or site coordinator for guidance and access to the software.

Confidentiality Statement

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

All persons, scenarios and addresses appearing in this product are fictitious. Any resemblance to persons living or dead is purely coincidental.

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

GE AND INVESTMENT DIVISION

November 12, 2009

Greetings Volunteers,

I wish I could extend a face-to-face welcome to each of you. With over 80,000 volunteers throughout the U.S. and overseas, I realize that is not a realistic option, so please accept my welcome and sincere appreciation for your time, talent and unyielding support. Each filing season brings exciting and rewarding challenges, and this year will be no exception.

In preparation for this year's training and filing season, I would like to encourage you to take advantage of the resources available at IRS.gov, search keyword: *Community Network*. The site contains a wealth of information that will assist you in providing quality tax return preparation assistance.

Throughout the spring and summer months of 2009, we have worked tirelessly to assist you in understanding the impact the American Recovery Reinvestment Act of 2009 (ARRA) has on the tax returns of our program participants (low-income, elderly, limited English-speaking, the disabled, military, etc). While there are numerous public and private outlets for ARRA information to supplement your training, the most reliable sources are Link & Learn Taxes (L&LT), our e-learning course and other tax information available at IRS.gov.

As you well know, consistent practice is key to effective training. The workbook (Publication 4491-W) in this kit is designed for that purpose. The problems can be completed using the Practice Lab available in the Link &Learn Taxes application or by using paper returns. You may also complete the test and retest (Form 6744) using the Practice Lab.

I welcome your suggestions for improving your experience, as well as that of the taxpayers you serve. Please adhere to the volunteer agreement in your training material and e-mail partners@IRS.gov or mail your concerns to:

Internal Revenue Service
Stop 45-WI – VITA/TCE Training
401 West Peachtree Street, NW
Atlanta, GA, 30308

Again, welcome and thanks. Let's make this our best filing season ever!

Sincerely,

Julieta D. Garcia
Director, Stakeholder Partnerships,
Education & Communication

What’s in my training kit?

Product	What’s New This Year
Publication 4491, Student Training Guide or Publication 4555, Instructor Guide	• New tax law content for 2009 • NEW identifies new tax laws • Tax software hints in the student and instructor training guides provide brief, helpful information. Specific guidance for entering data in the software is in the applicable yellow tab section of Publication 4012. • Income from Schedule K-1s (interest, dividends and capital gains) is a new Advanced topic in Lesson 12. • Lesson 14, Social Security Benefits is now a Basic lesson. • Penalty for early withdrawal of savings is now a Basic topic in Lesson 17.
Publication 4491-W, Comprehensive Problems & Exercises Workbook	• Problem and practice exercises that cover new 2009 tax law from the American Recovery and Reinvestment Act (ARRA) and changes to what’s in scope this year. • If possible, sites should wait to use the tax year 2009 tax preparation software that will be on the Software Practice Lab when Link & Learn Taxes is available on www.irs.gov in early November.
Publication 4012, Volunteer Resource Guide	• A job aid for using Form 13614-C, Intake/Interview & Quality Review Sheet • Additional guidance for entering data in the IRS-provided tax preparation software is in the yellow (desktop) and blue (on-line) tabs.
Form 6744, Test/Retest	• The test is designed for use with the software Practice Lab on Link & Learn Taxes. It is open book and can be taken and scored on Link & Learn Taxes. • Prior tax year forms and software cannot be used to complete the workbook or the test/retest exercises due to the impact of the American Recovery and Reinvestment Act (ARRA) on 2009 tax preparation.
Form 13222 and Form 13232, student and instructor course evaluation forms	• Share your ideas for enhancing these materials by completing the applicable evaluation form. Read the Director’s letter in the front of the book for additional guidance.
Software Practice Lab	• Reinforce your training using the IRS or service e-learning application for volunteers – Link & Learn Taxes. The site also contains an early release version of the IRS-provided tax preparation software.

Publication 4555 Notes to Instructors

Introduction

This guide and the products in this kit contain the information and guidance you need to satisfy our mutual goal of providing consistent, yet tailored training. Remember, all individuals including IRS-SPEC employees participating in the VITA/TCE Programs, who answer tax law questions, instruct tax law, prepare or correct tax returns and/or conduct quality reviews of completed tax returns must be certified.

The make-up of Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) sites are different from city to city. Because of these differences, not all the materials in this guide will apply to all sites. Therefore, it is up to you to provide your students the guidance, insights and skills required to provide high quality tax return preparation services. In the pages that follow, you will find:

- Information about the process-based training approach
- Answers to frequently asked instructor questions (Topics include: getting started, what's in this kit, which lessons you should teach, suggestions for maximizing your resources, student engagement and comprehension, etc.)
- Recommended presentation times for each lesson
- The student text (Publication 4491) with instructor notes in the margins

What is the training approach?

You can teach five of the seven VITA/TCE courses using this guide and the other products in your kit. Each course uses the process-based training (PBT) approach. PBT is a performance based training curriculum that uses a process based approach to teaching the return preparation process. Unlike tax law lecture driven training, PBT engages students in the return preparation process and requires extensive role-playing, and the completion of problems and exercises that simulate situations they will encounter at the site.

Many volunteers find it helpful to take the courses online, either in a classroom setting or in the privacy of their home. As explained on the back inside cover, Link & Learn Taxes (L&LT), the IRS' e-learning application for VITA/TCE volunteers, supports the PBT training approach and includes a link to the "Electronic Tax Software Practice Lab for VITA/TCE Volunteers."

The Practice Lab, which is programmed for Tax Year 2009, provides volunteers the opportunity to gain practical experience with the actual software that will be used at most sites when assisting taxpayers. Students may find the Practice Lab helpful for completing their practice exercises, comprehensive problems, and test.

TIP

The provisions of the American Recovery and Reinvestment Act (ARRA) require numerous tax law changes for 2009. If sites use the prior tax year forms and software to complete problems and exercises, they must also apply the prior year's tax law in order to exclude any ARRA material. If possible, sites should wait to use the 2009 tax preparation software that will be on the Practice Lab when L&LT is available on irs.gov in early November.

CAUTION

Do not use the Electronic Tax Software Practice Lab to complete actual returns.

What resources are available to me?

There are numerous resources available to you, including your partner/sponsor, Site Coordinator, IRS-SPEC Tax Consultant, the Community Network at www.irs.gov, and Publication 1084, Volunteer Site Coordinator's Handbook.

Publication 1084 contains a complete overview of the volunteer programs, training delivery options including information about ordering products, testing, and certification guidance. The publication is available from your IRS-SPEC Tax Consultant and can be downloaded from www.irs.gov.

How do I get started?

The training is based on a tiered strategy; each tier represents a complete course of study. **There are seven courses of study** – Basic, Intermediate, Advanced, Military, International, Puerto Rico, and Foreign Students. Five of the VITA/TCE courses are covered in your kit and the students' kit.

The courses for **Puerto Rico** (tax law specific to residents of Puerto Rico who must file a U.S. income tax return) and **Foreign Students** (U.S. tax law specific to international students and scholars) are available on L&LT only.

After obtaining your certification for the course(s) you will teach, we recommend the following prerequisites for each instructor:

1. Allow two hours of preparation time for every hour of instruction.
2. Review and discuss Lessons 1, 2, and 3 as a team. These lessons contain information that will flow throughout the course materials, i.e., each instructor will cover various aspects of Vanessa Franklin's tax return.
3. Establish an agenda for teaching the course using Exhibits 1 and 2, which contain a suggested syllabus for presenting the information.
4. Review the test/retest introductory information to make sure you understand the certification requirements and procedures.

CAUTION

Instructors must be certified in the course(s) they teach. Certification is required each year before instructional services are provided.

What's in this kit?

In addition to this publication, which contains the student guide in its entirety with instructional guidance for each lesson in the margins, your kit includes the following items. The purpose, changes, and other important information about the products are shown on page ii of this guide.

1. **Publication 4491-W, Comprehensive Problems and Exercises Workbook**
2. **Publication 4012, Volunteer Resource Guide**
3. **Form 6744, Test/Retest**
4. **Administrative products**: Form 13232, Instructor Course Evaluation, and Document 12107, Postage Paid Label for mailing evaluation forms to the IRS free of charge.

CAUTION

Students will use Publication 4012 at the tax preparation site.

TIP

If your students do not test and certify using L&LT, you will also need a copy of the test/retest answers (Publication 4189) from your IRS-SPEC Tax Consultant.

What are other recommended resources?

As explained later in the Course Introduction, you may find the following additional resources helpful:

1. Publication 17, Federal Income Tax Guide for Individuals
2. State tax materials
3. Form 1040 Instructions for paper/manual return preparation classes
4. Up-to-date tax products and information available on www.irs.gov.
5. Computers and/or Internet access for classes incorporating the tax preparation software and/or L&LT – this requires a computer for each student (if possible) and/or a computer and projector for the instructors, table space for documents, flash drives or other storage media for students to save their work, and (if possible) one assistant per five students
6. L&LT to grade/score the test/retest and/or to supplement classroom training
7. Software Practice Lab via L&LT for 24/7 access to the IRS return preparation software

> **CAUTION**
>
> When using products from other sources, including www.irs.gov, make sure you are aware of any content and processing changes before sharing them with your students.

How do I know what to cover?

Instruction for teaching the courses is provided in this publication. The reference tab in Publication 4012 contains a Scope of Service chart that you will find helpful for planning each lesson.

Beginning in lesson 8, the icons described below indicate topics that are required for each course.

The **Basic** course covers income from wages, interest, dividends, social security income, and the more frequently used tax credits for individuals and couples. Social security income and penalty on early withdrawal of savings are new this year in the Basic course. All volunteers are required to take this course.

The **Intermediate** course covers all tax topics in the Basic course plus education credits, additional income topics (such as alimony and Schedule C-EZ), itemized deductions, adjustments to income, and some pension issues for individuals and families.

The **Advanced** course covers all tax topics in the Basic and Intermediate courses plus additional pension topics. Also covered are stock and sale of home issues for individuals and families.

The **Military** course is generally the Advanced course with special emphasis on tax issues that affect armed services personnel and their families, such as combat pay, moving expenses, etc. Those assisting or instructing the U.S. Armed Forces overseas must also take the International course.

The **International** course is generally the Advanced course with special emphasis on international tax law for the U.S. Armed Forces overseas and U.S. residents living outside the U.S., especially those served by U.S. embassies and consulates.

TIP

Check www.irs.gov (keyword: community network) for training information and guidance beginning in November.

How can I maximize my resources?

The following points may be helpful in determining your training delivery method, presentation times, and certification method (paper or electronic):

- **What** *knowledge*, *skills*, and *abilities* (KSAs) do your students possess? For instance, computer and people skills, tax law knowledge, interviewing skills, foreign language(s), etc. What is their expertise/proficiency in each of the KSAs?
- **Where** will instruction take place? Do a large number of your students have computer access? Are your students in rural areas? Is it more beneficial to supplement classroom training with self-study training using L&LT or Publication 4491? Can some or all the students complete the course independently using Publication 4480 and L&LT with ad hoc face-to-face or electronic guidance from you?
- **Who** is the intended audience? Are they seniors, retirees, armed forces personnel, low-to-moderate wage earners, students, disabled individuals, etc.? Are your students familiar with special tax concerns of these taxpayers?
- **How** much time do you have for classroom instruction and administering and scoring the test?

TIP

Encourage students to use L&LT to score their test and obtain their certification.

Any pointers for keeping the students engaged?

Yes, breathe life into the course you teach by sharing your experiences and insights. It may take more time but, by following the process based training approach presented in this guide, your students will be engaged and require less assistance when preparing actual returns. The role-plays and problems and exercises in Publication 4491-W help students:

- Gain an understanding of the tax preparation process and the resources available to them
- Learn to use the resource materials available to them at the site

- Complete exercises and problems that provide them an understanding of tax law and how to apply it in various situations
- Understand the importance of following the return preparation process and safeguarding taxpayer information
- Complete an accurate return – each and every time

Using the introductory information in the test/retest, explain the testing and certification process. Encourage students to be aware of the test content for their level of certification.

How will I know if the students comprehended the information?

PBT is designed to assist you in determining if your students understand how to prepare a complete and accurate return. PBT requires extensive role plays, classroom demonstrations, and return preparation practice. Group dynamics are good indicators – body language, listening skills, etc. You can also observe the students' performance as they complete the comprehensive problem for their course.

Remember, you can reinforce your classroom training and provide further development by encouraging students to use L&LT during their free time. Ultimately, each student's achievement on the test and the results of quality reviews of the returns they prepared will determine if they understood the information.

How do I suggest changes to the course materials?

We welcome your comments and suggestions for enhancing your teaching experience. Your training kit contains Form 13232 for submitting your comments; students have Form 13222 in their training kit for the same purpose.

Forward all completed forms using the postage-paid business reply label (Document 12107) in your kit. Please be sure to follow these instructions:

- Enter the applicable city, state, and ZIP code
- Darken the circle bubbles; do not place an X or check mark in the bubbles
- Do not fold, staple, or photocopy the forms
- Mail forms in an envelope 9 x 12 inches or larger
- Mail the completed evaluation(s) at the conclusion of each course

CAUTION

Do not use the mailing label in your kit to mail tax documents; only mail course evaluations using the mailing label.

The survey results are shared with local IRS-SPEC tax consultants in early to late June.

Exhibit 1: Content and Courses

Lesson 1 – Course Introduction	All courses
Lesson 2 – Screening and Interviewing	All courses
Lesson 3 – Filing Basics	All courses
Lesson 4 – Filing Status	All courses
Lesson 5 – Personal Exemptions	All courses
Lesson 6 – Dependency Exemptions	All courses
Lesson 7 – Unique Filing Status and Exemption Situations	All courses
Lessons 8 through 16	See Lesson 8 for a chart of Income topics by lesson
Lesson 17 – Adjustments to Income	All courses (Basic should only cover Penalty for Early Withdrawal of Savings)
Lesson 18 – Military Moving Expenses	Military
Lesson 19 – Standard Deduction and Tax Computation	All courses
Lesson 20 – Itemized Deductions	All courses (except Basic)
Lesson 21 – Military Employee Business Expenses	Military
Lesson 22 – Business Travel Expenses	International
Lesson 23 – Credit for Child and Dependent Care Expenses	All courses
Lesson 24 – Education Credits	All courses (except Basic)
Lesson 25 – Foreign Tax Credit	All courses (except Basic)
Lesson 26 – Child Tax Credit	All courses
Lesson 27 – Miscellaneous Credits	All courses (Basic should only cover Elderly or Disabled and Qualified Retirement Savings)
Lesson 28 – Other Taxes	All courses
Lesson 29 – Payments	All courses
Lesson 30 – Earned Income Credit (EIC)	All courses
Lesson 31 – Refund / Amount of Tax Owed	All courses
Lesson 32 – Quality Review of the Tax Return	All courses
Lesson 33 – Concluding the Interview	All courses
Lesson 34 – Military Finishing and Filing the Return	Military
Lesson 35 – Amended Returns	All courses

Exhibit 2 – Curriculum Recommended Presentation Times

Lesson	Content	Estimated Minutes*
	Welcome & Introductions	15
1	Course Introduction	15 - 30
2	Screening and Interviewing	15
3	Filing Basics	15 - 45
4	Filing Status	60
5	Personal Exemptions	30
6	Dependency Exemptions	30
7	Unique Filing Status and Exemption Situations	30
8	Income - Wages, Interest, Etc.	90 - 165
9	Income - Business Income or Loss	60
10	Income - Capital Gains or Loss	90
11	Income - Retirement Income	105
12	Income - Rental and Schedule K-1s	60
13	Income - Unemployment Compensation	15 - 30
14	Income - Social Security Benefits	30
15	Income - Other Income	15 - 30
16	Military Income	60
17	Adjustments to Income	15 - 75
18	Military Moving Expenses	45 - 75
19	Standard Deduction and Tax Computation	15 - 45
20	Itemized Deductions	45
21	Military Employee Business Expenses	30
22	Business Travel Expenses	30
23	Credit for Child and Dependent Care Expenses	30
24	Education Credits	30
25	Foreign Tax Credit	60
26	Child Tax Credit	30
27	Miscellaneous Credits	30
28	Other Taxes	15
29	Payments	30
30	Earned Income Credit (EIC)	60 - 120
31	Refund / Amount of Tax Owed	30
32	Quality Review of the Tax Return	60
33	Concluding the Interview	30
34	Military Finishing and Filing the Return	60
35	Amended Returns	30
	Testing Guidelines (Using Form 6744)	15
	Review Test	240
	Closing & Evaluation Form 13222	15
* Estimated time does not include breaks or lunch		

Notes

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Lesson 9: Income – Business; Form 1040, Line 12

Lesson 10: Income – Capital Gain or Loss; Form 1040, Line 13

Lesson 11: Income – Retirement Income; Form 1040, Lines 15-16

Lesson 17: Adjustments to Income

Lesson 18: Military Moving Expenses

Lesson 19: Standard Deduction and Tax Computation

Lesson 20: Itemized Deductions

Lesson 20: Itemized Deductions (continued)

Lesson 21: Military Employee Business Expenses

Lesson 22: Business Travel Expenses

Lesson 23: Credit for Child and Dependent Care Expenses

Lesson 24: Education Credits

Lesson 25: Foreign Tax Credit

Lesson 26: Child Tax Credit

Lesson 27: Miscellaneous Credits

Lesson 28: Other Taxes

Lesson 29: Payments

Lesson 30: Earned Income Credit (EIC)

Lesson 31: Refund and Amount of Tax Owed

Lesson 32: Quality Review of the Tax Return

Lesson 33: Concluding the Interview

Lesson 34: Military Finishing and Filing the Return

Lesson 35: Amended Returns

Appendix A: Vanessa Franklin Taxpayer Scenario

Appendix B: Vanessa's Tax Documents

What’s New for 2009

Important Tax Law Changes for 2009

Economic Recovery Payment

The $250 Economic Recovery Payment was paid in 2009 to recipients of certain benefits administered by the Social Security Administration, Department of Veterans Affairs, and the Railroad Retirement Board. Eligible individuals received the payment automatically; they did not have to apply for the payment. Any economic recovery payment received during 2009 is not taxable, but it does reduce any making work pay tax credit.

Making Work Pay Tax Credit

The making work pay tax credit is a refundable tax credit of up to $400 for working individuals ($800 for Married Filing jointly). This credit is calculated at a rate of 6.2% of earned income. It is phased out (gradually reduced) for taxpayers with a modified adjusted gross income (AGI) in excess of $75,000 ($150,000 for Married Filing Jointly). To be eligible for the credit, taxpayers must have a valid social security number (SSN). For Married Filing Jointly taxpayers, at least one taxpayer must have a valid SSN.

TIP

Nonresident aliens and taxpayers who can be claimed as dependents on someone else’s tax return are not eligible for the credit.

Most Form W-2 wage earners have already benefited from the credit with a larger paycheck, as a result of the changes made to the federal income tax withholding tables in early 2009 (to implement the making work pay tax credit). The amount of the credit, however, must still be claimed on the taxpayer’s 2009 return (filed in 2010). Generally, Schedule M (Form 1040A or 1040), Making Work Pay and Government Retiree Credits, is used to claim the credit. Taxpayers filing Form 1040EZ do not have to file Schedule M. They will calculate the amount of the credit directly on the Form 1040EZ.

Special Credit for Certain Government Retirees

A one-time refundable credit of $250 is available in 2009 for certain government retirees who receive a pension from work and are not covered by social security. This one-time credit must be claimed on the 2009 income tax return and is a reduction to any making work pay tax credit. Individuals who receive an economic recovery payment must reduce the government retiree credit by the amount of the payment. Schedule M (Form 1040A or 1040), Making Work Pay and Government Retiree Credits, is used to claim the credit.

American Opportunity Tax Credit – Expanded Hope Credit

For tax years 2009 and 2010, the American opportunity tax credit makes temporary changes to the education credit known as the Hope credit. This new credit modifies the existing Hope credit, making it available to a broader range of taxpayers, including higher income taxpayers and those who owe no tax. It adds required course materials to the list of qualifying expenses and allows the credit to be claimed for four years of post-secondary education instead of two years. The maximum amount of the credit is increased to $2,500 per student. In addition, 40% of the credit may be refundable. The credit is phased out for taxpayers with a modified AGI between $80,000 and $90,000 ($160,000 and $180,000 if Married Filing Jointly).

TIP

There are some exceptions for taxpayers claiming the Hope credit for a student who attended a school in a Midwestern disaster area in 2009. For more information, see Publication 4492-B, Information for Affected Taxpayers in the Midwestern Disaster Areas, and Publication 970, Tax Benefits for Education.

Unemployment Compensation

For 2009, taxpayers can exclude from gross income up to $2,400 of unemployment compensation received in 2009. Unemployment compensation over $2,400 is subject to federal income tax.

First-time Homebuyer Credit

For homes purchased in 2009, taxpayers can qualify for a refundable credit of 10% of the purchase price up to $8,000 ($4,000 if Married Filing Separately). Generally, the credit for qualifying home purchases after December 31, 2008, and before December 1, 2009, do not have to be repaid, as long as the home remains the taxpayer's main home for 36 months after the purchase date.

The amount of the credit begins to phase out for taxpayers whose modified AGI is more than $75,000 ($150,000 if Married Filing Jointly). For purposes of the credit, taxpayers are considered to be first-time homebuyers if they did not own any other main home during the three-year period ending on the date of purchase.

Sale of Main Home

Gain from the sale or exchange of the main home is no longer excludable from income if allocable to periods of nonqualified use. Generally, nonqualified use means any period after 2008 where neither the taxpayer nor spouse (or former spouse) used the property as a main home (with certain exceptions). This issue can be complex and is outside the scope of the volunteer program. Refer taxpayers with "nonqualified use" issues to a professional tax preparer.

Definition of Qualifying Child Revised

For 2009, the following changes have been made to the definition of a qualifying child:

- To be a qualifying child, the child must be younger than the taxpayer, unless the child is permanently and totally disabled.
- A child who files a joint return cannot be a qualifying child, unless the return was filed only as a claim for refund and no tax liability would exist for either spouse on separate returns.
- If the parents of a child can claim the child as a qualifying child but neither parent claims the child, no one else can claim the child as a qualifying child unless that person's AGI is higher than the highest AGI of any parent of the child.
- A taxpayer's child is a qualifying child for purposes of the child tax credit only if the taxpayer can and does claim an exemption for the child.

Investment Income of Certain Children

The amount of taxable investment income a child can have without it being subject to tax at the parent's rate has increased to $1,900 for 2009.

Standard Deduction Amount Increased

The standard deduction for taxpayers who do not itemize deductions on Schedule A (Form 1040) has increased for 2009:

- $11,400 – Married Filing Jointly or Qualifying Widow(er)
- $8,350 – Head of Household
- $5,700 – Single or Married Filing Separately

Deduction Allowed for New Vehicle Purchase

For 2009, there is an additional deduction for state and local sales and excise tax (including certain fees in states that do not have a sales tax) on the purchase of qualified motor vehicles. A qualified motor vehicle must be new and includes a passenger automobile or light truck, a motorcycle, or a motor home.

CAUTION

Taxes and fees paid on purchases before February 17, 2009, are not eligible for this special deduction.

The deduction is limited to eligible taxes and fees paid on the first $49,500 of the purchase price on the vehicle. The deduction phases out for taxpayers with modified AGI of more than $125,000 ($250,000 if Married Filing Jointly).

The new vehicle deduction is available to taxpayers who claim the standard deduction, as well as taxpayers who itemize deductions on Schedule A (Form 1040). The new deduction can be used to increase the amount of the standard deduction or it can be taken as an itemized deduction (if the taxpayer is not electing to take the state and local general sales tax deduction).

CAUTION

Do not confuse the deduction for a new vehicle purchase with the "Cash for Clunkers" program. The Car Allowance Rebate System (CARS) or "Cash for Clunkers" program, is handled through the U.S. Department of Transportation, National Highway Traffic Safety Administration, not on a tax return. For more information about "Cash for Clunkers" go to www.cars.gov.

Limits Increased for Itemized Deductions

Taxpayers with an AGI above a certain amount may lose part of their itemized deductions. In 2009, this AGI amount is increased to $166,800 ($83,400 if Married Filing Separately).

Exemption Amount Increased

The amount each taxpayer can deduct for each exemption increased to $3,650 for 2009.

Phaseout of Exemption Amount

Taxpayers with an AGI above a certain amount may lose part of the benefit of their exemptions. The amount at which the phaseout begins depends upon the filing status. For 2009, the phaseout begins at:

- $125,100 – Married Filing Separately
- $166,800 – Single
- $208,500 – Head of Household, and
- $250,200 – Married Filing Jointly or Qualifying Widow(er)

For 2009, each exemption cannot be reduced to less than $2,433.

Standard Mileage Rate

- **Business-related mileage**
  For 2009, the standard mileage rate for the cost of operating a car, van, or pickup/panel truck for business use is 55 cents per mile.
- **Medical and move-related mileage**
  For 2009, the standard mileage rate for the cost of operating a vehicle for medical reasons or as part of a deductible move is 24 cents per mile.
- **Charitable-related mileage**
  For 2009, the standard mileage rate for the cost of operating a vehicle for charitable purposes remains at 14 cents per mile.

Earned Income Credit (EIC)

Amount of credit increased

For 2009, the maximum credit is:

- $3,043 with one qualifying child
- $5,028 with two qualifying children
- $5,657 with three or more qualifying children
- $457 with no qualifying child

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:

- $35,463 ($40,463 if Married Filing Jointly) with one qualifying child
- $40,295 ($45,295 if Married Filing Jointly) with two qualifying children
- $43,279 ($48,279 if Married Filing Jointly) with three or more qualifying children
- $13,440 ($18,440 if Married Filing Jointly) with no qualifying child

Investment income amount increased

Taxpayers whose investment income is more than $3,100 cannot claim the EIC.

Advance payment of the credit

Qualifying taxpayers can get advance EIC payments (up to $1,826) added to their pay, by their employer.

Additional Child Tax Credit

For 2009, the minimum amount of earned income needed to claim the additional child tax credit is reduced to $3,000.

New Rules for Children of Divorced or Separated Parents

For tax years beginning after July 2, 2008 (the 2009 calendar year for most taxpayers), new rules apply to allow the custodial parent to revoke a release of claim to exemption that was previously released to the noncustodial parent on Form 8332, Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent, or similar form. The revocation is effective no earlier than the tax year beginning in the calendar year following the calendar year in which the custodial parent provided, or made reasonable efforts to provide, the noncustodial parent with written notice of the revocation.

If the custodial parent provides notice of revocation to the noncustodial parent in 2009, the earliest tax year the revocation can be effective is the tax year beginning in 2010. Part III of Form 8332 may be used for this purpose. It must be attached to the tax return for each tax year the child is claimed as a dependent as a result of the revocation.

Post-1984 decree or agreement

If the divorce decree or separation agreement went into effect after 1984 and before 2009, the noncustodial parent can still attach certain pages from the decree or agreement to the tax return instead of Form 8332. For any decree or agreement executed after 2008, Form 8332 or similar form must be used.

Social Security and Medicare Taxes

The maximum amount of wages subject to the social security tax for 2009 is $106,800. There is no limit on the amount of wages subject to the Medicare tax.

Wage Threshold for Household Employees

The social security and Medicare wage threshold for household employees is $1,700 for 2009. This means that if a household employee was paid cash wages of less than $1,700 in 2009, the taxpayer does not have to report and pay social security and Medicare taxes on that employee’s 2009 wages.

Income Limits Increased for Student Loan Interest Deduction

For 2009, the amount of the student loan interest deduction is phased out for taxpayers who are married and file jointly, and whose modified AGI is between $120,000 and $150,000. If the modified AGI is $150,000 or more, no deduction is allowed.

For filing statuses Single, Head of Household, and Qualifying Widow(er), the student loan interest deduction is phased out for taxpayers whose modified AGI is between $60,000 and $75,000. If the modified AGI is $75,000 or more, no deduction is allowed.

CAUTION

Married taxpayers who file separately do not qualify for the student loan interest deduction.

Income Limits Increased for Lifetime Learning Credit

For 2009, the amount of the lifetime learning credit is phased out for taxpayers with a modified AGI between $50,000 and $60,000 ($100,000 and $120,000 if Married Filing Jointly). If the modified AGI is $60,000 or more ($120,000 or more for Married Filing Jointly) no credit is allowed.

Qualified Higher Education Expense (Section 529 Accounts)

For tax years 2009 and 2010, the definition of qualified higher education expenses for tax-free distributions from a qualified tuition program is expanded to include the purchase of computer technology, equipment, and Internet access (including related services) that are to be used by the beneficiary and the beneficiary’s family during any of the years that the beneficiary is enrolled at an eligible educational institution.

Deductible Long-Term Care Premium Limits Increased

For 2009, 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).

- $320 - age 40 or under
- $600 - age 41 to 50
- $1,190 - age 51 to 60
- $3,180 - age 61 to 70
- $3,980 - age 71 and over

TIP

The limit on premiums is for each person.

Income Limits Increased for Reduction of Education Savings Bond Interest Exclusion

For 2009, the amount of the interest exclusion is phased out for Married Filing Jointly taxpayers or Qualifying Widow(er) taxpayers whose modified AGI is between $104,900 and $134,900. If the modified AGI is $134,900 or more, no deduction is allowed.

CAUTION

Married taxpayers who file separately do not qualify for the exclusion.

For Single and Head of Household filing statuses, the interest exclusion is phased out for taxpayers whose modified AGI is between $69,950 and $84,950. If the modified AGI is $84,950 or more, no deduction is allowed.

Residential Energy Credits

Nonbusiness energy property credit

The new law reinstates and increases the tax credit for homeowners who make energy efficient improvements to their existing homes. The law increases the credit rate to 30% of the cost of all qualifying improvements and raises the maximum credit limit to $1,500 for improvements placed in service in 2009 and 2010.

The credit applies to improvements such as adding insulation, energy efficient exterior windows and doors, energy-efficient heating and air conditioning systems, and certain roofs. The credit has been expanded to include certain asphalt roofs and stoves that burn biomass fuel.

Residential energy efficient property credit

This nonrefundable energy tax credit will help individual taxpayers pay for qualified residential energy efficient property, such as solar hot water heaters, geothermal heat pumps, and wind turbines. The new law removes most of the previously imposed maximum amounts and maintains the 30% credit for the purchase of qualified property. This energy credit is claimed on Part II of Form 5695, Residential Energy Credits. This portion of the energy credit is complex. Refer taxpayers with these expenses to a professional tax preparer.

Self-Employment Tax

Self-employment tax consists of two parts, social security and Medicare. The maximum amount of net earnings subject to the social security part of the self-employment tax for tax years beginning in 2009 is $106,800. All net earnings of at least $400 are subject to the Medicare part of the tax.

IRAs and Other Retirement Plans

Temporary Waiver of Required Minimum Distributions (RMDs)

For 2009, taxpayers are not required to take an RMD from IRAs or most defined contribution plans. This waiver applies to plan participants as well as to beneficiaries. The waiver also applies to taxpayers who turn 70-1/2 in 2009 and delay their 2009 RMD until April 1, 2010. The waiver does not apply to RMDs for 2008, even for taxpayers who turned 70-1/2 in 2008 and choose to take the 2008 RMD by April 1, 2009.

Modified Adjusted Gross Income (AGI) Limit for Traditional IRA Contributions Increased

For 2009, if a taxpayer is 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 $89,000 but less than $109,000 for Married Filing Jointly taxpayers or Qualifying Widow(er),
- More than $55,000 but less than $65,000 for a Single or Head of Household, or
- Less than $10,000 for Married Filing Separately.

If only one spouse is covered by a retirement plan at work, and the taxpayers live together or file a joint return, the deduction is phased out if the modified AGI is more than $166,000 but less than $176,000. If the modified AGI is $176,000 or more, no deduction for contributions to a traditional IRA is allowed.

Modified AGI Limit for Retirement Savings Contribution Credit Increased

For 2009, taxpayers may be able to claim the retirement savings contribution credit if their modified AGI is not more than:

- $55,500 for Married Filing Jointly,
- $41,625 for Head of Household, or
- $27,750 for Single, Married Filing Separately, or Qualifying Widow(er).

Foreign Earned Income and Housing Exclusions

For 2009, the maximum Foreign Earned Income Exclusion increased to $91,400. The base housing amount increased to $40.07 per day or $14,624 for the entire calendar year.

Deduction for Credit or Debit Card Convenience Fees

Taxpayers who pay their income tax (including estimated tax payments) by credit or debit card, can deduct the convenience fee charged by the card processor for using the credit or debit card. The deduction is allowed for the year in which the fee was charged to the card as a miscellaneous itemized deduction on Schedule A (Form 1040) and is subject to the 2% of AGI floor.

Decreased Estimated Tax Payments for Qualified Individuals With Small Businesses

For 2009, qualified individuals with small businesses may be eligible to make smaller estimated tax payments. If the individual qualifies, the required annual payment for 2009 is the smaller of 90% of the tax shown on the 2008 tax return or 90% of the tax shown on the 2009 tax return.

Schedule L (Form 1040A or 1040), Standard Deduction for Certain Filers

Schedule L is a new form that is used to calculate the standard deduction for certain filers. Taxpayers can use this form if they are increasing their standard deduction by certain state or local real estate taxes, new motor vehicle taxes, or a net disaster loss.

Schedule M (Form 1040A or 1040), Making Work Pay and Government Retiree Credits

Schedule M is a new form that is used to figure the making work pay credit and government retiree credit.

Refund Options – Savings Bonds

Taxpayers who receive a tax refund, can use their 2009 tax refund to buy U.S. savings bonds, even without a bank account or an existing account with Treasury. Taxpayers can save all or part of their refund by checking a box when they file their return. Go to www.irs.gov for the latest information and a list of questions and answers.

⚠ CAUTION

Congress may enact additional legislation that will affect taxpayers after this publication goes to print. For the most current tax law information, go to www.irs.gov.

Notes

Lesson 1: 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. The components of the process are:

- Screening and interviewing taxpayers using Form 13614-C, Intake/Interview & Quality Review Sheet or an approved alternative form
- Understanding and applying tax law
- Using references, resources, and tools including return preparation software
- Conducting quality reviews

Instructor Notes

Emphasize their donated time provides a tremendous service to the American public and to the community.

Conduct an icebreaker and introductions at this time.

Introduction

Unlike most classes, there is no need to memorize a lot of information – everything about this course is open book. In order to be a successful tax preparer, you need to:

- Understand and have compassion for all types of people
- Know where and how to get the "right answer"
- Understand and apply tax law, and
- Prepare accurate returns

Your ability to prepare an accurate return will be measured in two ways:

1. The testing and certification process – used initially to gauge your understanding of the return preparation process
2. Quality review results of the returns you prepare – demonstrate your proficiency in all aspects of the process

TIP

The components for completing an accurate return are the same whether you prepare tax returns using computer software or prepare the return on paper.

Stress that accuracy is achieved by obtaining information from taxpayers during the screening and interview process, and from their supporting documentation. A return is accurate when tax law is applied correctly and the return is free from error.

Point out that quality reviews are discussed in a later lesson. Each VITA/TCE site must have a process for conducting a quality review of each return prepared by volunteer preparers.

Objectives

After completing this course, you will be able to:

- Certify as a volunteer tax return preparer by taking the test(s) located in the Link & Learn Taxes e-learning course on www.irs.gov (or on paper if this option is not available to you)
- Conduct the initial interview and screen the taxpayer using an approved intake and interview sheet
- Determine whether the taxpayer is required to file a tax return
- Use reference and technical materials, such as the Volunteer Resource Guide and Publication 17, to ensure that you ask the correct questions during your dialog with the taxpayer, in order to prepare a complete and accurate tax return

Summarize main points in the Introduction.

Review objectives with the class.

Point out the resources cited under **What do I need?** and describe the contents of the kit.

It will not always be possible to have all suggested forms and publications available in the classroom or site. These forms and publications can all be viewed or downloaded at www.irs.gov.

- Correctly complete a 1040 series return, as well as accompanying tax forms, using paper tax forms or the tax software provided at your site
- Use the quality review process to check the taxpayer's return
- Conclude the interview and assemble the return
- Prepare the return for electronic filing using tax software licensed by the IRS for use at VITA/TCE sites

In this **lesson** you will learn about:

1. The course of study as presented in this book and the associated workbook, test, and reference books
2. Important information about the VITA/TCE program and the role of the volunteers
3. The approved VITA/TCE process for preparing tax returns

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

- The major features of the course materials
- The major components of the VITA/TCE process
- What is expected of a volunteer after completing this course
- The resources available to assist you

Your course instructor will provide all the available technical publications and forms required for this course.

What do I need?

☐ Approved Intake and Interview Sheet
☐ Approved Quality Review Sheet
☐ Volunteer Resource Guide
☐ Publication 17
☐ Publication 4491
☐ Publication 4491-W
☐ Form 6744
☐ Form 13222
☐ Form 13614-C
☐ Form 13615
☐ 13614-C Job Aid

Optional:

☐ Publication 3
☐ Publication 596
☐ Publication 972
☐ Publication 4299
☐ Publication 4403
☐ Publication 4575
☐ Form 13645
☐ Internet Access (optional but highly recommended)

TIP

Seek feedback from your sponsor about the accuracy rate of the returns completed at your site.

TIP

Prior to assisting taxpayers at the VITA/TCE Site, be sure to complete the "Are You Ready to Get Started?" assessment in the front of the Volunteer Resource Guide.

Why is this publication so large?

There are five courses presented in this publication, each representing a level of certification. The first seven lessons apply to all levels of certification. Beginning in Lesson 8, the level of certification for the subject being covered will be indicated by the following icons:

Basic covers the completion of wage earner type returns.

Intermediate covers completion of returns for wage earners who receive pension income, and more complex Forms 1040. It requires completion of the Basic course.

Advanced covers the completion of the full scope of VITA/TCE returns. It requires completion of the Basic and Intermediate courses.

Military covers the full scope of VITA/TCE returns presented by members of the Armed Forces, Reserve, and National Guard. It requires completion of the Basic and Intermediate courses.

International covers the completion of returns for non-Military taxpayers living outside the United States who are assisted by volunteers working at U.S. Embassies and Consulates or other areas. It requires completion of the Basic and Intermediate courses.

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.

CAUTION

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, a new Publication 17, an instruction booklet (e.g., Form 1040 Instructions), or other publication.

What is the training approach?

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

Summarize process based training for the class.

- The intake questions from Form 13614-C, Intake/Interview & Quality Review Sheet or approved alternative form to screen the taxpayer for eligibility, 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 during your interview with the taxpayer in order to help you prepare a 100% accurate tax return.
- An approved quality review sheet to check the quality of all completed returns. Adhering to a quality review process helps ensure high quality returns at all VITA/TCE program sites.

Display the quality review sheet on the third page of Form 13614-C. Explain that the quality review sheet, Form 8158, or an approved alternative contain the same questions but with different headings, and are used to review the return.

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.

TIP

IRS e-file is a quick and easy alternative to traditional paper returns. Most VITA/TCE volunteer sites are now set up for electronic filing using tax software.

What do I need to get started?

In addition to this publication, your training kit includes the following items:

- Publication 4491-W, Workbook – Comprehensive Problems & Practice Exercises
- Publication 4012, Volunteer Resource Guide
- Form 6744, Test/Retest
- Draft tax forms
- Form 13222, Student Evaluation and Form13232, Instructor Evaluation

The purpose, changes and other important information about the products in your kit are shown on page ii of this guide.

What other resources are available to help me learn?

Show Publication 4491-W and how to locate the workbook exercises.

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 identify specific problems in Publication 4491-W that will allow you to practice the lesson material. Although it might not be possible to work each exercise suggested 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.

What happens after I complete this course?

You will be tested on your understanding of tax law and the guidelines and tools needed to prepare an accurate return. After you have been certified, you will be ready to volunteer at a VITA/TCE site.

How does this certification work?

To participate in the VITA/TCE program, you must pass at least the Basic certification test. After your Basic certification, you can test for Intermediate certification. Once you have achieved **both** of these certifications, you may test for any or all of the other certifications (Advanced, Military, and International). You may take online tests that are available in the IRS' Link and Learn Taxes e-learning course on www.irs.gov. Online testing is fast and efficient; you will know immediately if you have 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 (Form 6744) may also be available. Talk with your instructor or Site Coordinator for more information on these options.

Review testing options with the class.

All volunteers who train others in how to complete tax returns, prepare tax returns, transmit tax returns, or conduct quality reviews on completed returns must complete and pass the VITA/TCE certification test at a level equivalent to the level at which they train.

If a volunteer does not achieve the minimum required score on the Test or the Retest they are encouraged to participate in the program in another capacity such as greeter, publicity/communication, or resource acquisition, among others.

When you pass the test, your Site Coordinator or instructor may provide you with a VITA/TCE program Wallet Card, Form 13645.

Display/Circulate Form 13645, Wallet Card (if desired).

The Wallet Card was created to acknowledge the accomplishment of certified volunteers, as well as to assist internal and external stakeholders in identifying certified volunteers. This credential provides an objective measure that you have mastered enough tax law to prepare returns. If provided, you should bring your Wallet Card to the tax preparation site for identification purposes.

What types of returns can I prepare?

It is important that you assist only with returns, supporting schedules and forms for which you have been trained and certified. You should only prepare returns that fall within the scope of the VITA/TCE program. 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 program can be found in the Volunteer Resource Guide (Tab 14).

CAUTION

Remember to refer taxpayers with tax situations outside your scope of training, experience and certification to your Site Coordinator and/or a professional tax preparer.

How does the IRS identify volunteer-prepared returns?

Each paper or electronically filed return should be identified with the appropriate site identification number (SIDN) to ensure that all volunteer-prepared returns are readily identifiable by the Internal Revenue Service. Your SIDN is an 8-digit number preceded by the “letter S” which must be entered on all returns you prepare (Form 1040, Form 1040A, and Form 1040EZ) – both paper and electronic. Your Site Coordinator provides this number along with other necessary guidelines for completing the return.

Provide the site SIDN (if available) and suggest the students write it in the Volunteer Resource Guide.

The SIDN should appear in the “Paid Preparer’s Use Only” section of the return and will be discussed in detail in Lesson 32, Quality Review of Tax Return.

Am I legally liable for returns I prepare?

Because they accept payment for preparing a tax return, paid preparers are legally liable under federal law for the returns they prepare. VITA/TCE program volunteers are not considered paid preparers. 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 also 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.

TIP

Access a copy of this Act on the Internet by typing “Volunteer Protection Act of 1997” into any search engine.

What are my responsibilities as a VITA/TCE program volunteer?

As a VITA/TCE program 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, Volunteer Agreement, Standards of Conduct, which states that you will adhere to these standards:

- Treat all taxpayers professionally, with courtesy and respect.
- Safeguard the confidentiality of taxpayer information.

CAUTION

Identity theft is a growing problem and you need to do all you can to prevent taxpayer information from ending up in the wrong hands.

Show students the Volunteer Resource Guide listing of what is in scope.

- Apply the tax laws equitably and accurately to the best of your ability.
- Only prepare returns within the scope of your training and experience.
- Exercise reasonable care in the use and protection of equipment and supplies.
- Do not solicit business from taxpayers you assist or use knowledge you gained about them for any direct or indirect personal benefit for you or any other individual or organization.

Ask students to turn to Form 13615 in their Form 6744. Discuss each item in the agreement.

Explain to the students the importance of providing quality service and upholding the ethical standards of the VITA/TCE program.

Emphasize the last two standards: never solicit or accept payment for services. (This includes a donation jar for tips, the purchase of supplies, etc.)

- Do not accept payment for services provided. (Note: You may receive compensation from your site sponsor.)

Ensure the standards addressing return preparation are followed. These include becoming certified, using the intake and interview process, using reference materials, using the approved quality review process, completing the steps to electronically file tax returns, and adhering to the privacy and confidentiality guidelines.

CAUTION

Do not solicit or accept payment from taxpayers for services you provide.

How do I maintain the taxpayer's trust?

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 taxpayers and 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.
- Do not prepare a tax return when you suspect an individual is not providing truthful information.

TIP

More information can be found in Publication 4299, Privacy and Confidentiality – A Public Trust.

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

There are many cases each year in which a couple files a joint return and then later, one or both individuals file a return as Head of Household, using the same dependent information. Since only one original return can be filed each year using any given social security number, this scenario can cause a delay in processing any or all of the returns associated with that social security number. Credits and/or deductions may be disallowed. If you are assisting a taxpayer whom you believe fits this scenario, consult with your Site Coordinator.

TIP

You are the key to the integrity of the VITA/TCE program.

Are there other materials available to assist me?

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.

Point out students can always access such materials on the IRS website at www.irs.gov.

You should not use this training guide at your tax preparation site. It is designed for training purposes only. Take the Volunteer Resource Guide and Publication 17 with you for use at the site. Your Site Coordinator should be able to provide access to the following key resources as well:

- Instruction booklets, schedules, and worksheets for Forms 1040, 1040A, and 1040EZ
- Tax information publications that are frequently used at the sites (e.g., Publication 596, Earned Income Credit, Publication 972, Child Tax Credit, Publication 3, Armed Forces Tax Guide, etc.)
- Equipment and supplies along with security requirements and use restrictions
- Volunteer Quality Alerts

CAUTION

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 also reinforce your tax law training by viewing online training resources such as Link & Learn Taxes and Understanding Taxes – e-learning courses on www.irs.gov.

Provide instructions for accessing the practice lab.

There is also a toll-free tax information hotline 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, you can call 1-800-829-8482 (1-800-TAX-VITA). If you call, be sure to identify yourself as a volunteer. **Do not give this phone number to taxpayers.** The volunteer hotline is generally available from February 1 until the filing deadline. This number can be found on the back cover of the Volunteer Resource Guide.

TIP

Handy contact information is listed near the back of the Volunteer Resource Guide.

Point out the contact information on the Volunteer Resource Guide.

How do I get started using the tax software?

Many sites use the IRS sponsored tax preparation software. The tax software assists in preparing returns and also includes a help feature to assist in understanding the application of tax law.

If you are working at a site that uses tax preparation software, you will need to become familiar with the particular software package being used at your site. IRS contracts with a specific software company to provide software for use in the VITA/TCE program.

Point out the tax software comparison chart in the blue tab section of the Volunteer Resource Guide.

Since the majority of sites use tax preparation software, IRS training materials are geared to the use of tax software in both desktop and online (internet-based) versions.

Your instructor and/or Site Coordinator will provide you with the information and passwords required for logging into the program for training and/or tax preparation purposes. How to Use the Guide in the Volunteer Resource Guide will provide more information for making a comparison between the desktop and online versions.

Provide the login and passwords for the tax software.

If students are using the tax software desktop version, **point out** the tool bars and function keys listed under the tax software Quick Reference Guide in the Volunteer Resource Guide.

Point out that the tax software flow chart explains the sequence of using the software.

If students are using the tax software online version, **point out** the tool bars and short cuts available.

Note: References to function keys in tax software discussions only apply to the desktop version. There are many similarities between the two products, but they do have their differences.

Where do I find information about the tax software?

The Volunteer Resource Guide provides general information and helpful hints for using the tax software under the yellow tabs. Information specific to the online version is listed under the blue tabs. Information about completing the return is listed under the Finishing the Return tab.

Review the lesson summary.

Show the students the assessment (page 3 – Are you Ready to Get Started?) in the Volunteer Resource Guide.

Summary

Welcome to the VITA/TCE program. 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 each taxpayer's supporting documentation (including an approved intake and interview sheet) supports the entries on the return
- Know your rights and responsibilities and uphold the integrity of the VITA/TCE program
- Prepare returns:
  - that are within the scope of the VITA/TCE program
  - for which you have been certified
- Use VITA/TCE equipment and supplies (including hardware and software) for their intended purposes
- Complete the "Are You Ready to Get Started?" assessment in the Volunteer Resource Guide prior to assisting taxpayers to determine if you have everything you need to provide top quality professional service

Lesson 2: Screening and Interviewing

Introduction

Instructor Notes

This lesson assists you in developing interview and screening skills that will assure taxpayers that you have their best interest at heart. With these skills, you will be able to obtain the information necessary to prepare a complete and accurate return. You will be introduced to techniques that will help you conduct a probing interview during the taxpayer's initial screening for program eligibility. You will use these skills to clarify issues that may arise as you move through the tax return preparation process.

A probing interview to determine important facts about the taxpayer is required before and during the preparation of the tax return as well as during the quality review process. You will use the oral and written information gathered throughout the tax preparation process to prepare the taxpayer's return and to facilitate a quality review of the return after it is completed.

Objectives

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

Review objectives with the class.

- Describe the elements of the intake and interview process
- Locate the tools that will assist you in Publication 4012, Volunteer Resource Guide
- Probe for necessary information
- Use the various communications techniques necessary to successfully elicit the information needed to prepare a complete and accurate return such as:
  - Building rapport
  - Asking effective questions
  - Using active listening
  - Overcoming communication barriers

What do I need?

☐ Approved Intake and Interview Sheet
☐ Volunteer Resource Guide
☐ Approved Quality Review Sheet

Point out the resources cited under **What do I need?**

What is included in the intake and interview process?

When taxpayers arrive at a site, they should be given an approved intake and interview sheet. During the intake process, you or a certified screener will use the approved intake and interview sheet to screen taxpayers for program eligibility and validate the information they have provided. Throughout the screening process, listen for clues that will assist in completing the return – marital status, number of children, relatives living with them, childcare expenses, potential to qualify for credits, unreported income (e.g., cash transactions), etc.

Display or refer students to the approved intake and interview sheet.

The intake and interview process must include the following (at a minimum):

Point out that these are *minimum* expectations.

- An interview with the taxpayer that includes explaining the tax preparation process and encouraging them to ask questions throughout the interview process
- Use of an approved intake and interview sheet

- Confirmation of the accuracy of the taxpayer's responses provided on the front of the approved intake and interview sheet by a certified return preparer
- Use of probing questions to ensure complete information is gathered
- Review of all supporting documentation, Form(s) W-2, 1099, etc.
- Request for missing or incomplete documentation, if applicable

As you work with the taxpayer, apply these interview techniques:

- Building rapport
- Asking effective questions
- Using active listening skills
- Overcoming communication barriers

Point out that they will practice these in this lesson.

Where do I find the tools to assist me with this process?

The tools to assist you during the screening and interview process are included in the introductory section of the Volunteer Resource Guide, which is part of your training kit.

How do I use the tools?

How do I use the approved intake and interview sheet?

Every volunteer tax preparation site gathers taxpayer information using an approved intake and interview sheet. No matter which approved intake and interview sheet you use, it must ask for the basic intake information needed for a complete and accurate return.

Taxpayers complete the sections of the approved intake and interview sheet labeled "to be completed by the taxpayer." Once this is done, volunteers review each entry. Using the questioning techniques covered in this lesson, volunteers work with taxpayers to complete the rest of the form.

TIP

Form 13614-C, Intake/ Interview & Quality Review Sheet, is the IRS version of the form.

NEW The 13614-C Job Aid, which can be found in the Volunteer Resource Guide, is new in 2009, and gives line-by-line instructions on using the form.

Process

Compare the taxpayers' personal information to the supporting documents to ensure the names, addresses, and contact information are all correct.

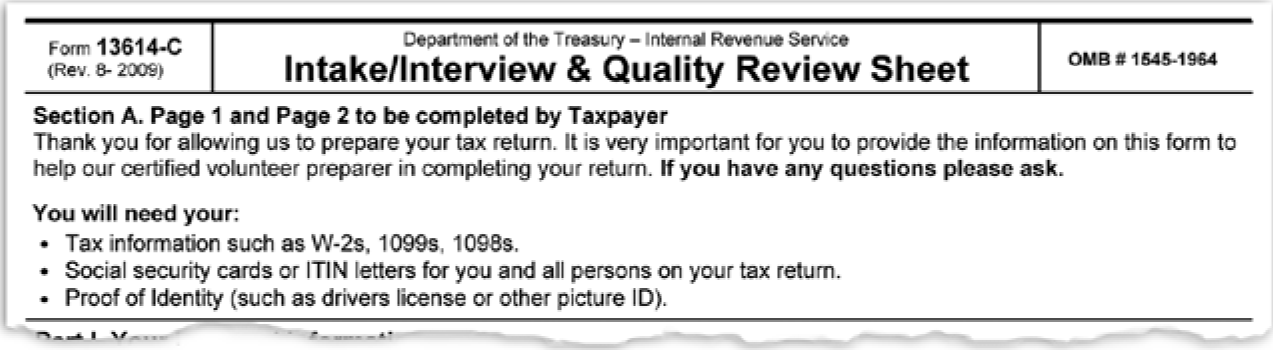
Pay particular attention to marital status and dependent information; use the decision trees in the Volunteer Resource Guide (or the Help feature in the tax software) to verify marital status.

Review the Income questions. Taxpayers may qualify for additional credits and deductions based on life events. If the taxpayer has answered "yes" to any of these questions, conduct further research to make a valid determination about eligibility for credits or deductions. Use the appropriate source documents listed on the 13614-C Job Aid. Review the "yes" boxes to determine what to enter on the return.

Review the Expenses questions. Some expenses are entered as adjustments to income, some are itemized on Schedule A, and certain expenses impact the additional standard deduction, which is covered in the Standard Deduction and Tax Computation lesson. If the taxpayer has any “yes” answers for the expenses questions, use the Volunteer Resource Guide, the 13614-C Job Aid, or the Help feature in the software to determine the qualification for these expenses.

Tell volunteers not to write on any of the taxpayer’s personal documents or take them out of the taxpayer’s sight.

Using the interview skills explained in these lessons, you will review each item on the approved intake and interview sheet with the taxpayer before you complete the tax return.



Form **13614-C**
(Rev. 8- 2009)

Department of the Treasury – Internal Revenue Service

Intake/Interview & Quality Review Sheet

OMB # 1545-1964

Section A. Page 1 and Page 2 to be completed by Taxpayer

Thank you for allowing us to prepare your tax return. It is very important for you to provide the information on this form to help our certified volunteer preparer in completing your return. **If you have any questions please ask.**

You will need your:

- Tax information such as W-2s, 1099s, 1098s.
- Social security cards or ITIN letters for you and all persons on your tax return.
- Proof of Identity (such as drivers license or other picture ID).

If a correction to the taxpayer’s information is required during the intake and interview process, it should be annotated on the approved intake and interview sheet prior to completing the return. These notes expedite the tax return preparation and the quality review process.

How do I use the Volunteer Resource Guide?

TIP

Information from the Volunteer Resource Guide is referred to throughout this training. You must use it at your VITA/TCE site, so refer to it often during class to prepare for your taxpayer interviews.

The Volunteer Resource Guide will help you as you interview the taxpayer. It includes decision trees, interview tips, and other information to gather, clarify, and verify the taxpayer’s information on the approved intake and interview sheet.

The Volunteer Resource Guide is divided into four major sections – General Information, Tax Law, the Tax Software and the Tax Software Online.

Direct students to follow along in their copy of the Volunteer Resource Guide.

- General information located in the front section and the covers of the book offers guidance and a copy of Form 13614-C Job Aid.
- White tabs contain tax law in the form of decision trees, charts and interview tips.
- Yellow tabs contain step-by-step procedures for electronic return preparation using the tax software.
- Blue tabs contain information specific to users of the web-based option for the tax software.

Tax Software Online users should take advantage of both the yellow and blue tabs as material which is universal for both applications will be contained in the yellow tab section.

Explain if the tax software tabs will or won’t be used during this lesson and why.

Remind students to take their Volunteer Resource Guide to their VITA/TCE site.

Tax Software Hint: Partners may use forms provided in the software in lieu of an approved intake and interview sheet.

Partners choosing this method must provide paper copies of the tax software forms, or access to the forms online, to the reviewer conducting a quality return review.

How do I welcome and screen the taxpayer?

How should I welcome the taxpayer?

If available, **play** the DVD or VHS based on Publication 4475, Interview Techniques.

Here are suggestions for welcoming the taxpayer:

- Greet the taxpayer and introduce yourself
- Take a few moments for small talk (weather, traffic, etc.)
- Explain the screening, tax preparation and quality review processes
- Explain that, once the taxpayer has completed the portion of the approved intake and interview sheet labeled "To be completed by the Taxpayer," you will complete the rest of it together, and you will assist with the taxpayer's portion if needed
- Ask if the taxpayer has any questions

Ask two volunteers to role-play the sample interview.

Review student observations on the volunteer's approach.

Here is an example of how Jorge, a volunteer welcomed Bill, a taxpayer:

SAMPLE INTERVIEW

VOLUNTEER SAYS...	BILL RESPONDS...
Hello, I'm Jorge. How are you today?	Hi, I'm Bill. I'm fine. How about you?
I'm fine, thanks. Did you have any trouble finding the place?	It wasn't too bad. The traffic was terrible though!
Yes, especially this time of day. Did the receptionist ask you to complete an intake sheet like this one?	Yes, I have it here.
Thank you. I'll have to see your photo ID and social security card and then I'll check your income to make sure you qualify for volunteer assistance. Next, we'll go over your information together and make sure it's complete. Then I'll input the information into the computer to create your tax return. Finally, I'll go over the return with you, and have our Site Quality Reviewer check it one last time for accuracy. You will then be able to sign and date it. Do you have any questions?	If I sign and date it, do I have to mail it right away?
I'm glad you asked that. We normally file your return electronically, so you won't have to mail your return at all. That way you can get your refund faster. Do you have any other questions before we look at your intake sheet?	I don't think so.
Okay, but please feel free to ask questions as we go along. The tax process isn't always clear to people, so it's always good to ask, okay?	Sure, I appreciate that, thanks.

How can I screen the taxpayer for eligibility?

When the taxpayer indicates that their portion of the approved intake and interview sheet is complete, begin the interview to complete the form and then screen the taxpayer for eligibility for the volunteer program. Screening methods differ between volunteer sites, but here are suggestions for this step:

Ask students to look at an approved intake and interview sheet.

- Ask the taxpayer for their completed intake and interview sheet.
- Verify the taxpayer's identity with a picture ID or other acceptable method.
- Obtain social security cards, a form or letter from the Social Security Administration and/or Individual Taxpayer Identification Number (ITIN) letters for each person to be listed on the return. Keep these documents available for reference throughout the return preparation process.
- Review the taxpayer's income information, such as Form(s) W-2, and Form(s) 1099, to determine if they fall within the scope of the volunteer program and your level of certification. Your Site Coordinator and/or instructor will let you know the tax return criteria for your program. If they do not fall within the scope of the program:
    - Courteously explain that volunteer services are limited to those who fall within the scope of the program and why they do not qualify.
    - Encourage the taxpayer to use the information they recorded on the intake and interview sheet in working with another tax preparation service.
    - Thank the taxpayer for coming and express regret that you cannot assist them.

CAUTION

Be sure not to recommend a specific business or a person when encouraging a taxpayer to use a tax preparation service.

Explain what to do if the taxpayer is eligible for the program, but not within the preparer's level of certification.

- If the taxpayer qualifies for volunteer assistance, begin the interview and complete the rest of the intake and interview sheet with the taxpayer. If the taxpayer qualifies but does not have all the necessary documentation, explain how to to acquire the documentation.

Ask two volunteers to role-play the sample interview.

Review student observations on the volunteer's approach.

Here is an example of how a volunteer screened taxpayer Robert Cornell for assistance:

SAMPLE INTERVIEW

VOLUNTEER SAYS...	ROBERT RESPONDS...
Mr. Cornell, you might be aware that the volunteer program is limited. We are volunteers and can only do tax returns within the scope of our training. Did anyone let you know that?	No, not really. I hope you can help me.
Well, we'll certainly do whatever we can. First, let's look at your Form W-2, interest statements, and anything else that reports your income. May I look at those?	Sure, here they are. I also own a duplex and collect some rent from it.
I'm sorry to tell you, but rental income is outside the scope of the volunteer program. I'm afraid we won't be able to help you.	Oh, I'm disappointed. Are you sure?
I'm afraid so. However, you are welcome to take the intake sheet with you – it may be helpful as you work with another preparer to complete your return. I'm sorry we weren't able to work together.	Well, me too, but rules are rules, I guess.
Yes, but thank you so much for coming in.	Okay, thanks anyway.

How do I conduct a probing interview?

As you become experienced with interviewing taxpayers, you will develop your own approach. Use the techniques you will learn in the next section, such as building rapport, asking effective questions, and active listening. As you use these techniques in an interview, be sure to cover these points:

- Review the taxpayer's portion of the approved intake and interview sheet.
- Ask if they were uncertain about any responses. Reassure them that you will help them complete the form accurately.
- Explain the tax preparation process and encourage them to ask questions throughout the interview.
- For each part of the approved intake and interview sheet, use the interview tips or a decision tree in the Volunteer Resource Guide to probe for accurate and complete information. If you are using Form 13614-C, after you have verified the taxpayer's information on pages 1 and 2, complete Section B on page 3. Section B will provide prompts for you to validate some of the most commonly overlooked items on the tax return. You may complete this section as you interview the taxpayer, or use it after the interview to ensure you have not missed anything.

TIP

The 13614-C Job Aid will help you obtain all the necessary information.

Review the Determination of Filing Status Interview Tips in Publication 4012 (Tab B) as an example.

Divide the class into pairs and ask students to role-play the sample interview.

Discuss the exercise.

Open the Volunteer Resource Guide to the charts, decision tree and interview tips located behind Tab B. The following sample interview demonstrates how a volunteer uses the interview tips to conduct a small part of a probing interview with Regina Reinhardt about which filing status is appropriate.

SAMPLE INTERVIEW

VOLUNTEER SAYS...	REGINA RESPONDS...
Ms. Reinhardt, were you uncertain how to answer any of the questions on the intake sheet?	Yes, actually I had trouble with the family and dependent section.
Okay, as we go over that part. I'll explain a little more about what they are looking for. You should feel free to ask questions. Fair enough?	Yes, thanks.
I'm going to ask you a few questions that will help us determine the best filing status for you and then we will go over your dependent information. First, I see from your intake sheet that you were married as of the last day of the tax year. Is that right? (Step 1)	Yes, I was, but my husband and I were living apart.
So, he was not living with you?	That's right. But we were still legally married.
Okay, do you plan on filing a joint return with your spouse? (Step 2)	Well, I'm not sure… I don't really like the idea of it. I was thinking of filing separately. Can I do that?
Yes, of course. Let's assume for now that you will file separately, and I'll ask you a few more questions. I see that you have two children. Did they live in your home during the tax year? (Step 3)	Yes, they lived with me.

As you can see, the volunteer used the interview tips and the information from the Volunteer Resource Guide in a natural and personal way. You will learn more about this approach in this lesson's section on interview techniques.

Advise students that future lessons will provide guidance for the taxpayer about missing SSNs, W-2, 1099s, etc.

Assign the following exercises.

Review answers with the class when complete.

EXERCISES

Read the interviews with these exercises and answer the questions. Answers are located after the lesson summary.

SAMPLE INTERVIEW

VOLUNTEER SAYS...	ROBERT RESPONDS...
Yes?	I'm here to do my taxes.
Here, fill out this intake form. You may sit over there.	What do I do when I'm finished?
Come back to me. Do you have any other questions?	No, thanks… I guess!

Question 1: From the list below, mark all the things the volunteer did.

- Greeted taxpayer
- Introduced himself or herself
- Made small talk
- Explained screening and tax preparation processes
- Asked taxpayer to complete the approved intake sheet to the best of their ability
- **Asked the taxpayer if they had any questions**

Volunteer did only one thing right: asked if the taxpayer had any questions – but asked rudely.

SAMPLE INTERVIEW

VOLUNTEER SAYS...	ROBERT RESPONDS...
Okay, let's take a look at your intake sheet. Did you have any questions about filling it out?	Yes, I wasn't sure what this question meant, and this one here.
Okay, don't worry. Let's start at the beginning and go step by step. When we get to those questions, I'll explain what they mean, and we'll try to answer them together. How does that sound?	That will help!
Please feel free to ask questions as we go over the intake sheet. Shall we begin?	Yes, let's get started.

Question 2: From the list below, select all the things the volunteer did.

- **Reviewed the approved intake and interview sheet**
- **Asked if taxpayer was uncertain about any responses**
- **Reassured taxpayer that they would help them complete the form**
- **Encouraged questions**

The volunteer did all of the recommended things courteously!

What techniques can I use to assist me with the interview?

What basic techniques are recommended?

As you use the intake and interview tools, you will need to put the taxpayer at ease and keep communication open. Applying these techniques can help you do that:

- Building rapport
- Asking effective questions
- Using active listening skills
- Overcoming communication barriers

How do I build rapport?

You want the taxpayer to feel comfortable with you. Try to establish the taxpayer's trust and confidence from the beginning. As you welcome the taxpayer:

- Be friendly and respectful
- Have materials organized
- Speak clearly and simply

Explain the process and make sure the taxpayer understands what will happen next. Encourage the taxpayer to ask questions. The sample interview presented earlier in this lesson is a good example of how a volunteer built rapport with a taxpayer.

How can I ask effective questions?

Working with a taxpayer requires you to ask many questions. You may feel that you are prying. You are not. You're eliciting the information needed to file an accurate return that allows taxpayers to enjoy all the benefits or credits they are due. When you start an interview, use one or two *open-ended* questions. These kinds of questions require more than a simple Yes/No answer.

TIP

Asking open-ended questions lets the taxpayer decide what is important, and that can help you discover special situations. For example, *"What changes have you had this year that might make your tax situation different from last year?"* and *"What more can you tell me about that?"*

Even questions on the approved intake and interview sheet that simply ask for a Yes/No response may confuse a taxpayer. A good approach is to ask the first key tax question and then explain why the information is necessary. This helps the taxpayer give a more accurate and focused answer.

Avoid asking *leading* questions because they make the taxpayer feel you have a specific answer in mind. Do not make assumptions about taxpayers – let them speak for themselves.

Here is how a volunteer used effective questioning with Dorothy Stone:

Ask the same student pairs to reverse roles for this interview.

Discuss the exercise.

SAMPLE INTERVIEW

VOLUNTEER SAYS...	DOROTHY RESPONDS...
Okay, Ms. Stone, I need to get some basic information today so we can complete your return. Before we do that, what tax documents did you bring with you today? [open-ended question]	My W-2s and interest statements.
When we sat down, you mentioned that you and your husband separated or divorced last year. Did you bring any paperwork related to that?	Oh, yes, sorry. Here it is.
Okay, that's good. Let's go over your intake sheet. Were you still married on December 31st of last year? What I mean to ask is, "did you receive a final decree of divorce by December 31st?" I need to ask so I can figure out how you should file. [question with explanation of why it is needed]	Well, we went to court and filed for the divorce on September 1st, but we won't have a final decree until the end of February, or beginning of March of this year.
I see, thank you. Now that we have clarified your marital situation, we can determine which exemptions you can claim.	Okay.

How do I use active listening skills?

Active listening shows that you are paying close attention. It reassures the other person that you care about what they have to say and that they can trust you. We all use active listening when we are truly interested in what someone is saying. Here are ways we show that we are actively listening:

- Using nonverbal cues such as nodding, smiling appropriately, and making eye contact
- Letting the other person take the time they need to express themselves
- Responding by restating what the other person has said to ensure that you understand
- Expressing sympathy or other appropriate emotions

Ask the same student pairs to reverse roles for this interview.

Discuss the exercise.

Here is how a volunteer demonstrated active listening in an interview with Marsha:

SAMPLE INTERVIEW

VOLUNTEER SAYS...	MARSHA RESPONDS...
I see that you left blank the question about whether you were living with your spouse on December 31st.	Yeah, I wasn't sure what to put there. My situation was kind of complicated at the end of last year.
I see. [nodding] *Can you tell me a little more?*	I guess so. My husband moved out in October, but he comes back sometimes to visit the kids.
I see. Thank you for the information. I know how difficult a situation like that can be. [expressing sympathy]	

How can I overcome communication barriers?

TIP

The introductory information in the Volunteer Resource Guide contains interview steps and suggested actions.

Communication can hit a barrier if the taxpayer becomes upset or defensive. When this happens, you can often overcome barriers by showing that you understand the taxpayer and care about their concerns, feelings, and needs. Here are a few ways to do that:

- Do not become upset
- Reassure the taxpayer (Example: "I hear you" or "I understand")
- Keep on track by asking the tax question
- Provide a motivator (Example: "This is difficult, but I need this information so I can make sure you are allowed all the benefits available to you.")
- Use your active listening skills
- Allow the taxpayer enough time to respond
    - If the taxpayer is silent, encourage them by saying, "Tell me more about that…"
    - If the taxpayer is upset, show that you understand by paraphrasing what they have told you

Ask the same student pairs to reverse roles for this interview.

Discuss the exercise.

Here is an example of how a volunteer overcame barriers to communicating in an interview with Jack Butler:

SAMPLE INTERVIEW

VOLUNTEER SAYS...	MR. BUTLER RESPONDS...
I'm sorry, according to this information, you don't qualify for the deduction.	What? Are you saying that I can't take that deduction? That means I am going to owe taxes! I thought I was going to get a refund! I can't afford to pay more taxes!
[not upset, sympathetic] *I understand, Mr. Butler, nobody wants to pay more taxes.* [paraphrasing, understanding] *Keep in mind that we're still trying to identify the deductions you* ***can*** *take, so your taxes will be as low as possible. Let's look at the next set of deductions, okay?* [did not become upset, kept on track by asking the tax question]	Okay, I know, you're trying to help. I'm just afraid that…*[silent]*
Take your time, Mr. Butler. Tell me more when you are ready. [gave taxpayer time to respond, asked him to "tell me more"]	I'm just afraid I won't be able to pay the bill on time.
Well, it makes sense that you would be concerned about being able to pay your tax bill on time. [paraphrasing] *Now, if you end up owing more in taxes, we can discuss some possible options for payment. Shall we keep looking for deductions?*	Yes, thank you. Let's go on.

TIP

Successful volunteers express empathy, understanding and compassion for all types of people. Overcome barriers by letting taxpayers know you understand and care about them.

What happens next?

Based on what you learn from the taxpayer's approved intake and interview sheet and from the interview, you have three options:

- Advise the taxpayer that their return is outside the scope of your training and seek assistance from your Site Coordinator. If there is another volunteer available who has the appropriate training, they can take over the interview.
- Advise the taxpayer that their tax situation is outside the scope of the program, or
- Assist the taxpayer with their return, request assistance from your Site Coordinator as needed. If the taxpayer qualifies but does not have all the necessary documentation, provide guidance necessary for them to acquire the documentation.

If the taxpayer's return is within the scope of the program and their tax situation is covered in your certification, you may complete their return. Refer taxpayers whose tax situations are outside your scope of training, experience and certification to your Site Coordinator and/or to a professional tax preparer.

If tax preparation assistance is not provided, return the approved intake and interview sheet to the taxpayer.

After the return is completed and the quality review is finished, the approved intake and interview sheet can be returned to the taxpayer along with a copy of their return(s) or it can be retained until the return has been accepted. For guidance on proper procedures, consult the Site Coordinator at the site where you are volunteering.

Summary

Review the lesson summary with the class.

Knowledge of tax law and interview skills are required to identify taxpayers who qualify for volunteer return preparation assistance and to conduct effective probing interviews. Good interview techniques, combined with IRS or partner-developed tools, make the interview more effective and comfortable for you and the taxpayer. Remember, establishing rapport and educating taxpayers produces accurate returns.

Having the ability to communicate with all types of people, knowing where and how to get "the right answer," understanding and applying tax law, and preparing accurate returns are the skills you will need to be a successful volunteer.

Necessary tools are:

- Probing questions
- Form 13614-C or other approved intake and interview sheet
- Volunteer Resource Guide
- Section C of Form 13614-C or other approved quality review sheet

TIP

During the screening and interviewing process, strive to acquire the information needed to prepare 100% accurate returns, and make notes on the approved intake and interview sheet. Remember, a return is accurate when tax law is applied correctly and the return is based on information acquired during this process.

Helpful interview techniques are:

- Building rapport
- Asking effective questions
- Using active listening skills
- Overcoming communication barriers

When assisting taxpayers, safeguard the confidential information they share with you.

EXERCISE ANSWERS

Answer 1: *The volunteer did a very poor job on almost all counts. The only thing he did right was ask if the taxpayer had any questions, but he did that rudely.*

Answer 2: *The volunteer did all of the recommended things and did them courteously!*

Notes

Lesson 3: Filing Basics

Introduction

Instructor Notes

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, completing the main information sheet or label on the return, and how long to keep taxpayer records.

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
- Select the correct form to use
- Determine how to file the return
- Tell taxpayers how long they should keep certain records and documents

What do I need?

☐ Approved Intake and Interview Sheet
☐ Volunteer Resource Guide
☐ Publication 17
☐ ***Optional:*** Publication 552

Review objectives with the class.

Point out the resources cited under **What do I need?**

Who must file?

U.S. citizens or residents of the United States must file a return based on three factors – age, gross income, filing status. 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 discussed in the Screening and Interviewing lesson when determining who must file.

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

Publication 17, Chapter 1 – Filing Information, contains additional information for other individuals who must or should file a return – dependents, children under age 18, self-employed, aliens.

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

Look at the approved intake and interview sheet for the taxpayer's date of birth. Confirm this date during the interview. Refer to the sample approved intake and interview sheet at the beginning of the Volunteer Resource Guide.

Direct the students to the appropriate line of the approved intake and interview sheet.

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

Remind the students to assemble all of the income reporting documents.

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 are not exempt from tax. It includes both earned and unearned income.

Point out that *exclud-able*, in this case, means *not taxable*.

The Income section of the Volunteer Resource Guide (Tab D) 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 lesson.

To approximate gross income:

- Obtain the total of wages, tips, and other employment compensation reported in box 1 of the taxpayer's Form(s) W-2
- On page 2 of the approved intake and interview sheet, review the income questions with the taxpayer to see if there was any additional income (from investments, retirement plans, social security, unemployment, or other income not reported on Form W-2 or Form 1099) and determine each amount. Take a look at Part IV on Page 2 of the sample approved intake and interview sheet at the beginning of the Volunteer Resource Guide.

Emphasize the importance of using the approved intake and interview sheet at the beginning of the process.

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

TIP

Do not include social security benefits when determining filing requirement unless the taxpayer is married, filing a separate return, and lived with their spouse at any time during the tax year.

CAUTION

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

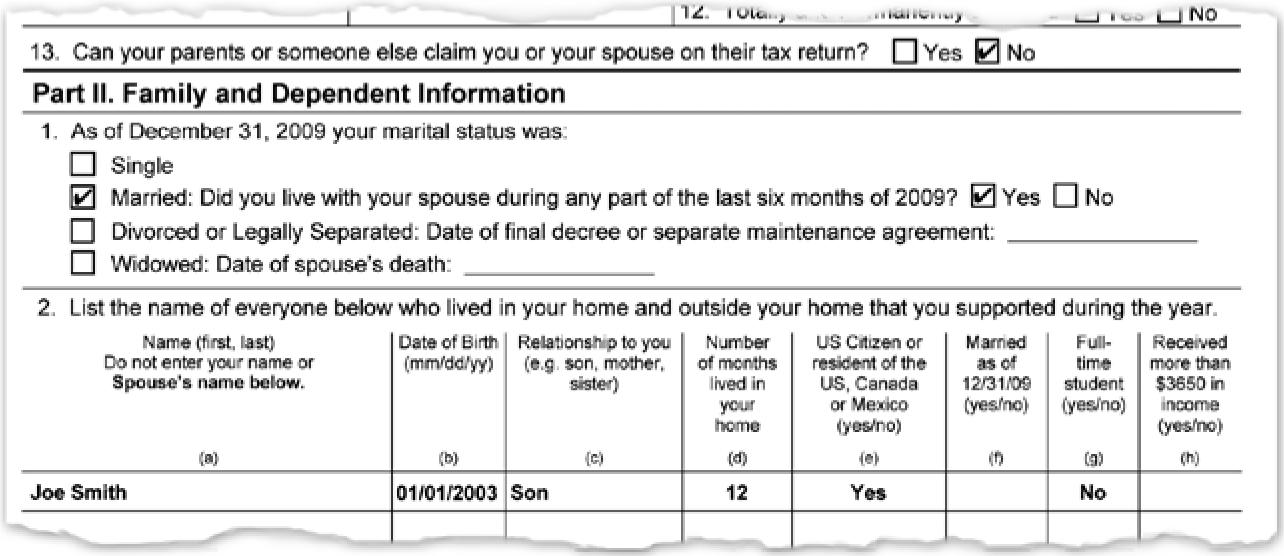
Where do I get information on the taxpayer's filing status?

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.

Review the example shown here.

example

Based on the approved intake and interview sheet shown below, this taxpayer will most likely use the Married Filing Jointly filing status.



13. Can your parents or someone else claim you or your spouse on their tax return? ☐ Yes ☑ No

Part II. Family and Dependent Information

1. As of December 31, 2009 your marital status was:

☐ Single
☑ Married: Did you live with your spouse during any part of the last six months of 2009? ☑ Yes ☐ No
☐ Divorced or Legally Separated: Date of final decree or separate maintenance agreement: ______________
☐ Widowed: Date of spouse's death: ______________

2. List the name of everyone below who lived in your home and outside your home that you supported during the year.

Name (first, last) Do not enter your name or **Spouse's name below.** (a)	Date of Birth (mm/dd/yy) (b)	Relationship to you (e.g. son, mother, sister) (c)	Number of months lived in your home (d)	US Citizen or resident of the US, Canada or Mexico (yes/no) (e)	Married as of 12/31/09 (yes/no) (f)	Full-time student (yes/no) (g)	Received more than $3650 in income (yes/no) (h)
Joe Smith	**01/01/2003**	**Son**	**12**	**Yes**		**No**	

Check the Taxpayer Information section of the approved 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 (Tab B) for helpful probing questions.

Explain that many military couples who are separated by the service assume they must file separately. The decision tree can help correct this misconception.

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 (Tab A), Chart A – For Most People Who Must File, and Chart B – For Children and Other Dependents. Turn there now and review the dollar amounts in both Charts A and B.

Point out that the amounts change each year.

example

Lucy, is 36 years old, single, and her gross income is $20,000. She must file a tax return and will use the Single filing status.

Use the examples to illustrate the use of the Volunteer Resource Guide.

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 $16,000, they do not have to file a return.

For Special Situations

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

Some of the most common situations you may see when individuals are legally required to file a return are:

- **Self-employed** with net earnings of $400 or more
- **Advanced Earned Income Tax Credit payment recipients** who have an amount in box 9 of their Forms W-2
- **Taxpayers who owe Special Taxes**

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 $9,550 during the tax year. Based only on this information, is he required to file a tax return? ☑ **Yes** ☐ No

Bob's gross income was over $9,350.

Assign the exercises.

Review the answers with the class when complete.

EXERCISES (continued)

Their combined gross income was less than $19,800.

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 $16,200. Based only on this information, are they required to file a tax return? ☐ Yes ☑ **No**

Her gross income was over $15,050.

Question 3: Juanita can file as a Qualifying Widow with Dependent Child. She is 47 years old. Her gross income was $15,400. Based only on this information, is she required to file a tax return?
☑ **Yes** ☐ No

Who should file?

Even if an individual is not required to file a tax return, they should file a return to get money back if they qualify in certain situations. Remember to use the interview techniques and tools discussed in the Screening and Interviewing lesson.

Who should file a federal tax return?

Although some individuals may not be *required* to file, they *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
- The First-Time Homebuyer Credit

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

Direct students to this section of the Volunteer Resource Guide.

These items are listed in the Volunteer Resource Guide (Tab A) Who Must File section, Chart D – Other Situations.

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?

To determine whether a person should file a return in order to claim a tax refund or refundable tax credit, check the taxpayer's:

- Form(s) W-2 (boxes 2 and 17) and Form(s) 1099
- The Family and Dependent Information section of the approved intake and interview sheet

The taxpayer may qualify for a tax refund, Earned Income Tax Credit, and/or Additional Child Tax Credit if:

- Federal or state income tax was withheld on any income form, and/or
- The taxpayer had earned income, and/or
- The taxpayer has a qualifying child

When in doubt, it may be worthwhile to begin a tax return for the taxpayer and then file the return only if the taxpayer is eligible for a refund.

Refer taxpayers who may qualify for the Health Coverage Tax Credit to a professional tax preparer.

TIP The Earned Income Tax Credit may apply with or without a child. See the Earned Income Credit and Child Tax Credit lessons for details on determining eligibility for these tax credits.

Remind students that some taxpayer's needs are beyond the scope of the VITA/TCE program.

How do I verify taxpayer identity?

To verify a taxpayer's identity, use the interview techniques and tools discussed in the Screening and Interviewing lesson.

TIP Identity documents consist of a driver's license (U.S.), employer ID, school ID, birth certificate, state identification card (U.S.), Military ID, national identity card, visa, or passport. However, any other valid form of identification that would normally be used to prove identity is acceptable.

Point out that time spent verifying these issues can save time for the site coordinator and the taxpayer.

What documents do I use to verify identity?

Before you enter the taxpayer identification information on the tax return, you should first verify the identity of the taxpayer(s), the accuracy of each SSN (or ITIN), and the spelling of names entered on the taxpayer's approved intake and interview sheet.

- Ask to see a social security card, an ITIN letter, or other legal document for each individual who will be listed on the return
- Ask to see proof of identity for the taxpayer (and the spouse if filing a joint return)
- Verify the SSN (or ITIN) and proof of identity are for the same person
- Verify the SSN (or ITIN) and the spelling of each individual's name on the social security card or other acceptable documents match the information you enter on the tax return
- Verify the address and birth date on the approved intake and interview sheet matches the information on the identification and discuss any discrepancies with the taxpayers
- Make sure the taxpayer understands how critical it is to have the correct information in order to receive any age-related tax benefits

Taxpayers who cannot substantiate their identity should seek professional tax assistance.

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 (SSN).

TIP 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 social security numbers. The IRS issues an ITIN 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 an SSN (XXX-XX-XXXX), but begins with the number 9. You should enter the ITIN on the return wherever the social security number is requested.

Who has an Adoption Taxpayer Identification Number?

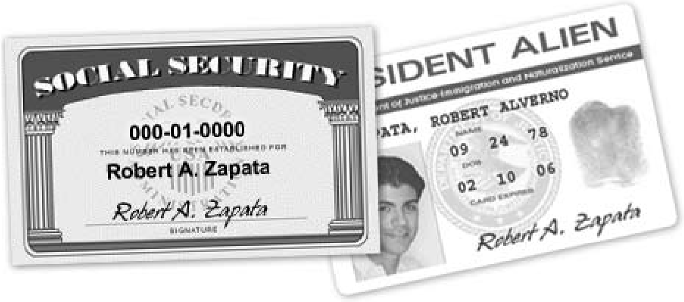
Taxpayers who are in the process of adopting a child and who are able to claim the child as their dependent or are able to claim a childcare credit need an ATIN for their adoptive child.

The IRS issues an ATIN for the child while 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.

TIP

Taxpayers who cannot obtain an 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 instructions for Form W-7.



CAUTION

Taxpayer, spouse, and dependent name and social security number mismatch is rated as one of the top five errors in processing a tax return.

What are acceptable documents if the taxpayer doesn't have a social security card?

For individuals who do not bring their social security card, you may accept either of the following:

- An SSA letter
- An ITIN card or letter

TIP

Driver's licenses and passports are *not* acceptable substitutes for social security or TIN cards.

What if the taxpayer doesn't have an 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 an SSN, refer them to the IRS for Form W-7, Application for Individual Taxpayer Identification Number.

For a taxpayer who cannot obtain an 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 Apply for an ITIN, in the Volunteer Resource Guide (Tab 1).

When preparing a tax return for an ITIN application, include all Forms W-2, even if the TIN 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 is. Since it is not going to be transmitted electronically, it does not matter if the TIN does not match in the software.

Attach the tax return behind Form W-7, Application for Individual Taxpayer Identification Number 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
- If taxpayers need assistance in completing Form W-7, refer them to an IRS walk-in office or for professional assistance unless a volunteer at that site has been trained in completion of Form W-7 or an authorized acceptance agent is available

TIP

If preparing the return on paper, leave the TIN spaces on the return blank and follow the W-7 procedures.

What if the TIN on the Form W-2 doesn't match the TIN on the tax return?

SSN (or ITIN) on the taxpayer's Form W-2 is expected to match the one you entered on the tax return. A mismatch will delay return processing and can create serious errors.

Taxpayers with a valid SSN

If the taxpayer's Form W-2 does not have the correct SSN, you can prepare the tax 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 under their ITINs (and other taxpayers without valid SSNs), often attach Forms W-2 showing erroneous SSNs. If such an ITIN/SSN mismatch occurs:

- Do *not* change any information on the Form W-2
- Effective in 2006, 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 inputting the Form W-2(s), the mismatched SSN should be entered exactly as shown on the Form W-2 issued by the employer
- The taxpayer is not eligible for the Earned Income Credit (EIC)

Assign the exercise.

Review the answer with the class when complete.

EXERCISES (continued)

Question 4: It is your responsibility as a volunteer tax preparer to check the accuracy of every social security number provided to you by taxpayers.

☑ **True** ☐ False

Checking the accuracy of names and social security numbers prevents delays.

How do I enter the identification data?

Demonstrate how the tax software warns the user if a social security number might be incorrect or invalid.

For paper returns, fill in the name, address, and social security information in the label section of the return. If you are using tax software, turn to the Main Information Sheet section in the Volunteer Resource Guide (Tab 1). Be sure to read all the details and helpful hints for entering the taxpayer's identification information.

Tax Software Hint: Turn to the Volunteer Resource Guide (Tab 1) for more information about the Main Information Sheet.

How do I choose the appropriate tax return form?

All taxpayers can use Form 1040. Individuals must meet certain requirements to use Form 1040EZ or Form 1040A.

Tax Software Hint: If you are e-filing the tax returns, the IRS does not care which form is used. You may determine the easiest form for the taxpayer's benefit. This information is displayed at the top of the Main Information Sheet.

Form 1040EZ

Of all the tax return forms, Form 1040EZ is the simplest. The one-page form is designed for individuals who file as either Single or Married Filing Jointly and who have no dependents. Most individuals who can be claimed as a dependent on another taxpayer's return use Form 1040EZ.

Ask a volunteer to read the Trudy example.

example

Trudy, a single 22-year-old full-time college student, is claimed as a dependent on her mother's tax return. Last year Trudy grossed $6,100 from her part-time job as an administrative assistant. Trudy should use Form 1040EZ.

Form 1040A

Form 1040A is a two-page form. Page 1 shows the filing status, exemptions, income, and adjusted gross income. Page 2 shows standard deduction, exemption amount, taxable income, tax, credits, payments, amount owed or refund, and signature.

Turn to the Which Form to File chart in the Volunteer Resource Guide (Tab A) to see which income and expenses can be reported with a Form 1040A.

example

Ramon and Julia are married and have two dependents. They will file Married Filing Jointly. Their sources of income include salaries from their jobs, Ramon's pension, and Julia's IRA. Their combined taxable income was $65,000 for the tax year. Ramon and Julia can file Form 1040 or 1040A, however, Form 1040A is recommended.

Ask a volunteer to read the Ramon and Julia example.

Form 1040

Form 1040 is a two-page form that contains all the entries on Form 1040A plus entries for more types of income, itemized deductions, and other taxes. Form 1040 provides schedules for reporting these various types of income and deductions.

Taxpayers whose taxable income exceeds $100,000 or who have self-employment income must use form 1040.

example

Cynthia is divorced and will file as Head of Household. She has two children she will claim as dependents. She owns a medical transcription business and earned $35,000 in taxable income for the tax year. She plans to itemize her deductions. Cynthia will file Form 1040.

Ask a volunteer to read the Cynthia example.

Which tax form do I select?

When filling out a paper tax return, you can refer to the Which Form to File table in the Volunteer Resource Guide (Tab A) as you interview the taxpayer.

When using tax software, always select Form 1040 from the Main Information Sheet. Based on the information you enter when completing the return, the program will tell you the simplest form to use. All returns filed electronically are transmitted in the same format regardless of the form selected.

TIP

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!

EXERCISES (continued)

Using the Volunteer Resource Guide, answer the following questions.

Question 5: Lenny and Lisa are filing a joint return and have no dependents. Their combined income was $31,000, which included $35 in taxable interest and two months of unemployment income for Lisa. They want to take the standard deduction. Which is the simplest form that Lenny and Lisa can use for their tax return?

Form 1040EZ

Question 6: Ray is married, but he and his wife Stella are filing separate returns. Their combined income was $105,000, but Ray's income was $64,000, half of which was self-employment income. Ray is claiming only one exemption for himself, and he wants to itemize his deductions. Which is the simplest form that Ray can use for his tax return?

Form 1040

Assign the exercises.

Review the answers with the class when complete.

How do I file a return?

A return can be filed by sending in a paper return or by using IRS electronic filing (*e-file*).

What is electronic filing?

IRS *e-file* is a quick and easy alternative to traditional paper returns. Most VITA/TCE volunteer sites are now set up for filing electronically using tax software.

TIP

Detailed instructions for completing and filing the return are covered in the Concluding the Interview lesson.

Electronic filing is faster and more accurate than traditional paper filing. With *e-filing*, taxpayers receive their refund in half the usual time, and even faster with direct deposit.

How do the two filing procedures compare?

How do I file a traditional paper return?	How do I file an IRS e-file return?
Manually review all entries and check calculations.	Check the software forms tree for any red exclamation points; review corresponding forms and complete red entries. Run diagnostics and correct errors.
Enter the site identification number in the Paid Preparer section.	The software automatically enters the site identification number in the Paid Preparer section of the return.
Assemble the return with all its properly labeled forms, schedules, and attachments in the correct sequence.	The software automatically assembles and labels all of the return's forms, schedules, and attachments.
Submit for quality review. • Correct errors as needed	Create the e-file and submit for quality review. • If needed, correct errors, re-run diagnostics, and recreate the e-file
Provide two copies of the tax return to the taxpayer. Have the taxpayer sign the return.	• Print one copy of the return for taxpayer. • Print 2 copies of Form 8879, if applicable (one for the taxpayer and one for the volunteer site). • Have the taxpayer sign both copies of Form 8879, if applicable.
Provide instructions on where and when to send the tax return to the IRS.	Electronically filed returns are transmitted to the correct IRS Processing Center, usually by the Site Coordinator. The taxpayer doesn't mail anything.

Point out that some of the common elements are: quality review, site ID nos, and signature (manual or PIN docs.)

What do I tell taxpayers about recordkeeping?

Taxpayers should keep a copy of the tax return, worksheets used, and records of all items appearing on it (such as 1099 forms) until the statute of limitations runs out for that return. Usually, this is the later of:

- Three years from the date the return was due or filed, or
- Two years from the date the tax was paid

Taxpayers should keep:

- Forms W-2 until the Social Security Administration has recorded the earnings reflected on the forms
- Property records (including those on a home) as long as they are needed to figure the basis of the original or replacement property
- Closing statements for a home until the home is sold
- Brokerage statements showing the purchase price of stock until the stock is sold
- Records of contributions to nondeductible IRAs until all IRA funds are withdrawn
- Calculations determining the nontaxable portion of pension income until all of the pension income is taxable

TIP

For additional recordkeeping information, see Publication 552, Recordkeeping for Individuals.

How do I answer taxpayers' administrative questions?

The Volunteer Resource Guide and Publication 17 contain the answers to many administrative questions that are asked by taxpayers during the interview process.

Such questions as: "How can I get a copy of my prior year's return" or, "How can I get a copy of an IRS form or publication" can be answered by researching your reference materials.

Turn to the "Frequent Taxpayer Inquiries" located at the back of the Volunteer Resource Guide 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 the answers to the taxpayers' inquiries for questions not answered in the Volunteer Resource Guide,

EXERCISES (continued)

Using your reference materials, answer the following question.

Question 7: A taxpayer wants to know what the Presidential Election Campaign Fund is. Where can you find that information?

Publication 17 - the chapter on Filing Information.

Assign the exercise.

Review the answer with the class when complete.

Additional information on a variety of topics can be obtained by contacting the IRS at 1-800-829-1040, accessing their web site at www.irs.gov, or by visiting an IRS Tax Assistance Center in your area.

If the internet is available, **demonstrate** the search feature of the IRS website

What potential pitfalls should I keep in mind?

Remember:

- 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.
- Many taxpayers erroneously report amounts from Form 1099-MISC, Miscellaneous Income, with wages or other income. Income from box 7 of the Form 1099-MISC generally should be reported on Schedule C or C-EZ and on Schedule SE, Self-Employment Tax. If the income is reported incorrectly, the IRS may later issue a notice of proposed tax increase for the self-employment income and tax.
- 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 from a company 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)

Point out that volunteers should notify their site coordinator of any suspicious behavior.

Notify your site coordinator if you suspect any fraudulent or unusual activity.

Which forms and documents need to be filed?

Turn to the chart that lists the forms, types of income, and the line item entries for both Form 1040 and the tax software in the Volunteer Resource Guide (Tab 2).

Tax Software Hint: Once the main information and income statements are entered, the software automatically makes available most forms and applicable schedules. These credit forms and schedules will be annotated with a red exclamation point. The volunteer must still be alert to other deductions and credits (such as American Opportunity, Hope, and Lifetime Learning Credits, and retirement savings contribution credit if there is only a Roth IRA contribution).

Practice – Vanessa Franklin

Let’s practice what we’ve learned with our taxpayer, Vanessa Franklin. Go to Appendix A-1 to determine if Vanessa has a filing requirement and verify her identity.

Direct students to Appendix A, page A-1.

Summary

Review the lesson summary with the class.

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 Who Must File section of the Volunteer Resource Guide (Tab A)

How do I verify taxpayer identity?

Before entering the taxpayer’s identity information in the Main Information Sheet 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.

When completing a paper tax return, refer to the Which Form to File table in the Volunteer Resource Guide (Tab A).

When using tax software, always select Form 1040 from the Main Information Sheet. After you have completed the return, the Main Information Sheet will tell you the simplest form you can use to print the return.

Filing the Return

Most VITA/TCE volunteer sites are now set up for filing electronically using tax software. E-filing is faster and more accurate than traditional paper filing, and taxpayers receive their refund in half the usual time.

Recordkeeping Requirements

Taxpayers should keep a copy of the tax return, worksheets used, and records of all items appearing on it (such as Forms 1099) until the later of:

- Three years from the date the return was due or filed, or
- Two years from the date the tax was paid

Refer to Publication 552, Recordkeeping for Individuals, for more information.

EXERCISE ANSWERS

Answer 1: *Yes, Bob is required to file a return because his gross income was over $9,350.*

Answer 2: *No, Janet and Harry are not required to file because their combined gross income was less than $19,800.*

Answer 3: *Yes, Juanita must file because her gross income was over $15,050.*

Answer 4: *True. To prevent processing delays, you should check the accuracy of each social security number, as well as the spelling of the name associated with the number.*

Answer 5: *Lenny and Lisa can use Form 1040EZ to file their tax return.*

Answer 6: *Ray will need to file Form 1040 both for two reasons: because he had self-employment income and because he is itemizing deductions.*

Answer 7: *The index in Publication 17 directs us to a paragraph in the chapter on Filing Information.*

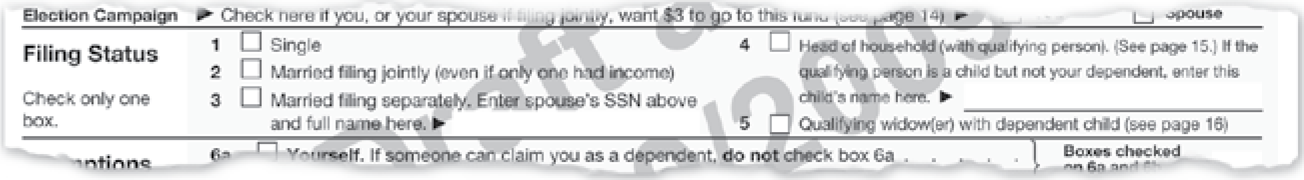
Notes

Lesson 4: Filing Status

Introduction

Instructor Notes

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.



Election Campaign ► Check here if you, or your spouse if filing jointly, want $3 to go to this fund (see page 14) ► ☐ Spouse

Filing Status Check only one box.	1 ☐ Single 2 ☐ Married filing jointly (even if only one had income) 3 ☐ Married filing separately. Enter spouse's SSN above and full name here. ►	4 ☐ Head of household (with qualifying person). (See page 15.) If the qualifying person is a child but not your dependent, enter this child's name here. ► 5 ☐ Qualifying widow(er) with dependent child (see page 16)

ptions 6a ☐ Yourself. If someone can claim you as a dependent, **do not** check box 6a . . . . . . Boxes checked

Reporting of the correct filing status is handled differently, depending on which tax form you use:

- Form 1040 or Form 1040A: check the box for taxpayer's filing status in the Filing Status section.
- Form 1040EZ: does not require an entry for filing status. Use it only for taxpayers filing as Single or as Married Filing Jointly with no dependents.

To determine a taxpayer's filing status, use the interview techniques and tools discussed in the Screening and Interviewing lesson. See the Volunteer Resource Guide (Tab B) for the Determination of Filing Status decision tree and the interview tips for helpful probing questions.

Objective

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

- Determine the most advantageous (and allowable) filing status for the taxpayer

What do I need?

☐ Approved Intake and Interview Sheet
☐ Volunteer Resource Guide
☐ Publication 17

Optional:

☐ Publication 501
☐ Publication 555
☐ Publication 971
☐ Form 1040
☐ Form 8379

Review objective with the class.

Point out the resources cited under **What do I need?**

Refer students to Tab B in the Volunteer Resource Guide.

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) with Dependent Child
- 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 (most beneficial) for the taxpayer. Use the Volunteer Resource Guide (Tab B) to help determine the correct filing status(es).

Ask the students which filing statuses they have used in the past. Would their taxes be higher or lower if they could use one of the other filing statuses?

Tax Software Hint: Filing status is selected on the Main Information Sheet. Go to the Volunteer Resource Guide (Tab 1), Main Information Screen, to review the software entries.

How does marital status affect filing status?

The first step in determining the taxpayer's filing status is to confirm their marital status *on the last day of the tax year.* Avoid using the 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 of the tax year

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?

There are different requirements for each filing status.

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.

CAUTION

Avoid selecting a filing status that results in a higher tax for the taxpayer. For example, Single taxpayers with a qualifying person may qualify for Head of Household, which often results in a lower tax. The rules for who is a qualifying person are addressed in the Who is Head of Household? topic.

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 as husband and wife
- Were married and living apart, but were not legally separated or divorced

Point out for Married Filing Jointly, one Form 1040EZ, 1040A, or 1040 is filed, which covers both spouses.

- Lived together in a common law marriage that is recognized in the state where they currently live or the state where the common law marriage began, or
- Did not remarry after their spouse died during the year

CAUTION

A citizen or resident alien married to a nonresident alien may be able to file a joint return. More information can be found in the Unique Filing Status and Exemption Situations lesson.

CAUTION

The rules around common law marriages are complex and differ from state to state. As a volunteer, it is not your responsibility to determine whether a couple is involved in a common law marriage. If a taxpayer is not certain, refer him/her to a professional tax preparer.

Ask under what circumstance can someone not be legally married on the last day of the year, but still be considered to be married for tax purposes?

Answer: If the person's spouse died during the year *and* the person did not remarry during that same year.

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

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. 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. This topic is beyond the scope of the VITA/TCE Program. Refer taxpayers in this situation to a professional tax preparer. For more information, see Publication 971, Innocent Spouse Relief. This publication can be downloaded from www.irs.gov.

What is Married Filing Separately?

The Married Filing Separately status is for taxpayers who qualify as married under the definition provided above, 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 discussed in other topics in this lesson.

Can Married Filing Separately taxpayers qualify for another status?

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

Explain that if the spouse is temporarily away but is expected to return home, the taxpayer is probably not considered unmarried.

Why are taxes usually higher for Married Filing Separately?

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

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

If one spouse filing MFS is itemizing, the other spouse, if filing MFS, must itemize *or* take a standard deduction of zero.

TIP

The question of who is itemizing only comes into consideration when both taxpayers are filing as Married Filing Separately. If one spouse qualifies to file as Head of Household, the fact that the other one is filing as Married Filing Separately and is itemizing doesn't apply.

Refer students to the list in Publication 17.

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 wish to file separate returns may be considered as separate income or community income for tax purposes. Each state has its own community property laws. See Publication 555, Community Property, for more information.

If your local tax assistance program views community property tax laws for Married Filing Separately taxpayers 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: Go to the Volunteer Resource Guide (Tab 1). Find the section of the Main Information Sheet that addresses filing status. Notice the questions asked of the Married Filing Separately taxpayers. If the taxpayer is in one of the community property states mentioned on the form, additional questions must be answered. You may have to complete a worksheet entitled Allocation of Income for Community Property Income.

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 current spouse's outstanding prior debt. This includes past due child support, past due student loans, or a tax liability the current spouse incurred when they were not married to each other.

If a taxpayer wants to file separately, ask for the reason to elect this status. If a potential offset is the reason, educate the taxpayer about the possibility of avoiding at least their share of the refund offset and attaching Form 8379, Injured Spouse Allocation. See the Publication 17 Index, keyword: "Injured Spouse," for additional information. The Form 8379 instructions are also informative. This form can be e-filed.

Display Form 8379.

Ask students to find this information in Publication 17 by using the index. Recommend they make a note of the page number.

Be aware of community property law requirements, which may affect the amount of tax owed by taxpayers living in community property states.

What if a spouse died during the tax year?

Remember, taxpayers whose spouses died during the tax year are considered married to that spouse for the entire year, providing the surviving spouse did not remarry. The surviving spouse is eligible to file as Married Filing Jointly or Married Filing Separately.

If the surviving spouse has remarried:

- He or she must file either jointly with the new spouse (Married Filing Jointly) or separately from the new spouse (Married Filing 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 in a subsequent section.

Who is Head of Household?

Taxpayers may qualify for the Head of Household filing status, if they:

- Are unmarried or considered unmarried and are not a qualifying widow(er) with dependent child on the last day of the tax year, *and*
- Paid more than half the cost of keeping up a home during the tax year, *and*
- Had a qualifying person living in their home for more than half the year (except for temporary absences such as school)

Point out that some aspects of Head of Household filing status depend on if the qualifying person is the taxpayer's dependent. Explain that dependent qualifications will be covered in Lesson 6.

For a married taxpayer to be considered unmarried, the taxpayer must also have a child who is claimed as a dependent. Exception: if the only reason the taxpayer is not claiming an exemption for the child is because the noncustodial parent can claim the exemption, this requirement is met.

Point out that college students who attend school in another area often qualify as living in the home.

Taxpayers may also choose the Head of Household filing status if they are not married and maintain a home for their parent(s). This home must be the principal place of abode for the parent(s), but it does not have to be the same home as that of the taxpayer. The parent(s) must qualify as the taxpayer's dependent(s).

Point out that dependent parents are not required to live with the taxpayer.

Who is a qualifying person for Head of Household status?

Refer students to the Filing Status decision tree in the Volunteer Resource Guide (Tab B).

Turn to the Volunteer Resource Guide (Tab B), Filing Status. Look at the Determination of Filing Status – Decision Tree.

A qualifying person is defined as:

- A qualifying child
- 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 in the Volunteer Resource Guide Interview Tips for Dependency Exemption for Qualifying Relative under Step 1 only. See Footnote 7.

TIP

A person may qualify as a "qualifying relative" dependent, but not qualify the taxpayer for Head of Household filing status.

For a married taxpayer, the qualifying person for Head of Household must be the taxpayer's dependent child. (Exception: the noncustodial parent rule.)

Refer students to the Who is a Qualifying Person Qualifying You To File as Head of Household? table in the Volunteer Resource Guide (Tab B).

Ask a student to read the exercise.

Review student answers with the class when complete.

EXERCISES

Answers are after the lesson summary.

Question 1: Alexandra's younger brother, Sebastian, is seventeen years old. Sebastian lived with some friends from January-February of 2009. From March-July of 2009, he lived with Alexandra. August 1, Sebastian moved back in with his friends, with whom he stayed 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" for 2009? ☐ Yes ☑ **No**

No, because Sebastian only lived with Alexandra for five months, which is less than half the year.

Notice that the relatives that qualify a person for Head of Household may not be the same relatives that could qualify a taxpayer for a dependency exemption.

Ask a volunteer to read the example about Joan and Mary Ann.

Point out that Joan falls under the definition of qualifying relative defined in the Dependency Exemption for Qualifying Relative table in the Volunteer Resource Guide (Tab C).

example

Since Joan's husband died five years ago, she has lived with her friend, Mary Ann. Joan is a U.S. citizen, she is single and lived with Mary Ann all year, she had no income and received all of her support from Mary Ann. Mary Ann is also a widow. No one can claim Mary Ann as a dependent on his or her return. Joan falls under the definition of a "qualifying relative" and Mary Ann can claim Joan as a dependent on her return.

However, Joan would not qualify Mary Ann for Head of Household purposes, because she does not fall under the "other relative" definition stated in the Volunteer Resource Guide (Tab B), Filing Status.

When you get to Step 7 of the Filing Status Interview Tips in the Volunteer Resource Guide, be sure to refer to the definitions of a qualifying person on the previous page if you have any questions.

TIP

The qualifying person for Head of Household filing status is always related to the taxpayer.

For Head of Household, a qualifying child does not have to be a dependent of the taxpayer. Exception: a married taxpayer considered unmarried for Head of Household purposes.

If the child is *not* the taxpayer's dependent, enter the qualifying child's name on line 4 of Form 1040A or Form 1040. Only enter one child's name.

Tax Software Hint: Turn to the Volunteer Resource Guide (Tab 1). Find the Main Information Sheet that shows the filing status section. The child's name and social security number must be entered in line 4 if the child is not included in the Dependents/Nondependents 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.

Can married taxpayers ever file as Head of Household?

Married taxpayers may be considered unmarried and file as Head of Household if they meet the tests for married persons living apart with dependent children. Taxpayers are considered unmarried and can file as Head of Household if they:

- File a return, separate from their spouse, for the tax year. If a joint return has been filed, the filing status cannot be changed if the due date of the return has passed.
- Have paid more than half the cost of keeping up their home for the tax year. See Publication 17, Filing Status: Head of Household for the Cost of Keeping Up a Home worksheet.
- Have 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.
- Have provided the main home of a dependent child, stepchild, adopted child, or foster child placed by an authorized agency for more than half the year. Certain exceptions exist. To find details, see Publication 17, Personal Exemptions and Dependents, Exemptions for Dependents, and Children of Divorced or Separated Parents.

Point out the spouse is considered to have lived in the home even if temporarily absent due to special circumstances, such as military service or education.

Taxpayers who are divorced or legally separated under a separate maintenance agreement are considered single. They can file as Single, or they might qualify for Head of Household. They would have to meet the same rules as a single person would for Head of Household.

A taxpayer who is married to a nonresident alien spouse may be able to file as Head of Household even if they have lived together during the year. Review the Unique Filing Status and Exemption Situations lesson for more information.

Who is a Qualifying Widow(er) with Dependent Child?

A taxpayer, whose spouse died in one of the two tax years prior to 2009 (either 2008 or 2007) *and* who has one or more dependent children, may claim the Qualifying Widow(er) with Dependent Child 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 2007 or 2008. The taxpayer must not have remarried before the end of 2009.
- Have a child, stepchild, or adopted child who qualifies as the taxpayer's dependent for the year.
- Have furnished over half the cost of keeping up a home for himself/herself and the qualifying child for the entire year, except for temporary absences.

TIP

A foster child does not qualify a taxpayer for the Qualifying Widow(er) with Dependent Child filing status.

In the year a taxpayer's spouse dies, if the taxpayer does not remarry, the Married Filing Jointly filing status can be used with the deceased spouse.

Taxpayers may be able to use the Qualifying Widow(er) with Dependent Child filing status for two years following the year of death, provided they do not remarry.

The standard deduction and tax tables are the same for Qualifying Widow(er) with Dependent Child and Married Filing Jointly filing statuses. These are more favorable than those for Head of Household filing status.

Ask a volunteer to read the example about Laura and Jim.

Ask students if they have any questions about the example.

example

Laura's husband, Jim, died in September of the tax year. She has not remarried, and provides all the support for their dependent children, ages 7 and 9. Laura can file as Married Filing Jointly, claiming an exemption for her deceased husband. For the next two years, she can use the Qualifying Widow(er) with Dependent Child status if she has not remarried.

Tax Software Hint: Go to the Volunteer Resource Guide (Tab 1), Main Information Sheet, which includes the filing status section, for the software entries.

How do I determine the correct filing status?

To determine the best filing status, follow the Filing Status Interview Tips and the Determination of Filing Status flow chart in the Volunteer Resource Guide (Tab B). Then enter the filing status on the approved intake and interview sheet.

EXERCISES (continued)

Check your understanding of each filing status. Feel free to review the lesson if you are not sure of an answer and use the Volunteer Resource Guide (Tab B). The answers are at the end of the lesson.

Question 2: Jane's husband died in 2009. She and her husband qualified to file a joint return in 2008, but they did not. Jane's children are grown and they maintain households of their own. She has not remarried. What filing status(es) can she use?

- Single
- **Married Filing Jointly**
- **Married Filing Separately**
- Head of Household
- Qualifying Widow(er) with Dependent Child

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) with Dependent Child

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) with Dependent Child

Question 5: Sydney's wife died in January of 2007. He filed a joint return for that year as the surviving spouse. In 2009, Sydney, who has not remarried, still maintains a home for his young children all year, and he provides their sole support. What filing status(es) can he use?

- **Single**
- Married Filing Jointly
- Married Filing Separately
- **Head of Household**
- **Qualifying Widow(er) with Dependent Child**

Review answers with the class when complete, demonstrating how to use the Filing Status Interview Tips and the Determination of Filing Status Decision Tree.

Assign the exercises.

Instruct students to use both pages in the Filing Status Interview Tips, Volunteer Resource Guide (Tab B), to complete the exercises.

Review answers with the class when complete.

EXERCISES (continued)

Assign the exercise.

Review answers with the class when complete.

Question 6: An earlier question referred to Sydney, whose wife died in January 2007. He filed a joint return for that year as the surviving spouse. In 2009, Sydney, who did not remarry, maintained a home for his young children, and he provided their sole support. We determined that he could file as Single, Head of Household or Qualifying Widow(er) with Dependent Child. Go back to the interview tips and use them to identify the recommended filing status for Sydney. Outline the answers to the interview steps. What filing status should he use?

- Single
- Married Filing Jointly
- Married Filing Separately
- Head of Household
- **Qualifying Widow(er) with Dependent Child**

Practice – Vanessa Franklin

Direct students to Appendix A-6.

Let's take a look at how a volunteer helped our taxpayer, Vanessa Franklin. Go to Appendix A-6 to determine the most appropriate filing status for her.

Summary

Review the lesson summary with the class.

Ask students how filing status impacts the tax return.

Answer: Filing status can impact the amount of tax, credits, and deductions.

Remind students that it is important to determine the correct filing status so the taxpayers do not pay more tax than is required.

This lesson covered the five filing statuses, as listed on the return, they are:

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

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 status is for unmarried taxpayers who paid more than half the cost of maintaining a home for a qualifying person during the tax year. However, some married taxpayers who lived apart from their spouse during the last six months of the year and provided for dependent children may 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) with Dependent Child filing status, which is available for two years following the year of the spouse's death.

EXERCISE ANSWERS

Answer 1: *No, because Sebastian only lived with Alexandra for five months, which is less than half the year.*

Answer 2: *Remember, if a spouse died during the year, and the surviving spouse did not remarry, the surviving spouse is considered to be married on December 31 for filing status purposes. Answer "yes" to Step 1.*

Because she was widowed in 2009 and has not remarried, Jane can file as Married Filing Jointly or Married Filing Separately. However, she is likely to pay a lower tax if she chooses Married Filing Jointly. Jane is not eligible for the Qualifying Widow(er) with Dependent Children status because those rules are in effect for the two years after the year in which the spouse has died and she must have dependent children. Note: The exercise question stated they didn't file as Married Filing Jointly in 2008, and this would be an opportunity for you to use your interview techniques to determine why they didn't. There might have been circumstances that made it more advantageous to file as Married Filing Separately, which might still exist.

Answer 3: *Because he is not married and has no dependents living in his household, nor does he have dependent parents, Seth can only file as Single.*

Answer 4: *Because she is legally divorced, Tanya can file as Single. However because she has children, she may be able to file as Head of Household, which may result in a lower tax.*

Answer 5: *Sydney can file as Single but he also meets the test for Head of Household and Qualifying Widow(er) with Dependent Child. Qualifying Widow(er) with Dependent Child will likely give him the lowest tax.*

Answer 6: *The interview tips say that he should use the Qualifying Widow(er) with Dependent Child status. The interview steps are:*

- *Step 1: No*
- *Step 5: Yes*
- *Step 6: Yes*

Notes

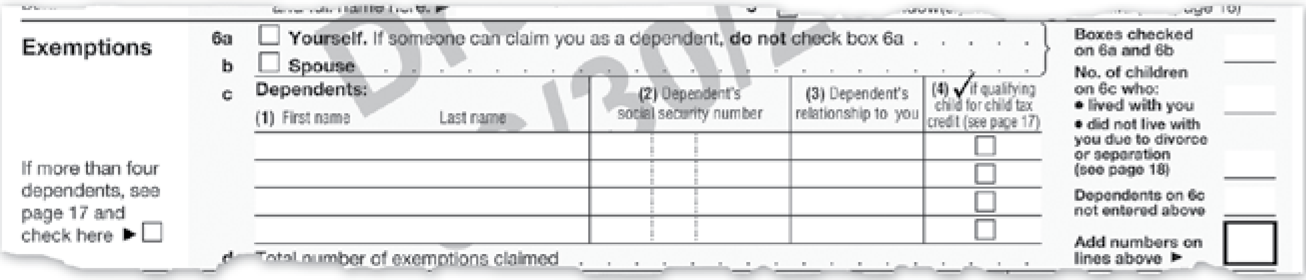
Lesson 5: Personal Exemptions

Introduction

Instructor Notes

This is the first of two lessons covering the Exemption section of the tax return. Identifying and entering the correct number of exemptions is a critical component of completing the taxpayer's return, because each allowable exemption reduces their taxable income.

Personal exemptions are reflected in the Exemptions section of the tax software and on page 1 of the Form 1040 series. Refer to the Volunteer Resource Guide (Tab 1) for a display of an entry screen.



Exemptions

6a ☐ **Yourself.** If someone can claim you as a dependent, **do not** check box 6a . . . . . .

b ☐ **Spouse** . . . .

c **Dependents:**

(1) First name Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) ✓ if qualifying child for child tax credit (see page 17)
			☐
			☐
			☐
			☐

If more than four dependents, see page 17 and check here ► ☐

d Total number of exemptions claimed . . . .

Boxes checked on 6a and 6b

No. of children on 6c who:
- lived with you
- did not live with you due to divorce or separation (see page 18)

Dependents on 6c not entered above

Add numbers on lines above ►

Objectives

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

- Distinguish between personal and dependency exemption
- Determine if a taxpayer can claim a personal exemption
- Determine how many personal exemptions a taxpayer can claim

Review the objectives with the class.

What do I need?

☐ Approved Intake and Interview Sheet
☐ Volunteer Resource Guide
☐ Publication 17
☐ ***Optional:*** Publication 501

Point out the resources cited under **What do I need?**

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.

TIP

The exemption amounts are indexed for inflation and are generally updated every year.

When can a taxpayer claim personal exemptions?

To determine the personal exemptions that a taxpayer can claim, use the interview techniques and tools discussed in the Interview lesson. See the Volunteer Resource Guide (Tab C) for the Interview Tips referenced in this lesson. They can provide helpful probing questions.

To claim a personal exemption, the taxpayer must be able to answer “no” to the intake question, “Can you or your spouse be claimed as a dependent on the income tax return of any other person for 2009?”

This applies even if another person does not actually claim the taxpayer as a dependent. A taxpayer who could be claimed as a dependent must claim “0” exemptions. This means they won’t 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).

TIP

Always use the Interview Tips in the Volunteer Resource Guide (Tab C) to determine the number of exemptions each taxpayer can claim.

Review the main points to ensure that the students understand.

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 cannot be claimed as a dependent on another person’s tax return, and
- Files a joint return, or files a separate return *and* the spouse had no income and is not filing a return

Ask a volunteer to read the tips.

TIP

Taxpayers who are divorced or legally separated at the end of the tax year cannot claim their (former) spouse as an exemption.

TIP

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. Legal advice may be necessary to determine if a common-law marriage exists. Note: 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?

The Interview Tips for Personal Exemptions can help determine whether the taxpayer can claim any personal exemptions. Take a look at the Interview Tips in the Volunteer Resource Guide (Tab C). While you interview the taxpayer, use these questions as a guide to help you get the information you need from the taxpayer.

Direct students to the Interview Tips for Personal Exemptions in the Volunteer Resource Guide (Tab C).

How do I enter the personal exemptions?

Personal exemptions are claimed on line 6a and 6b of Form 1040.

On **line 6a** of the tax return, check the box next to "Yourself" if the taxpayer meets the requirements for claiming themselves as an exemption.

On **line 6b**, check the box next to "Spouse" if the taxpayer meets the requirements for claiming their spouse as an exemption.

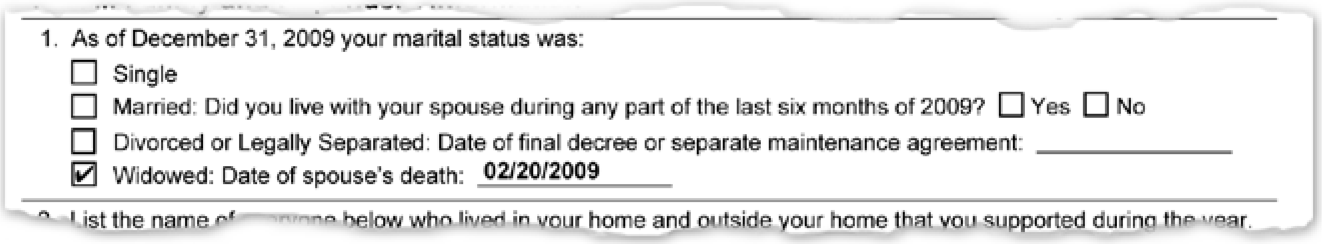
When filing a paper return for a taxpayer who is filing as Head of Household and claiming an exemption for a nonresident alien spouse, check the box on **line 6b** and enter the spouse's first name, last name, and SSN or ITIN.

Tax Software Hint: The tax software will auto-fill the entries for lines 6a and 6b as well as for "Number of boxes checked on 6a and 6b." The software automatically checks the exemptions box for the taxpayer (and for their spouse if Married Filing Jointly status is selected). Review the Main Information screen in the Volunteer Resource Guide (Tab 1).

Taxpayer Interview and Tax Law Application

Ray Jackson is a widower whose wife died during the 2009 tax year. Ray's approved intake and interview sheet shows the following responses.

Direct students to Ray Jackson's intake sheet, shown here.



1. As of December 31, 2009 your marital status was:

☐ Single

☐ Married: Did you live with your spouse during any part of the last six months of 2009? ☐ Yes ☐ No

☐ Divorced or Legally Separated: Date of final decree or separate maintenance agreement: ______________

☑ Widowed: Date of spouse's death: 02/20/2009

2. List the name of [illegible] below who lived in your home and outside your home that you supported during the year.

Which personal exemptions can Ray claim?

Use the Interview Tips for Personal Exemptions in the Volunteer Resource Guide (Tab C) to help you complete lines 6a and 6b on his tax return. Here's how the conversation might sound:

Ask two volunteers to role-play the sample interview.

SAMPLE INTERVIEW

VOLUNTEER SAYS...	RAY RESPONDS...
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 in February. I'm sorry for your loss, sir. Did you remarry sometime during the rest of the tax year?	No, I haven't remarried.
Are you filing a joint return with your late wife this year?	Yes.
Can anyone else claim either of you as dependents?	Well, I don't think so. We lived off our own income.
Based on your answers, you can claim an exemption for yourself and for your late wife. [On the approved intake and interview sheet, volunteer should check "No" for the question, "Can your parents or someone else claim you or your spouse as a dependent on their tax return?" which Ray left blank.]	

Tax Software Hint: Review the Main Information screen in the Volunteer Resource Guide (Tab 1).

Because Ray can claim himself and his late wife as personal exemptions, you will enter both their names and SSNs in the Main Information Sheet in the tax software. The software automatically checks the boxes on lines 6a and 6b and enters "2" for "Number of boxes checked on 6a and 6b." You will also enter the Date of Death under the spouse in the Taxpayer Information area of the Main Information Sheet in the tax software.

If you are preparing a paper return, write "Deceased" along with the deceased spouse's name and Date of Death across the top of the return. Once you complete the Date of Death in the software, the program will automatically print that notation.

NEW Exemption for individual(s) displaced by a Midwestern disaster

Review this new topic with class.

The taxpayer may be entitled to an additional exemption if housing was provided to a person displaced by the storms, tornadoes, or flooding in a Midwestern disaster area. The taxpayer can claim this exemption for up to four displaced individuals, but not for their spouse or dependent. The exemption amount is $500 per person housed, and the maximum amount that may be claimed for all displaced individuals is $2,000 ($1,000 if Married Filing Separately).

To take this exemption all of the following must apply:

- The taxpayer must have provided housing in their main home for at least 60 consecutive days to a person displaced by the storms, tornadoes, or flooding in a declared Midwestern disaster area.
- The displaced person lived in a Midwestern disaster area when the disaster occurred.
- The taxpayer did not receive rent or any payment for providing housing.

This exemption is claimed on Form 8914, Exemption Amount for Taxpayers Housing Midwestern Displaced Individuals. For detailed information, see Publication 4492-B, Information for Taxpayers Affected in the Midwestern Disaster Areas.

Practice - Vanessa Franklin

Let's take a look at how a volunteer helped our taxpayer, Vanessa Franklin. Go to Appendix A-8 to determine the personal exemptions she can claim.

Direct students to Appendix A-8.

Summary

There are two types of exemptions – personal and dependency. A personal exemption can be claimed for:

Review the lesson summary with the class.

- The individual taxpayer, unless they can be claimed as a dependent on another person'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 their own return, and is not a dependent of another person

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 one of the most common errors made on a return.
- The taxpayer may be eligible for an additional exemption for providing housing to a person or persons displaced by the storms, tornadoes, or flooding in a Midwestern disaster area.
- When preparing a paper return for a taxpayer filing as Head of Household and claiming an exemption for a nonresident alien spouse, check the box on line 6b and write in the spouse's full name and SSN or ITIN.

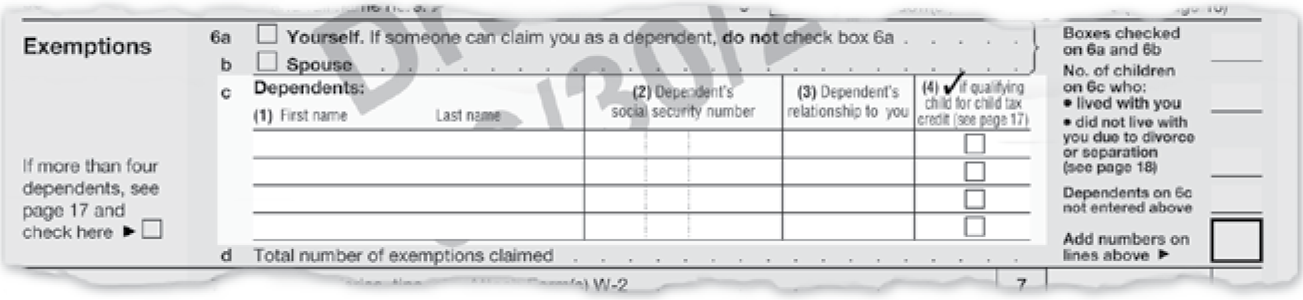
Notes

Lesson 6: Dependency Exemptions

Introduction

Instructor Notes

This is the second and final lesson covering the Exemptions section of the tax return. Identifying and entering the correct number of exemptions is a critical component of completing the taxpayer's return. A taxpayer can claim one exemption for each qualified dependent on their return, thereby reducing their taxable income.



Exemptions

6a ☐ **Yourself.** If someone can claim you as a dependent, **do not** check box 6a

b ☐ **Spouse**

c **Dependents:**

(1) First name Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) ✓ if qualifying child for child tax credit (see page 17)
			☐
			☐
			☐
			☐

If more than four dependents, see page 17 and check here ► ☐

d Total number of exemptions claimed

Boxes checked on 6a and 6b

No. of children on 6c who:
- lived with you
- did not live with you due to divorce or separation (see page 18)

Dependents on 6c not entered above

Add numbers on lines above ►

W-2

7

To determine the dependency exemptions, use the interview techniques and tools discussed in the Screening and Interviewing lesson. See the Volunteer Resource Guide (Tab C) for the interview tips in this lesson. The interview tips can provide helpful probing questions.

When the interview is complete, the results are documented on the approved intake and interview sheet. This information will be the basis of your entries in the tax software.

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.

A taxpayer can claim one exemption for each qualified dependent, thereby reducing the taxable income.

TIP

Persons who qualify to be claimed as a dependent may file a return for taxes withheld, but they cannot claim any exemptions.

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 dependency test
- Determine how many exemptions a taxpayer can claim for dependents

What do I need?

☐ Approved Intake and Interview Sheet
☐ Volunteer Resource Guide
☐ Publication 17
Optional:
☐ Publication 501
☐ Form 2120
☐ Form 8332

Review objectives with the class.

Point out the resources cited under **What do I need?**

Who may be claimed as a dependent?

A dependent may be either a "Qualifying Child" or a "Qualifying Relative." The requirements for both have much in common, but there are some tests that are specific to qualifying child or qualifying relative.

TIP

The tests for qualifying relative are applied only when the tests for qualifying child are not met.

NEW The definition of qualifying child has been revised for 2009.

- A qualifying child must be younger than the taxpayer, unless the child is permanently and totally disabled. See Form 1040 Instructions, page 6.
- A child cannot be the taxpayer's qualifying child if the child files a joint return, unless the return was filed only as a claim for refund.
- If the child's parents can claim a qualifying child but choose not to, no one else can claim the child as a qualifying child unless that person's adjusted gross income (AGI) is more than the highest of either parent's AGI.
- The child is a qualifying child for purposes of the child tax credit only if the taxpayer claims an exemption for the child.

In addition to the tests specific to qualifying child and qualifying relative, all of the following tests must be met for both:

- Dependent taxpayer test
- Joint return test
- Citizen or resident test

Use caution when preparing this section of the taxpayer's return. The interview tips in the Exemptions section of the Volunteer Resource Guide (Tab C) cover the requirements for all the dependency tests. Avoid using information from the taxpayer's prior year documents to complete this section.

How do I apply the dependency tests?

The Family and Dependent Information section of the approved 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.

Direct students to the Volunteer Resource Guide (Tab C).

Use the Volunteer Resource Guide (Tab C) to help you ask probing questions to verify the information on the approved intake and interview sheet. Use the interview tips to apply the dependency tests.

TIP

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 – see the Volunteer Resource Guide (Tab C), Table 3, as well as the special multiple support rules.

How do I use the interview tips?

One way to apply the dependency tests is to refer to the interview tips for each dependency test.

What are the tests for qualifying children?

To determine if the taxpayer has a dependent, begin by applying the rules for a qualifying child. If these tests are not met, then you can continue on to the tests for a qualifying relative. Remember, a person must meet the requirements of either a qualifying child or a qualifying relative to be claimed as a dependent.

Relationship

Review step 2 of the Table 1 interview tips, in the Volunteer Resource Guide (Tab C).

This step determines if the child is related to the taxpayer in one of the following ways:

- The taxpayer's child, stepchild or adopted child, or their descendant (grandchild)
- The taxpayer's brother, sister, stepbrother, stepsister or their descendant (niece or nephew)
- A foster child placed with the taxpayer by an authorized placement agency or court order

Ask students to locate the interview tips in the Volunteer Resource Guide (Tab C) for determining the Dependency Exemption for Qualifying Child.

Age

The next step is determining the child's age. Review steps 1 and 3 of the Table 1 interview tips in the Volunteer Resource Guide (Tab C).

The child must be at least one of the following:

- Under age 19 and younger than the taxpayer at the end of the tax year
- Under age 24, a full-time student (as defined by the school) for at least 5 months of the year, and younger than the taxpayer
- Any age and permanently and totally disabled

TIP

To be considered a student, the taxpayer's child must attend school full time (as determined by the school) for some part of each of five calendar months of the year. School does not include an on-the-job training course, correspondence school, or a school offering courses only through the Internet.

Support

Step 4 of the interview tips in the Volunteer Resource Guide determines the level of support by the child, not the person who wants to claim the child as a dependent. A child cannot have provided more than half of his/her own support during the tax year. A person's own funds are not support unless they are actually spent for support.

example

Bob is 22, a full-time student and lives at home with his parents when he is not in the dorm. He worked part-time and made $6,000, but that was not 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.

Ask a volunteer to read the Bob example.

Ask what if Bob's earnings were over half of his total support.

Answer: He would fail the support test.

Ask a volunteer to read the Doris example. Answer any student questions.

Ask what if her parents used her earnings to defray household expenses.

Answer: She might fail the support test.

example

Doris 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 at home all year. Doris meets the relationship, age, and support tests. If she meets the rest of the tests for a qualifying child, she can be claimed as a dependent by her parents.

Residence

Step 5 of the interview tips examines residency. The child must have the same principal residence as the taxpayer for more than half the year. The child is considered to have the same place of residence as the taxpayer even if the child (or the parent) is temporarily absent due to special circumstances such as education, illness, vacation, business, or military service. The taxpayers' home can be 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.

Special Exceptions for the Residence Test

Point out the special circumstances for kidnapping or birth and death of a child.

Taxpayers may claim an exemption for a child who has been kidnapped, a child who was born alive at any time during the year and then died, or any other dependent that died during the year, as long as the dependent meets other dependency tests.

TIP

In the case of a child who was born and died during the year, an SSN is not required but the return cannot be e-filed. The tax return must be mailed in. Refer to the Filing Information chapter of Publication 17.

Read the Hugh example. Answer any student questions.

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 dependency exemptions for a housekeeper, other household employee, or for a stillborn child.

Refer to the Personal Exemptions and Dependents chapter of Publication 17 for detailed information regarding the residency test.

Special rules that apply to custodial and non-custodial parents will be discussed later in this lesson.

Additional Rules

The first five steps covered above apply specifically to qualifying children. The next five interview tips cover additional rules for considering a qualifying child as a dependent. Some of these steps will also apply when we talk about qualifying relatives.

Citizenship or Residency

Step 6 is sometimes referred to as the citizen or resident test. Do not get it confused with step 5 which refers to who the child is living with (residency test). To pass the citizen or resident test, the dependent must be either a U.S. citizen, U.S. national, or resident of the U.S., Canada or Mexico. Note that:

Point out the details listed here and answer any student questions.

- Children are usually citizens or residents of the country in which their parents are citizens. So, if either parent is a U.S. citizen, a child born in a foreign country can be recognized as a U.S. citizen for tax purposes.

- If a U.S. taxpayer legally adopts a child who is not a U.S. citizen or resident, this test is met as long as the child lives with the taxpayer as a member of the household all year. If all the other dependency tests are met, the taxpayer can claim the child as a dependent.
- Foreign exchange students generally are not U.S. residents and do not meet the citizen or resident test, so they cannot be claimed as dependents.

example

Joan, who is a U.S. citizen, adopted an infant boy from Cambodia who has lived with her for the entire tax year. Even though Joan's child is not yet a U.S. citizen or resident, he meets the citizen or resident test because he was a member of Joan's household for the entire year.

Ask a volunteer to read the Joan example. Answer any student questions.

Joint Return

Look at steps 7 and 8 in the interview tips for qualifying child in the Volunteer Resource Guide (Tab C). To pass the joint return test, the dependent must *not* file a joint return for the year, unless:

- The joint return is filed only to claim a refund of taxes withheld, and
- No tax liability would exist for either spouse on separate returns

example

Ruth had no income. She married in November of the tax year. Ruth's husband had $16,700 income and they claimed two personal exemptions on their return. Even though 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. While they are filing a return just to claim a refund of taxes withheld, Ruth's husband would have tax liability if he filed a separate return.

Ask a volunteer to read the Ruth example.

Can the child be a qualifying child of more than one person?

Review step 9 and the associated footnotes in the Volunteer Resource Guide.

Point out the footnotes to the interview tips.

If the child meets the conditions to be the qualifying child of more than one person, only one person can claim the child as a qualifying child for all of the following tax benefits (unless the special rule for children of divorced or separated parents applies):

- Dependency exemption
- Child tax credits
- Head of Household filing status
- Credit for child and dependent care expenses
- Exclusion for dependent care benefits
- Earned income credit

No other taxpayer can take any of these six tax benefits unless they have another qualifying child. If any taxpayer can claim the child as a qualifying child, the following rules apply:

- If only one of the taxpayers is the child's parent, the child is treated as the qualifying child of the parent.
- If two of the persons are the child's parents, the child is treated as the qualifying child of the parent with whom the child lived for the longer period of time in 2009. If the child lived with each parent for the same amount of time, the child is the qualifying child of the parent who had the higher adjusted gross income (AGI) for 2009.
- 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 2009.
- If a parent can claim the child as a qualifying child but no parent does so, the child is treated as the qualifying child of the person who had the highest AGI for 2009, but only if that person's AGI is higher than the highest AGI of either of the child's parents.

Ask a volunteer to read the Lynne and Margaret example. Answer any student questions.

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.

See the Volunteer Resource Guide (Tab C) and Publication 501 for more information and examples about a qualifying child of more than one person.

If the qualifying child is actually claimed on more than one tax return in a given year, the IRS will apply the Qualifying Child of More Than One Person rules listed in Publication 17, Personal Exemptions and Dependents.

Dependent Taxpayer

Display or refer to step 10 of the interview tips for determining the Dependency Exemption for Qualifying Child.

The final interview question for a qualifying child is step 10 in the Volunteer Resource Guide (Tab C). Look at the question in Part I on the taxpayer's approved intake and interview sheet that asks "Can your parents or someone else claim you or your spouse on their tax return?" To claim a dependency exemption, a taxpayer cannot be a dependent on another person's tax return. If a taxpayer can be claimed as a dependent by another person, the taxpayer may not claim anyone else as a dependent, even if the taxpayer has a qualifying child or qualifying relative.

What are the tests for qualifying relatives?

Display or refer to the interview tips in the Volunteer Resource Guide (Tab C) for determining the Dependency Exemption for Qualifying Relative.

Dependents who do not meet the tests for qualifying child might meet the slightly different tests to be a qualifying relative. The tests are:

- Not a qualifying child test
- Member of household or relationship test
- Citizenship or residency test
- Gross income test
- Support test (to be a qualifying relative)

- Joint return test
- Dependent taxpayer text

Turn to the Qualifying Relative Interview Tips in the Volunteer Resource Guide (Tab C).

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 other taxpayer is not required to file an income tax return and:

- Does not file an income tax return, or
- Only files a return to get a refund of income tax withheld

Special rules that apply to custodial and noncustodial parents are covered later in this lesson.

Ask volunteers to read the following examples.

example

Todd has lived with his girlfriend, Eva, and her two children all year in his home. Eva is not required to file a 2009 tax return, and does not file a 2009 tax return. Todd has provided more than half of their support for the entire year. Eva and her two children are Todd's qualifying relatives because they meet the member of household or relationship test, gross income test, and support test. (Eva and Todd's relationship does not violate local laws.)

example

All the facts are the same as in the previous example, except that Eva is required to file a tax return. She still meets all the tests to be Todd's qualifying relative dependent. Since Eva has a filing requirement and her children meet the tests to be Eva's qualifying child dependents, Todd can no longer claim the children as qualifying relative dependents. He can still claim Eva as a dependent, and Eva may not claim herself or any dependents on her own.

example

Since late in 2008, Sally has been supporting her friend, Ann, and Ann's young son, Bobby. Ann and Bobby lived with Sally all of 2009 and meet all the tests to be Sally's qualifying relative dependents. Ann worked part-time and made $3,100 in wages during 2009. 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.

example

All the facts are the same as in the previous example, except, when Ann files her tax return, she also claims the earned income credit. Because Ann did not file her return only to get a refund of her withholding, Bobby must be considered Ann's qualifying child. Therefore, Sally cannot claim Bobby as a dependent. Ann cannot claim Bobby as a dependent either, since Ann is a dependent herself. Ann *can* use Bobby as a qualifying child for the earned income credit (covered in the Earned Income Credit lesson).

Member of Household or Relationship Test

To meet this test, the person has to have a close familial relationship with the taxpayer or have lived with the taxpayer for the entire year. It is important to note that a close relative of the taxpayer does not have to live in the same household to meet this test.

Ask a volunteer to read the Susan and Ted example. Answer any student questions.

example

Susan and Ted are married and file a joint return. They have supported Ted's parents for the majority of 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. Step 3 probes to determine if the person is an individual (other than a spouse) who had the same principal place of abode as the taxpayer and was a member of the taxpayer's household for the entire year, regardless of relationship. 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:

Point out the details listed here and answer any student questions.

- Temporary absences due to illness, education, business, vacation, military service, and placement in a nursing home are acceptable.
- A relationship established by marriage, such as mother-in-law or sister-in-law, does not end with divorce or death of a spouse; they are qualifying relatives even if they do not live with the taxpayer.
- 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.

The Dependency Exemption Interview Tips, steps 2 and 3, can help you determine if a person passes the qualifying relative, member of household, or relationship test.

Citizenship or Residency Test

Step 4 will guide you to determine citizenship or residency. Also look at Part II, Family and Dependent Information of the taxpayers' approved intake and interview sheet, which asks the taxpayer about citizenship or residency. A dependent must be a U.S. citizen, U.S. national, U.S. resident alien, or a resident of Canada or Mexico.

This is a general rule for dependents. It applies to both qualifying child and qualifying relative.

Gross Income Test

Step 5 of the interview tips addresses the gross income test. The dependent's gross income for the tax year must be less than the personal exemption amount ($3,650 for 2009). There is an exception if the person is disabled and has income from a sheltered workshop. Gross income is defined in Publication 17, Personal Exemptions and Dependents. Remember this test does not apply to qualifying children, only qualifying relatives.

example

Joe is 65 years old and lives with his son and daughter-in-law. In 2009, Joe's taxable pension income was $4,700. Joe's son and daughter-in-law cannot claim a dependency exemption for Joe because Joe's income exceeds the exemption amount for 2009, which is $3,650.

Ask a volunteer to read the Joe example.

Support

Step 6 of the interview tips asks about support. The taxpayer must have provided more than 50% of the dependent's total support for the tax year. Note that this support test is different than the one for a qualifying child.

When calculating the amount of total support, taxpayers should compare their contributions with the entire amount of support their dependent received from all sources (such as taxable income, tax-exempt income, and loans). Review the list of valid support expenses and the worksheet in the Personal Exemptions and Dependents chapter, Publication 17.

TIP

Publication 17 contains a worksheet for determining support.

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.

Ask a volunteer to read the Sherrie example.

Ask what if Sherrie's father had spent all his income on himself?

Answer: He would not pass the support test.

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.

Ask a volunteer to read the Steve example. Answer any student questions.

Social Security benefits received by a child and used towards support are considered to have been provided by the child.

If the taxpayer provides over half the person's total support, you can skip steps 7 through 10 and go directly to step 11. If the taxpayer has not provided over half the person's support, go to step 7 to see if someone else is providing over half the support.

TIP

State benefit payments like welfare, Temporary Assistance for Needy Families (TANF), food stamps, Medicaid, or housing assistance are considered support provided by the state, not by the taxpayer.

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)

If one person has not provided over half the support, go to step 8 to determine if multiple support exists. Multiple support means that two or more people together, who could claim the person as a dependent except for the support test, provide more than half the dependent's support. However, *only one taxpayer* can claim the exemption for a dependent with multiple support. In this situation, the individuals who provide more than 10% of the person's total support (step 9), and who meet the other tests for a qualifying relative, can agree that one of them will take the person's exemption.

Step 10 guides you in asking if the taxpayer has the appropriate documentation.

- The taxpayer who is claiming the exemption for the dependent must attach to their tax return Form 2120, Multiple Support Declaration or similar statement.
- The other supporting taxpayers must sign this written statement agreeing *not* to claim the exemption for that year. The person who claims the exemption must keep this written statement as a record.

TIP

Multiple Support Agreements apply only to a qualifying relative, not to a qualifying child.

Read the Fred and Charlie example. Answer any student questions.

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, and 9% from Charlie's friend. Either Fred or Charlie's brother can take the exemption for Charlie because they each provided more than 10% of Charlie's support, and together contributed more than 50% towards his support. Whoever is not going to take the exemption must sign a statement agreeing not to take the exemption.

Ask a volunteer to read the Diane example.

Ask what if Diane and her brother each provided half of the support and the two unrelated persons contributed nothing.

Answer: Either Diane or her brother could claim the exemption because together they provided 100% of their grandmother's support.

example

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. No one is entitled to the dependency exemption, since more than half of the grandmother's support is provided by people who can't claim her exemption.

TIP

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.

Joint Return

To pass the joint return test (steps 11 and 12), the dependent must *not* file a joint return for the year, unless:

- The joint return is filed only to claim a refund, and
- No tax liability would exist for either spouse on separate returns

This is a general rule for dependents. It applies to both a qualifying child and qualifying relative.

Dependent Taxpayer

Display or refer to the approved intake and interview sheet question mentioned here.

The final interview question for a qualifying relative is step 13. Look at the question on the taxpayer's approved intake and interview sheet that asks "Can your parents or someone else claim you or your spouse on their tax return?" To claim a dependency exemption, a taxpayer cannot be a dependent on another person's tax return. If a taxpayer can be claimed as a dependent by another person, the taxpayer may not claim anyone else as a dependent, even if the taxpayer has a qualifying child or qualifying relative.

Special Rule for Children of Divorced, Separated, or Never Married Parents

Display or refer to the Children of Divorced, Separated, or Never Married Parents Interview Tips in the Volunteer Resource Guide (Tab C).

Special rules apply if the dependent is supported by parents who are divorced or separated; these rules also apply to parents who were never married. After first starting with Table 1, use Table 3: Children of Divorced or Separated Parents within the Volunteer Resource Guide (Tab C) to determine which parent is entitled to claim the child as a dependent.

In general, the child will be considered a dependent of the custodial parent, assuming the child meets all the rules for a qualifying child or qualifying relative. However, the custodial parent can agree to allow the noncustodial parent to treat the child as a qualifying child or qualifying relative if certain conditions are met. A signed Form 8332 or equivalent is required and must be attached to the noncustodial parent's return, or attached to Form 8453 if filing electronically.

What are the new rules for children of divorced or never married parents?

NEW Revocation of Release of Claim to an Exemption

For tax years after July 2, 2008 (the 2009 calendar year for most taxpayers), new rules allow the custodial parent to revoke release of claim to exemption previously filed on Form 8332, Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent, or similar form. 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. Therefore, if the custodial parent provides notice of revocation to the noncustodial parent in 2009, the earliest the revocation can take effect is the 2010 tax year. 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.

NEW Use of Divorce Decree or Separation Agreement Instead of Form 8332

If the divorce decree or separation agreement went into effect after 1984 and before 2009, the noncustodial parent can still attach certain pages from the decree or agreement instead of Form 8332 or similar form.

Beginning with divorce decrees granted in 2009, the noncustodial parent will no longer be able to attach pages from the decree or agreement. Form 8332 must be filed if the decree or agreement was made after 2008.

Pre-1985 decree of divorce or separate maintenance or written separation agreement is still applicable for 2009 when the decree gives the exemption to the noncustodial parent and the parent pays at least $600 in child support *only if the child is permanently and totally disabled.*

The Special Rule for Children of Divorced or Separated Parents is described in detail in the Personal Exemptions and Dependents chapter of Publication 17.

CAUTION

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.

Read the examples. Answer any student questions.

example

The taxpayer has a 1999 divorce decree that states they can claim their child as a dependent. Since the divorce decree was created prior to 2009, the divorce decree can be attached to the tax return and the taxpayer can claim the dependent.

example

The taxpayer has a 2009 divorce decree that states they can claim their child as a dependent. The taxpayer cannot attach a copy of the divorce decree to the tax return even if it states the taxpayer can claim the child as a dependent. The taxpayer must attach a signed Form 8832 to the tax return in order to claim the child as a dependent.

How do I enter the exemptions in the tax software?

Display or refer to the Dependents/Nondependents section of the tax software Main Information Sheet in the Volunteer Resource Guide (Tab 1).

The tax software determines the taxpayer's dependency exemptions based on the Dependents/Nondependents information entered on the tax software Main Information Sheet.

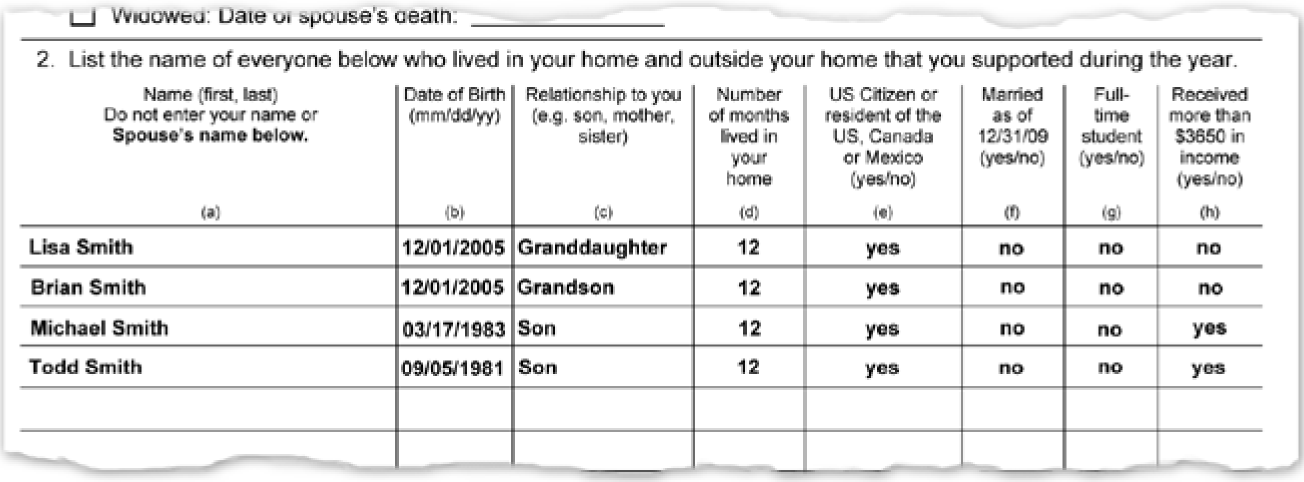
Be sure to include and verify all the family and dependent information on the taxpayer's approved intake and interview sheet before entering the following data into the Dependents/Nondependents section of the tax software.

For detailed instructions, refer to the Volunteer Resource Guide (Tab 1), Main Information Sheet.

Taxpayer Interview and Tax Law Application

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 is the main provider for her two grandchildren and two of her grown sons, who live with her. Her sons worked part time and earned $4,000 each. They are not disabled. The grandchildren are not the children of the sons that live with her. She would like to file a tax return and claim her sons and grandchildren as dependents.

Form 13614-C should look like this:



☐ Widowed: Date of spouse's death: ____________

2. List the name of everyone below who lived in your home and outside your home that you supported during the year.

Name (first, last) Do not enter your name or **Spouse's name below.** (a)	Date of Birth (mm/dd/yy) (b)	Relationship to you (e.g. son, mother, sister) (c)	Number of months lived in your home (d)	US Citizen or resident of the US, Canada or Mexico (yes/no) (e)	Married as of 12/31/09 (yes/no) (f)	Full-time student (yes/no) (g)	Received more than $3650 in income (yes/no) (h)
Lisa Smith	12/01/2005	Granddaughter	12	yes	no	no	no
Brian Smith	12/01/2005	Grandson	12	yes	no	no	no
Michael Smith	03/17/1983	Son	12	yes	no	no	yes
Todd Smith	09/05/1981	Son	12	yes	no	no	yes

How do I apply the dependency tests to Elaine’s sons?

Use the interview tips in the Volunteer Resource Guide to apply the test to each of Elaine’s sons.

Walk through the sequence of steps in the interview tips, if time permits.

How do I apply the dependency tests to Elaine’s grandchildren?

Use the interview tips in the Volunteer Resource Guide to apply the test to each of Elaine’s grandchildren. You will find that Lisa and Brian are qualifying children of Elaine and her adult sons, Michael and Todd. However, under the tie-breaker rules, Elaine would be entitled to the dependency exemptions for Lisa and Brian because she has the highest AGI.

Dependents/Nondependents Determinations

Elaine can claim her two grandchildren as dependency exemptions, but not her adult sons. Therefore, you use the Family and Dependent Information section of Elaine’s approved intake and interview sheet to enter the information for her two grandchildren.

Practice – Vanessa Franklin

Let’s take a look at how a volunteer helped our taxpayer, Vanessa Franklin. Go to Appendix A-9 and review the sample interview with Vanessa related to dependency exemptions.

Direct students to Appendix A-9.

Summary

Review the lesson summary with the class.

- You cannot claim any dependents if you, or your spouse if filing jointly, could be claimed as a dependent by another taxpayer.
- You cannot claim a married person who files a joint return as a dependent unless that joint return is only a claim for refund and there would be no tax liability for either spouse on separate returns.
- You cannot claim a person 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.)
- You cannot claim a person as a dependent unless that person is your *qualifying child* or *qualifying relative*.

Tax Software Hint: After verifying that the dependents are qualified, enter the taxpayer’s dependents’ information in the Dependents/Nondependents section of the tax software Main Information Sheet. The tax software will use this information to calculate the taxpayer’s exemption deduction.

Notes

Lesson 7: Unique Filing Status and Exemption Situations

Instructor Notes

Introduction

This lesson will assist you in addressing some filing status issues you may encounter when helping service members or others whose spouses are nonresident aliens (not U.S. citizens or permanent resident aliens).

This lesson also covers exemption issues related to taxpayers who want to claim an exemption for:

- A nonresident alien spouse who does not qualify to be a resident alien for tax purposes, and/or
- Nonresident alien stepchildren

Tax situations involving nonresident aliens can be complex. If the taxpayer has a J, Q, F, or M visa, ask the site coordinator if there is a volunteer who is trained and certified to prepare these types of returns.

If there isn't a certified volunteer at the site or if you are faced with a situation not covered in this lesson, refer the taxpayer to a professional tax preparer.

Objectives

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

- Determine whether an individual, for example, an Armed Forces member's spouse, is a nonresident alien or resident alien
- Determine if an Armed Forces member is entitled to claim the personal exemption for a spouse who is a nonresident alien
- Apply the support test and citizen/resident test to determine whether an individual can be claimed as a dependent by an Armed Forces member
- Apply special rules for Head of Household status when the spouse is a nonresident alien

What do I need?

☐ Approved Intake and Interview Sheet
☐ Volunteer Resource Guide
☐ Publication 17
☐ Publication 519

Optional:

☐ Publication 3
☐ Publication 54
☐ Form 1040NR-EZ
☐ Form 1040NR

Point out the resources cited under **What do I need?**

Review objective with the class.

How do I apply tax law to nonresident aliens?

Nonresident aliens can be students, teachers, trainees, and/or undocumented immigrants. Your role is to determine if the nonresident alien can be treated as a resident alien for tax purposes; if so, most tax rules (with certain exceptions) that apply to a U.S. citizen will apply to the nonresident alien, including filing status and exemption issues. Resident aliens and U.S. citizens must report worldwide income on their tax return.

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/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 citizen, resident alien, or nonresident alien?

Let's begin by looking at the approved intake and interview sheet. Locate the part of the form where taxpayers and/or their spouses indicate whether or not they are U.S. citizens or resident aliens. In another part of the form, taxpayers indicate citizenship or residency of family members and dependents.

Ask students to find these parts of the approved intake and interview sheet.

If the taxpayer has checked "no" for U.S. citizen or resident alien on the approved 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. These people 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.

Ask students: When a green card has been issued, what is the residency status?

Answer: Resident alien

More information about green card holders is available in Publication 4588, Basic Tax Guide for Green Card Holders, found at www.irs.gov.

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. If individuals do not have green cards, find out if they meet the Substantial Presence test, which allows them to be treated as resident aliens for tax purposes.

Ask students to turn to the Resident Alien or Nonresident Alien? decision tree in the Volunteer Resource Guide, page 9.

Page 9 of the Volunteer Resource Guide reprints the decision tree, Nonresident Alien or Resident Alien? from Publication 519, U.S. Tax Guide for Aliens. It is used to determine if an alien is a resident alien or nonresident alien for tax purposes.

Use the Resident Alien or Nonresident Alien? decision tree to determine an individual's residency status.

example

PFC Gloria Benton's husband, Dante, has neither a green card nor a visa. Dante does not have a tax home in another country. He was physically present in the U.S. for 150 days in each of the years 2007, 2008, and 2009. Is Dante a resident alien under the Substantial Presence test for 2009?

The decision tree indicates that Dante does meet the Substantial Presence test and is considered a resident alien for tax purposes.

2009: 150 days 2008: 1/3 of 150=50 days
2007: 1/6 of 150 days=25 days

Total days=225 days

Ask a volunteer to read the example about PFC Benton's husband. Answer any student questions.

Who is exempt from the Substantial Presence test?

People who are in the U.S. on valid F, J, M or Q visas are usually considered exempt from the Substantial Presence test. Taxpayers must follow the rules described in Forms 1040NR or 1040NR-EZ instructions.

For individuals with valid visas, do not count the days present in the U.S. for purposes of the Substantial Presence test. In general, these people will be considered *nonresident aliens for tax purposes*. Other examples of exempt individuals include:

- Nonresident aliens with medical conditions that prevent them from leaving the country, and
- Certain commuters between the U.S., Canada and Mexico

CAUTION

Most VITA sites do not prepare returns for individuals with F, J, M, or Q valid visas. Ask the site coordinator if there is a volunteer who is certified to prepare these types of returns. If not, refer the taxpayer to a professional tax preparer.

Point out the caution.

Publication 519 has more detailed information on who is an exempt individual.

TIP

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 they are 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.

CAUTION

An individual with an ITIN is not entitled to the Earned Income Credit. This will be covered in the Earned Income Credit lesson.

TIP

A return with an ITIN can be e-filed. A return missing an ITIN *cannot* be e-filed.

A taxpayer obtains an ITIN by filling out Form W-7 or Form W-7SP. Attach this form to the tax return. (You may prepare the return for the taxpayer.) Follow the instructions in the Volunteer Resource Guide (Tab 1) for preparing the return without a valid SSN or ITIN. A return with the Form W-7 application cannot be e-filed; it must be mailed.

IRS Taxpayer Assistance Centers or acceptance agents can help the taxpayer complete Form W-7 or Form W-7SP. Most acceptance agents, other than the IRS, charge a fee for this service.

For more information about acceptance agents, see Publication 4393, What is an IRS ITIN Acceptance Agent. You can find this publication and more information about acceptance agents on www.irs.gov, keyword “acceptance agent.”

Use the Resident Alien or Nonresident Alien? decision tree in the Volunteer Resource Guide (page 9) to determine if a person meets the Substantial Presence test.

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 volunteer who has been trained and certified to prepare returns for nonresident aliens or a professional tax preparer to file Form 1040NR or Form 1040NR-EZ.

If the nonresident alien is married and the spouse does not qualify to be treated as a resident alien using the Green Card or Substantial Presence test, you can provide assistance.

Ask a volunteer to read the example about Sgt. Paul Kingman and his wife. Answer any student questions.

example

Sgt. Paul Kingman and his wife, Gabriella, were married at the end of 2009. Gabriella does not have a green card nor a valid visa. They have no children and are not supporting anyone else.

Gabriela lived in the U.S. for 120 days in 2009 (from September to December) as a nonresident alien. She was also in the U.S. for 120 days in each of the years 2007 and 2008. 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.

2009: 120 days 2008: 1/3 of 120 days=40 days 2007: 1/6 of 120 days=20 days

Total days = 180

Refer students back to the Resident Alien or Nonresident Alien? decision tree in the Volunteer Resource Guide.

Married couples in this situation have a few options when it comes to filling a tax return. In the example, Gabriella (wife of Sgt. Paul Kingman) does not meet the Green Card nor Substantial Presence test. Thus, she is considered a nonresident alien.

As a citizen married to a nonresident alien spouse who does not meet either the Green Card or Substantial Presence test, Sgt. Kingman has four filing status options:

Ask students to turn to the Filing Status Interview Tips in the Volunteer Resource Guide (Tab B).

1. He may choose to file as Married Filing Separately
2. The couple may chose to file as Married Filing Jointly
3. He may qualify for Head of Household under the regular rules for a married person who is *considered unmarried* for Head of Household purposes
4. He may qualify to file as Head of Household, even *while living with the nonresident alien spouse*

Who can file a joint return?

Even though Gabriella does not pass the Green Card test or the Substantial Presence test, it is possible for this married couple to file a joint return. The couple may elect to treat the nonresident alien spouse as a resident alien for tax purposes. This information can be found in Publication 519, U.S. Tax Guide for Aliens.

How does a couple elect to treat the nonresident alien spouse as a U.S. resident for tax purposes?

If the nonresident alien spouse agrees to file a joint return, worldwide income must be reported, and a signed declaration is attached to the joint return stating:

- One spouse was a nonresident alien and the other spouse a U.S. citizen or resident alien on the last day of the tax year, and both choose to be treated as U.S. residents for the entire year
- The name, address, and SSN or ITIN of each spouse

How does this election affect 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.

TIP

Make a note by step 2 of the Personal Exemptions chart in the Volunteer Resource Guide that, if a spouse is a nonresident alien, the taxpayer can still make the choice declaration.

Display or refer students to Table 1-1, Ending the Choice, in Publication 54.

example

Even though Gabriella, Sgt. Paul Kingman's nonresident alien wife, does not pass the Green Card or Substantial Presence test, they both agree to choose to treat Gabriella as a resident alien by attaching a signed statement to their joint return. Paul and Gabriella 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.

Ask a volunteer to read the example about Gabriella.

As you learned in a previous lesson, married taxpayers can be *considered unmarried* and claim Head of Household status if they have not lived with their spouse for the last six months of the year, and if they meet a few other requirements.

Tax Software Hint: Follow the filing status interview tips in the Volunteer Resource Guide (Tab B) to see if the citizen spouse qualifies to file as Head of Household.

Can citizens or resident aliens who live with their nonresident alien spouse ever file as Head of Household?

There is an exception that allows U.S. citizens and resident alien spouses who live with nonresident aliens 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 and meets all the "considered unmarried" rules for Head of Household except for living with the nonresident alien spouse
- The nonresident alien spouse does not meet the Substantial Presence test
- The nonresident alien spouse does not choose to file a joint return

Assign the exercises.

Review answers with the class when complete.

EXERCISES

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 does Gloria have for 2009?

Gloria can file as either Married Filing Jointly or Married Filing Separately.

Question 2: Sgt. Raul Thomas 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

Yes, he can claim Head of Household status since his spouse is a nonresident alien who won't file a joint return with him, and he meets the other qualifications for Head of Household.

Can a taxpayer filing Head of Household who is married to and living with a nonresident alien spouse claim the Earned Income Tax Credit, if they are otherwise eligible?

No. Taxpayers who are considered unmarried for Head of Household purposes (because they are married to a nonresident alien) are still considered married for purposes of the Earned Income Credit. Taxpayers are only entitled to the credit if they file a joint return and meet the EIC qualifications.

TIP

In the Volunteer Resource Guide, turn to Tab B, Filing Status. Notate the fact that, if a spouse is a nonresident alien, the *living apart* rule does not apply to the citizen spouse. You will also find this information in Publication 17, under *Head of Household, nonresident alien*.

TIP

In this situation, the 2009 1040 Instructions say to enter "NRA" on line 4 (Head of Household status) of Form 1040. When preparing a paper return for such a nonresident alien taxpayer, also write "no" on the dotted line next to line 64a (Earned Income Credit) of Form 1040.

Personal Exemptions

Can the citizen/resident alien spouse claim the personal exemption of the nonresident alien spouse when the nonresident alien spouse does not meet the Substantial Presence test and does not choose to file a joint return?

Yes, if certain tests are met. Turn to the personal exemptions Interview Tips in the Volunteer Resource Guide under Tab C. Use the Interview Tips to see if the citizen spouse can claim the personal exemption of the nonresident alien spouse. It does not matter if the citizen spouse is filing as Married Filing Separately or as Head of Household. Make a note on step 6 that, for a nonresident alien spouse, income is defined as U.S.-sourced income only. All the other rules apply as stated. To clarify step 7, the person cannot be claimed as a dependent of another on a U.S. tax return.

example

Raul (mentioned earlier) 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 ITIN or SSN.

Ask a volunteer to read the example about Raul.

example

Major Tom Beckley is a U.S. citizen. He married Anna, a Korean citizen, in 2009, 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. Major Beckley is filing as Married Filing Separately. Anna has no U.S.-sourced income and cannot be claimed as a dependent on anyone else's U.S. tax return. She has an ITIN for now. Major Beckley can claim her personal exemption on his tax return.

Ask a volunteer to read the example about Major Tom Beckley and his wife.

TIP

When preparing a paper return for a taxpayer who is filing as Married Filing Separately, claim the exemption by checking box 6b (spouse's exemption) of Form 1040. Enter the name of the spouse in the space to the right of the box. Enter the ITIN or SSN of the spouse in the space provided at the top of Form 1040. This is where the spouse's SSN or ITIN would be entered if a joint return was being filed.

How do I enter the filing status into the tax software?

Turn to the Volunteer Resource Guide (Tab 1). Find the Main Information Sheet screen shots. Notate on the appropriate pages how to claim the nonresident alien spouse's personal exemption for each of these situations.

Find the page with the filing status section. If the taxpayer is filing as Married Filing Separately, go to the line that says Married Filing Separately and fill in the spouse's name and SSN or ITIN. Now find the Main Information Sheet screen shot that shows the dependents/nondependent section. List the spouse's name, date of birth and SSN or ITIN and write "other" in the relationship column. Enter the number of months, if any, the spouse lived in the home. Enter "3" in the code column. A "3" means all other dependents.

Direct students to the Filing Status section of the Main Information screens shown in the Volunteer Resource Guide (Tab 1).

If the taxpayer is filing as Head of Household and claiming the nonresident alien spouse's personal exemption, go to that line in the filing status section of the Main Information Sheet. Check the Head of Household box. On the Main Information Sheet, under "exemptions," check the box under 6(c) that states that you are using filing status 4 and claiming an exemption for a nonresident alien spouse. Enter the person's name and TIN in the space provided. Do not enter the person again in the dependent/nondependent section of the Main Information Sheet.

Dependency Exemptions

Can a taxpayer claim a dependency exemption for a child born overseas, a foreign-born stepchild, and/or an adopted foreign-born child?

Child born overseas to a U.S. citizen

Children born overseas to U.S. citizen parents are considered to be U.S. citizens 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 for the purpose of establishing an official record of the child's claim to U.S. citizenship at birth. Form FS-240, Consular Report of Birth, establishes official evidence that the child is a U.S. citizen.

Ask a volunteer to read the example about Sgt. Spencer and Gilberto.

example

Sgt. Patricia Spencer, a U.S. citizen, is married to Gilberto, a nonresident alien from Spain. Their daughter, Eva, was born in Spain, where they live.

Eva is entitled to U.S. citizenship. Her mother should check with the military office for information on reporting the birth of the child so Eva will be recognized as a U.S. citizen. Eva will need a social security number to be claimed as a dependent on her mother's tax return.

TIP

While applying for the Consular Report of Birth, 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 nor take advantage of credits, such as the Earned Income Tax 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?

If a child is a nonresident alien, before addressing the dependency exemption question, it is necessary to confirm the child's U.S. residency status for tax purposes. Turn to the Resident Alien or Nonresident Alien? interview tips in the Volunteer Resource Guide, (Tab C).

Read the example about Sgt. Summers.

example

Sgt. Terry Summers, a U.S. citizen, is married to a German citizen whose three children are German citizens and do not have green cards. Sgt. Summers has not adopted the children. They all live in Germany.

Follow the interview tips. The children do not have green cards and were not physically present in the U.S. during the tax year. They are nonresident aliens for tax purposes.

Now turn to the interview tips under Dependency Exemption for Qualifying Child in the Volunteer Resource Guide (Tab C). Step 6 asks, "Is the person a U.S. citizen, U.S. national, or a resident of Canada or Mexico?" The answer is "no." The children do not meet the citizenship test. Sgt. Summers cannot claim the children as dependents.

What if Sgt. Summers adopted the stepchildren?

Continuing the example above, if Sgt. Summers adopted the stepchildren and *they lived with him all year*, even though they are still not citizens of the U.S., Sgt. Summers could answer "yes" to the citizenship test. If all the other rules were met for a qualifying child or qualifying relative, he could claim the adopted nonresident alien children as dependents on his tax return. Of course, the children would have to obtain SSNs, ITINs, or ATINs to be claimed on his tax return.

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 the case of a foreign adoption when the child already possesses a green card or a certificate of citizenship (a form claiming citizenship because a child was born overseas to a U.S. citizen).

See Publication 17 under the Citizen or Resident test in Chapter 3 for more information, including who is considered a U.S. national.

TIP

An adopted nonresident alien child must live with the taxpayer all year to pass the citizen or resident alien test.

EXERCISES (continued)

Question 3: Sgt. Summers moved his family to the U.S. in January. The stepchildren are still not U.S. citizens and they do not have green cards. They met 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

Yes, the children meet the Substantial Presence test because they were in the United States more than 183 days.

He would answer "yes" to step 6, the citizen/resident test; they must also meet the requirements for qualifying child/relative and obtain SSNs or ITINs.

Question 4: Sgt. John Ramsey, a U.S. citizen who has been in the U.S. Army for 13 years, is stationed 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. Sgt. Ramsey's 12-year-old stepdaughter, a German citizen whom Sgt. Ramsey has not adopted, also lives with them. The Ramseys provide total support for the two children. How many dependency exemptions can Sgt. Ramsey claim on a joint return?

A. One

B. Two

C. Three

D. Zero

He can claim one dependency exemption (his son, a U.S. citizen); the stepdaughter does not meet the test, and a spouse is never a dependent.

Assign the exercises.

Review answers with the class when complete.

Summary

Review lesson summary with the class.

Before filing a tax return, U.S. citizens married to a spouse who is not a U.S. citizen, national, or resident alien must determine what filing status options are available and whether the noncitizen spouse will be treated as a resident alien for tax purposes or as a nonresident alien.

Resident aliens follow the same tax laws as U.S. citizens. Nonresident aliens follow another set of tax laws, most of which are outside the scope of the VITA program.

To determine the residency status of a noncitizen, use the Resident Alien or Nonresident Alien? decision tree in the Volunteer Resource Guide (Tab C).

A married couple, where a citizen or resident alien is married to a person who does not meet the Green Card or Substantial Presence test, still has the option of electing to treat the nonresident spouse as a resident alien and file as Married Filing Jointly.

If the nonresident alien spouse does not meet the Green Card or Substantial Presence tests and does not choose to file a joint return, under certain circumstances, the U.S. citizen or resident alien can file as Head of Household even though the couple lives together.

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.-sourced income
- Cannot be claimed as a dependent on someone else's U.S. tax return, and
- Has a TIN

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 who does not meet the Green Card or Substantial Presence tests cannot be claimed as a dependent of the U.S. citizen or resident alien because the child does not pass the citizenship test.

An adopted nonresident alien child can usually be claimed as a dependent of a U.S. citizen or resident alien if the child lives with the U.S. citizen the entire year.

EXERCISE ANSWERS

Answer 1: *Gloria can file as either Married Filing Jointly or Married Filing Separately. Since Dante meets the Substantial Presence test, he is a U.S. resident alien for tax purposes. He and Gloria can file as Married Filing Jointly, or they can both file as Married Filing Separately. Dante must follow the U.S. tax laws since he is considered a resident alien.*

Answer 2: *Yes. Raul can claim Head of Household status since his spouse is a nonresident alien, she does not choose to file a joint return with him, and Raul meets the other qualifications for Head of Household. If Raul had* not met *the other qualifications for Head of Household, he would have to file as Married Filing Separately.*

Answer 3: *Yes. The children meet the Substantial Presence test because they were in the United States more than 183 days. Sgt. Summers' stepchildren are considered resident aliens for tax purposes. He would answer "yes" to step 6, the citizen/resident test. As long as the other requirements for qualifying child or qualifying relative are met, Sgt. Summers can claim the stepchildren as dependents on his tax return. They have to obtain SSNs or ITINs.*

Answer 4: *A. Sgt. Ramsey can claim one dependency exemption for his son on his joint return. 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 Sgt. Ramsey may be able to take her personal exemption.*

Notes

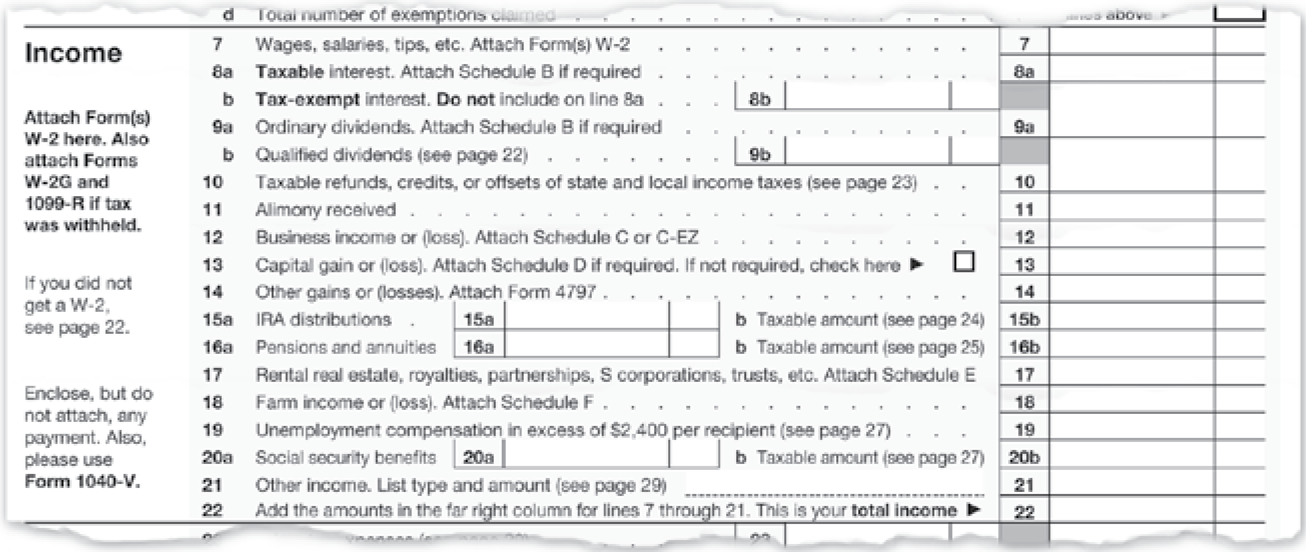
Notes

Lesson 8: Income – Wages, Interest, Etc.; Form 1040, Lines 7-11

Introduction

Instructor Notes

This is the first of nine lessons (lessons 8 through 16) 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 through 22.



	d	Total number of exemptions claimed	
Income	7	Wages, salaries, tips, etc. Attach Form(s) W-2	7
	8a	**Taxable** interest. Attach Schedule B if required	8a
	b	**Tax-exempt** interest. **Do not** include on line 8a . . . 8b	
Attach Form(s) W-2 here. Also attach Forms W-2G and 1099-R if tax was withheld.	9a	Ordinary dividends. Attach Schedule B if required	9a
	b	Qualified dividends (see page 22) . . . 9b	
	10	Taxable refunds, credits, or offsets of state and local income taxes (see page 23)	10
	11	Alimony received	11
	12	Business income or (loss). Attach Schedule C or C-EZ	12
	13	Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ ☐	13
If you did not get a W-2, see page 22.	14	Other gains or (losses). Attach Form 4797	14
	15a	IRA distributions 15a b Taxable amount (see page 24)	15b
	16a	Pensions and annuities 16a b Taxable amount (see page 25)	16b
	17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E	17
Enclose, but do not attach, any payment. Also, please use **Form 1040-V.**	18	Farm income or (loss). Attach Schedule F	18
	19	Unemployment compensation in excess of $2,400 per recipient (see page 27)	19
	20a	Social security benefits 20a b Taxable amount (see page 27)	20b
	21	Other income. List type and amount (see page 29)	21
	22	Add the amounts in the far right column for lines 7 through 21. This is your **total income** ▶	22

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 lines 7 through 11 of Form 1040

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?

☐ Approved Intake and Interview Sheet
☐ Volunteer Resource Guide
☐ Publication 17
☐ Publication 4491-W
Optional:
☐ Form 1040 Instructions
☐ Schedule B
☐ Publication 531
☐ Publication 926
☐ Publication 970

Review objectives with the class.

Point out the resources cited under **What do I need?**

Lesson	Form 1040	Topics	Certification Course				
			Basic	Intermediate	Advanced	Military	International
8	Line 7	Wages	■	■	■	■	■
8	Line 8	Interest Income	■	■	■	■	■
8	Line 9	Dividend Income	■	■	■	■	■
8	Line 10	Taxable Refunds	N/A	■	■	■	■
8	Line 11	Alimony Received	N/A	■	■	■	■
9	Line 12	Business Income	N/A	■	■	■	■
10	Line 13	Capital Gain/Loss	N/A	N/A	■	■	■
N/A	Line 14	Other Gains/Losses	N/A	N/A	N/A	N/A	N/A
11	Line 15	IRA Distributions	N/A	■*	■	■	■
11	Line 16	Pensions/Annuities	N/A	■*	■	■	■
12	Line 17	Rental Income	N/A	N/A	N/A	■	■
		Schedule K-1 Distributions	N/A	N/A	■	■	■
N/A	Line 18	Farm Income	N/A	N/A	N/A	N/A	N/A
13	Line 19	Unemployment Compensation	■	■	■	■	■
14	Line 20	Social Security Benefits	■	■	■	■	■
15	Line 21	Other Income	■	■	■	■	■
		Foreign Earned Income	N/A	N/A	N/A	N/A	■
16	Line 21	Military Income	N/A	N/A	N/A	■	■
	*Pensions/Annuities are Intermediate if the taxable amount is already determined.						

Walk through the chart to help students interpret and apply it to their certification needs.

There are income topics that are not included in the VITA/TCE training program:

- Other Gains/Losses
- Farm Income
- Dependent child under the age of 18 (age 24 if a full-time student), who has investment income of more than $1,900

Taxpayers with income from these sources should be referred to a professional tax preparer.

How are taxable and nontaxable income determined?

The income chart in the Volunteer Resource Guide (Tab D) 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., even if part or all of that income will not be taxable. Gross income may include part of unemployment compensation, part of social security benefits received, and certain scholarship and fellowship grants.

What are types of nontaxable or exempt income?

NEW Beginning in 2009, each recipient of unemployment compensation can exclude from gross income up to $2,400 of the amount received during the year.

- Nontaxable income – includes such things as gifts and inheritances. Excludible income is 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, e.g. tax-exempt interest income.

Direct students to the Income section of the Volunteer Resource Guide (Tab D).

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; business income reported on Form 1040, Schedule C, Profit or Loss From Business; Form 1040, Schedule C-EZ, or Net Profit From Business
- Unearned income – any income produced by investments, such as interest on savings, dividends on stocks, or rental income

Point out that the earned/unearned income concept will be important later in the training, especially when learning about the earned income credit.

Ask students to explain the difference between taxable and nontaxable income. Correct any misunderstanding.

How do I get started?

To determine a taxpayer's income, discuss and review the Income section of the approved intake and interview sheet with the taxpayer. Use the interview techniques and tools discussed in the Screening and Interview lesson to probe for this information.

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. (Note: Do not confuse Form 1099 with Form 1098. Generally, Form 1098 reports expenses the taxpayer has paid, not income they have received.) You may also find it useful to use page 1 of Form 1040 as a guide to address income items.

Tax Software Hint: After you have collected all the income statements, review Income and How/Where to Enter Income in the Volunteer Resource Guide (Tab 2). These pages will show you where to correctly report income items.

How do I report wages, salaries, tips, etc.?

What is Form W-2?

Refer students to Publication 4491-W for examples of Form W-2.

Most employers issue a standardized version of Form W-2. Review Form W-2 in the Volunteer Resource Guide (Tab 2).

Employers must report wages and other employee compensation on Form W-2 and have it available to the employee by January 31. The employer is not required to mail out Forms W-2, but they must make them available to the employees. The employee may need to pick up Form W-2 from their employer.

TIP

If there is a mismatch of the ITIN on the Form 1040 and the SSN on Form W-2 or Form 1099, enter the Form W2 or Form 1099 exactly as shown. Use the ITIN on Form 1040. The return can be e-filed using the ITIN.

What if the taxpayer does not receive Form W-2 by January 31?

If the taxpayer does not receive Form W-2 by January 31, they should first contact the employer and find out if, or when, Form W-2 was mailed or if the taxpayer can pick up Form W-2 in person. Some employers make Form W-2 available online to their employees as an option.

If Form W-2 is still not received after allowing a reasonable amount of time for the employer to issue or reissue Form W-2, then the taxpayer should contact the IRS for assistance at 1-800-829-1040, but not before February 15.

If, after requesting Form W-2 from the employer, the taxpayer does not receive it in sufficient time to file the return, they should file the 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. The taxpayer should keep a copy of Form 4852 for their records. Usually Form 4852 can be used with a state return as well.

TIP

You always want to stress to the taxpayer that, when they finally receive the employer's Form W-2, if the numbers are different from those on their Form 4852, they need to amend their returns to report the correct amounts.

Direct students to How/Where to Enter Income in the Volunteer Resource Guide (Tab 2).

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 (Tab 2) for instructions on entering income into the software. It is important to enter the information from Form W-2 exactly as it appears. Once you enter all Form(s) W-2 into the software, it automatically reports the total on line 7 of Form 1040. The tax software automatically

Ask a volunteer to read the Bob example.

example

In 2009, Bob left his old employer and took a job with a new one. He received two Forms W-2, each listing a different address. His return will list his wages as the total of the amounts in box 1, but each Form W-2 must be entered into the program separately.

transfers necessary information for credits, deductions, withholding, etc. from forms to other sections of the tax return.

Entering Form(s) W-2 information when preparing a paper Form 1040

- The amount in box 1 should be entered on line 7 of Form 1040.
- The amount in box 2 should be entered on line 61 of Form 1040.
- The amount in box 8 should be included on line 7 of Form 1040 and on Form 4137.
- The amount in box 9 should be included on line 59 of Form 1040 and check the box for AEIC payments.
- The amount in box 10 should be included on line 14 of Form 2441.
- If there is an amount in box 12 labeled with a "D," complete Form 8880 when you get to the nonrefundable credit section to see if the taxpayer is eligible for the retirement savings contributions credit. Other codes may impact eligibility for the Retirement Savings Contributions credit; check the reverse side of the taxpayer's copy of Form W-2.

Tip Income

If the taxpayer has a job in which tips are normally received (i.e. waiter/waitress, bellhop, motel maid, etc.), be sure to ask about any tips they may have received. All tip income is taxable, whether it is reported to the employer or not.

- If individuals who receive more than $20 per month in tips, while working one job, report their tip income to their employer, the tips will be included in wages on Form W-2, box 1.
- The individual is not required to report tip income of $20 or less per month while working for one employer. Since these tips are taxable, ask taxpayers if they have any tip income that was not reported to their employer.
- Noncash tips (for example, tickets or passes) do not have to be reported to the employer, but must be included as taxable income at their fair market value.
- Any tip income not reported to the employer is added to other amounts on line 7 of Form 1040.
- If tips were more than $20 a month, the taxpayer must also pay Medicare and social security taxes on this money. If these were reported to the employer, then they are included in boxes 6 and 7 of Form W-2. If they were not reported to the employer, then complete Form 4137 for the taxpayer.
- Tips of less than $20 per month or noncash tips must be reported as income on line 7 of Form 1040, but are not subject to social security and Medicare taxes.

Direct students to the Volunteer Resource Guide, (Tab 2), How to Enter Unreported Tips.

Information on how to report unreported tips and pay social security and Medicare taxes on qualifying unreported tips is covered in the Other Taxes lesson. Also, the Volunteer Resource Guide (Tab 2) provides detailed information on how to enter unreported tips.

Allocated Tips

For some businesses, giving employees tips is customary. These businesses include restaurants, bars, and similar businesses. 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 box 8 of Form W-2. Social security and Medicare taxes are not withheld on allocated tips. Allocated tips are not included in the amount in box 1 of Form W-2. Explain to the taxpayer that unless the taxpayer 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 line 7 of Form 1040. If the taxpayer did keep a reliable written record of tips, then their figures are used in place of the amount in box 8 when including tip income on line 7 of Form 1040.

Tax Software Hint: When allocated tips are reported in box 8 of Form W-2, the software automatically adds them to line 7 of Form 1040 and also completes Form 4137. If this amount is not correct, based on the taxpayer's records, an adjustment will need to be made on Form 4137.

Allocated tips are also subject to social security and Medicare taxes. Report the allocated tip amount on Form 4137, along with any unreported tips to calculate social security and Medicare taxes.

TIP

For more information about tip income, see Publication 531, Reporting Tip Income.

Other W-2 Income

Emphasize that the volunteer tax preparers will correctly determine this income only by interviewing the taxpayer and noting it on the intake sheet.

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, if a taxpayer, working as a household employee, earned less than $1,700 a year while working in the employer's home, the employer is not required to provide the taxpayer with Form W-2 and no social security or Medicare taxes are owed. Regardless whether Form W-2 is issued, the income must be included on Form 1040, line 7. However, if the employer withheld federal income taxes from the taxpayer's wages, the employer must issue Form W-2.

If you are preparing a paper return and the taxpayer's household employer is not required to issue Form W-2, enter "HSH" and the amount on the dotted line next to line 7, then include the amount in the total on line 7.

TIP

For further information and a definition of who is a household employee, see Publication 926, Household Employers Tax Guide.

Are scholarships and fellowships taxable income?

Form W-2 and Form 1098-T

Scholarships and fellowships may be fully, partially, or non-taxable. 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 just as you would for any other Form W-2. This income is included in the total on line 7 of Form 1040.

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.

To determine if any scholarship or grant received is taxable, or to determine if the taxpayer can claim an education credit, see Publication 970, Tax Benefits for Education. Education credits will be discussed in a later lesson.

Review these points to check student understanding.

Tax Software Hint: After asking questions about the scholarship/fellowship money, record the taxable portion in the software. See the Volunteer Resource Guide (Tab 2) for guidance on where to enter the income.

When preparing a paper return, if the taxpayer did not receive Form W-2 for the scholarship or fellowship, report the taxable portion of the scholarship or fellowship on line 7 of Form 1040. Write “SCH” and the amount on the dotted line next to line 7 of Form 1040 and include the amount in the total for line 7.

Are distributions from Educational Savings Accounts, such as a Coverdell ESA and a 529 plan, taxable?

Coverdell ESA (section 530 plan) and Qualified Tuition Program (section 529 plan) are educational savings accounts that include the following provisions:

- Money is contributed to a special account.
- The contribution is never deductible.
- Earnings on the after-tax contributions become tax-deferred.

When a distribution is made, none of the money will be taxable as long as it is a qualified distribution. If it is not used for qualified education expenses, some of the money that was never taxed (the earnings) becomes taxable income and may be subject to an extra penalty tax.

NEW Effective for 2009, qualified education expenses include 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.

Distributions from Educational Savings Accounts and Qualified Tuition Programs (under Sections 529 and 530) are reported on Form 1099-Q. Coverdell ESA distributions can be used to pay for qualified elementary, secondary, and postsecondary expenses. Qualified Tuition Program (QTP) plan distributions can only be used to pay qualified postsecondary expenses.

Additional information about educational savings accounts, distributions, and qualified education expenses can be found in Publication 970, Tax Benefits for Education.

Tax Software Hint: Form 1099-Q is not available in the software because the form does not contain enough information to determine how much, if any, of the distribution is taxable.

Ask the taxpayer if all the funds were used for qualified educational expenses. (Qualified educational expenses have different requirements for each plan.) If yes, none of the distribution is taxable. You do not report anything on the return.

TIP

A choice can be made to report the taxable part of the distribution (if any) and claim the Hope or Lifetime Learning Credit on the whole distribution. See Publication 17 and Publication 970, Tax Benefits for Education, for more details.

Review the circumstances that require referring a taxpayer to a professional tax preparer.

Refer the taxpayer/beneficiary to a professional tax preparer if:

- The funds were not used for qualified education expenses or
- The distribution was more than the amount of the qualified expenses

What interest is taxable?

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.

TIP

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.

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.

Original Issue Discount (OID), long-term obligations that pay no interest before maturity, are considered to be issued at a discount and are fully taxable.

If the taxpayer cashed in Series EE or Series I bonds, they should have a form 1099-INT from the bank. Most taxpayers don’t report savings bond interest as it accrues every year. They report the total interest when they cash the bonds. If the taxpayer says they have been reporting the interest as it accrues each year, see Publication 17 under Interest Income for directions to report the current year interest.

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 under Interest Income.

- If the taxpayer has Series HH bonds, they 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.

TIP

Interest on qualified U.S. Series EE and Series I savings bonds that is used to pay for higher education expenses may be eligible for exclusion from income using Form 8815, Exclusion of Interest From Series EE and I U.S. Savings Bonds Issued After 1989.

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. Bob reports that interest on Schedule B of his tax return.

Ask a volunteer to read the Bob example.

What interest income is tax-exempt?

TIP

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.

Certain types of interest are exempt from federal income tax. However, they may be taxable by the state, so read the form carefully. (And sometimes the reverse is true, some 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

Emphasize that the gain/loss from sale of these bonds is taxable.

The taxpayer's Form(s) 1099-INT may list both taxable and tax-exempt interest. Read the form(s) carefully. Sometimes interest from Private Activity Bonds (PAB) is shown on the statement with tax-exempt interest and must be included.

Although tax-exempt interest is not taxable, the taxpayer must report all tax-exempt interest on the tax return on line 8b of form 1040. In some situations, tax-exempt interest, while not taxable, is used in calculating the taxability of other income items, such as social security income.

What about the interest on an IRA?

Interest on a Roth IRA is generally never taxable.

Interest on a traditional IRA is tax deferred. Do not include that interest until the taxpayer makes withdrawals from the IRA. The taxpayer will be issued a Form 1099-R to report a distribution. See the lesson on Retirement income for the proper way to report this income.

See Publication 17 and Publication 590 for more information on IRAs.

Ask a volunteer to read the Mike example.

example

Mike holds municipal bonds issued in his state, as well as a traditional IRA to which he makes contributions each year. For each of these, he gets statements listing the interest earned. Although not taxable, Mike reports his tax-exempt interest from the municipal bonds on line 8b of his Form 1040. He does not report any of the interest income on his traditional IRA on his tax return.

Direct students to How/Where to Enter Income in the Volunteer Resource Guide (Tab 2).

How do I report the interest income?

Tax Software Hint: Refer to the Volunteer Resource Guide (Tab 2), How/Where to Enter Income, for instructions on entering interest income in the Interest Statement.

NEW Effective for the 2009 tax year, Form 1040A, Schedule 1, Interest and Ordinary Dividends, is obsolete. Form 1040A taxpayers will use Form 1040, Schedule B.

If preparing a paper return, first complete Schedule B, Part I, if the taxpayer has any of the following:

- Over $1500 of taxable interest
- Nominee interest (taxpayer is nominee for interest that actually belongs to someone else)
- A seller-financed mortgage
- Tax-exempt interest
- A distribution from a foreign trust or foreign bank account
- Educational savings bond exclusion

Otherwise, you would enter the interest income directly on Form 1040, page 1, line 8a or line 8b or Form 1040A, line 8a or 8b. Amounts in Form 1099-INT, boxes 1 and 3, are reported as taxable interest, and box 8 is reported as tax-exempt interest. Be sure that any other entries on the Form 1099-INT are entered in their proper places on Form 1040, e.g. box 2 goes in the Adjustments section, box 4 goes in the Payments section, and box 6 goes in the Credits section. If any other boxes contain amounts, refer the taxpayer to a professional tax preparer.

Tax Software Hint: Regardless of the amount, when entering interest income, use the Interest Statement as shown in the Volunteer Resource Guide (Tab 2).

Taxpayer Interview and Tax Law Application

Ask two volunteers to role-play the sample interview.

Direct the class to listen and complete Part IV of the approved intake and interview sheet.

Barbara Smith is a window 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!
Let me enter your Form W-2 information… *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.
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 in 2009, or did any of them mature that 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. Let's enter that now. [On page 2 of the approved intake and interview sheet, indicate Barbara's responses to these questions.]	

How do I handle dividends?

The corporate distributions that volunteer tax preparers may handle are:

- Ordinary dividends
- Qualified dividends and distributions
- Capital gain distributions

These are all found on Form 1099-DIV.

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 in box 1a of Form 1099-DIV.

Ask a volunteer to read the Robert example.

example

Robert held both common stock and preferred stock in several U.S. corporations. Several of them paid dividends during 2009. In January 2010 he received Forms 1099-DIV listing these as ordinary dividends.

What are qualified dividends?

Qualified dividends are ordinary dividends that are eligible for a lower tax rate than other ordinary income. They are shown in box 1b of Form 1099-DIV.

See Form 1040 Instructions, Line 9b, for the 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 in box 2a of Form 1099-DIV.

TIP

“Capital gains” and “Capital gain distributions” are not the same. A capital gain occurs when the owner of a mutual fund or other capital asset sells the asset for more than the cost and realizes a capital gain. A capital gain *distribution* is the owner’s portion of the capital gains realized when the mutual fund or REIT sells assets. If the taxpayer has actually sold their mutual fund shares, or other shares of stock, and you are not certified in this area, you should refer them to a VITA/TCE preparer who has been trained to handle capital gains and losses.

Ask a volunteer to read the Robert example.

example

During 2009, Robert owned shares in a mutual fund and in a real estate investment trust. Both made capital gain distributions that year. In January 2010, he received Forms 1099-DIV listing these capital gain distributions.

Review examples of Form 1099-Div in Publication 4491-W. Point out where ordinary, qualified, and capital gain distributions are found.

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 taxpayer did not receive a Form 1099-DIV for a dividend, ask if they received the information on their shareholder’s annual brokerage statement.)

How do I report dividend information?

Generally, all dividend income is reported on these forms:

- Form 1040A, lines 9a and 9b
- Form 1040, lines 9a and 9b

Schedule B is needed if the taxpayer's ordinary dividends are greater than $1,500, or if the taxpayer was the nominee for dividends that actually belong to someone else.

Tax Software Hint: Look at the Volunteer Resource Guide (Tab 2). Find How/Where to Enter Income. Follow the guidance for entering interest and/or dividend income on Schedule B. If the taxpayer has multiple accounts, the software adds all the dividends for you, preventing math errors. Also, correct use of the worksheet ensures that the income will be taxed correctly and that other entries from Form 1099-DIV will be distributed to the proper locations on the return.

If you are preparing a paper return, be sure the amounts in boxes 1a and 1b of Form 1099-DIV are recorded on the correct lines on the return. Be sure that any other entries on the Form 1099-DIV are entered in their proper places on the Form 1040, e.g. box 2a goes on the Capital Gain line in the Income section unless a Schedule D is required, box 4 goes in the Payments section, and box 6 goes in the Credits section. If any other boxes contain amounts, refer the taxpayer to a professional tax preparer.

If the taxpayer has received a qualified dividend or capital gains distribution, and you are preparing a paper return, the Qualified Dividends and Capital Gain Tax Worksheet is required. The worksheet can be found in Form 1040 Instructions.

Taxpayer Interview and Tax Law Application

Ask two volunteers to role-play the sample interview.

Leonard Stark, Gloria's spouse, is self-employed. They 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. Are these the only Forms 1099-DIV that you received?	Yes.
We will enter the information from each of these on the Dividend Statement. It will add everything up and display it as your dividend income. [On page 2 of the approved intake and interview sheet, indicate Leonard's responses to these questions.]	

What should be reported on line 10 of Form 1040?

Only volunteers certifying at the intermediate level or above are required to cover this topic. If you are teaching a Basic only class, skip to page 8-15 for Vanessa Franklin Practice. Upon completion, proceed to Lesson 13, Unemployment Compensation.

Taxpayers who receive a refund of state or local income taxes may receive Form 1099-G listing their refund amount in box 2. 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

Advise the students they will learn about standard and itemized deductions later in this course.

Only those taxpayers who itemized deductions and received a tax benefit for deducting their state or local income taxes have to include their state/local tax refunds in income. If they itemized deductions and deducted the state sales tax instead of the state income tax withheld, none of the refund is taxable.

Ask a volunteer to read the Bob example.

example

Bob itemized his deductions on his 2008 federal return. He included the taxes he had paid to his state during 2008. However, he received a refund in 2009 on the overpaid portion of those taxes. He must use the state tax refund worksheet to see how much of the refund to include in his federal taxable income.

Tax Software Hint: Refer to the Volunteer Resource Guide (Tab 2) for guidance on entering the state tax refund received in a prior year. The software then calculates the taxable part of the refund (if any) on line 10 of Form 1040.

When preparing a paper return, complete the State and Local Income Tax Refund Worksheet in Form 1040 Instructions when required.

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.

TIP

If the taxpayer is unsure whether a payment is alimony or child support, ask if the payments will stop once the child is grown.

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 payer, and the two amounts must agree.

TIP

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.

How do I report alimony?

Tax Software Hint: On line 11, enter the alimony amount. There is no worksheet for reporting alimony income, and the social security number of the person paying the alimony is not needed.

When preparing a paper return, record the alimony received by the taxpayer on Form 1040, line 11.

Practice – Vanessa Franklin

Our volunteer is working with our taxpayer, Vanessa Franklin. Go to Appendix A-12 and review the sample interview to identify Vanessa's wage and interest income.

Direct students to Appendix A-12.

Summary

This lesson covered some general concepts on income for lines 7-11 of Form 1040 including how to determine what is considered taxable and nontaxable income. Review the list of taxable and nontaxable income in the Volunteer Resource Guide (Tab D), Income.

Review lesson summary with the class.

How to determine what income is considered earned and unearned was covered. Earned income is any income accumulated by personal effort, such as wages or business income reported on Schedules C or C-EZ. Unearned income is any income produced by investments, such as interest on savings, dividends on stock, etc.

How to report income was also covered. Following is information on how to report income on Lines 7-11 of Form 1040.

- Line 7 income includes wages, salaries and tips, and scholarships. This income is generally reported to the taxpayer on Form W-2.
- Lines 8a and 8b, interest income, is reported to the taxpayer on Form 1099-INT. Common sources of taxable interest income are checking and savings accounts, certificates of deposit (CDs), savings certificates, U.S. government bonds, etc. Interest on certain bonds (such as from state political subdivisions, District of Columbia, port authorities, etc.) are exempt from federal income tax, but must be reported on line 8b.
- Lines 9a and 9b 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 are eligible for a lower tax rate than other ordinary income.

- Line 10 is for taxpayers who itemized deductions in the previous year and received a tax benefit from deducting their state or local income taxes. Taxpayers who receive Form 1099-G may have to include part or all of their state refund on this line.
- Line 11 is used to report alimony received. Alimony is a payment to or for a spouse or former spouse under a separation or divorce instrument.

Assign the workbook exercise and review as a class when done (optional).

TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem, practice exercise(s), or supplements 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.

Notes

Lesson 9: Income – Business; Form 1040, Line 12

Introduction

This lesson will help you assist taxpayers who have business income, including self-employment income. Business income or loss is reported on Schedule C-EZ, Net Profit From Business, or Schedule C, Profit or Loss From Business. Schedule C is out of scope for volunteer preparers. The lesson also covers those self-employed taxpayers who pay self-employment tax and participate in the social security and Medicare programs.

Objectives

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

- How to report business income
- Who can use Schedule C-EZ
- How to complete Schedule C-EZ

What do I need?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 17
- ☐ Publication 463
- ☐ Publication 4491-W
- ☐ Form 1099-MISC
- ☐ Schedule C-EZ
- ☐ Schedule SE

Instructor Notes

Review objectives with the class.

Point out the resources cited under **What do I need?**

Where do I get business income or loss information?

Based on your interview and the completion of the taxpayer's approved intake and interview sheet, you may discover that the taxpayer or spouse had business income; this includes income as a self-employed person or independent contractor.

Even if taxpayers say they did not have self-employment income, be sure to ask again, rephrasing your questions to probe deeper. Many taxpayers have jobs on the side or have a small home-based business and do not think of themselves as "self-employed" if they make most of their money from W-2 wages.

Ask for any Form(s) 1099-MISC that document this income. Also ask for documentation of any business income that was not reported on Form W-2 or Form 1099-MISC (for example, check stubs generated by the taxpayer's client).

CAUTION

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.

Refer students to Publication 4491-W for examples of Form 1099-MISC.

How is business income reported?

Business income is reported on either:

- Schedule C-EZ, Net Profit From Business, or
- Schedule C, Profit or Loss From Business

The total profit or loss is then transferred to Form 1040, line 12.

If preparing a paper return, complete the items on Schedule C-EZ. The net profit 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.

Volunteer tax preparers who complete this lesson may, at the discretion of the site coordinator, assist self-employed individuals who qualify to use Schedule C-EZ. Taxpayers who must file Schedule C should see a professional tax preparer.

Who can use Schedule C-EZ?

There are a number of conditions that the taxpayer 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
- Have positive net income (do not have a net loss)
- Operate only one business as a sole proprietor during the tax year
- Have no employees during the year
- Are not required to compute depreciation (Form 4562)
- Do not deduct expenses for business use of a home
- Do not have prior year unallowed passive activity losses from this business

Emphasize that before starting to prepare the return, the volunteer must determine if the business qualifies to be reported on Schedule C-EZ. This means estimating business income and expenses.

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.
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 taxpayer has such a cost, they should be referred to a professional tax preparer.

In your probing interview, explain that there are a number of conditions that the taxpayer must meet in order to use Schedule C-EZ, and then walk through each of these conditions with the taxpayer. If taxpayers do not meet these conditions, explain that volunteers are not trained to handle the preparation of Schedule C. Apologize for being unable to complete the return, and explain that they should seek help from a professional tax preparer to complete their return.

Taxpayer Interview and Tax Law Application

Ask two volunteers to role-play the sample interview. Ask the rest of the class to listen and take notes.

As you use the approved 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...
What kind of business do you have and were you the sole owner?	I install air conditioners and yes, I own the business myself. No partners or anything.
Do you have a record of your business income and expenses for last year?	Yeah, I've got a separate checking account for my business. I had a pretty decent first year actually.
Do you use the cash method of accounting?	Yes. I have a printout of my year-end summary here.
And what were your expenses?	Well, I do the installations myself; I don't have any employees, so I spend a lot of money on gas, tools that last less than a year and equipment repairs. My expenses for the year were $2,212.
Do you keep any parts in inventory?	No, I purchase the parts wholesale when an order is placed with me.
And you say you had a good year? Did you have a net loss? In other words, did you make a profit?	That's correct. No losses.
Do you plan on deducting expenses for the business use of your home?	No I don't.
Okay, and how much business income did you have? [On page 2 of the approved intake and interview sheet, indicate Jason's responses to these questions.]	My receipts totaled $30,762.

EXERCISE

Question 1: Based on this information, does Jason qualify to fill out a Schedule C-EZ? ☑ **Yes** ☐ No

Yes. Jason meets all requirements for using Schedule C-EZ.

Assign the exercise.

Review the answer with the class when complete.

How do I complete Schedule C-EZ?

Direct students to follow along in the Volunteer Resource Guide (Tab 2) on the page titled Schedule C-EZ Business Income.

Part I: General Information

Enter the type of business on line A. Enter the Principal Business Code on line B. A listing of Principal Business Codes can be found in Schedule C Instructions and in Form 1040 Instructions.

Tax Software Hint: To find Principal Business Codes, bring up the Help screen while in the Schedule C-EZ. A list is available under Business Codes.

Enter the business name, if there is one, on line C. If the business has an Employer Identification Number (EIN), enter it on line D (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 on line E.

Part II: Figure Net Profit

Enter total gross receipts on line 1. This includes all the income paid to the business, whether or not it was reported on a Form 1099-MISC. If any of the income was reported on Form W-2 and the "Statutory employee" box on the form was checked, check the box on line 1 of Schedule C-EZ.

If preparing a paper return, total all income from Form 1099-MISC and other taxpayer records and enter the amount on Schedule C-EZ, line 1.

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 these expenses include advertising, car and truck expenses, commissions and fees, insurance, interest, legal and professional services, office expense, 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.

Ask a volunteer to read the Kiana example.

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.

If preparing a paper return, total all the deductible business expenses including auto expenses, calculated by using the standard mileage rate. Record the amount on Schedule C-EZ, line 2. Calculate the net profit by subtracting line 2 from line 1. The net profit is reported on Form 1040, line 12.

Tax Software Hint: Refer to the Volunteer Resource Guide (Tab 2) for guidance on entering expenses on the Schedule C-EZ. The tax software will total all the expenses and transfer the total 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 the business location and the lunch place. 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 employment, only the travel from one temporary place to another is counted. See Publication 463, Travel, Entertainment, Gift, and Car Expenses (Chapter 4) for more details.

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 program. If the taxpayer has used actual expenses in the past, or wishes to use actual expenses in the current year, they must be referred to a professional tax preparer.

The standard mileage rate (.55/mile for 2009) is multiplied by the number of business miles to calculate the vehicle expense. Add the total vehicle expenses to all non-vehicle expenses in line 2.

Complete the information in Schedule C-EZ, Part III.

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, line 56, to be added to other taxes owed. The Schedule SE is attached to Form 1040, and discussed in Lesson 28, Other Taxes.

Self-employed people may claim an adjustment to income of half of the social security and Medicare taxes they pay. Enter the amount from Schedule SE, line 6, to Form 1040, line 27, as an adjustment to income.

Refer students to Publication 4491-W for an example of Schedule SE.

Practice – Vanessa Franklin

Recall that our taxpayer, Vanessa Franklin, is an employee but she also has her own cosmetics business. Go to Appendix A-14 to gather more information about her self-employment income.

Direct students to Appendix A-14.

Summary

This lesson explained:

- Where to get business income and loss information
- How business income or loss is reported
- Who can use Schedule C-EZ
- How to complete Schedule C-EZ

Review the lesson summary with the class.

Assign the workbook exercise and review as a class when done (optional).

TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem, practice exercise(s), or supplements 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 ANSWER

Answer 1: *Yes. Jason meets all requirements to qualify for completing Schedule C-EZ.*

Notes

Lesson 10: Income – Capital Gain or Loss; Form 1040, Line 13

Instructor Notes

Introduction

This lesson will help you assist taxpayers who must use Schedule D, Capital Gains and Losses, to report capital gains and/or losses on the sale of assets. In this lesson we will discuss the sale of stock, mutual funds, and the sale of a personal residence. If the taxpayer has sold any other assets refer him/her 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.

To determine if the taxpayer must report the sale of investments or the sale of a home, use the interview techniques and tools discussed in the lesson, Screening and Interviewing. The approved intake and interview sheet lists income from the sale of property such as stock, bonds, or real estate. It is important to ensure that all income is accurately reported on the return. Ask taxpayers if they sold any stock, securities, other investment property, or a home during the tax year.

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 523, Selling Your Home, and Publication 4681, Canceled Debts, Foreclosures, Repossessions, and Abandonments.

Objectives

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

- Determine the adjusted basis of stock
- Determine if the asset's holding period is long-term or short-term
- Calculate the taxable gain or deductible loss from the sale of stock
- 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
- Determine if a taxpayer can exclude debt forgiven or canceled on their principal residence from taxable income

Review objectives with the class.

Point out the resources cited under **What do I need?**

What do I need?

☐ Approved Intake and Interview Sheet
☐ Volunteer Resource Guide
☐ Publication 17
☐ Publication 4491-W

Optional:

☐ Publication 523
☐ Publication 525
☐ Publication 544
☐ Publication 551
☐ Publication 564
☐ Publication 4681
☐ Publication 4731
☐ Form 982
☐ Form 1040 Instructions
☐ Form 1040 (Schedule D)
☐ Form 1099-A
☐ Form 1099-B
☐ Form 1099-C
☐ Form 1099-DIV
☐ Form 1099-S

What information must I have to report a capital gain or loss?

To report capital gain or loss on Form 1040, Schedule D, 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, major improvements, etc.)
- 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
- Proceeds from the sale:
  - Form 1099-B reflects gross or net proceeds for a stock or mutual funds
  - Form 1099-S usually reflects gross proceeds of real estate transactions
  - Other evidence in the absence of the above

Tax Software Hint: To review information related to the software, go to the Volunteer Resource Guide (Tab 2), How/Where to Enter Income and Capital Gain or Loss Transactions Worksheet.

What is the basis of stock?

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 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 employee stock option plan (ESOP), and does not know the basis of the stock, you will need to 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.

Events after the purchase of stock can require adjustments (increases or decreases) to the per share basis of stock.

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.
- Stock splits are decided by the corporation as a way to bring down the market price of stock. A two for one stock split will decrease the basis per share by half. 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.

TIP

Although stock splits and stock dividends do not occur often, always ask taxpayers if they received any additional shares from a stock split or stock dividend.

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 564, Mutual Fund Distributions.

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 ($1,100/100). 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 ($1,100/110).

Ask a volunteer to read the Alice example. Answer any student questions.

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. It is beyond the scope of VITA/TCE.

- Inherited Property – The basis of inherited property 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 basis of the inherited property is determined by a method other than the FMV of the property on the date of the decedent's death, it is beyond the scope of VITA/TCE. The taxpayer will need to be referred to a professional tax preparer.

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.

How do I determine the holding period?

Long-Term or Short-Term

Schedule D requires entries for the stock purchase and sale date. Taxpayers must provide the date the stock was acquired and Form 1099-B will indicate the date the stock was sold. These two dates will determine the holding period. Schedule D classifies capital gains and losses as 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
- Stock held for more than one year has a long-term holding period

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 low long the property is held.

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.

Ask a volunteer to read the Erma example. Answer any student questions.

example

Erma bought stock on January 11, 2008 (trade date). Her holding period began the next day, January 12, 2008. If she sold that stock on January 11, 2009, she would own the stock exactly one year, and the holding period would be short-term. However, if she sold the stock on January 12, 2009 or later, the holding period would be one year and one day, which constitutes long-term.

Ask a volunteer to read the Lenny example. Answer any student questions.

example

On February 18, 2003, Lenny bought 500 shares of XYZ Corporation stock for $1,500, including his broker's commission. On April 6, 2009, XYZ distributed a 2% nontaxable stock dividend (10 shares). Three days later, 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. Some of these issues and transactions, such as like-kind exchanges, wash sales, and worthless securities can be complex. Refer taxpayers with these issues to a professional tax preparer.

> **TIP**
>
> In general, a wash sale occurs when a taxpayer sells or otherwise disposes of stock or securities (including a contract or option to acquire or sell stock or securities) at a loss and, within 30 days before or after the sale or disposition the taxpayer buys, acquires, or enters into a contract or option to acquire substantially identical stock or securities.

Mutual Funds

A mutual fund is a regulated investment company generally created by "pooling" funds of investors, which allows investors to take 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 capital gains distributions from sales of stock held by the mutual fund. Profits of these sales are reported to the shareholders of the fund as capital gains distributions. If taxpayers (owners) decide to sell any of their shares in the mutual fund itself, then 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 Form 1040, Schedule D.

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. Therefore, figuring the basis can be more difficult. 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 sell or exchange of mutual fund shares, refer to Publication 564.

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." If the taxpayer does not do this, the shares sold are treated as coming from the earliest block purchased (FIFO method – or First In, First Out). To be valid, the specification must be made before or at the time of sale, **not** after the sale.

Ask a volunteer to read the Marie example.

example

In 1998, Marie bought 100 shares of Antrim Corporation stock for $2,000. In 1999, she bought another 100 shares of Antrim for $2,300. In 2009, 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 bought in 1999, 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. If boxes 3, 9, 10, 11, or 12 have entries, refer the taxpayer to a professional tax preparer. To see a copy of Form 1099-B, refer to the Advanced Comprehensive problem for Kent in Publication 4491-W.

Sales Date

In box 1 on Form 1099-B, the stockbroker reports the date the stock was sold. Use this date, along with the purchase date provided by the taxpayer, to determine the holding period.

Sales Price

In box 2 on Form 1099-B, the stockbroker reports the sales price of the stock, and checks a box to indicate if the amount in box 2 is gross proceeds or net proceeds:

- If Gross proceeds is checked, ask the taxpayer for the amount of commissions/fees paid and add it to the taxpayer's basis
- If gross proceeds less commissions and option premiums (net proceeds) is checked, the broker already subtracted the commissions and fees from the proceeds

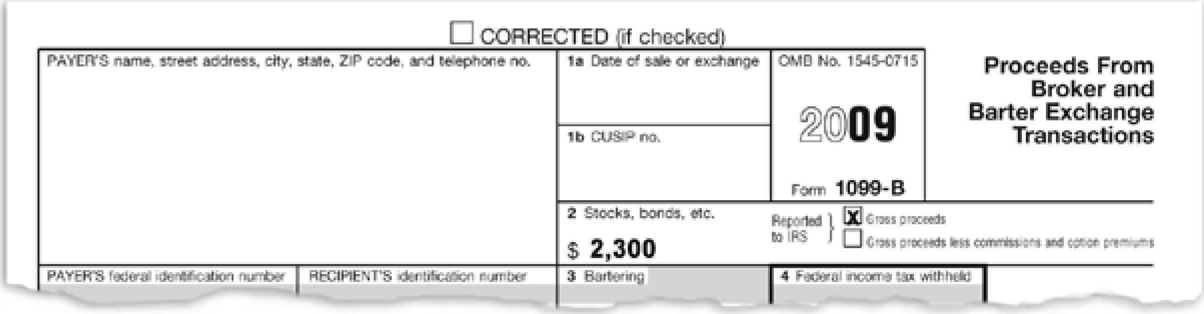
Ask a volunteer to read the Richard example. Answer any student questions.

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 the gross proceeds, so:

- Box 2 of Form 1099-B showed $2,300
- The box next to "Gross proceeds" is checked

Because box 2 shows *gross* proceeds, you need to add the broker's commissions and fees ($35) to Richard's basis in the stock.



☐ CORRECTED (if checked)

PAYER'S name, street address, city, state, ZIP code, and telephone no.

1a Date of sale or exchange

1b CUSIP no.

OMB No. 1545-0715

2009

Form 1099-B

Proceeds From Broker and Barter Exchange Transactions

2 Stocks, bonds, etc.

$ 2,300

Reported to IRS ☒ Gross proceeds

☐ Gross proceeds less commissions and option premiums

PAYER'S federal identification number

RECIPIENT'S identification number

3 Bartering

4 Federal income tax withheld

If preparing a paper return, add the broker's commission and fees ($35) to the basis and enter the total in column e in Part I or Part II of Form 1040, Schedule D.

Tax Software Hint: You will need to add the broker's commissions and fees ($35) to Richard's basis in the stock before entering the amount on the Capital Gain or Loss Transactions Worksheet. To review information related to the software, go to the Volunteer Resource Guide (Tab 2).

EXERCISES

Answers are after the lesson summary.

Question 1: Kevin paid his broker a $75 fee on the sale of his stock. Box 2 of his Form 1099-B shows $925, and the box next to "Gross proceeds" is checked. What is the amount Kevin reports as his sales price on Schedule D?

A. $925

B. $1,000

C. $850

D. $75

You never adjust the sales price. If box 2 shows gross proceeds, you need to add the broker's fee to the basis or purchase price of the stock.

Assign the exercise.

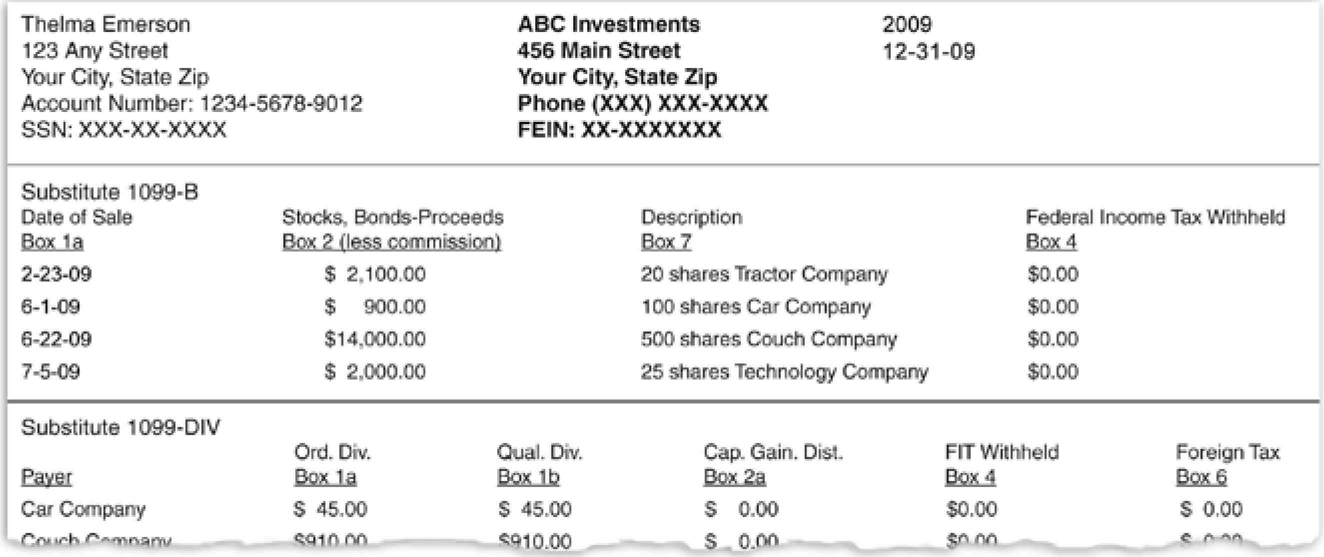
Review answer with the class when complete.

Other Information

Form 1099-B does 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 you with the information.

TIP

Some brokers do not issue standard Forms 1099-B. Instead they issue a statement, sometimes entitled a "1099 Consolidated Statement," which shows stock sales and other types of distributions, such as dividends and interest. The tax reporting statement is sometimes referred to as a "Substitute 1099."



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2009
12-31-09

Substitute 1099-B

Date of Sale Box 1a	Stocks, Bonds-Proceeds Box 2 (less commission)	Description Box 7	Federal Income Tax Withheld Box 4
2-23-09	$ 2,100.00	20 shares Tractor Company	$0.00
6-1-09	$ 900.00	100 shares Car Company	$0.00
6-22-09	$14,000.00	500 shares Couch Company	$0.00
7-5-09	$ 2,000.00	25 shares Technology Company	$0.00

Substitute 1099-DIV

Payer	Ord. Div. Box 1a	Qual. Div. Box 1b	Cap. Gain. Dist. Box 2a	FIT Withheld Box 4	Foreign Tax Box 6
Car Company	$ 45.00	$ 45.00	$ 0.00	$0.00	$ 0.00
Couch Company	$910.00	$910.00	$ 0.00	$0.00	$ 0.00

How do I enter data on Schedule D, Parts I and II?

Information from Form 1099-B is entered on Schedule D. Part I is for short-term sales and Part II is for long-term sales.

Tax Software Hint: To review information related to the software, go to the Volunteer Resource Guide (Tab 2), Capital Gain or Loss Transactions Worksheet.

When preparing a paper return, determine the holding period for each block of stock sold. This will indicate whether the sale should be reported in Schedule D Part I (short term) or Part II (long term). Record the information on each sale in columns a-e and calculate the gain or loss for column f.

How do I report capital gain distributions?

Capital gains distributions are reported to the taxpayer on Form 1099-DIV. If there are no capital gains from the sale of property, the Form 1099-DIV amount is entered on Line 13 of Form 1040.

If a taxpayer has both a 1099-DIV *and* a Form 1099-B, then capital gains distributions are added to Schedule D in Part II, Line 13.

Assign the exercise.

Review answer with the class when complete.

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

Only Marriah sold stock and received Form 1099-B.

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 Statement for Schedule B (along with the other information) and will automatically carry over to the capital gain distributions line (Line 13) in Part II of Schedule D.

Ask a volunteer to read the Eldridge example. Answer any student questions.

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 a net sales price of $1,200 on the sale of 600 shares of ABC Group, Inc. He bought the stock on February 19, 2004, and sold it on August 25, 2009. 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?

Combining all the amounts in column f on Schedule D, Part I, results in a net short-term capital gain or loss. Combining all the amounts in column f 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:

Basis = ($15,000 ÷ 1,000) x 600 = $9,000

Sales Price = $7,800

Gain or Loss = Sales Price – Basis = $7,800 - $9,000 = -$1,200

Bill had a short-term loss of $1,200.

Ask a volunteer to read the Bill example. Answer any student questions.

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 gross proceeds of $2,000 as the sales price.

Basis = ($1,500 + $25 + $25) = $1,550

Sales Price = $2,000

Gain or Loss = Sales Price – Basis = $2,000 - $1,550 = $450

Margo had a long-term gain of $450.

Ask a volunteer to read the Margo example. Answer any student questions.

EXERCISES (continued)

Question 3: Stella's cost basis for 600 shares of KLM Corporation stock she purchased in June 2003 and sold in March 2009 was $2,400. Stella sold the 600 shares for $4,400 and paid a $100 commission. Her broker reported the gross proceeds of $4,400 on Form 1099-B. What was the sales price for the shares and the amount of capital gain?

A. $4,400 sales price and $2,000 gain

B. $4,400 sales price and $1,900 gain

C. $4,500 sales price and $2,100 gain

D. $4,300 sales price and $1,900 gain

The sales price was $4,400, which was $1,900 more than the adjusted basis of $2,500 ($2,400 cost + $100 commission) of the shares.

Assign the exercise.

Review answer with the class when complete.

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. The carryover losses are combined with the gains and losses that actually occur in the next year.

Capital Loss Carryover Worksheet

To figure any capital loss carryover from 2008 to 2009, use the Capital Loss Carryover Worksheet from the 2009 Schedule D instructions. To complete the worksheet, you will need information from the 2008 return.

If tax software was used to prepare the 2008 return, ask the taxpayer for a copy of the software's Schedule D Worksheet 2 (Capital Loss Carryovers from This Year to Next Year) to determine the carryover amounts from 2008 to 2009.

- Enter short-term capital loss carryovers (from Schedule D Worksheet 2, Line 8) on Schedule D, Part I, line 6
- Enter long-term capital loss carryovers (from Schedule D Worksheet 2, Line 14) on Schedule D, Part II, line 13

If the taxpayer's 2009 capital loss exceeds the deduction limit and the remainder must be carried forward to 2010, remind the taxpayer to bring a copy of the 2009 return when the 2010 return is prepared. Make a note on the outside of the taxpayer's tax return record envelope to help alert next year's preparer. Next year, whoever assists the taxpayer will use the Capital Loss Carryover Worksheet in the 2010 Schedule D instructions or the printed copy of the Schedule D Worksheet 2 to figure how much capital loss the taxpayer can carry over from 2009 to 2010.

If preparing a paper return, complete the Capital Loss Carryover Worksheet in the Form 1040 instructions. 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, tax software reports the maximum allowable deduction. The remainder can be carried over to future tax years.

Taxpayer Interview and Tax Law Application

Ask two volunteers to role-play the sample interview.

Taxpayers Jeremy and Janice Smith checked the "Yes" box for interest/dividend income on the approved 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.
[Later in interview] *Earlier, you gave me this 1099-DIV from a mutual fund and these 1099-B forms from the stocks you sold. We already included the capital gain distribution from the mutual fund when we entered the dividends. We'll enter the stock sale information on Schedule D Capital Gain or Loss Worksheet. 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, 1999.
I see the sale date was March 10, 2009. That means the holding period for the stock was more than one year. They call that long-term and it determines both where we enter the information on Schedule D 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 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 $10,123. The 1099-B shows that you received gross proceeds of $8,859 when you sold the stock. We'll put all these numbers into this worksheet in the tax software. As you can see, the software has calculated your net loss; this is the sale price minus the basis, for a net loss of $1,264. 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 approved intake and interview sheet.]	

Answer any student questions about the conclusions drawn in the interview.

Who must file Schedule D for the sale of a home?

Now we will discuss if the sale of the taxpayer's residence will need to be reported on Schedule D. You will need to identify whether the home was the taxpayer's main home, if the taxpayer meets the ownership and use tests, and if the gain is more than the allowed exclusions amount. For additional information to help you make this determination, refer to the Selling Your Home Chapter in Publication 17 or Publication 523.

CAUTION

Special rules apply to foreclosures and cancellation of debt income on a principal residence. Under the Mortgage Forgiveness Debt Relief Act of 2007, taxpayers may exclude certain debt forgiven on their principal residence. These rules are covered later in this lesson.

To determine if the taxpayer meets the criteria for reporting the sale of a home, use the interview techniques and tools discussed in the Screening and Interviewing lesson. The intake and interview sheet lists income from the sale of real estate. It is important to ensure that all income is accurately reported on the return. 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.

CAUTION

Taxpayers who claimed the first-time homebuyer credit and then sold their home may have to repay the credit. For more information, refer to Lesson 28, Other Taxes, Lesson 29, Payments, and Form 5405.

Who must report the sale of a home?

Taxpayers must report the sale of a home when one of the following is true:

1. The taxpayer does not meet the ownership test.
2. The taxpayer does not meet the use test.
3. During the two-year period ending on the date of the sale, the taxpayer has excluded the gain from the sale of another home.
4. The gain from the sale is more than the amount that the taxpayer may exclude: $250,000 for individual taxpayers, $500,000 for Married Filing Jointly.

What is considered a "main" home?

Only a gain from the sale of a taxpayer's main home may be excluded from the taxpayer's income; a gain from a sale of a home that is *not* the taxpayer's main home will generally have to be reported as income.

So the first step is to find out if the home meets the definition of a "main" home. A taxpayer's main home is where the taxpayer lives 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 and must have cooking, sleeping, and bathroom facilities. The taxpayer's main home may also be a rented house or apartment. Taxpayers who have more than one home cannot choose which home to designate as their main home.

Ask a volunteer to read the Lucille example. Answer any student questions.

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. For over half the year, she lives in Denver. Lucille's main home is her rental apartment in Denver, because she lives there most of the time, even though she does not own the apartment in Denver.

What are the ownership and use tests?

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 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

In 2001, Helen lived in a rented apartment. The apartment building was later changed to a condominium, and she bought her apartment on December 1, 2006. In 2007, Helen became ill and on April 14 of that year she moved into her daughter’s home. On July 10, 2009, while still living in her daughter’s home, she sold her apartment.

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, 2004, to July 10, 2009, the date she sold the apartment. She owned her apartment from December 1, 2006, to July 10, 2009 (over two years). She lived in the apartment from July 11, 2004 (the beginning of the five-year period), to April 14, 2007 (over two years).

Ask a volunteer to read the Helen example. Answer any student questions.

Ask what if Helen had to move in with her daughter one year earlier.

Answer: It would make a difference: She would miss the requirement of two years in a five-year period by 3 months.

EXERCISES (continued)

Question 4: Emily, who is single, bought a home in 1996. She lived in the home until May 31, 2007, when she accepted an assignment with the Peace Corps in Venezuela and left the house vacant. Emily returned to her home on May 31, 2008 and lived there until she sold the house on January 10, 2009. Does Emily meet the ownership and use test? ☑ **Yes** ☐ No

Emily meets the ownership and use test because she owned and lived in the home for at least two years of the five-year period ending on the date of the sale.

Assign the exercise.

Review the answer with the class when complete.

Reduced Exclusion

Taxpayers who owned and used a home for less than two years (and so 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.

Ask a volunteer to read the Jennifer example. Answer any student questions.

example

Jennifer, who is single, bought her first home in August 2007. In December 2008, the company she worked for notified her that she would be transferred to another town by the end of 2009. She continued to live in the home until June 2009, when she sold it at a gain and moved 500 miles to the new town. Jennifer owned and lived in the home less than two years, so she does not meet the ownership and use tests. However, she may qualify to exclude all or part of the gain because she sold the home due to a change in place of employment. Jennifer should be referred to a professional tax preparer.

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 current sale of the 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 2 years after the date of the deceased spouse's death, and all other requirements are met.

How do I figure the gain (or loss) from the sale of a home?

Once you've determined that a taxpayer is eligible for the exclusion, you can 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 ($250,000 if Single, $500,000 if Married Filing Jointly), you do not need to calculate the gain on the sale of the home. None of the gain will be taxable. Loss on the sale of a residence is not reported on the return. For more information, see the Selling Your Home section in Publication 17.

TIP

If the taxpayer used the home for business purposes or as rental property after May 6, 1997, refer the taxpayer to a professional tax preparer. The taxpayer cannot exclude the part of the gain equal to the depreciation allowed or allowable as a deduction.

CAUTION

A loss on the sale of a personal residence is not deductible.

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.

TIP

If the taxpayer can exclude the entire gain from the sale of a personal residence, the person responsible for closing the sale (for example, a real estate broker or settlement agent) generally will not issue a Form 1099-S. If a Form 1099-S is issued and you determine that the gain is excludable, the sale should be shown on Schedule D to notify IRS that the gain is excludable.

Amount Realized

The amount realized is the selling price minus selling expenses (commissions, advertising fees, legal fees, and loan charges paid by the seller, such as points). Amount realized can be calculated using Worksheet 2, Gain or (Loss), Exclusion, and Taxable Gain on Sale of Home, in Publication 523. (A similar worksheet is available in the tax software.)

Amount realized = Selling price - Selling expenses

$246,000 = $250,000 - $4,000

EXERCISES (continued)

Question 5: Jan meets the eligibility requirements for claiming the exclusion on the gain from the sale of his home. The selling price of the home was $195,000. The selling expenses were $15,000. What is the amount realized in this sale? **$180,000**.

The amount realized on Jan's sale is $180,000 (selling price minus selling expenses).

Assign the exercise.

Review answer with the class when complete.

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.

CAUTION

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 the taxpayer to seek assistance from a professional tax preparer.

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 installing a recreation room or putting on a new roof. 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 needs to be referred to a professional tax preparer.

Adjusted basis = Basis + Increases - Decreases

TIP

To figure the adjusted basis of a home, use Worksheet 1, Adjusted Basis of Home Sold, in Publication 523.

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, you 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 are Married Filing Jointly may exclude up to $500,000.

TIP

Use Worksheet 2, Gain or (Loss), Exclusion, and Taxable Gain on Sale of Home in Publication 523 to figure the gain or loss, the exclusion, and the taxable gain from a sale. Note that line 3 is the amount realized, line 4 is the adjusted basis, and line 5 is the amount of gain or loss from the sale.

CAUTION

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. For more information on how to adjust the basis of the home if the first-time homebuyer credit was received and exceptions to the repayment rule, see the Form 5405 Instructions.

NEW Gain from the sale or exchange of a main home is no longer excludable from income if allocable to periods of nonqualified use. Generally, nonqualified use means any period after 2008 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 553. To figure the portion of nonqualified use, multiply the gain by the following fraction:

$$\frac{\text{Total nonqualified use during period of ownership after 2008}}{\text{Total period of ownership}}$$

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?

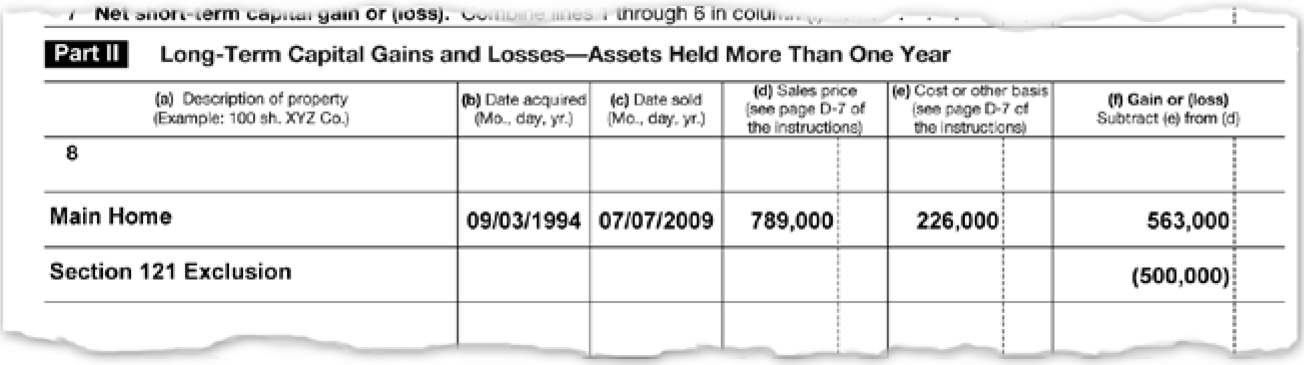
Proceeds from the sale of a main home that meets the ownership and use tests must be reported only if the gain is greater than the taxpayer's allowed exclusion; only the excess must be reported. Gain from the sale of a home that is *not* the taxpayer's main home will generally have to be reported as income.

In both cases, the gain is taxable gain and must be reported on Schedule D, Capital Gains and Losses. 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. A loss on the sale of your main home cannot be deducted.

Tax Software Hint: To review information related to the software, go to the Volunteer Resource Guide (Tab 2).

If preparing a paper return, complete Schedule D, Part II, as shown in the following illustration.



7 Net short-term capital gain or (loss). Combine lines 1 through 6 in colu

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

(a) Description of property (Example: 100 sh. XYZ Co.)	**(b)** Date acquired (Mo., day, yr.)	**(c)** Date sold (Mo., day, yr.)	**(d)** Sales price (see page D-7 of the instructions)	**(e)** Cost or other basis (see page D-7 of the instructions)	**(f) Gain or (loss)** Subtract (e) from (d)
8					
Main Home	**09/03/1994**	**07/07/2009**	**789,000**	**226,000**	**563,000**
Section 121 Exclusion					**(500,000)**

Taxpayer Interview and Tax Law Application

Jeremy and Janice Smith checked the "Yes" box for selling some real estate on the approved intake and interview sheet. The volunteer asks for details.

Ask two volunteers to role-play the sample interview.

SAMPLE INTERVIEW

VOLUNTEER SAYS...	JEREMY RESPONDS...
Did you sell a home during 2009?	*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. First, how long did you own the home?	*Three and a half years. We bought it in January 2006 and sold it in June 2009.*
And was it the main place you lived for at least two years of that time?	*Well, yes, sort of. We lived and worked on a cruise ship from June 2006 to December 2006 and let my brother live there while we were gone.*
That's okay, the rule is that it must be the main place you lived for a total of 24 full months or 730 days during the five-year period prior to the sale. 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.*

SAMPLE INTERVIEW (continued)

VOLUNTEER SAYS...	JEREMY RESPONDS...
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 $580,000. Do you have anything that lists the basis in the home, that is, the value 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.*
Clearly, with a basis of $300,000, your gain from the sale is $280,000 or less. 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 approved intake and interview sheet.]	

Answer any student questions about the conclusions drawn in the interview.

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.

⚠ CAUTION

This extension of time can apply to taxpayers who have recently left the military.

Ask a volunteer to read the Peter example.

Ask what if Peter had not been on qualified extended duty but merely rented out his home while he lived in another city?

Answer: He would not meet the use test in the five-year period.

example

Peter bought a home in 2000 and lived in it for 2½ years. Beginning in 2003, he was on qualified official extended duty in the U.S. Army. He sold his home in 2009 and had a $12,000 gain. Peter would normally not meet the use test in the five-year period before the sale (2004 – 2009). Peter can disregard those six years. The test period consists of the five years before he went on qualified official extended duty.

EXERCISES (continued)

Question 6: John purchased a home in 1999. Through your interview process, you discover that he sold his main home in 2009. 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.

The only circumstance that will allow the taxpayer to exclude the gain is if he can extend the five-year period due to official extended military duty.

Assign the exercise.

Review answer with the class when complete.

How is a cancellation of debt for a principal residence reported on the return?

A segment of the cancellation of debt issue is in scope for the volunteer tax preparer. Cancellation of various types of debt could result in a reportable item on the taxpayer's return. VITA/TCE volunteers are limited to the type that involves the taxpayer's main, personal residence. All other cancellation of debt issues should be referred to a professional tax preparer. The topic that follows will help you recognize when you will be able to help taxpayers and when you must refer them to a professional tax preparer.

Emphasize only cancellation of qualified principal residence indebtedness is within scope for the volunteer program.

Cancellation of indebtedness issues frequently involve auto loans, credit card debt, debt for 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, other than as a gift or bequest, the taxpayer must include the canceled amount in income. A debt includes any indebtedness for which a taxpayer is liable or which attaches to the taxpayer's property.

Under the Mortgage Forgiveness Debt Relief Act of 2007, taxpayers may exclude 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.

The taxpayer may also have a reportable transaction on Schedule D if the property was foreclosed on or abandoned. When this occurs, the taxpayer will generally receive Form 1099-A, Acquisition or Abandonment of Secured Property, from the lender. Form 1099-A will have information needed to determine the gain or loss due to the foreclosure/abandonment. If the debt is canceled, the taxpayer may also receive Form 1099-C, Cancellation of Debt. If the foreclosure and cancellation of debt occur in the same calendar year, the lender has the option of filing Form 1099-C only by reporting additional information in certain boxes on the Form 1099-C. You will learn more about these forms and how to report the information on the taxpayer's return later in this lesson.

What are the exceptions and exclusions to the general rule for cancellation of debt income?

Cancellation of debt income may be eliminated by applying *exceptions* or reduced by applying *exclusions* to the general rule.

Exceptions: There are several exceptions to the inclusion of canceled debt in income. These exceptions apply before the next section on exclusions. The exceptions are:

- 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)

Exclusions: There are several exclusions from the general rule of inclusion of canceled debt in income. Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness, is required to 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

The issues involved in these exclusions can be complicated and complex. *Only the exclusion for discharge of "qualified principal residence indebtedness" is within scope for the VITA/TCE program.* Use Publication 4731, Screening Sheet for Cancellation of Debt, to assist in identifying those taxpayers with cancellation of debt issues that can be assisted at VITA/TCE sites. This exclusion provision, added by the Mortgage Forgiveness Debt Relief Act of 2007, is in-scope for the volunteer program ONLY if the criteria on the screening sheet are met. A copy of the screening sheet can be found in the Volunteer Resource Guide (Tab D).

What questions are on the screening sheet?

VITA/TCE volunteers may assist taxpayers with canceled or forgiven mortgage debt issues on a limited basis at volunteer sites. The screening sheet will assist in identifying taxpayers who fall within the scope of the volunteer program. Taxpayers with more complex issues should be referred as noted in Step 6 of the screening sheet.

Borrowers whose debt is canceled in whole or in part will receive Form 1099-C, Cancellation of Debt, from their lender. Box 2 of Form 1099-C shows the amount of debt forgiven or canceled.

Refer to the screening sheet for Form 1099-C, Cancellation of Debt, for step-by-step guidance to determine if the cancellation of debt is within scope.

Publication 4731

Screening Sheet for Form 1099-C, Cancellation of Debt

For Volunteers with Advanced Certification Only

step **1** Did the taxpayer receive Form 1099-C, Cancellation of Debt, from their lender only in relation to a home mortgage loan and is the information shown on the form correct?

YES – Go to Step 2
NO – Go to Step 6

step **2** Did the taxpayer ever use the home in a trade or business or as rental property?

YES – Go to Step 6
NO – Go to Step 3

step **3** Was the debt canceled as a result of a bankruptcy case?

YES – Go to Step 6
NO – Go to Step 4

step **4** Ask the following questions to determine if the discharged debt is "qualified principal residence indebtedness":

a. Was the mortgage taken out to buy, build, or substantially improve the taxpayer's principal residence? (NOTE: A principal residence is generally the home where the taxpayer lives most of the time. A taxpayer can have only one principal residence at any one time.)

YES – Go to Step 4b
NO – Go to Step 6

b. Was the mortgage secured by the taxpayer's principal residence?

YES – Go to Step 4c
NO – Go to Step 6

c. Was any part of the mortgage used to pay off credit cards, purchase a car, pay for tuition, pay for a vacation, pay medical/dental expenses, or used for any other purpose other than to buy, build, or substantially improve the principal residence?

YES – Go to Step 6
NO – Go to Step 4d

d. Was the mortgage amount more than $2 million ($1 million if Married Filing Separately)?

YES – Go to Step 6
NO – Go to Step 5

step **5** The discharged debt is "qualified principal residence indebtedness."

The Mortgage Forgiveness Debt Relief Act of 2007, as extended in the Emergency Economic Stabilization Act of 2008, allows individuals to exclude from gross income any discharges of "qualified principal residence indebtedness" made after 2006 and before 2013. The volunteer should complete the applicable lines on Form 982, and file it with the taxpayer's return. If the residence was disposed of, the taxpayer may also be required to report the disposition (sale) on Schedule D.

step **6** These tax issues are outside the scope of the volunteer program. The taxpayer may qualify to exclude all or some of the discharged debt. However, the rules involved in the mortgage debt relief exclusions are complex.

Refer the taxpayer to:

- www.irs.gov for the most up-to-date information
- An IRS Representative: 1-800-829-1040
- An IRS Taxpayer Assistance Center (TAC)
- The Taxpayer Advocate Service (TAS): 1-877-777-4778, TTY/TDD 1-800-829-4059. TAS may help if the problem cannot be resolved through normal IRS channels.
- A tax professional

Additional Resources:

- Publication 523, Selling your Home
- Publication 525, Taxable and Nontaxable Income (Canceled Debts)
- Publication 4681, Canceled Debts, Foreclosures, Repossessions, and Abandonments
- Publication 4702, Mortgage Forgiveness PowerPoint
- Publication 4705, Overview of Mortgage Debt Forgiveness
- Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment) and Instructions

What is qualified principal residence indebtedness?

Qualified principal residence indebtedness is any debt incurred in acquiring, constructing, or substantially improving a principal residence and which is secured by the principal residence. Qualified principal residence indebtedness also includes 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 the amount of the debt does not exceed the amount of the refinanced debt.

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."

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.

Applicable Tax Years: 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.

Criteria for VITA/TCE Program: You may assist taxpayers who meet the following requirements for excluding canceled debt from income:

- The home was never used in a business or as rental property
- The debt was not canceled because the taxpayer filed bankruptcy
- 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 $2,000,000 ($1,000,000 if Married Filing Separately)

If the taxpayers do not meet these requirements, they still may qualify for the exclusion. However, the issues may be complex and beyond the scope of VITA/TCE. Such taxpayers should be referred to a professional tax preparer. Use Publication 4731, Screening Sheet for Cancellation of Debt, to help you identify those taxpayers that can be assisted at a VITA/TCE site. A copy of the screening sheet can be found in the Volunteer Resource Guide (Tab D).

What is the difference between recourse and nonrecourse debt?

Debt for which a borrower is personally liable is recourse debt. All other debt is nonrecourse debt.

- **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 will be treated as ordinary income from cancellation of indebtedness and will be required to be included in gross income unless the cancellation of indebtedness qualifies for one of the exceptions or exclusions from gross income under some provision of the Internal Revenue Code. In addition to cancellation of indebtedness income, the taxpayer may realize a gain or loss on the disposition of the property. This is determined by the difference between the taxpayer's basis in the property and the FMV of the property at the time of the foreclosure.
- **Nonrecourse debt** is satisfied by the surrender of the secured property regardless of the fair market value (FMV) at the time of surrender and the borrower is not personally liable for the debt. If property subject to nonrecourse debt is abandoned, foreclosed upon, subject of a short sale, or repossessed by the lender, the circumstances will be 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 will be treated as an amount realized.

How is a foreclosure and canceled debt reported on a return?

A foreclosure or repossession is treated as a sale. Generally, you figure the gain or loss from the sale the same way as a gain or loss from any other sale. But the selling price of the home used to figure the amount of the gain or loss depends, in part, on whether the taxpayer was personally liable for repaying the debt secured by the home as shown in the following chart:

IF the taxpayer was...	THEN the taxpayer's selling price includes...
not personally liable for the debt (nonrecourse debt)	the full amount of debt canceled by the foreclosure or repossession
personally liable for the debt (recourse debt)	the amount of canceled debt up to the home's fair market value; the taxpayer may also have ordinary income

Generally, when a lender acquires a taxpayer's personal residence through abandonment or foreclosure and cancels a portion of the debt, the taxpayer has a gain or loss on the disposition/sale of the property reportable on Schedule D, Capital Gains and Losses. If the taxpayer is personally liable for the debt and the canceled debt is more than the home's fair market value, the taxpayer will have cancellation of debt income. This amount is reportable as ordinary income on line 21 of Form 1040 or on Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness, if the debt canceled qualifies as "excludable" from gross income.

CAUTION

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.

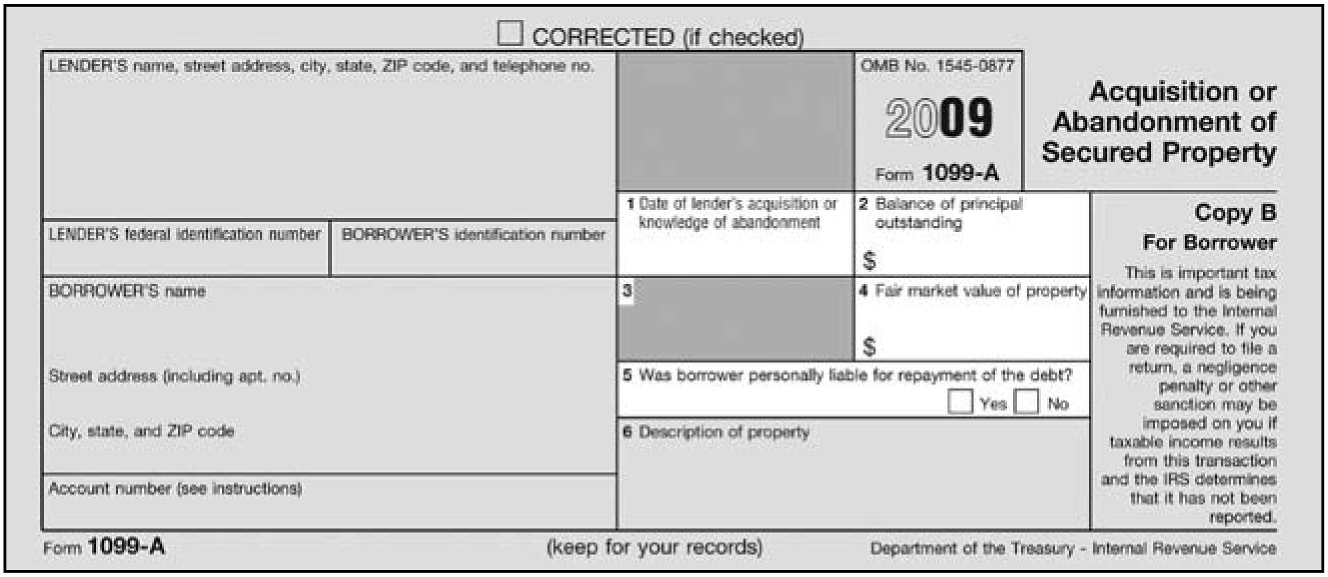
How do I handle the information from Form 1099-A and Form 1099-C?

When a personal residence is abandoned or foreclosed upon and the lender cancels a portion of the **recourse** debt, the taxpayer will generally receive Form 1099-A, Acquisition or Abandonment of Secured Property, and Form 1099-C, Cancellation of Debt. If in the same calendar year, the debt is canceled in connection with a foreclosure or abandonment 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 box 5, Was borrower personally liable for repayment of the debt? and box 7 (fair market value of property) on Form 1099-C.

Taxpayers often question the taxability of a foreclosure and canceled debt because they did not receive money in hand and feel that, by giving back the property alone, they are relieved from any further obligation. You will need to explain that the benefit to the taxpayer is the relief from the personally liable debt. Information in Publication 17 can assist you with the explanation. Additional resources include Publication 523, Selling Your Home, Publication 525, Taxable and Nontaxable Income, Publication 544, Sales and Dispositions of Assets, and Publication 4681, Canceled Debts, Foreclosures, Repossessions, and Abandonments.

Form 1099-A and Schedule D: When a residence that is security for a mortgage is taken by the lender (foreclosure) or given up by the borrower (abandonment), it is treated as having been sold. This may result in a gain or loss that has to be reported on the return subject to the rules for a Sale of Residence. The reportable gain or loss is determined by comparing the taxpayer's adjusted basis with the amount considered the selling price.

Form 1099-A



☐ CORRECTED (if checked)

LENDER'S name, street address, city, state, ZIP code, and telephone no.

OMB No. 1545-0877

2009

Form 1099-A

Acquisition or Abandonment of Secured Property

LENDER'S federal identification number

BORROWER'S identification number

1 Date of lender's acquisition or knowledge of abandonment

2 Balance of principal outstanding
$

Copy B
For Borrower

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.

BORROWER'S name

3

4 Fair market value of property
$

Street address (including apt. no.)

5 Was borrower personally liable for repayment of the debt? ☐ Yes ☐ No

City, state, and ZIP code

6 Description of property

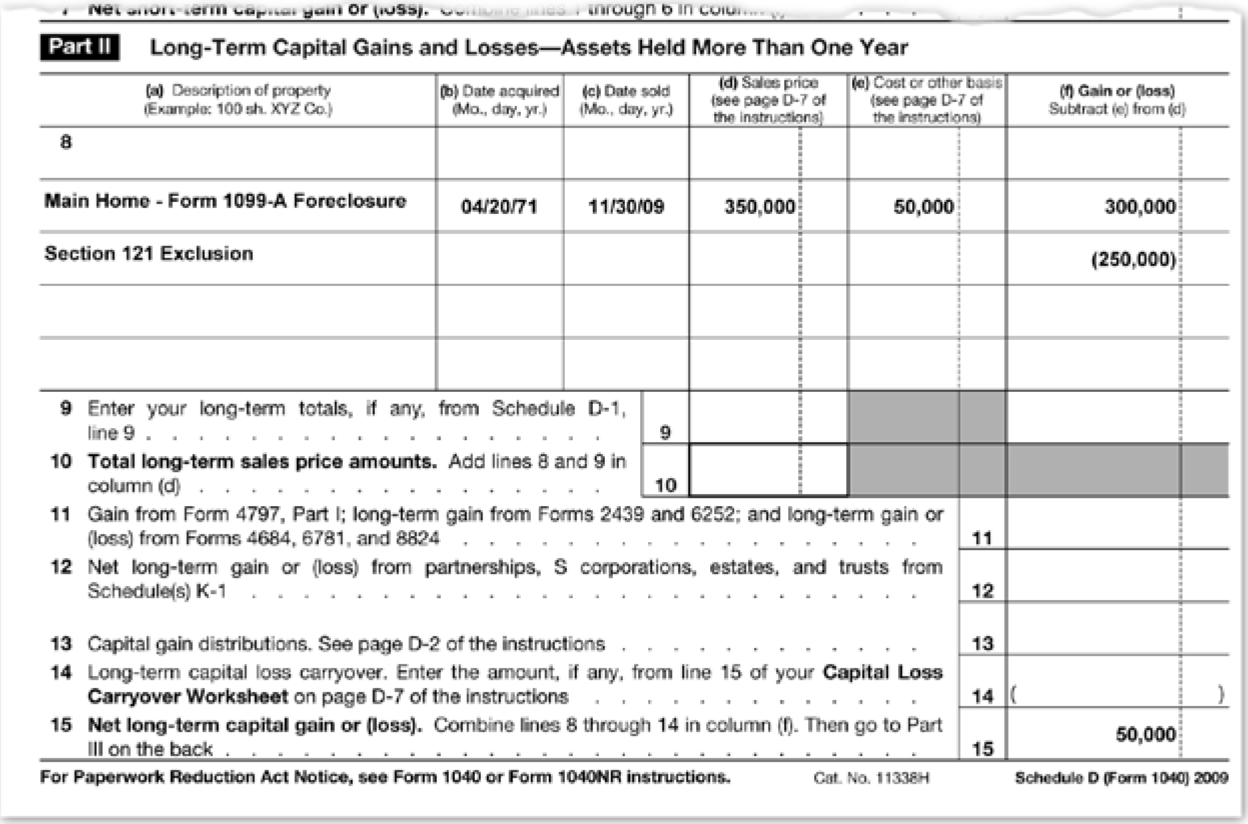
Account number (see instructions)

Form **1099-A** (keep for your records) Department of the Treasury - Internal Revenue Service

Form 1099-A is issued by the lender. In addition to debtor information, the form reports the balance of the debt outstanding and the fair market value of the property. This form will have information needed to determine the amount of the gain or loss due to the foreclosure or abandonment. **Information shown on Form 1099-A should be reported on Schedule D whether it is a gain or loss. Failure to file Schedule D may result in an IRS notice to the taxpayer.** The sales price is computed based on whether the taxpayer is personally liable (recourse loan) or not personally liable (nonrecourse loan). If the taxpayer is personally liable, then the sales price is the lesser of the balance of the debt outstanding (box 2 of Form 1099-A) or fair market value (box 4 of Form 1099-A). If the taxpayer is not personally liable, then the full amount of the debt outstanding as reflected in box 2 of Form 1099-A is reported as the selling price.

Review the following examples of a partially completed Schedule D that illustrates how the information shown on Form 1099-A would be reflected on a paper return. 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 taxpayers), the sale does not have to be reported on Schedule D. However, when Form 1099-A is issued by the lender, the taxpayer should report the sale to account for the basis in the home. Failure to report the transaction on Schedule D may result in an IRS notice to the taxpayer.

Schedule D – Foreclosure results in gain – Section 121 Exclusion for part of gain



7 Net short-term capital gain or (loss). Combine lines 1 through 6 in column

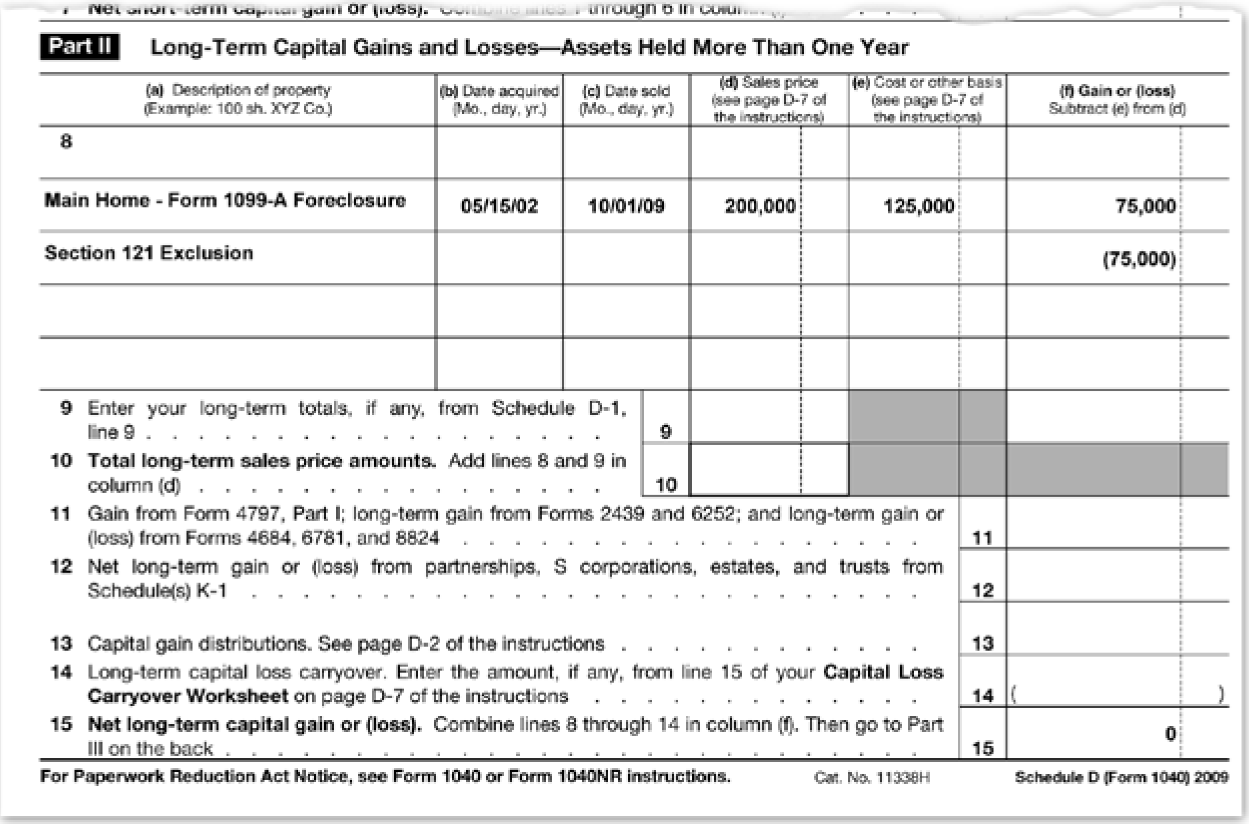
Part II **Long-Term Capital Gains and Losses—Assets Held More Than One Year**

(a) Description of property (Example: 100 sh. XYZ Co.)	**(b)** Date acquired (Mo., day, yr.)	**(c)** Date sold (Mo., day, yr.)	**(d)** Sales price (see page D-7 of the instructions)	**(e)** Cost or other basis (see page D-7 of the instructions)	**(f) Gain or (loss)** Subtract (e) from (d)
8					
Main Home - Form 1099-A Foreclosure	**04/20/71**	**11/30/09**	**350,000**	**50,000**	**300,000**
Section 121 Exclusion					**(250,000)**

9 Enter your long-term totals, if any, from Schedule D-1, line 9	9		
10 **Total long-term sales price amounts.** Add lines 8 and 9 in column (d)	10		
11 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	
12 Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1		12	
13 Capital gain distributions. See page D-2 of the instructions		13	
14 Long-term capital loss carryover. Enter the amount, if any, from line 15 of your **Capital Loss Carryover Worksheet** on page D-7 of the instructions		14	( )
15 **Net long-term capital gain or (loss).** Combine lines 8 through 14 in column (f). Then go to Part III on the back		15	**50,000**

For Paperwork Reduction Act Notice, see Form 1040 or Form 1040NR instructions. Cat. No. 11338H **Schedule D (Form 1040) 2009**

Schedule D – Foreclosure results in gain – Section 121 Exclusion applied to total gain



7 Net short-term capital gain or (loss). Combine lines 1 through 6 in column

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

(a) Description of property (Example: 100 sh. XYZ Co.)	**(b)** Date acquired (Mo., day, yr.)	**(c)** Date sold (Mo., day, yr.)	**(d)** Sales price (see page D-7 of the instructions)	**(e)** Cost or other basis (see page D-7 of the instructions)	**(f) Gain or (loss)** Subtract (e) from (d)
8					
Main Home - Form 1099-A Foreclosure	**05/15/02**	**10/01/09**	**200,000**	**125,000**	**75,000**
Section 121 Exclusion					**(75,000)**

9 Enter your long-term totals, if any, from Schedule D-1, line 9 . . . 9

10 **Total long-term sales price amounts.** Add lines 8 and 9 in column (d) . . . 10

11 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

12 Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1 . . . 12

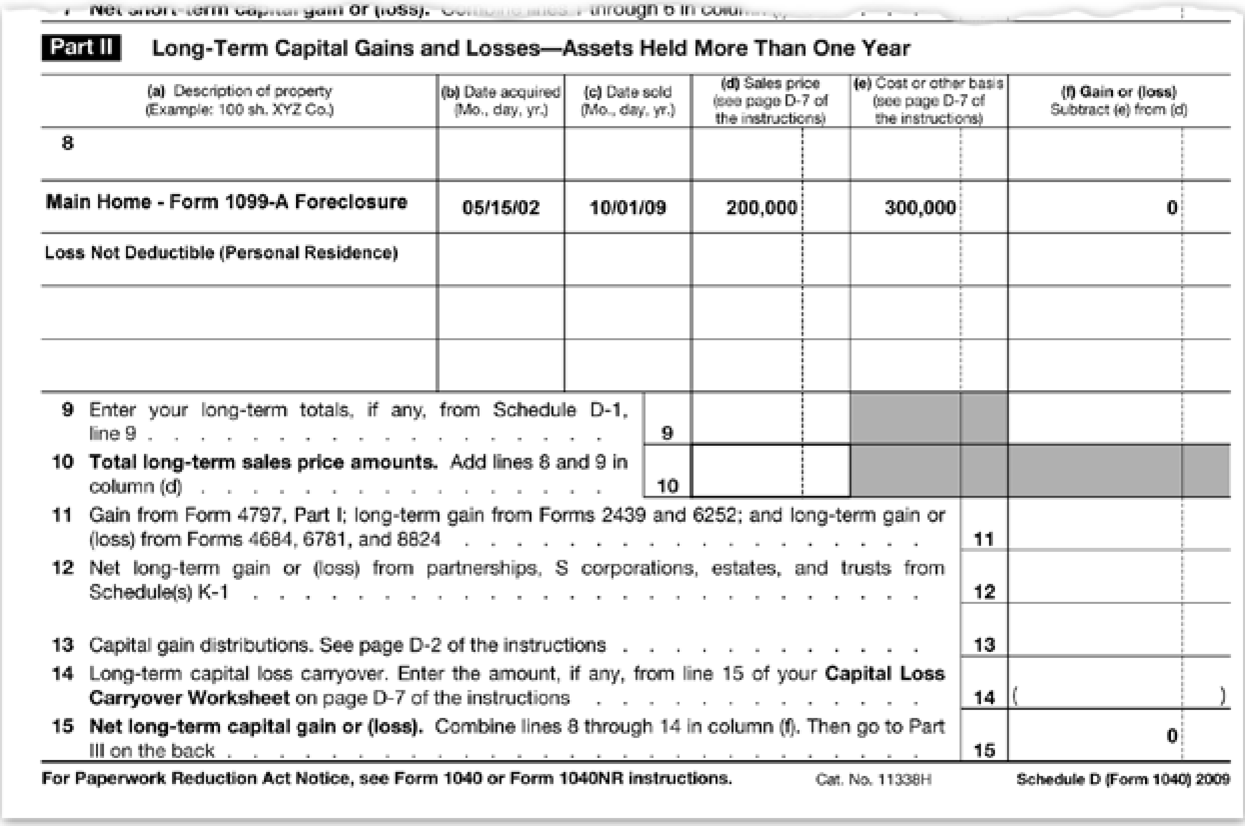
13 Capital gain distributions. See page D-2 of the instructions . . . 13

14 Long-term capital loss carryover. Enter the amount, if any, from line 15 of your **Capital Loss Carryover Worksheet** on page D-7 of the instructions . . . 14 ( )

15 **Net long-term capital gain or (loss).** Combine lines 8 through 14 in column (f). Then go to Part III on the back . . . 15 **0**

For Paperwork Reduction Act Notice, see Form 1040 or Form 1040NR instructions. Cat. No. 11338H **Schedule D (Form 1040) 2009**

Schedule D – Foreclosure results in loss (non-deductible)



7 Net short-term capital gain or (loss). Combine lines 1 through 6 in column

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

(a) Description of property (Example: 100 sh. XYZ Co.)	**(b)** Date acquired (Mo., day, yr.)	**(c)** Date sold (Mo., day, yr.)	**(d)** Sales price (see page D-7 of the instructions)	**(e)** Cost or other basis (see page D-7 of the instructions)	**(f) Gain or (loss)** Subtract (e) from (d)
8					
Main Home - Form 1099-A Foreclosure	**05/15/02**	**10/01/09**	**200,000**	**300,000**	**0**
Loss Not Deductible (Personal Residence)					

9 Enter your long-term totals, if any, from Schedule D-1, line 9 . . . 9

10 **Total long-term sales price amounts.** Add lines 8 and 9 in column (d) . . . 10

11 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

12 Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1 . . . 12

13 Capital gain distributions. See page D-2 of the instructions . . . 13

14 Long-term capital loss carryover. Enter the amount, if any, from line 15 of your **Capital Loss Carryover Worksheet** on page D-7 of the instructions . . . 14 ( )

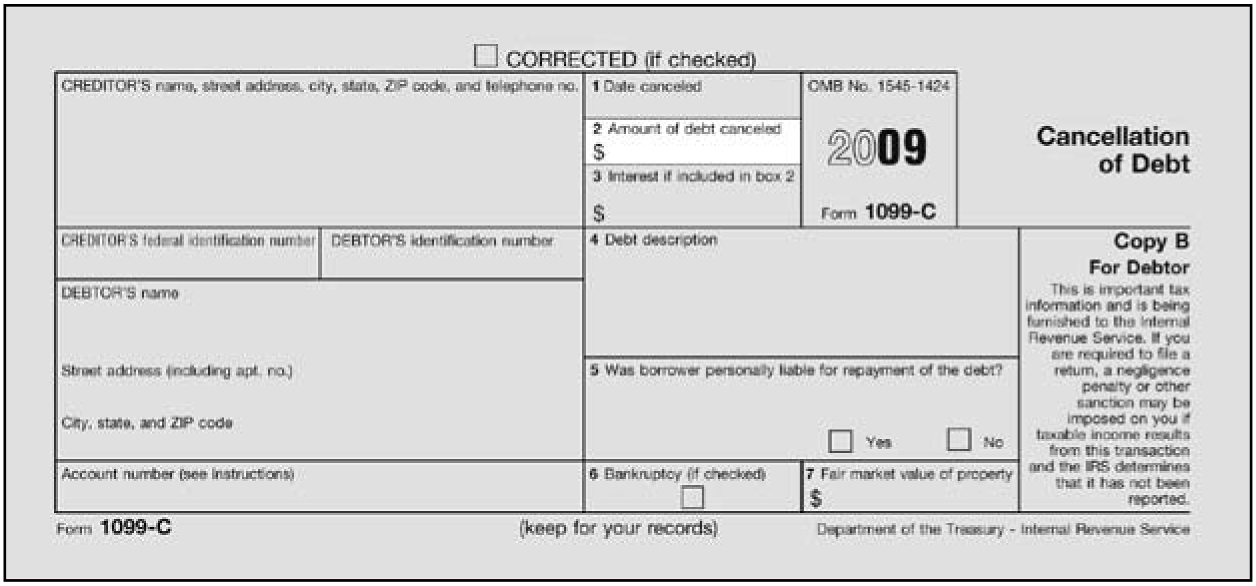
15 **Net long-term capital gain or (loss).** Combine lines 8 through 14 in column (f). Then go to Part III on the back . . . 15 **0**

For Paperwork Reduction Act Notice, see Form 1040 or Form 1040NR instructions. Cat. No. 11338H **Schedule D (Form 1040) 2009**

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).

Form 1099-C and Form 982: 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, 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.

Form 1099-C



☐ CORRECTED (if checked)

CREDITOR'S name, street address, city, state, ZIP code, and telephone no.

1 Date canceled

2 Amount of debt canceled
$

3 Interest if included in box 2
$

OMB No. 1545-1424

2009

Form 1099-C

Cancellation of Debt

CREDITOR'S federal identification number

DEBTOR'S identification number

DEBTOR'S name

Street address (including apt. no.)

City, state, and ZIP code

Account number (see instructions)

4 Debt description

5 Was borrower personally liable for repayment of the debt?
☐ Yes ☐ No

6 Bankruptcy (if checked)
☐

7 Fair market value of property
$

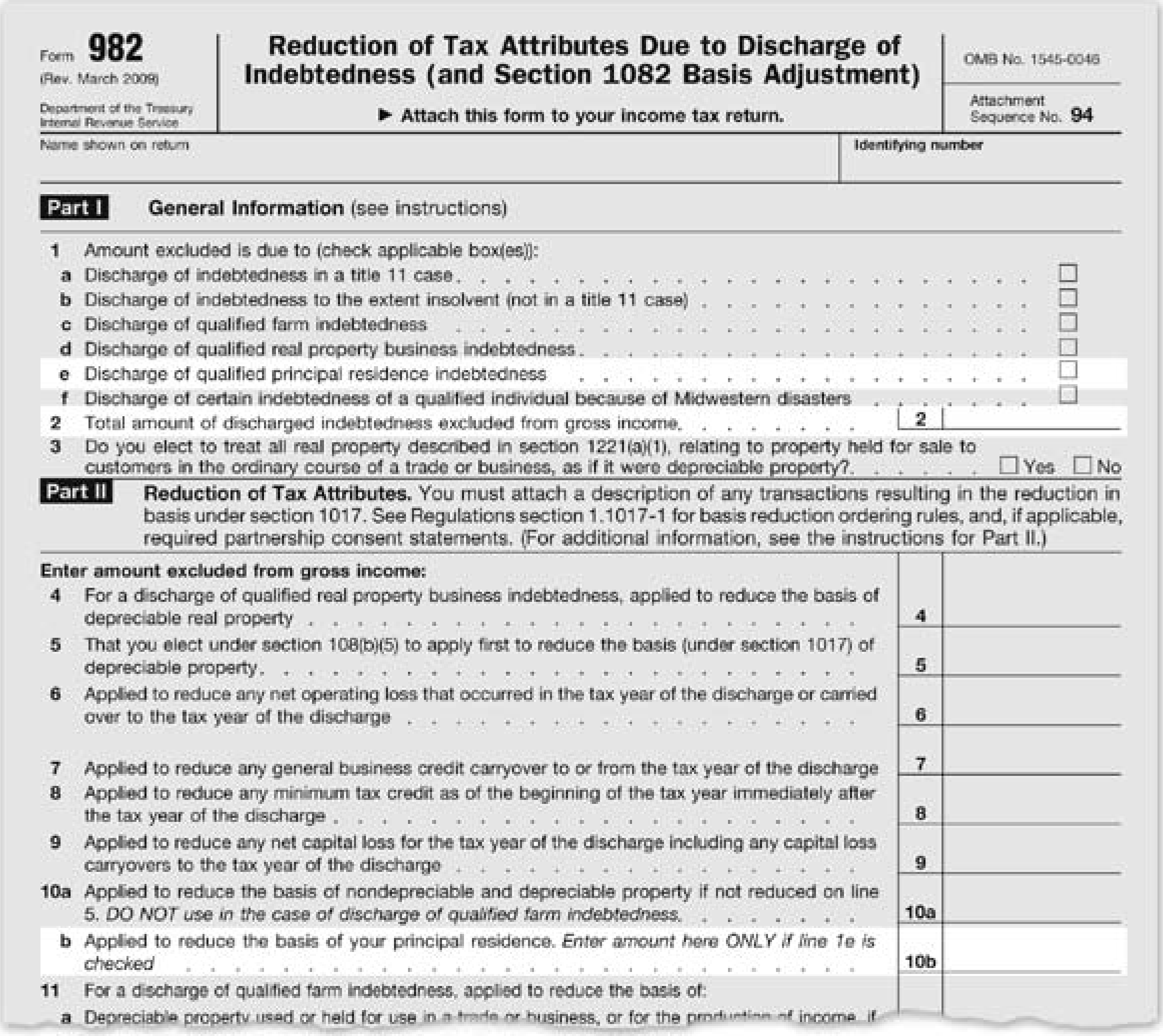
Copy B
For Debtor

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.

Form **1099-C** (keep for your records) Department of the Treasury - Internal Revenue Service

In addition to debtor information, Form 1099-C reports the amount of debt canceled and the date canceled. If box 6 for bankruptcy is checked or if an amount is included in box 3 for interest, then the taxpayer should be referred to a professional tax preparer.

Form 982 must be filed with the taxpayer's return to report the excluded amount of discharge indebtedness and the reduction of certain tax attributes. Taxpayers excluding only discharged debt from "qualified principal residence indebtedness" only must complete a few lines on Form 982; check box 1e and include the amount from Form 1099-C, box 2, on Form 982, line 2. If the taxpayer kept ownership of the home, complete line 10b to reflect the basis adjustment to the principal residence for the excluded canceled debt.



Form **982**
(Rev. March 2009)
Department of the Treasury
Internal Revenue Service

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

▶ **Attach this form to your income tax return.**

OMB No. 1545-0046

Attachment Sequence No. **94**

Name shown on return

Identifying number

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 ☐
- **f** Discharge of certain indebtedness of a qualified individual because of Midwestern disasters ☐

2 Total amount of discharged indebtedness excluded from gross income **2**

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:

4 For a discharge of qualified real property business indebtedness, applied to reduce the basis of depreciable real property **4**

5 That you elect under section 108(b)(5) to apply first to reduce the basis (under section 1017) of depreciable property **5**

6 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 **6**

7 Applied to reduce any general business credit carryover to or from the tax year of the discharge **7**

8 Applied to reduce any minimum tax credit as of the beginning of the tax year immediately after the tax year of the discharge **8**

9 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 **9**

10a Applied to reduce the basis of nondepreciable and depreciable property if not reduced on line 5. *DO NOT use in the case of discharge of qualified farm indebtedness* **10a**

b Applied to reduce the basis of your principal residence. *Enter amount here ONLY if line 1e is checked* **10b**

11 For a discharge of qualified farm indebtedness, applied to reduce the basis of:

a Depreciable property used or held for use in a trade or business, or for the production of income, if

Tax Software Hint: If the taxpayer meets all the requirements to exclude the income from the cancellation of debt, use the "Add a form" process to add Form 982.

Coordination with Form 1099-A: If a personal residence is abandoned/foreclosed and debt is canceled in the same year, the taxpayer may receive Form 1099-C only with the required filing information from Form 1099-A shown in boxes 5 and 7 of Form 1099-C. Generally, the gross foreclosure bid price is considered to be the fair market value (FMV). For an abandonment or voluntary conveyance in lieu of foreclosure, the FMV is generally the appraised value of the property. The sales price is the lesser of the balance of the principal debt outstanding or fair market value (Box 7 of Form 1099-C).

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 debt canceled in box 2. Since the taxpayer kept ownership of the home, there is no gain or loss to be reported on Schedule D. 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. Check box 1e on Form 982. The amount from Form 1099-C, box 2, should be entered on line 2. In addition, the amount on line 2 should be entered on line 10b to report the reduction to the basis of the taxpayer's home.

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.

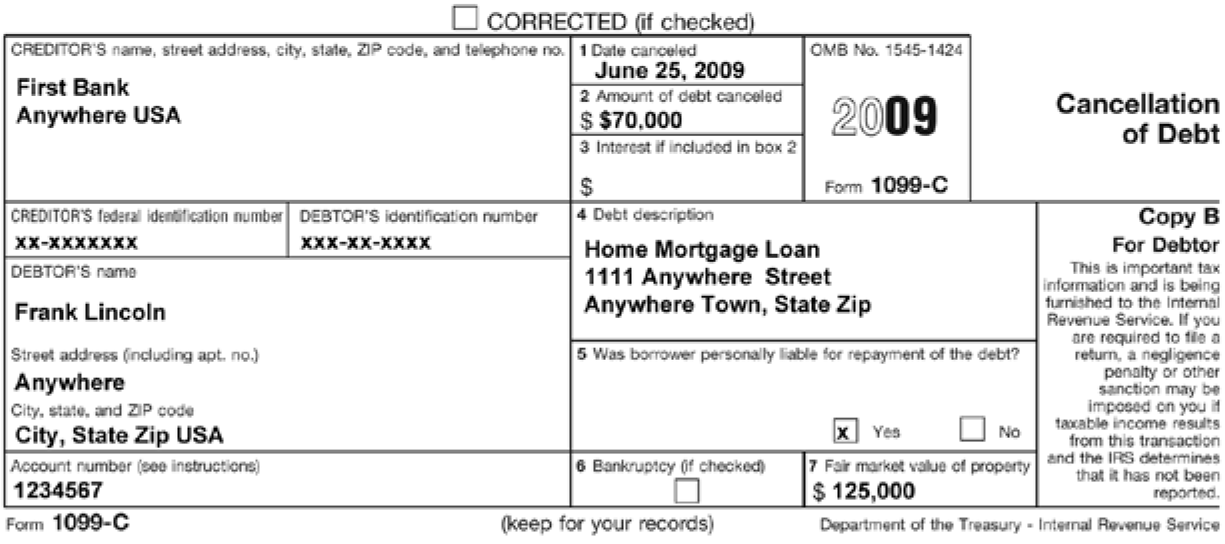
Form 982 should be completed and attached to the tax return if the exclusion for "qualified principal residence indebtedness" is applicable.

Verify Information: You will need to 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.

example

Frank bought his home on May 14, 2003. His basis in the home was $200,000. After he lost his job last year, he wasn't able to make the payments. The bank foreclosed in June 2009, 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 this Form 1099-C.



☐ CORRECTED (if checked)

CREDITOR'S name, street address, city, state, ZIP code, and telephone no.
First Bank
Anywhere USA

1 Date canceled
June 25, 2009

2 Amount of debt canceled
$ $70,000

3 Interest if included in box 2
$

OMB No. 1545-1424

2009

Form 1099-C

Cancellation of Debt

CREDITOR'S federal identification number
xx-xxxxxxx

DEBTOR'S identification number
xxx-xx-xxxx

4 Debt description
Home Mortgage Loan
1111 Anywhere Street
Anywhere Town, State Zip

Copy B
For Debtor

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
Frank Lincoln

Street address (including apt. no.)
Anywhere

City, state, and ZIP code
City, State Zip USA

5 Was borrower personally liable for repayment of the debt? ☒ Yes ☐ No

Account number (see instructions)
1234567

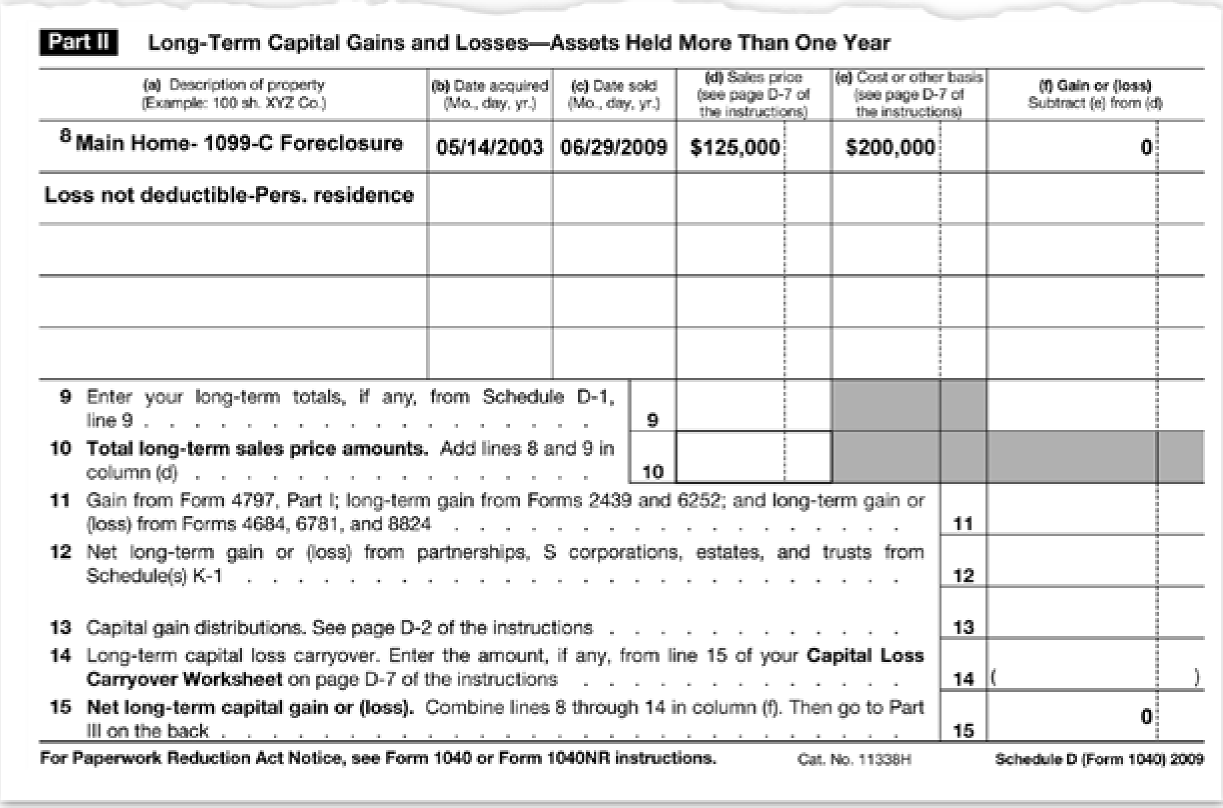
6 Bankruptcy (if checked) ☐

7 Fair market value of property
$ 125,000

Form 1099-C (keep for your records) Department of the Treasury - Internal Revenue Service

example (continued)

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



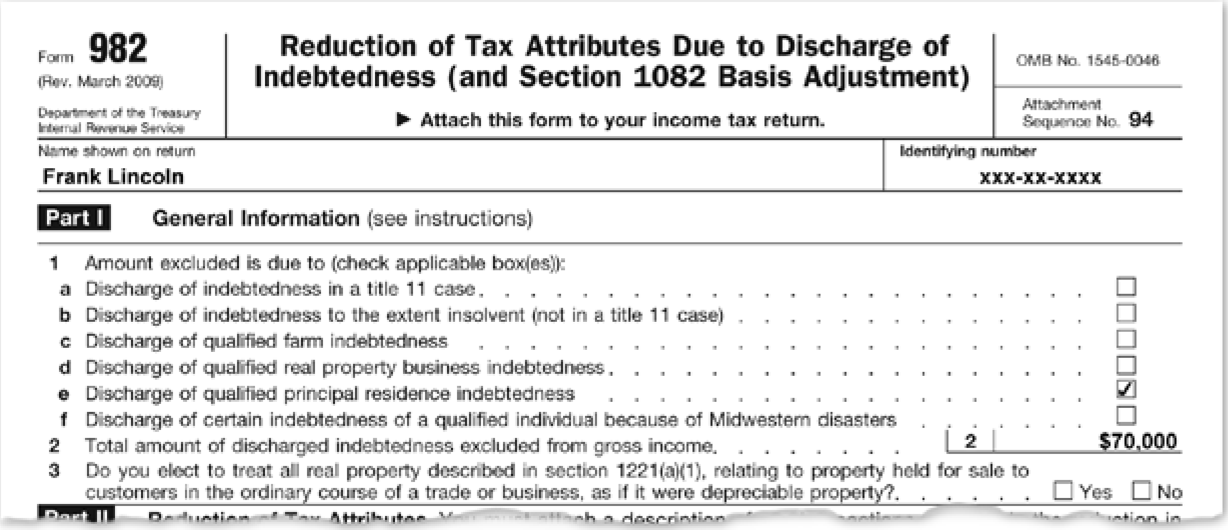
Part II **Long-Term Capital Gains and Losses—Assets Held More Than One Year**

	(a) Description of property (Example: 100 sh. XYZ Co.)	**(b)** Date acquired (Mo., day, yr.)	**(c)** Date sold (Mo., day, yr.)	**(d)** Sales price (see page D-7 of the instructions)	**(e)** Cost or other basis (see page D-7 of the instructions)	**(f) Gain or (loss)** Subtract (e) from (d)
8	**Main Home- 1099-C Foreclosure**	**05/14/2003**	**06/29/2009**	**$125,000**	**$200,000**	**0**
	Loss not deductible-Pers. residence					

9	Enter your long-term totals, if any, from Schedule D-1, line 9	9	
10	**Total long-term sales price amounts.** Add lines 8 and 9 in column (d)	10	
11	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	
12	Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1	12	
13	Capital gain distributions. See page D-2 of the instructions	13	
14	Long-term capital loss carryover. Enter the amount, if any, from line 15 of your **Capital Loss Carryover Worksheet** on page D-7 of the instructions	14	( )
15	**Net long-term capital gain or (loss).** Combine lines 8 through 14 in column (f). Then go to Part III on the back	15	0

For Paperwork Reduction Act Notice, see Form 1040 or Form 1040NR instructions. Cat. No. 11338H **Schedule D (Form 1040) 2009**

Tax Software Hint: When using tax software, you may have to force the net amount in column (f) to zero (-0-) in a loss situation.



Form **982**
(Rev. March 2009)
Department of the Treasury
Internal Revenue Service

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

▶ **Attach this form to your income tax return.**

OMB No. 1545-0046
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 ☑
- f Discharge of certain indebtedness of a qualified individual because of Midwestern disasters ☐

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.**

example (continued)

If Frank had been able to negotiate a work-out with his mortgage lender (reducing the amount he owed on the mortgage and staying in the home), he would not have completed Schedule D (because he didn't dispose of the asset). His Form 982 would be similar to the one shown, but he would also have entered the amount of debt forgiven on line 10b (or his basis in the home, whichever was smaller), and his basis in the home would be decreased by that amount.

EXERCISES (continued)

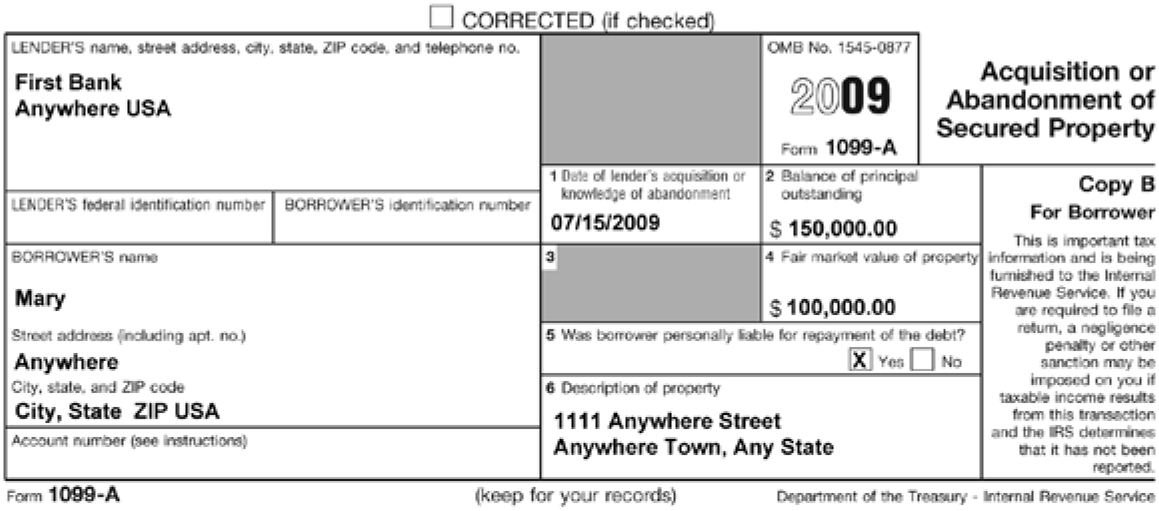
Question 7: Mary purchased her main home in June 2004 for $175,000. In 2009, she lost her job and was no longer able to make her mortgage payments. In July, Mary moved out of the home to live with relatives. On July 15, 2009, the bank foreclosed on the home. On November 15, 2009, the bank discontinued 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.

Assign the exercise.

Review answer with the class when complete.

Does Mary's mortgage debt qualify for the principal residence indebtedness exclusion on Form 982? ☑ **Yes** ☐ No

Is Schedule D required? ☑ **Yes** ☐ No



☐ CORRECTED (if checked)

LENDER'S name, street address, city, state, ZIP code, and telephone no.
First Bank
Anywhere USA

OMB No. 1545-0877
2009
Form 1099-A

Acquisition or Abandonment of Secured Property

LENDER'S federal identification number
BORROWER'S identification number

1 Date of lender's acquisition or knowledge of abandonment
07/15/2009

2 Balance of principal outstanding
$ **150,000.00**

Copy B
For Borrower

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.

BORROWER'S name
Mary

3

4 Fair market value of property
$ **100,000.00**

Street address (including apt. no.)
Anywhere

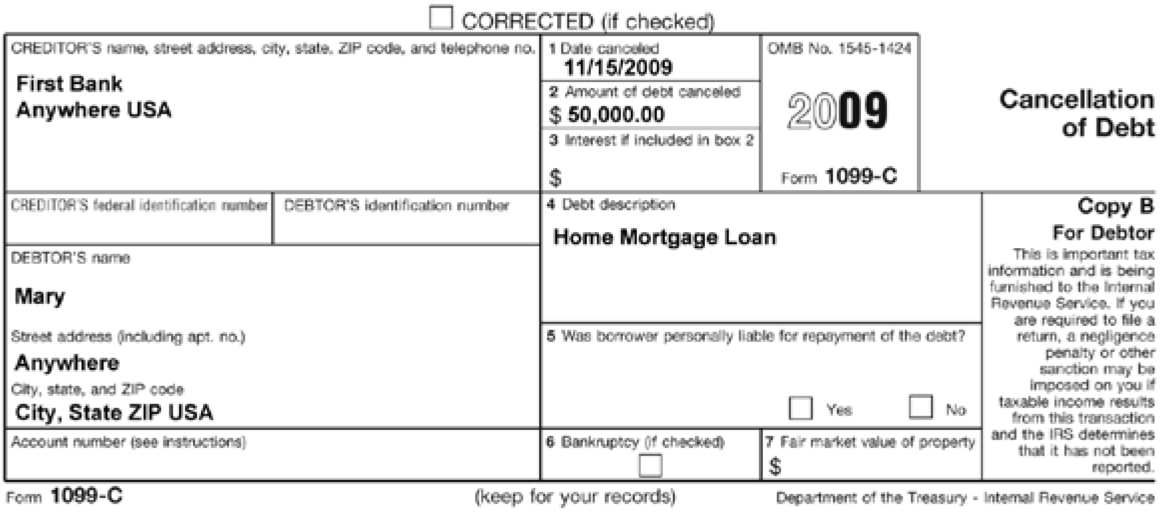
5 Was borrower personally liable for repayment of the debt? ☒ Yes ☐ No

City, state, and ZIP code
City, State ZIP USA

6 Description of property
1111 Anywhere Street
Anywhere Town, Any State

Account number (see instructions)

Form **1099-A** (keep for your records) Department of the Treasury - Internal Revenue Service



☐ CORRECTED (if checked)

CREDITOR'S name, street address, city, state, ZIP code, and telephone no.
First Bank
Anywhere USA

1 Date canceled
11/15/2009

2 Amount of debt canceled
$ **50,000.00**

3 Interest if included in box 2
$

OMB No. 1545-1424
2009
Form 1099-C

Cancellation of Debt

CREDITOR'S federal identification number
DEBTOR'S identification number

4 Debt description
Home Mortgage Loan

Copy B
For Debtor

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
Mary

Street address (including apt. no.)
Anywhere

5 Was borrower personally liable for repayment of the debt? ☐ Yes ☐ No

City, state, and ZIP code
City, State ZIP USA

Account number (see instructions)

6 Bankruptcy (if checked) ☐

7 Fair market value of property
$

Form **1099-C** (keep for your records) Department of the Treasury - Internal Revenue Service

EXERCISES (continued)

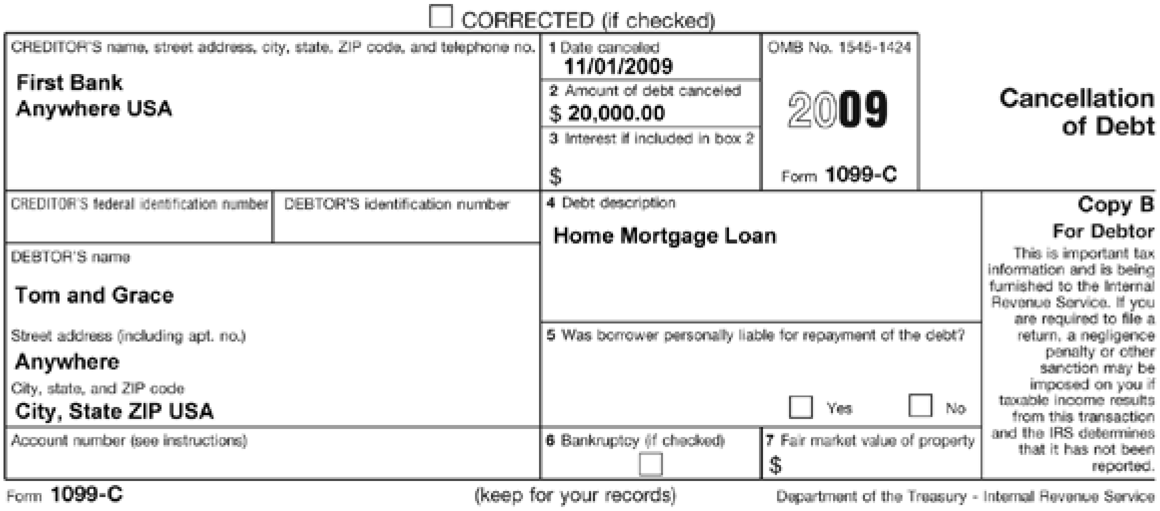
Assign the exercise.

Review answer with the class when complete.

Question 8: Tom and Grace were having difficulty making their mortgage payments in 2009 after Tom became ill and couldn't work full time. Rather than go through the expense of a foreclosure, the lender agreed to reduce the principal on their loan and refinance the loan with a better interest rate and lower payments. The principal balance before the 11/1/2009 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 improve the principal residence.

Does Tom and Grace's debt cancellation qualify for the principal residence indebtedness exclusion on Form 982? ☑ **Yes** ☐ No

Is Schedule D required? ☐ Yes ☑ **No**



☐ CORRECTED (if checked)

CREDITOR'S name, street address, city, state, ZIP code, and telephone no.
First Bank
Anywhere USA

1 Date canceled
11/01/2009

2 Amount of debt canceled
$ **20,000.00**

3 Interest if included in box 2
$

OMB No. 1545-1424

2009

Form **1099-C**

Cancellation of Debt

CREDITOR'S federal identification number

DEBTOR'S identification number

DEBTOR'S name
Tom and Grace

Street address (including apt. no.)
Anywhere

City, state, and ZIP code
City, State ZIP USA

Account number (see instructions)

4 Debt description
Home Mortgage Loan

5 Was borrower personally liable for repayment of the debt? ☐ Yes ☐ No

6 Bankruptcy (if checked) ☐

7 Fair market value of property
$

Copy B
For Debtor

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.

Form **1099-C** (keep for your records) Department of the Treasury - Internal Revenue Service

Assign the exercise.

Review answer with the class when complete.

Question 9: Fred went to his local VITA site to have his 2009 tax return prepared. The volunteer went through his records and noticed he had Form 1099-C reflecting a canceled debt of $50,000.

Using Publication 4731, Screening Sheet for Cancellation of Debt, for assisting taxpayers with Form 1099-C as a guide, the volunteer learned Fred lost his job in 2009 and could no longer make his mortgage payments. The bank foreclosed on his home. Due to the housing market slump, the value of Fred's home had declined. 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 sales price.

Upon further questioning, the volunteer learned Fred had refinanced his home 2 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**

Summary

This lesson covered how to report the sale of stock and the taxable portion of a sale of a residence. It also covered how to report the cancellation of debt income on a taxpayer's principal residence.

Review the lesson summary with the class.

A taxpayer must use 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.

Under the Mortgage Forgiveness Debt Relief Act of 2007, taxpayers may exclude 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.

VITA/TCE tax preparers with Advanced certification may assist taxpayers with canceled or forgiven mortgage debt issues on a limited basis. Use Publication 4731, Screening Sheet for Form 1099-C, which provides questions and step-by- step guidance for the volunteer tax return preparer.

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.

TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem, practice exercise(s), or supplements 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.

Assign the workbook exercise and review as a class when done (optional).

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 advanced part of 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.

EXERCISE ANSWERS

Answer 1: *A. You never adjust the sales price. If box 2 shows gross proceeds, you need to add the broker's fee to the basis or purchase price of the stock.*

Answer 2: *A. Only Marriah sold stock and received Form 1099-B.*

Answer 3: *B. The sales price was $4,400, which was $1,900 more than the adjusted basis of $2,500 ($2,400 cost + $100 commission) of the shares.*

Answer 4: *Yes. Emily meets the ownership and use test because she owned and lived in the home for at least two years of the five-year period ending on the date of the sale.*

Answer 5: *The amount realized on Jan's sale is $180,000 (selling price minus selling expenses).*

Answer 6: *C. The only circumstance that will allow the taxpayer to exclude the gain is if he can extend the five-year period due to official extended military duty.*

Answer 7: *Yes. The volunteer would need to complete Schedule D and Form 982. Although there is a loss, it cannot be deducted, and, per the instructions it is reported as zero on Schedule D. 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 8: *Yes. The volunteer would complete Form 982. The $20,000 in debt cancellation is covered by qualified principal residence indebtedness exclusion on Form 982 and is not counted as income on the tax return. In addition to completing box 1e and line 2, the volunteer would also need to complete line 10b to report the reduction in the basis of the home. Schedule D is not required because Tom and Grace did not dispose of the home.*

Answer 9: *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 per the guidance on the screening sheet.*

Lesson 11: Income – Retirement Income; Form 1040, Lines 15-16

Instructor Notes

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, 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:

- 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

Review objectives with the class.

What is retirement income?

Retirement income can include social security benefits as well as any 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?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 17
- ☐ Publication 4491-W

Optional:

- ☐ Publication 575
- ☐ Publication 590
- ☐ Publication 721
- ☐ Publication 919
- ☐ Publication 939
- ☐ Form 1040 Instructions
- ☐ Form 1099-R
- ☐ Form 5329
- ☐ Form 8606
- ☐ Form W-2
- ☐ Form W-4P
- ☐ Form W-4V
- ☐ Simplified Method Worksheet

Point out the resources cited under **What do I need?**

Where can I get information about a taxpayer's retirement income?

To determine if the taxpayer must report retirement income, use the interview techniques and tools discussed in the Screening and Interviewing lesson. 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 income was 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.

Emphasize the need to be considerate in probing for information.

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.

Emphasize that the Intermediate level covers Pension income where the taxable amount is predetermined; the Advanced level covers computing the taxable amount.

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, Intermediate certified volunteers can complete the return. In general, if the taxable amount is not indicated, volunteers certified in Advanced, Military, and/or International must calculate the taxable portion using the Simplified Method Worksheet.

Display or refer to the 1099-R Pension and Annuity Income illustration in the Volunteer Resource Guide (Tab 2).

What if the taxable portion is already calculated?

In many instances, the payer will compute the taxable portion of the distribution and report it in box 2a of Form 1099-R. Taxpayers with Form RRB-1099-R can only be helped by volunteers certified in the Advanced, Military, or International courses, because the taxable portion is not shown on the form.

Tax Software Hint: Refer to the Volunteer Resource Guide (Tab 2), 1099-R Pension and Annuity Income.

If preparing a paper return, record the amounts as follows:

- The gross amount (box 1 of Forms 1099-R, CSA- and CSF-1099-R) should be shown on Form 1040, line 16a, or on Form 1040A, line 12a
- If the IRA/SEP/SIMPLE box is checked on Form 1099-R, report the gross amount on Form 1040, line 15a, or on Form 1040A, line 11a
- The taxable amount (box 2a of Forms 1099-R, CSA- and CSF-1099-R) should be shown on Form 1040, line 16b, or on Form 1040A, line 12b
- If the IRA/SEP/SIMPLE box is checked on Form 1099-R, report the taxable amount on Form 1040, line 15b, or on Form 1040A, line 11b

Any amount in box 4 of 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?

If the payer did not include an amount in box 2a of 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 that is needed to calculate the taxable portion of distributions from IRAs, pensions, or annuities.

What do I need to know about retirement income distributions?

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.

TIP

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.

Employee Contributions	Contributions		Taxability of Distributions	
	Before-Tax	After-Tax	Fully	Partially
No	n/a	n/a	Yes	—
Yes	Yes	—	Yes	—
Yes	—	Yes	—	Yes

example

Mark retired in 2009 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.

Ask a volunteer to read the Mark example.

Read the tip to the class.

TIP

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 with a check in box 7. 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

Review the definitions in the tip.

TIP

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; that portion may be total or partial.

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.

Ask a volunteer to read the Richard example.

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 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 59 1/2, 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)

Review the different ways each type of IRA is handled.

If the above requirements are not met, the Roth IRA distributions could be partially taxable and subject to a 10% additional tax. Refer taxpayers in this situation to a professional tax preparer.

TIP

Taxpayers are considered disabled if they cannot engage in any substantial gainful employment because of a physical or mental condition. A physician must determine that the condition can be expected to result in death or to be of long, continued, and indefinite duration.

CAUTION

The next two topics are out of scope for VITA. The definitions are included for your information only.

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

Assign the exercises.

Review the answers with the class when complete.

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**

Nondeductible contributions to traditional IRAs are not taxed when distributed.

Question 2: Mary opened a Roth IRA 3 years ago. In 2009, 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**

She did it before the 5-year period ended.

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

It was made six years after her first contribution and after age 59½.

How are IRA distributions reported?

Traditional IRA

If IRA/SEP/SIMPLE is checked in box 7 of 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 it on Form 1040A, lines 11a and 11b or on Form 1040, lines 15a and 15b. If not, the distribution is partially taxable. In that case, refer the taxpayer to a professional tax preparer.

TIP

An early distribution from a traditional or Roth IRA may be subject to a 10% additional tax. Refer to lesson 28, Other Taxes, for more information.

TIP

Distributions from a SIMPLE IRA and from a SEP IRA are generally fully taxable and are out of scope for VITA/TCE.

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 will 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 a similar retirement account within 60 days.

Form 1099-R will be issued to the taxpayer by the financial institution. If it was a direct rollover by the institution to another institution, box 7 will contain code G. If there is no code G, then the taxpayer must have redeposited 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.

Point out the explanations of box 7 codes in the software, or on the back of Form 1099-R.

Tax Software Hint: Additional information must be entered for retirement account rollovers. Refer to the Volunteer Resource Guide (Tab 2), 1099-R Exclusion Worksheet.

If you are preparing a paper return, the amount of the distribution is reported on Form 1040A, line 11a or on Form 1040, line 15a. To show that this is a qualified rollover and none of the amount is taxable, enter zero on Form 1040A, line 11b or on Form 1040, line 15b, and write "Rollover" next to line 11b or 15b.

EXERCISES (continued)

Question 4: Andrew changed jobs and received Form 1099-R from his previous employer in 2009. The 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 excludible 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

Excluded from income because it was rolled over into an IRA.

Assign the exercise.

Review the answer with the class when complete.

What if the distribution is used for charitable purposes?

The taxpayer can have a qualified charitable distribution (QCD) made to an organization eligible to receive tax-deductible contributions. If all requirements are met, this action will exclude any part of the distribution that would normally be taxable. Form 1099-R will be issued to the taxpayer; there is no distribution code for box 7 that identifies a QCD.

The requirements for a QCD include:

- The taxpayer must be at least 70½ years old at the time of the distribution.
- Only distributions from traditional IRAs are eligible for this treatment.
- The distribution must be made by the trustee directly to the eligible organization.
- The amount cannot be more than $100,000. (On a joint return, the spouse is eligible for the same amount.)
- The amount cannot be included with other charitable contributions on Schedule A.

The taxpayer may have marked the box for “Charitable contributions” on the approved intake and interview sheet. If there is a Form 1099-R for a traditional IRA account and the taxpayer (or spouse) is at least 70½ years old, ask if any of the funds were a direct transfer to a charitable organization.

Taxpayers should have a written acknowledgment from the recipient stating:

- The organization’s name
- The amount
- The date
- A statement indicating there was no personal benefit to the taxpayer

This amount counts toward the required minimum distribution.

If any part of the distribution is a return of after-tax contributions, Form 8606, Nondeductible IRAs, may need to be completed. 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.

Tax Software Hint: You must indicate in the software if a qualified charitable contribution was made. Refer to the Volunteer Resource Guide (Tab 2), 1099-R Exclusion Worksheet.

If you are preparing a paper return, enter the total distribution on Form 1040, line 15a. Write "QCD" next to the amount on line 15b. This will indicate that all or part of the distribution is not taxable because it met the requirements of a QCD.

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 (box 7 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

TIP

Social security benefits and IRA distributions are not reported on the pension line of the tax return.

Ask a volunteer to read the Sue example.

example

Sue worked for a software development company for 20 years. She retired in 2009 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

There are two methods used to figure the taxable portion of each pension or annuity payment: the General Rule and the Simplified Method. Unless an exception applies, retirees must use the Simplified Method for annuity payments from a qualified plan. 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.

Display the Volunteer Resource Guide (Tab 2), 1099-R Exclusion Worksheet illustration of the Simplified General Rule.

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.

Taxpayer's cost basis ÷ Number of monthly payments = Monthly Tax-Free Portion

Emphasize to students that the ages of both taxpayers must be used with a joint/survivor annuity.

Tax Software Hint: Refer to the Volunteer Resource Guide (Tab 2), 1099-R Exclusion Worksheet.

If preparing a paper return, use the Simplified Method Worksheet found in the Form 1040A and Form 1040 Instructions to calculate the taxable portion to be reported on line 12b/16b of the return. Do not forget to include any amounts in box 4 of Form 1099-R in the Payments section of the tax return.

To calculate the taxable portion of a pension or annuity using the Simplified General Rule, you will need certain information:

- The cost in the plan (box 9b of Form 1099-R)
- The taxpayer's age on the date the annuity began (and the spouse's age if joint/survivor annuity is selected)
- 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 in 2009. 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.

Ask a volunteer to read the Melvin example.

EXERCISES (continued)

Question 5: Dotty worked for the local tire plant for 32 years. She retired in June of 2009 and receives a monthly pension of $1,679. (She received six payments for July through December 2009.) 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

The amount is fully taxable because she never paid income taxes on employer contributions.

Assign the exercise.

Review the answer with the class when complete.

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.

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:

TIP

If disability pay is treated as wages, it might affect Earned Income Tax Credit.

- 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

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 preparing a paper return and the taxpayer has not reached the minimum retirement age, report the disability income as wages on line 7 of Form 1040A or Form 1040. If the taxpayer has reached the minimum retirement age, report the disability income as a taxable pension on the appropriate lines of Form 1040A or Form 1040.

Assign the exercise.

Review the answer with the class when complete.

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. 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

B. Line 16a

C. Line 16b

D. Line 7

Annie Jo is below minimum retirement age so the income is reported as 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. 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 (Tab 2), 1099-R Exclusion Worksheet.

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. The completion of this form is not included in the VITA/TCE training. Refer taxpayers who must complete Form 5329 to a professional tax preparer.

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 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 payment must have been made:

- Because the plan participant died
- After the participant reached age 59 1/2
- 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

Review the criteria for a lump-sum distribution.

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, box 7 indicates a distribution code of A, it is a lump-sum distribution and qualifies 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 59 1/2. Early distributions can be subject to an additional 10% tax. The tax applies to the taxable portion of the distribution or payment.

Certain early distributions are excluded from the early distribution tax. If the distribution code in box 7 of Form 1099-R is 2, 3, or 4, the taxpayer does not have to pay the additional tax.

If the distribution code in box 7 is 1, the taxpayer will be subject to the additional 10% tax, unless an exception applies. If preparing a paper return, enter 10% of the taxable amount in the Other Taxes section of Form 1040 and write “No” on the line to indicate Form 5329 is not required. However, if after reviewing Publication 17, Individual Retirement Arrangements (IRAs) or Retirement Plans, Pensions and Annuities, you determine that the taxpayer meets one of the exceptions and does not have to pay the additional tax, refer the taxpayer to a professional tax preparer.

Minimum Distributions

To avoid an additional tax, participants in retirement plans must begin taking a Required Minimum Distribution (RMD) by a previously 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 if the taxpayer is employed. 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.

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.

CAUTION

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.

Ask a volunteer to read the caution.

Check student understanding of this section.

NEW Temporary Waiver of Required Minimum Distributions (RMDs) for 2009

For 2009, taxpayers are not required to take an RMD from their IRAs or defined contribution plans. This waiver applies to plan participants as well as to beneficiaries. The waiver also applies to taxpayers who turned 70 1/2 in 2009 and delayed their 2009 RMD until April 1, 2010. The waiver does not apply to RMDs for 2008, even if the taxpayer turned 70 1/2 in 2008 and chose to take the 2008 RMD by April 1, 2009.

Ask a volunteer to read the examples.

example

Ralph retired in 2003. He turned 70½ in 2008. He must begin taking minimum distributions from his qualified plans by April 1, 2009.

example

Myrna was 72 when she retired in 2008. She must begin taking minimum distributions from her qualified plans by April 1, 2009. The waiver does not apply to her required minimum distribution for 2008, even though she has until April 1, 2009 to take it.

example

Sam retired in 2005. He turned 70 1/2 in 2009. The temporary waiver of RMDs for 2009 applies to Sam.

example

Irving was still employed when he turned 72 on March 12, 2009. He was required to begin taking minimum distributions from his traditional IRA after age 70½ even though he was not yet retired. He turned 70½ on September 12, 2007 and began taking minimum distributions before April 1, 2008. Irving is not required to take an RMD from his IRA in 2009 due to the temporary waiver.

Withdrawal of Excess IRA Contributions

An excess IRA contribution is the amount contributed to a traditional IRA during the year that is more than the smaller of:

- $5,000 ($6,000 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. 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, 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.

Assign the exercises.

Review the answers with the class when complete.

EXERCISES (continued)

Question 7: Taxpayers who withdraw excess contributions by the end of the tax year are not subject to an additional 6% tax on the excess contribution.
☑ **True** ☐ False

They must withdraw excess contributions/earnings by the return due date to avoid the tax.

Question 8: Helen turned 71 on March 17, 2009. She retired in 2001. 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, 2009

B. Take a distribution of at least $1,479 by April 1, 2009

C. Take a distribution of $2,958 by December 31, 2009

D. Not take any distributions until 2010

The $1,479 is for tax year 2008, the year Helen reached 70½ years old. Due to the temporary waiver, an RMD is not required for 2009.

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 Concluding the Interview lesson.

Sometimes taxpayers are not aware that they can request federal income tax to 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.

For additional help, taxpayers can refer to Publication 919, How Do I Adjust My Tax Withholding?, or visit the IRS Web site at 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 have enough federal income tax paid 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.

TIP

Taxpayers who receive a very large refund may make better use of their funds if the withholding is lowered. Explain ways they can reduce their withholding.

EXERCISES (continued)

Assign the exercise.

Review the answer with the class when complete.

Question 9: Faith comes to your site to get her 2009 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, 2010. 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

This form is used to request a change in withholding on a pension.

Summary

Review the lesson summary.

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.

TAX LAW APPLICATION USING THE WORKBOOK

Assign the workbook exercise and review as a class when done (optional).

To gain a better understanding of the tax law, complete the comprehensive problem, practice exercise(s), or supplements 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 intermediate and advanced parts of 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.

EXERCISE ANSWERS

Answer 1: *False. In addition to Roth IRAs, nondeductible contributions to traditional IRAs are also not taxed when they are distributed.*

Answer 2: *False. Mary's distribution was not made after the 5-year period beginning with the first taxable year she made a contribution to her Roth IRA. Therefore, the earnings/investment gains portion of the distribution will be taxable income. (She may also owe an additional tax on early distributions. This will be discussed in Lesson 28.)*

Answer 3: *True. Amy's distribution can be excluded from her taxable income because it was made more than five years after the beginning of the taxable year of her first contribution, and it was made on or after age 59½.*

Answer 4: *B. Andrew can exclude the entire distribution from income because it was rolled over into an IRA within the allowed 60-day period.*

Answer 5: *C. Dotty's entire pension amount of $10,074 (6 x $1,679) is fully taxable because she has never paid income taxes on her employer's contribution to her pension.*

Answer 6: *D. Because Annie Jo has not reached the minimum retirement age set by her employer, you should report her disability income as wages on line 7 of her Form 1040.*

Answer 7: *True. Taxpayers must withdraw excess contributions and any earnings by the due date of the return (including extensions) to avoid the additional 6% tax on the excess contribution.*

Answer 8: *B. Taxpayers are required to begin receiving distributions from their qualified plan by April 1 of the calendar year following the year in which they reach age 70½. Helen was 70½ by the end of 2008. She should take a distribution of $1,479 for tax year 2008 by April 1, 2009. Due to the temporary waiver, an RMD is not required in 2009.*

Answer 9: *A. Generally, Form W-4P, Withholding Certificate for Pension and Annuity Payments, is used to request a change in withholding on a pension.*

Notes

Lesson 12: Income – Rental and Schedule K-1s

Instructor Notes

Introduction

This lesson will help you identify and report certain income from Schedule K-1s; Form 1041, Form 1065, and Form 1120S. This topic is in-scope for the first time this year for Advanced, Military and International courses.

This lesson also covers rental income and expenses for the Military and International courses.

> **CAUTION**
>
> The at-risk and passive activity issues in this lesson are beyond the usual scope of volunteer training, with the exception of assisting military and other government employees living abroad and with limited access to both resources and professional preparers.

To determine if a taxpayer needs to file Schedule E, use the interview techniques and tools discussed in the Screening and Interviewing lesson. The approved intake and interview sheet lists income from rental property, but does not list income from Schedule K-1s. It is important to ensure that all income is accurately reported on the return. Ask taxpayers if they rented out their home or other property during the tax year or if they received a Schedule K-1 (Form 1041, Form 1065, or Form 1120S) from a trust, partnership, or S corporation.

> **CAUTION**
>
> This lesson does not apply to taxpayers who are in the actual business of renting properties.

What do I need?

☐ Approved Intake and Interview Sheet
☐ Volunteer Resource Guide
☐ Publication 17
☐ Publication 4491-W
☐ Publication 541
☐ Publication 527
☐ Publication 551
☐ Schedule A
☐ Schedule E

Optional:

☐ 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)

Objectives

Review objectives with the class.

Point out the resources cited under **What do I need?**

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 program
- Determine how to report Schedule K-1 income items
- Determine which types of rental income must be reported
- Identify how to report rental expenses

NEW Schedule K-1s

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. Accurate filing of the forms is important because the IRS matches income from Schedule K-1 to other tax returns. The income, other distributions, deductions, and credits will be reported on Forms 1041, 1065, or 1120S.

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 program includes:

- Interest income (Schedule B)
- Dividend income (Schedule B)
- Net short-term capital gains and losses (Schedule D)
- Net long-term capital gains and losses (Schedule D)
- Tax-exempt interest income (Form 1040, line 8b)

CAUTION

Any other income, deductions, credits, etc. reported on Schedule K-1 is out of scope for VITA/TCE 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 the 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 page 2 of Form 1041, Schedule K-1.

Tax Software Hint: The name and identification number of the estate or trust are reported in Part III of Schedule E. For software entries, see the Volunteer Resource Guide (Tab 2), Income.

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. Although the partnership is not subject to income tax, the taxpayer is liable for tax on their share of the partnership income, whether that income is distributed or not.

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 taxpayer is liable for tax on their share of the corporation’s income, whether that income is distributed or not.

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. Page 2 of Schedule K-1 lists the appropriate forms and schedules where the taxpayer's income from these sources should be reported.

Tax Software Hint: The name and identification number of the partnership or S corporation are reported in Part II of Schedule E. For software entries, see the Volunteer Resource Guide (Tab 2), Income.

TIP

Schedule K-1s are not filed with the tax return. Advise taxpayers to keep Schedule K-1s with their records.

What is rental income?

Renting a room or a home to a tenant is an income-producing activity. 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
- Payments for breaking a lease
- Expenses paid by the tenant
- Fair market value of property or services received in exchange for rental payments

TIP

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; the accrual method reports income when earned and expenses when incurred. Most individuals use the cash basis method.

Tax Software Hint: Use Schedule E to report rental income only when taxpayer is not in the business of renting property. For software entries, see the Volunteer Resource Guide (Tab 2), Schedule E – Rental Income and Loss.

CAUTION

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 report mortgage interest and property taxes as itemized deductions on Schedule A. However, when a taxpayer rents out a home, those become rental expenses along with the cost of repairs, maintenance, and certain other operating expenses.

What about mortgage interest and property taxes?

Mortgage interest 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, etc.) 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 maintaining 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.

TIP

Generally, mortgage interest expense is fully deductible. However, refer taxpayers with rental-related interest expenses other than mortgage interest to a professional tax preparer.

Ask a volunteer to read the Paul example. Answer any student questions.

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 (Jan – Sept) of mortgage interest and property taxes as itemized deductions on Schedule A, i.e. $1,800 and $450, and the other three months (Oct-Dec) as expenses on Schedule E, i.e. $600 and $150.

Assign the exercise.

Review the answer with the class when complete.

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

John lived in the home for 8 of 12 months. He rented the home 4 of 12 months. The amount he can claim on Schedule E is 4/12.

What about property insurance?

The property insurance 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 which covers the current year.

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
- Property taxes
- Mortgage interest and points
- Legal and professional fees
- Property management fees
- Repairs
- Utilities paid for the tenant
- Other rental-related expenses, such as rental of equipment and long distance phone calls, condominium/cooperative maintenance fees, etc.

TIP

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.

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 into or outside of the U.S., the taxpayer 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. The standard mileage rate of operating your car for rental-related trips is 55 cents a mile.

The standard mileage method multiplies the miles driven for business by a standard cost. 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
- The vehicle was leased and used the standard method for the life of the lease

The standard mileage rate for miles driven for business purposes is 55 cents per mile. The actual expense method figures the deduction based on a variety of factors, including gasoline, oil, repairs,insurance, rentals, and may even involve depreciation or the value of a vehicle provided by the taxpayer's employer.

TIP

This lesson discusses only the standard mileage rate. If the taxpayer wishes 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, or adapts it to new uses; the cost must be depreciated over the recovery period for the improvement. The total cost of an improvement includes material, labor, and installation.

TIP

Additional information on rental income can be found in Publication 527, Residential Rental Property, and Publication 946, How to Depreciate Property.

Tax Software Hint: For software entries, go to Schedule E - Rental Income and Loss in the Volunteer Resource Guide (Tab 2).

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 hot water tank
Repairing the roof	Putting on a new roof
Repairing appliances	Replacing/adding major appliances

Assign the exercises.

Review the answers with the class when complete.

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 tenant

D. Repairs made to the homeowner's personal residence

Costs and fees must relate to the rental property to be deductible as rental expenses.

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

D. Repairing a broken furnace

Fencing adds to the value of the property so it cannot be deducted as a rental expense; it must be depreciated over the useful life of the improvement.

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.

Point out if taxpayers don't claim the correct amount of depreciation every year, they must still reduce their basis by the amount of depreciation they could have deducted.

"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.

The annual amount of depreciation on property reduces the taxpayer's 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 affect depreciation?

The factors that affect the depreciation amount are:

- Depreciation method
- Basis of the property
- Recovery period for the property

Depreciation Method

The most common methods for determining depreciation are:

- Property placed in service before 1981: Straight line or declining balance
- Property placed in service after 1980 but before 1987: ACRS (Accelerated Cost Recovery System), and
- Property placed in service after 1986: MACRS (Modified Accelerated Cost Recovery System)

This training focuses on the MACRS method.

Assign the exercises.

Review the answers with the class when complete.

EXERCISES (continued)

Question 4: Taxpayers have the option of not claiming a depreciation deduction they are entitled to and avoid reducing the basis in their depreciable property.

☐ True ☑ **False**

Taxpayers should claim the correct amount of depreciation every year.

Question 5: All of the following property may be depreciable EXCEPT ___.

A. Furniture

B. Buildings

C. Land

D. Vehicles

The value of land is not depreciable; furniture and vehicles are depreciable property.

EXERCISES (continued)

Question 6: Which method of depreciation is used for property placed in service after 1986?

A. Straight line

B. MACRS

C. ACRS

D. Declining balance

MACRS (modified ACRS) is the method used for 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 on which it sits. 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.

TIP

For taxpayers who built their own home or acquired it as an inheritance or gift, the basis may not be the original cost. For more information, see Publication 551, Basis of Assets.

Ask a volunteer to read the Carlos and Vanetta example. Answer any student questions.

example

Carlos and Vanetta purchased a house in 1985 for $100,000. The value of the building was $85,000. They made no improvements. In 2009, they were transferred overseas and decided to rent out the home, which was their personal residence. The value of the house and land in 2009 was $125,000. The basis for depreciation is $85,000.

The basis of property must be increased or decreased to reflect certain adjustments before the depreciation deduction is computed. To find the adjusted basis, add the purchase price of a home to the cost of any improvements minus:

- Any casualty losses or depreciation previously deducted, and
- Land value

The basis of depreciable property should also be adjusted when it is acquired in a purchase with a trade-in. Again, the value of any associated land must be assessed and excluded from the basis of the property.

What are considered recovery periods?

The recovery period of property is the number of years over which the taxpayer recovers its cost or other basis. The MACRS method uses the class life of property to determine the length of time the property will be depreciated.

example

A set of major appliances that Mark Newcomb used in his rental property had an adjusted basis of $500. He acquired a set of new appliances with a fair market value of $2,000 by trading in the old appliances and paying $1,000 in cash. Although the fair market value of the new appliances was $2,000, Mark's basis for depreciation purposes is $1,500 (the $500 adjusted basis plus his $1,000 cash payment).

Ask a volunteer to read the Mark example.

EXERCISES (continued)

Question 7: The purchase price of Wayne's rental property, including land, was $255,000, when the value of the land was assessed at $155,000. He spent $50,000 on improvements to the building, and another $10,000 on landscaping. What is Wayne's basis for depreciation in the property?

A. $305,000

B. $255,000

C. $160,000

D. $150,000

Wayne's basis for depreciation is $150,000 ($255,000 minus $155,000 plus $50,000). The basis does not include landscaping expenses.

Assign the exercise.

Review the answer with the class when complete.

How do I figure the MACRS deduction?

To figure the MACRS deduction, you need to know the property's:

- Placed in service date
- Recovery period
- Depreciable basis

What is the placed in service date?

For depreciation purposes, property is considered placed in service when it is in a condition or state of readiness and availability for use. A property's depreciation deduction is prorated in the year it is placed in service. However, a depreciation deduction may not be claimed until the property is actually used either in business or for the production of income.

What are considered recovery periods under MACRS?

The recovery period of the property depends on the class the property is in. Each item of depreciable property is assigned to a property class. Property classes are based on the property's class life and determine its recovery period. Under General Depreciation System (GDS), the recovery period of an asset is generally the same as its property class. A table is available in Publication 527, Residential Rental Property, to help determine the correct recovery period for an item.

TIP

See Publication 946, How to Depreciate Property, Appendix A for Tables of Depreciation, which show the recovery periods for different property classes.

Under MACRS:

- A home converted in 1986, or later, to a rental property would be depreciated over a recovery period of 27.5 years
- A stove used in this same rental would be assigned a 5-year recovery period

Direct students to review the different types of property classes in Publication 527, Recovery Periods Under GDS.

Property located outside the U.S. has a longer recovery period than property in the U.S., and the taxpayer must use the Alternative Depreciation System (ADS) under MACRS. ADS generally increases the number of years over which the property is depreciated and therefore decreases the annual deduction. Residential rental property located in a foreign country is depreciated over a 40-year recovery period.

EXERCISES (continued)

Assign the exercise.

Review the answer with the class when complete.

Question 8: Which of the following properties would generally have the shortest recovery period for depreciation? (Use the table in Publication 527.)

A. A rental home located in the U.S.

B. A washing machine in a rental unit located in the U.S.

C. Improvements to a rental unit located outside the U.S.

D. A rental home located outside the U.S.

The recovery period of an appliance is shorter than that of a home; property inside the U.S. has a shorter recovery period than property outside the U.S.

Ask two volunteers to role-play the sample interview. Ask the rest of the class to listen and take notes.

Taxpayer Interview and Tax Law Application

As you use the approved intake and interview sheet with a taxpayer, ask questions to determine if they have any rental income and expenses. Use the Interview Tips to help obtain additional information, as shown in this sample interview.

SAMPLE INTERVIEW

VOLUNTEER SAYS...	TONY RESPONDS...
I see you were stationed overseas last year from March through December. Did you rent out your home during that time?	Yes. From February 1 through the end of the year. Actually, the tenant was there for thirteen months – he just moved out.
We only need to deal with last year. Now, during January of last year you were the only one living in the house?	Yes, that's right. How does all that affect my taxes?
For January, we'll report a twelfth of your mortgage interest and property taxes as itemized deductions on Schedule A. For February through December, we'll report your mortgage interest, most property taxes, the cost of maintenance and repairs, and other expenses on Schedule E.	O.K.
Now, how much did you receive in rent and other payments from February through December?	There was rent of $1,200 each month, and the last month's cleaning deposit.

SAMPLE INTERVIEW (continued)

VOLUNTEER SAYS...	TONY RESPONDS...
I have Form 1098 for your mortgage interest and the invoice for your property taxes. I'll need the amount of your homeowners insurance for the year. Did you have any other expenses related to renting, such as repairs or improvements?	Yes, just before I left the country, I spent $1,000 having the place painted and I installed a new refrigerator.
We'll report the paint job on Schedule E as an expense. We'll also work out the depreciation on both the house and the refrigerator.	

How do I handle rental property that the taxpayer also uses?

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 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 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.

Point out that taxpayers who rent out part of a property allocate mortgage interest and property taxes separately on both schedules.

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:

- 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 house to a tenant. The total square footage of her house is 1,200 square feet. 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

Ask a volunteer to read the Gloria example.

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

Assign the exercise.

Review the answer with the class when complete.

EXERCISES (continued)

Question 9: 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

The rental portion of utilities, home insurance, repairs, and depreciation are rental deductions claimed on Schedule E, but the personal portions are not reported on Schedule A.

How should taxpayers report rental expenses that exceed their rental income when they live in the home?

The way taxpayers report rental expenses depends on how much they use the property. How taxpayers report rental expenses that exceed their rental income depends on how much they use the property.

Taxpayers who do not use the rental home as their residence should:

- Include the rent as income, and
- Deduct all the rental expenses, even if expenses exceed income

Taxpayers who rent out their residence 15 days or more during the year should:

- Include the rent as income, and
- Deduct the rental expenses up to the rental income; expenses that exceed rental income may not be deductible

Taxpayers who rent out their residence fewer than 15 days during the year may *not* include the rent as income or deduct rental expenses.

Are there any limitations?

Deductibility limitations apply to rental expenses for a dwelling the taxpayer uses as a home more than the greater of:

- 14 days, or
- 10% of the number of days during the tax year the property is rented at fair market value

.

TIP

A residence or dwelling unit might be a house, apartment, condominium, mobile home, boat, or similar property. The limitations do not apply to hotels, motels, inns, or similar dwelling units.

example

Latricia converted the basement of her home into a one-bedroom apartment. She rented the apartment out at a fair rental price to college students during the nine-month school year. During June, Latricia's brother stayed in the apartment rent-free. (This is considered personal use.) Limitations apply to Latricia's rental expense deductions because the apartment was used for personal purposes for 30 days, which was more than the greater of:

- 14 days, or
- 10% of the 270 days it was rented (27 days)

Ask a volunteer to read the Latricia example. Answer any student questions.

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" if, for 12 or more consecutive months, they rented or tried to rent the dwelling unit at a fair rental price. In this case, days of personal use do not include the time the taxpayer used the property as his or her main home before or after renting it or offering it for rent.

This exception applies for the purposes of determining whether to limit the deductibility of rental expenses. It does not apply when dividing expenses between rental and personal use.

Direct students to review the Worksheet for Figuring Rental Deductions for a Dwelling Unit Used as a Home in Publication 17, Chapter 9, Rental Income and Expenses.

Any day the taxpayer spent working substantially full time repairing and maintaining the rental property is not counted as a day of personal use, even if the taxpayer's family members used the property for recreation purposes on the same day.

example

On February 28, 2008, Trent moved out of the house he had lived in for six years because he accepted a job in another town. He rented his house at a fair rental price from March 15, 2008, to May 14, 2009. On June 1, 2009, he moved back to town 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.

Ask a volunteer to read the Trent example. Answer any student questions.

EXERCISES (continued)

Question 10: Which of the following taxpayers cannot deduct any of their rental expenses?

A. Julio, who rented out his house eight months last year. After the tenants moved out, he let his sister and brother-in-law stay in the house two months rent-free.

B. Marcel, who rented a room of his condo all year and lived there himself 11 months.

C. Cherice, who offered a room for rent in her home all year, but had only one renter who stayed just one month.

D. Lois, who rented her home 12 days, then allowed her father to live there rent-free the rest of the year while she worked overseas.

Lois rented her home out fewer than 15 days during the year and used it for personal purposes by allowing her father to live there rent-free.

Assign the exercise.

Review the answer with the class when complete.

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 (Tab 2), Schedule E – Rental Income and Loss.

How do I handle rental losses?

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 law

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 is the Passive Activity Law?

The passive activity law states 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.

Passive vs. Active

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.

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.

TIP

For more information, see Publication 925, Passive Activity and At-Risk Rules.

example

Sally Jenkins, a U.S. citizen, lives in Europe and is paid $25,000 in wages by the U.S. Government, and $100 of interest income. She rented out her U.S. home and incurred $1,000 in rental loss for the tax year. Although her sister collects the rent, Sally makes all of the decisions as to whom, and for what amount, the property will be rented. While Sally is in Europe, she pays her sister to manage the property. Sally's rental loss of $1,000 may be offset against her gross income of $25,100 because she is considered to be an active participant in the rental activity.

Ask a volunteer to read the Sally example. Answer any student questions.

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)

Refer taxpayers with an AGI over $100,000 to the IRS or a professional tax preparer.

EXERCISES (continued)

Question 11: Which restriction limits the deductibility of rental loss to the amount of rental income?

A. Phase-Out of Offset

B. Passive activity law

C. Active participation rule

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.

Assign the exercise.

Review the answer with the class when complete.

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 adjusted gross income (AGI) of less than $100,000

Tax Software Hint: The tax software will automatically generate and complete Form 8582 if required. If any questions arise regarding whether to file or how to complete Form 8582, refer the taxpayer to the IRS or a professional tax preparer.

Assign the exercise.

Review the answer with the class when complete.

EXERCISES (continued)

Question 12: Which taxpayer is most likely required to file Form 8582, Passive Activity Loss Limitations?

A. Chelsea, who owns two rental dwellings with no net loss and has an AGI of $111,000

B. Lance, who owns one rental dwelling with a loss of $1,444, and has an AGI of $34,000

C. Sean, who owns one rental dwelling with a loss of $800, and has an AGI of $103,000

Sean wouldn't have to file Form 8582 if his AGI was less than $100,000 and he only had one passive rental loss.

Summary

Review the lesson summary with the class.

The taxpayer's income interest, dividends (ordinary and qualified), and capital gains (net short-term and net long-term) should be reported on the appropriate forms and schedules as listed on page 2 of Form 1041, Schedule K-1.

Taxpayers receive a Schedule K-1 (Form 1065 or Form 1120S) reporting the income they received from interest, dividends (ordinary and qualified), and capital gains (net short-term and net long-term) from partnerships and corporations. Page 2 of Schedule K-1 lists the appropriate forms and schedules where the taxpayer's income from these sources should be reported.

Rental income and deductible rental expenses are reported on Part I of Schedule E, Supplemental Income and Loss. 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. Those who rent out their homes:

- 15 days or more during the year may not be able to deduct rental expenses that exceed rental income
- Fewer than 15 days during the year should not report any of the income or deduct any of the rental expenses

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.

The passive activity law states 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.

TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem, practice exercise(s), or supplements 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.

Assign the workbook exercise and review as a class when done (optional).

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. Fencing adds to the value of the property, so the cost cannot be deducted as a rental expense. Instead, it must be depreciated over the useful life of the improvement.*

Answer 4: *False. Taxpayers should claim the correct amount of depreciation every year. If they don't, they still must reduce their basis in the property by the amount of depreciation that they could have deducted.*

Answer 5: *C. The value of land is not depreciable; furniture and vehicles are depreciable property.*

Answer 6: *B. MACRS (modified ACRS) is the method used for property placed in service after 1986.*

Answer 7: *D. Wayne's basis for depreciation is $150,000 ($255,000 minus $155,000 plus $50,000). The basis does not include landscaping expenses.*

Answer 8: *B. The recovery period of an appliance, based on its class life, is shorter than that of a home, and property located inside the U.S. has a shorter recovery period than property outside the U.S.*

Answer 9: *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 10: *D. Lois rented her home out fewer than 15 days during the year and used it for personal purposes by allowing her father to live there rent-free.*

Answer 11: *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.*

Answer 12: *C. If Sean had an AGI of less than $100,000, he wouldn't have to file Form 8582 because he had only one passive rental loss.*

Notes

Lesson 13: Income – Unemployment Compensation; Form 1040, Line 19

Instructor Notes

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?

☐ Approved Intake and Interview Sheet
☐ Volunteer Resource Guide
☐ Publication 17
☐ Publication 4491-W
☐ ***Optional:*** Form 1099-G

Review objectives with the class.

Point out the resources cited under **What do I need?**

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 most cases, it is taxable.

Ask the students to determine if unemployment compensation is earned income.

Refer students to the Volunteer Resource Guide (Tab H).

Where can I get unemployment compensation information?

Begin with the unemployment question on the approved 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, a taxpayer can elect to have federal income taxes withheld from their unemployment compensation benefits. Be sure to review box 4 of Form 1099-G for any federal income tax withheld.

How do I report unemployment compensation?

The total for all amounts of unemployment received in box 1 of Form(s) 1099-G should be entered on:

- Line 3 of Form 1040EZ
- Line 13 of Form 1040A
- Line 19 of Form 1040

The amount of withholding from Form 1099-G, box 4 should be entered on:

- Line 7 of Form 1040EZ
- Line 38 of Form 1040A, or
- Line 61 of Form 1040

NEW What’s different for 2009?

Under the American Recovery and Reinvestment Act, every taxpayer who receives unemployment benefits during 2009 is eligible to exclude the first $2,400 of these benefits. For a married couple, the exclusion applies to each spouse, separately. If both spouses receive unemployment benefits during 2009, each may exclude the first $2,400 of benefits they receive from their income.

If filing a paper return, there is no worksheet or form required to take this exclusion. The taxable amount is entered directly on page 1 of Form 1040. If Married Filing Jointly and both spouses received unemployment, deduct $2,400 from each spouse’s total benefit, then add the two amounts together and enter on the tax return. If one taxpayer received less than $2,400 in unemployment, their taxable amount is $0.

example

Mike and his wife Ana both received unemployment compensation during the tax year. Mike received $4,000, and Ana’s benefits totaled $1,800. Mike’s taxable amount is $1,600 ($4,000 - $2,400), but Ana’s taxable amount is $0 because she received less than $2,400. The total unemployment compensation income reported on their tax return will be $1,600.

Tax Software Hint: To review information related to the software, go to the Volunteer Resource Guide (Tab 2).

Practice – Vanessa Franklin

Direct students to Appendix A-16.

Let’s take a look at how a volunteer helped our taxpayer, Vanessa Franklin. Go to Appendix A-16 to determine if Vanessa has to report any unemployment compensation.

Summary

Review lesson summary.

This lesson explained:

- How to identify unemployment compensation
- How to report unemployment compensation
- How to exclude the first $2,400 of unemployment compensation for each taxpayer

Assign the workbook exercise and review as a class when done (optional).

TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem, practice exercise(s), or supplements 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.

Lesson 14: Income – Social Security Benefits; Form 1040, Line 20a

Instructor Notes

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.

To properly report income, use the interview techniques and tools discussed in the Screening and Interviewing lesson. The approved 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 Forms RRB-1099, Payments by the Railroad Retirement Board, and RRB-1099-R, Annuities or Pensions by the Railroad Retirement Board.

See Publications 575, Pension and Annuity Income, and 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
- Report social security and railroad retirement benefits on the tax return

Review objectives with the class.

Point out the resources cited under **What do I need?**

What do I need?

☐ Approved Intake and Interview Sheet
☐ Volunteer Resource Guide
☐ Publication 17
☐ Publication 4491-W

Optional:

☐ Publication 575
☐ Publication 915
☐ Form RRB-1099
☐ Form RRB-1099-R
☐ Form SSA-1099
☐ Social Security Benefits Worksheet

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, survivors, disability insurance (OASDI) benefits and some workers' compensation 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, can get a printout of benefits from their local social security office or request a replacement by accessing the Social Security Administration's web site at SSA.gov.

Form RRB-1099

Review how each type of retirement benefit is reported.

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 approved 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.

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 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. If the taxpayer received social security benefits and other income, complete the Social Security Benefits Worksheet to calculate the taxable portion.

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 are also taxable if the taxpayer is Married Filing Separately and lived with his or her spouse at any time during the year.

TIP

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, combine the income and benefits of both spouses when completing the worksheet. Even if one spouse received no social security benefits, include that spouse's other income when completing the worksheet. If both spouses received benefits, combine both their benefits and income when completing the worksheet for the return.

Complete the Social Security Benefits Worksheet in the Form 1040 Instructions to determine if any portion of the benefits is taxable.

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 worksheet to calculate if any of their benefits are taxable.

Ask a volunteer to read the Wanda and Dan example.

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. Go to the Volunteer Resource Guide (Tab 2), Railroad Retirement, Civil Service, and Social Security Benefits, for software entries.

If you are preparing a paper return, first complete the other income and certain adjustment items on Form 1040, page 1. Next, calculate the taxable amount of social security benefits by entering the box 5 amounts from all Forms SSA-1099 and RRB-1099 into the Social Security Benefits Worksheet in the Form 1040 Instructions. On Form 1040, enter the total amount of benefits received on line 20a and the taxable portion on line 20b. If none of the benefits are taxable, enter “0” on Form 1040, line 20b. If the taxpayer is itemizing deductions, include Medicare premiums (Part B and D) from the Forms SSA-1099 and RRB-1099 on Schedule A. Additionally, be sure to report any federal income tax withholding on the appropriate line of Form 1040, page 2.

The American Recovery and Reinvestment Act (ARRA) of 2009 provides a $250 payment to recipients of certain benefits received from the Social Security Administration or the Railroad Retirement Board. This economic recovery payment is not taxable, but it does reduce any making work pay tax credit the recipient may be entitled to. The economic recovery payment is covered in Lesson 29, Payments.

Assign the exercise.

Review the answer when complete.

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 in 2008. In 2009, he sold his farm and moved into senior housing. The sale of the farm 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

Up to 85% of a taxpayer's benefits can be taxable.

What are lump-sum benefit payments?

Some taxpayers may have received a lump-sum benefit payment in 2009. This payment could be for the current tax year and for prior tax years. Box 5 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.

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 in 2009, 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 (2009) and included on Form 1040, line 20b.

If the taxpayer chooses to spread the payments back to earlier years, only 2009 income will be adjusted. The taxpayer does not file amended returns for the earlier years. However, a special procedure must be used to figure the taxable portion of the benefits assigned to the earlier years. If taxpayers want to use this option, refer them to a professional tax preparer or to Publication 915.

EXERCISES (continued)

Question 2: Joan presents you with her Form SSA-1099, which includes a lump-sum benefit payment for both 2008 and 2009. For which option would you refer her to a professional tax preparer?

A. Averaging the benefit over the number of years

B. A special procedure used to figure the taxable portion of the benefits assigned to the earlier years

C. Reporting the whole payment in 2009

D. Reporting half the payment in 2008 and the other half in 2009

Assign the exercise.

Review the answer when complete. Emphasize that B and C are the only options available under the current tax law. Answers A and D are not allowable options.

Summary

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 must be completed 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 earlier year or years. Taxpayers who want to use the latter option should be referred to a professional tax preparer or Publication 915.

Review the lesson summary with the class.

TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem, practice exercise(s), or supplements 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.

Assign the workbook exercise and review as a class when done (optional).

If you are unable to complete the entire exercise, complete as much of it as you can. Come back later to finish the exercise after you covered 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.*

Answer 2: *B. There are only two options available for figuring the taxable portion of social security benefits paid as lump-sum benefit payments. The first option allows the taxpayer to report the whole payment in the year it was received. The other option is a special procedure that must be used to figure the taxable portion of the benefits assigned to the earlier years. Refer taxpayers who want to use this option to a professional tax preparer or to Publication 915.*

Notes

Lesson 15: Income – Other Income; Form 1040, Lines 21-22

Instructor Notes

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 requires using the contemporaneous exchange rate or, if not known, an average annual exchange rate.

This lesson will help you determine who is eligible for the foreign earned income exclusion and how to calculate the excludible amount by using Form 2555, Foreign Earned Income, or Form 2555-EZ, Foreign Earned Income Exclusion.

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
- How to properly report income earned from worldwide sources
- Who is eligible for the foreign income exclusion and how to calculate the excludible amount using Form 2555, Foreign Earned Income or Form 2555-EZ, Foreign Earned Income Exclusion

What do I need?

☐ Approved Intake and Interview Sheet
☐ Volunteer Resource Guide
☐ Publication 17
☐ Publication 54
☐ Publication 4491-W
☐ Form 1040 Instructions
☐ Form 2555
☐ Form 2555-EZ
☐ ***Optional:*** Publication 525

Review objectives with the class.

Point out the resources cited under **What do I need?**

How do I handle other income?

"Other income" is anything that does not have its own line on Form 1040. Here are examples:

- Prizes and awards
- Gambling winnings, including lotteries and raffles
- Jury duty fees
- Alaska Permanent Fund dividends

If you are unsure about sources of other income, consult the Volunteer Resource Guide (Tab D) and Publication 17, Other Income, or discuss the income item with your Site Coordinator.

CAUTION

Total gambling winnings must be reported on line 21 of Form 1040. If the taxpayer also had gambling losses, the losses can only be deducted on Schedule A. (See the Itemized Deductions lesson for more information.)

To ensure that all taxable income has been included, use the interview techniques and tools discussed in the Screening and Interviewing lesson.

How do I report other income?

In most cases, if a taxpayer has “other income” they must file Form 1040 and report the income on line 21.

Tax Software Hint: To review information related to the software, go to the Volunteer Resource Guide (Tab 2).

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 and the foreign tax credit.

Ask a volunteer to read the Alfredo example.

example

In 2009, Alfredo Kendall earned $40,000 while working in Dallas, Texas, for Dade Corporation. In September 2009, 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; enter $70,000 on line 7 of his Form 1040.

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.

TIP

Foreign income might be reported to the taxpayer on forms or in ways that are not used in the United States. Question the taxpayer closely to ensure that the taxpayer is reporting all worldwide income. Review the income records to ensure that includible amounts are accurate and complete.

EXERCISES

Answers are listed following the lesson summary.

Question 1: Marta Bremer, a U.S. citizen, lives in Mussbach, Germany. Her 2009 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

Her gross income includes wages and interest.

Question 2: Mary Carleton, a U.S. citizen, lives in Belgium. Her 2009 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 total income?

A. $8,000

B. $10,200

C. $18,200

D. $25,200

Only her child support payments are nontaxable.

Assign the exercises.

Review answers with the class when complete.

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 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

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.

CAUTION

The exchange rates used here are just examples. You should use the exchange rates in effect when the income was actually received.

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 ÷ 0.74855 = $4,007.75

Ask a volunteer to read the Ryan example.

In other words:

$$\frac{\text{Amount of foreign currency}}{\text{Exchange rate of foreign currency to one U.S. dollar}} = \text{Amount in U.S. dollars}$$

$$\frac{\text{3,000 Euros}}{0.74855} = \$4{,}007.75$$

Assign the exercises.

Review answers with the class when complete.

EXERCISES (continued)

Question 3: 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

Divide 200 Euros by .75514.

Question 4: 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

Divide 36,000 Euros by .7000 exchange rate.

Which exchange rate should I use?

The exchange rate for a particular currency is likely to change every day, so the exchange rate is determined by the date of transaction. The date of transaction is either the date on the check or the date the money is credited to the taxpayer's account.

However, the taxpayer can use the average annual exchange rate if:

- They have received foreign income 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.

Ask a volunteer to read the Edward example.

example

Edward Hall worked in Dallas for Lubbock Incorporated from January until September 2009. 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 2009 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 IRS International office at 215-516-2000 (not toll-free) 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. Exchange rates can also be found at 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.

Tax Software Hint: To review information related to the software, go to the Volunteer Resource Guide (Tab 2).

Direct students to the tax software tab mentioned here.

What is the foreign earned income exclusion?

Certain taxpayers can exclude income earned in, and while living in, foreign countries. For 2009, the maximum exclusion amount is $91,400. 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.

For tax years beginning after 2005, nonexcluded income is taxed for both the regular tax and the AMT (Alternative Minimum Tax) at the rates that would apply if taxable income included the foreign earned income exclusion and foreign housing exclusion.

The Foreign Earned Income Tax Worksheet from the Form 1040 Instructions must be used to calculate the tax. The tax software will do this automatically.

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.

CAUTION

Form 6251, Alternative Minimum Tax, is out of scope. Refer the taxpayer to a professional tax preparer if Form 6251 is applicable.

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.

Point out that volunteers should help taxpayers determine if taking the exclusion will benefit them.

Once the taxpayer chooses to exclude foreign earned income, that choice remains in effect for that year and all later years until revoked. Taxpayers 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 husband and wife are working overseas, each must meet all requirements to qualify for the exclusion. If they do qualify, each is entitled to an exclusion of up to $91,400 (on qualified income) for 2009.

TIP

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.

Assign the exercise.

Review answer with the class when complete.

EXERCISES (continued)

Question 5: Miranda has lived in Puerto Rico since 2001. Is she eligible for the foreign earned income exclusion?

☐ Yes ☑ **No**

Puerto Rico is not a foreign country.

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- or ship-based. **Generally, most U.S. military members and their dependents do not qualify for the foreign earned income exclusion.**

Ask a volunteer to read the John and Mary example.

example

John and Mary are both in the armed forces and have been permanently stationed in Germany since August 2004. Their tax home for 2009 is Germany.

EXERCISES (continued)

Question 6: Alan has lived and worked in China since August 16, 2002. For 2009, China is his tax home.
☑ **True** ☐ False

Generally, the tax home is the country in which taxpayers maintain their place of business.

Assign the exercise.

Review answer with the class when complete.

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.

Point out that detailed information on determining the taxpayer's abode and tax home is in Publication 54.

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 (contacts, job seeking, leave of absence, ongoing business, etc.) 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.

Ask a volunteer to read the Henry example.

example

Henry is a member of the armed forces. He was assigned to a post in Japan in 2009. 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 2009 is Japan.

Assign the exercise.

Review answer with the class when complete.

EXERCISES (continued)

Question 7: Stan is employed on an off-shore 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**

He is considered to have an abode in the United States.

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 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.

Ask a volunteer to read the Charles example.

example

Charles is a military spouse who has lived and worked in England since 2003. His mother still lives in the U.S. Charles came to the U.S. for two weeks in 2009 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.

Assign the exercise.

Review answer with the class when complete.

EXERCISES (continued)

Question 8: 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 wife, 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

Having established permanent residence in Spain with his wife, he meets the test.

What is the physical presence test?

If the taxpayer does not meet the bona fide residence test then they may qualify under the physical presence test rules. To qualify, the taxpayer 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.

Ask a volunteer to read the taxpayer example.

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

Ask a volunteer to read the Margaret example.

example

Margaret, a U.S. resident, is a member of the armed forces and has lived in Japan since 2007. 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.

Ask a volunteer to read the Earl example.

example

Earl works and lives in the Bahamas. In 2009, he worked 50 weeks in the Bahamas. He attended a business meeting in Florida for one week, and was on vacation for one week. One-fiftieth or 2% of his wages are not foreign earned income, because of the week spent working in Florida.

Assign the exercise.

Review answer with the class when complete.

EXERCISES (continued)

Question 9: 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**

Social security benefits, pension, and dividends are not earned income, so she does not qualify.

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 $91,400 or less
- Have no business or moving expense deductions

Taxpayers who do not meet these restrictions should file Form 2555 to claim the exclusion.

example

Michael and his wife, Eva, have been stationed in Australia since 2006. Michael is a member of the 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.

Ask a volunteer to read the Michael and Eva example.

EXERCISES (continued)

Question 10: 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

Her earned income is less than $91,400.

Assign the exercise.

Review answer with the class when complete.

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 who have deductions allowed in figuring adjustments to gross income that are allocable to the excluded income. The three most common deductions that may affect the exclusion are:
    - One-half self-employment tax plus all expenses on Schedule C-EZ (self-employment income may be exempt from income tax but not self-employment tax)
    - Itemized deductions
    - Moving expenses

Display the Form 1040 page in the tax software and demonstrate the link to Form 2555 or Form 2555-EZ.

Tax Software Hint: To review information related to the software, go to the Volunteer Resource Guide (Tab 2).

Direct students to find the approved intake and interview sheet in Publication 4491-W.

Ask two volunteers to role-play the sample interview.

Taxpayer Interview and Tax Law Application

Look at the approved intake and interview sheet for taxpayers Jack and Jill Hill (see Military Practice Exercises, Exercise 16, in Publication 4491-W.)

SAMPLE INTERVIEW

VOLUNTEER SAYS...	JILL SAYS...
	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.
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?	No, Bavaria Advertising is a foreign company owned by a family right there in Munich.
Great, that would qualify, but Jack's military pay won't. [Volunteer links to Form 2555-EZ on the tax software.] *Let's see. You are a U.S. Citizen. You earned wages in a foreign country and the total was less than $91,400. 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.*	Yeah, that all sounds right.
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 sure hope you know what you are doing, it sounds complicated to me.
Don't worry, I just need to ask you a few questions. How long did you say you were in Germany?	We moved on base in Germany on March 3, 2008 and just returned to the states on January 10, 2010.
No problem then. You were living in Germany for the entire year so you are considered a bona fide resident in 2009. 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?	1567 Albion Street, Munich.
What did you do for Bavaria Advertising?	I was a copywriter.
Do you have Bavaria Advertising's address?	I sure do, it is right here on this statement.
Were you present in the U.S. during 2009? I have to enter the dates on this form. [On page 2 or 4 of the approved intake and interview sheet, indicate Jill's responses to these questions.]	Not in 2009. But we did come home for the holidays in 2008.

Summary

Review the lesson summary with the class.

Total income from all sources is entered on:

- Line 22 (Form 1040, lines 7-21)
- Line 15 (Form 1040A, lines 7-14)
- Line 4 (Form 1040EZ, lines 1-3) (total income is the same as adjusted gross income)

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 in Lines 7 through 20 of Form 1040.

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. The exchange rates used should reflect the closest accurate rate.

If the taxpayer is eligible to exclude some or all of his/her foreign earned income, then Form 2555 or Form 2555-EZ will be completed. The excludible amount will be entered as a negative number on line 21 to offset the income reported on line 7 or line 12.

TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem, practice exercise(s), or supplements 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.

Assign the workbook exercise and review as a class when done (optional).

EXERCISE ANSWERS

Answer 1: *B. Marta's gross income includes her wages and interest, both of which should be reported on her tax return.*

Answer 2: *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 3: *A. Dividing 200 Euros by the .75514 exchange rate comes to $264.85.*

Answer 4: *C. Dividing 36,000 Euros by the .7000 exchange rate comes to $51,428.57.*

Answer 5: *No. Miranda is not eligible for the foreign earned income exclusion because Puerto Rico is not a foreign country.*

Answer 6: *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 7: *No. Stan is considered to have an abode 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 8: *Yes. Since Zach went to Spain to work and has established a permanent residence there with his wife, he meets the bona fide residence test.*

Answer 9: *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 10: *B. Since Mallory's earned income is wages (not self-employment) and is less than $91,400, she can file Form 2555-EZ.*

Lesson 16: Military Income

Instructor Notes

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.

To identify these types of income, use the interview techniques and tools discussed in the Screening and Interviewing lesson.

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?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 3
- ☐ Publication 525
- ☐ Publication 527
- ☐ Publication 555
- ☐ Publication 4491-W

Review objectives with the class.

Point out the resources cited under **What do I need?**

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 excludible from gross income.

Refer to the Volunteer Resource Guide (Tab D) for detailed lists of these types of military pay and to determine if they are included in gross income, or excluded.

Direct students to Publication 3 for this section and the exercises.

What income is includible?

Includible items are subject to tax and must be reported on the taxpayer's tax return. The items listed in Table 1 of Publication 3 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 in box 1 of Form W-2 and reported on line 7 of Form 1040.

CAUTION

If the amount shown in box 1 of Form W-2 differs from the last Leave and Earnings Statement for 2009, advise the taxpayer to contact the local accounting and finance or payroll office for an explanation.

What income is excludible?

Excludible income does not have to be reported as income on Form 1040, Form 1040A, or Form 1040EZ. The exclusion applies whether or not the item is furnished in kind or is a reimbursement or allowance.

For example, the Basic Allowance for Housing (BAH) can be excluded from gross income as a qualified military benefit. Excludible income will not be included in the amount in box 1 on Form W-2.

TIP

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.

Assign the exercises.

Review answers with the class when complete.

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**

Bonuses are reflected on Form W-2.

Question 2: Which of the following items is excludible from U.S. Armed Forces members' income?

A. Student loan repayments

B. Basic Allowance for Housing (BAH) and Basic Allowance for Subsistence (BAS) income

Both allowances are nontaxable income.

C. Basic pay

D. Hardship duty pay

What is military separation with disability severance pay?

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 service 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 service of the veteran 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.

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 in Form W-2 or Form 1099-R. The amount of the disability benefit is calculated by the VA, based on the percentage of disability and other factors.

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.

Point out the need to file an amended return under the conditions described here.

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

Disability payments are paid directly from the VA and not listed on Form W-2.

Assign the exercise.

Review answer with the class when complete.

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 2008. Here are the payments she reported on her 2008 tax return:

Payments	*Amount*
• Disability severance pay	$10,000
• Service pension	$33,000
• Active duty pay	$ 5,000

In 2009, the VA determined that she was retroactively entitled to a VA disability pension of $837 each month from the date of her discharge (February 2008). She can amend her 2008 tax return to exclude $9,207 ($837 x 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 2009 Form 1099-R will not include the nontaxable VA disability retirements received during 2009.

Ask a volunteer to read the Anita example.

Answer any student questions.

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.

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.

Emphasize that volunteers will not need to determine what income is excludible. Form W-2 information can only be changed by the payroll office, which then must issue a correct Form W-2.

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 the Form W-2 when inputting 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 keep 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

TIP

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.

example

Sgt. Bobby Osage was not assigned to a combat zone but he did duty that was qualified for hostile fire pay. He can exclude that income.

Ask a volunteer to read the Sgt. Osage example.

Ask what if Sgt. Osage did not qualify for hostile fire pay but had to pass through a combat zone on the way to his assignment.

Answer: His pay during that trip is includable.

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.

Includes qualifying for hostile fire/imminent danger pay while serving in direct support of a combat zone.

Assign the exercise.

Review answer with the class when complete.

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 if it's only 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 of Form W-2, with code Q. If service members believe the taxable wages on Form W-2 are incorrect, they should contact the finance office to request a corrected Form W-2. Nontaxable combat pay sometimes increases Child Tax Credit or the Earned Income Tax Credit. If using the tax software, be sure to enter all fields on Form W-2. If filing a paper return, be sure to consider the combat pay amount when calculating these credits.

Tax Software Hint: To review information related to the software, go to the Volunteer Resource Guide (Tab 1).

Taxpayer Interview and Tax Law Application

Ask two volunteers to role-play the sample interview.

The Military Comprehensive Problem in the workbook has an example of Form W-2 with combat pay excluded. Here's how a volunteer might help a taxpayer that has combat pay:

SAMPLE INTERVIEW

VOLUNTEER SAYS...	MRS. FANNIN RESPONDS...
Let's talk for a minute about where your husband was stationed.	My husband was in a combat zone for part of the year. Do I need to tell you the dates or anything?
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 Operation Iraqi Freedom?	That's right.

Point out that responses to these questions would be noted on page two of the approved intake and interview sheet.

What are the laws regarding community property?

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 were domiciled in a community property state.

How do community property laws affect Armed Forces pay?

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.

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.

For military members residing in community property states, the key word is *domicile*. Domicile describes someone's legal, permanent residence. It is not always where the person presently lives.

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

Special rules may govern whether certain income received by members of the U.S. Armed Forces is includible or excludible from taxable income reported on the return:

- Medical separation with disability severance pay
- Combat zone exclusion
- Community property laws

Review the lesson summary with the class.

TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem, practice exercise(s), or supplements 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.

Assign the workbook exercise and review as a class when done (optional).

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 in any Form W-2.

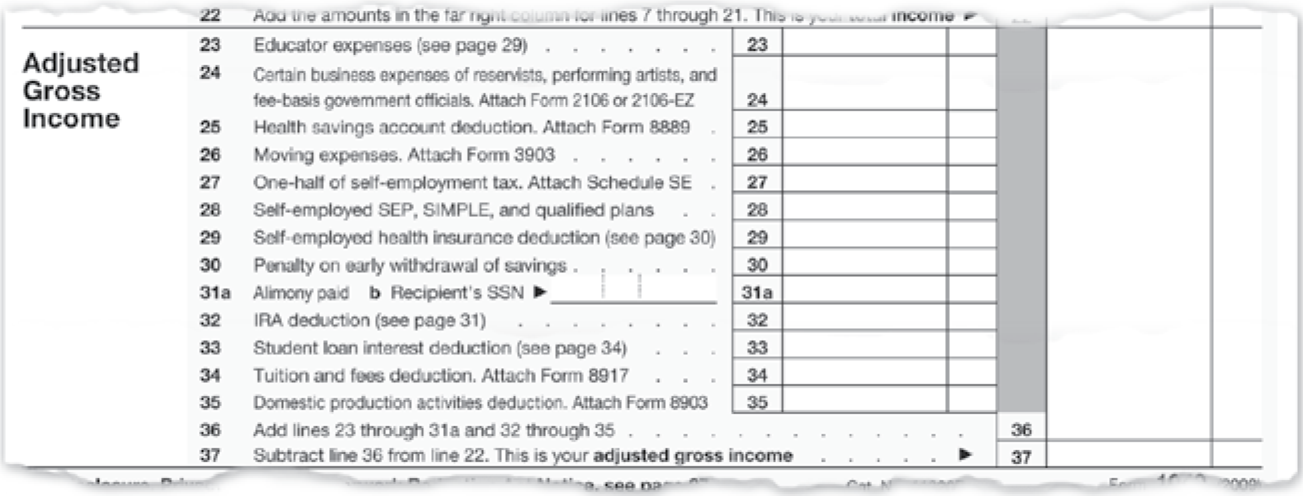
Answer 4: A. Military members are considered to be serving in a combat zone if they are either assigned on official duty to a combat zone or they qualify for hostile fire/imminent danger pay while serving in direct support of a combat zone.

Notes

Lesson 17: Adjustments to Income

Introduction

This lesson covers the Adjusted Gross Income section of the tax return. Taxpayers can subtract certain expenses, payments, contributions, fees, etc. from their total income. The figure remaining after computing the taxpayer's adjustments to income is their adjusted gross income or "AGI." The line items under the Adjusted Gross Income section of the tax return are all Intermediate topics, except the penalty on early withdrawal of savings, which is a Basic topic.



	22	Add the amounts in the far right column for lines 7 through 21. This is your total income ►	
Adjusted Gross Income	23	Educator expenses (see page 29)	23
	24	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ	24
	25	Health savings account deduction. Attach Form 8889	25
	26	Moving expenses. Attach Form 3903	26
	27	One-half of self-employment tax. Attach Schedule SE	27
	28	Self-employed SEP, SIMPLE, and qualified plans	28
	29	Self-employed health insurance deduction (see page 30)	29
	30	Penalty on early withdrawal of savings	30
	31a	Alimony paid **b** Recipient's SSN ►	31a
	32	IRA deduction (see page 31)	32
	33	Student loan interest deduction (see page 34)	33
	34	Tuition and fees deduction. Attach Form 8917	34
	35	Domestic production activities deduction. Attach Form 8903	35
	36	Add lines 23 through 31a and 32 through 35	36
	37	Subtract line 36 from line 22. This is your **adjusted gross income** ►	37

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 Program
- Calculate and accurately report the adjustments to income that are within the scope of the VITA/TCE Program

What do I need?

☐ Approved Intake and Interview Sheet
☐ Volunteer Resource Guide
☐ Publication 17
☐ Publication 4491-W

Optional:

☐ Publication 504
☐ Publication 590
☐ Publication 970
☐ Form 1040 Instructions
☐ Form 1040 (Sch SE)
☐ Form 1098-E
☐ Form 1099-INT
☐ Form 1099-OID
☐ Form 8606
☐ IRA Deduction Worksheet

Instructor Notes

Review objectives with the class.

Point out the resources cited under **What do I need?**

How do I determine if the taxpayer has adjustments to income?

To identify the adjustments to income that a taxpayer can claim, you will need to ask the taxpayer if they had the types of expenses listed on the Adjusted Gross Income section of the tax return. To determine the taxpayer's adjustments to income, use the interview techniques and tools discussed in the Screening and Interviewing lesson. Review the taxpayer's answers on their approved intake and interview sheet.

During the tax year did the taxpayer or spouse:

- Have any expenses as an educator?
- Receive income from self-employment?
- Pay a penalty for early withdrawal of savings?
- Pay alimony?
- Make contributions to a traditional IRA?
- Pay student loan interest?
- Receive income from jury duty that was turned over to an employer?
- Pay college tuition?

Direct students to Form 1040 – Adjustments to Income in tax software, in the Volunteer Resource Guide (Tab 3).

There are other adjustments to income on Form 1040. In general, these are beyond the scope of the VITA/TCE program. If you believe a taxpayer could benefit from one of these other adjustments, encourage the taxpayer to consult a professional tax preparer.

You can see the tax software entry screen for Adjustments to Income in the Volunteer Resource Guide (Tab 3).

How do I handle educator expenses?

Who is eligible?

Eligible educators can deduct up to $250 of qualified expenses paid in 2009. If the taxpayer and spouse are both eligible educators, they can deduct up to $500, but neither can deduct more than their first $250. Any excess expenses may be treated as an itemized employment-related deduction on Schedule A.

At this point in the interview, you will know 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)

What expenses qualify?

If the taxpayer or spouse is an eligible educator, ask for documentation of qualified expenses. Advise taxpayers who do not have receipts with them, 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 1,800 hours of employment in 2009. She spent $262 on supplies for her students. Of that amount, $212 was for educational software. The other $50 was for pamphlets for a unit she teaches sixth graders on reproductive health. Only the $212 is a qualified expense. She can deduct $212.

Ask a volunteer to read the two examples.

example

Debbie is a part-time art teacher at an elementary school. In 2009, she spent $185 on qualified expenses for her students. Because she has only 440 hours of documented employment as an educator in 2009, she cannot deduct her educator expenses.

What other rules apply?

Continue to 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 on Form W-2?
- Did you redeem tax-free interest on U.S. Series EE and I Savings Bonds?
- Did you receive nontaxable earnings from a Qualified Tuition Program (QTP) or Coverdell Education Savings Account (ESA)?

Educator expenses are reduced by any of these applicable reimbursements.

example

Evelyn managed to work 1,000 hours as an educator in 2009 while completing graduate studies. She spent $200 to buy qualified school supplies for her students. She covered $400 of her own educational expenses from her Coverdell ESA. She cannot take the deduction for educator expenses.

Ask a volunteer to read the Evelyn example.

How do I report this?

Educator expenses are entered on line 23 of Form 1040. Don't forget to reduce the total educator expenses by any reimbursements, nontaxable savings bond interest, or nontaxable distributions from an ESA or QTP.

Tax Software Hint: To review information related to the software, go to the Volunteer Resource Guide (Tab 3), Adjustments to Income.

Taxpayer Interview and Tax Law Application

Ask two volunteers to role-play the sample interview.

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...
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. Did you bring your receipts?	[Janet] Yes, all teachers keep careful records of their expenses. Here are my receipts and here are Bob's.
Can you tell me what you purchased? Janet, maybe you could go first.	Sure. Three are for quick reference cards for my chem students. And two are for special reagents the department doesn't stock.
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.	[Bob] These four are for art supplies – paint and brushes, as you can see – and these two are for special papers and sculpting clay.
Yours total $263. Now, did either of you receive any reimbursement that is not listed on Form W-2?	[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.
That would bring your total down to $213.	[Janet] Can't we apply some of my excess expense to Bob and bring his total up to $250?
No, I'm sorry, each person's expenses have to stand alone. Did either of you receive any reimbursement that is not listed on a Form W-2, from any other source?	No.
Did you redeem U.S. series EE and I Savings Bonds in 2009?	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. Any questions before we go on? [On the approved Intake and Interview Sheet, indicate that the taxpayers are entitled to the Educator Expense Adjustment.]	[Janet] No, I think we understand.

How do I handle self-employment tax?

Self-employed taxpayers can subtract half of their self-employment tax from their income. (This is equal to the amount in social security tax and Medicare tax that an employer pays for an employee, and which is excluded from an employee's income.)

If, based on the interview, you establish that the taxpayer and/or spouse has self-employment income, work with the taxpayer to calculate the self-employment tax using Form 1040 (Schedule SE), Self-Employment Tax; this is covered in Lesson 28, Other Taxes.

Tax Software Hint: To review information related to the software, go to the Volunteer Resource Guide (Tab 3).

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.

If you're using tax software, you should have entered the early withdrawal penalty amount when you entered the interest received on the electronic Interest Statement -Schedule B. If preparing a paper return, enter the penalty amount on line 30 of Form 1040.

example

In 2009, 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.

Ask a volunteer to read the Gloria example.

Tax Software Hint: To review information related to the software, go to the Volunteer Resource Guide (Tab 3).

How do I handle alimony paid?

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.

Remind students that child support payments are not deductible for the taxpayer and are not taxable to the recipient.

A summary of the alimony requirements can be found in the Adjustments section of the Volunteer Resource Guide (Tab E).

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.

Ask a volunteer to read the Anthony example.

example

Anthony has been divorced for three years. Under his divorce instrument, he paid his ex-wife $12,000 in 2009. As a favor, he also made $2,400 in payments to cover part of her vehicle lease so she could keep steady employment. He can take the $12,000 as an adjustment to income. He cannot count the lease payments because those were payments not required by the divorce instrument.

For additional information on alimony, refer to the Alimony chapter in Publication 17 and Publication 504, Divorced or Separated Individuals.

Tax Software Hint: To review information related to the software, go to the Volunteer Resource Guide (Tab 3).

Assign the exercise.

Review answer with the class when complete.

Direct students to the Alimony chapter in Publication 17, and Publication 504, Divorced or Separated Individuals.

EXERCISES

Answers are at the end of the lesson summary.

Question 1: Victoria divorced in 2006, Her divorce settlement states that she must pay her ex-husband $15,000 a year. She is also required to pay his ongoing medical expenses for a condition he acquired during their marriage. In 2009, the medical expenses were $11,345. How much can she deduct as an adjustment to income?

A. $15,000

B. $11,345

C. $26,345

D. $3,655

She can deduct the full amount because it is all required by the divorce instrument.

How do I handle IRA contributions?

“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 can't 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. In 2009, 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.

Ask a volunteer to read the Fred example.

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 70-1/2 years of age at the end of the tax year. Check the taxpayer's birth date (and spouse's if applicable) indicated on the approved intake and interview sheet. To meet the age requirement for 2009, a taxpayer must have been born on, or after, July 1, 1939.
- Compensation: Individuals must have taxable compensation (wages, self-employment income, commissions, taxable alimony, and 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 April 15, 2010.

TIP

Be sure the taxpayer knows that if a contribution is reported on the 2009 return but is not made by the deadline, the taxpayer must file an amended return.

How much can a taxpayer contribute to an IRA?

There is a limit to the amount that a taxpayer can contribute to an IRA each year. The total contribution (combined contributions to all accounts, including Roth and traditional IRAs) cannot be more than the **smaller** of:

- $5,000 ($6,000 for a person who is age 50 or older by the end of the tax year)
- The individual's taxable compensation

What is the compensation requirement?

Compensation is generally the income a taxpayer has earned from working; it also includes alimony, and other forms of income. (See Publication 17 for more information on compensation.) Taxpayers cannot make IRA contributions that are greater than their compensation for the year.

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:

- $5,000 ($6,000 if age 50 or older), 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 $5,000 (or $6,000 for 50 and older) to their own IRA.

Ask a volunteer to read the Gene and Sue example.

Review the example to ensure that all students understand it.

example

Gene and Sue are married and are both over 50 years old. Gene earned $70,000 and Sue earned $1,500. In 2009, 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 (that is, $71,500 - $5,500). If Gene and Sue file jointly, they can contribute up to $6,000 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.

Ask a volunteer to read the Bill example.

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 2009 cannot exceed $5,000.

Assign the exercises.

Review answer with the class when complete.

EXERCISES (continued)

Question 2: Stan is 47; he contributed $1,000 to a Roth IRA. What is the maximum he can contribute to a traditional IRA?

A. $3,000

B. $4,000

C. $1,000

D. $2,000

$4,000 + $1,000 = $5,000 maximum for 2009.

Question 3: Bob and Carol are married and both are 55 years old. They both work and each has a traditional IRA. In 2009, 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? **$2,000**

If Married Filing Separately, he can contribute no more than his $2,000 compensation.

Question 4: If Bob and Carol (from Question 3) file jointly, what is the maximum they can contribute to Bob's IRA? **$6,000** What is the maximum they can contribute to both of their IRAs? **$12,000**

If Married Filing Jointly, they can contribute a maximum of $12,000, up to $6,000 each.

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 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?

Display or direct students to the Traditional IRA Deduction Phaseout Charts in the Adjustment section (Tab E) of the Volunteer Resource Guide.

Make sure you are discussing a traditional IRA with the taxpayer. Deductions cannot be taken for contributions to other types of IRAs. The taxpayer's deduction for IRA contributions may be "phased out" (that is, 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 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 non-deductible 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?

You will help taxpayers determine if they qualify to deduct all or part of their traditional IRA contributions from their income. 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. Review the tables in the Adjustment tab of the Volunteer Resource Guide (Tab E). These tables are also in the IRA chapter of Publication 17.
- 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.

How do I complete the IRA Deduction Worksheet?

Display or direct students to find the IRA Deduction Worksheet in the Form 1040 Instructions.

If the taxpayer and spouse meet the general eligibility requirements, continue the interview by using the IRA Deduction Worksheet, found in the Form 1040 Instructions, as your guide.

Retirement coverage at work

Ask if the taxpayer and/or spouse were covered by a retirement plan at work at any time during 2009 (worksheet step 1). If so, their deduction may be limited. Employees covered by a retirement plan will have box 13 on Form W-2 checked.

Confirm that all students are following this process on the IRA Deduction Worksheet.

If the taxpayer (or spouse, on a joint return) is not covered by a retirement plan, step 1b on the IRA Deduction Worksheet will direct you to line 7 of the worksheet, where you enter the maximum IRA contribution limit—that is, the most the taxpayer can deduct. For a joint return, complete worksheet line 7b for the spouse.

Filing status and income

If the taxpayer or spouse is covered by a retirement plan, the worksheet will show the income limits for deducting IRA contributions, based on the filing status of the return. The worksheet will also help you calculate the MAGI, by subtracting certain other adjustments to income from the total income on the return. Notice that the income limitation amount on line 2 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 non-covered spouse will have a higher income limit before their IRA deduction is phased out.

Confirm that students understand.

If the MAGI is greater than the income limits, line 6 of the worksheet tells you that 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 deduction is allowed, continue the calculation to determine if the taxpayer is entitled to a full deduction or a partial deduction. The entry on line 7a (and line 7b if a joint return) represents the maximum allowable deduction for that taxpayer.

Point out the caution.

Line 8 of the worksheet asks you to enter the earned income shown on the return. This calculation determines the amount of compensation earned by the taxpayer(s). If the taxpayers are married and filing jointly, and their compensation is less than the maximum IRA contribution allowed, you will have to go to Publication 590 to figure their deduction. Otherwise, continue with the worksheet.

Next, on line 11, enter the total contributions to traditional IRAs that were made (or will be made) by April 15, 2010. The worksheet then helps you figure the amount that can be deducted from income.

CAUTION

If the taxpayer's IRA contribution is more than the lesser of $5,000 ($6,000 if age 50 or older) or their compensation, advise the taxpayer 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.

How do I report the IRA deduction?

Report the deduction on line 32 of Form 1040.

Tax Software Hint: To review information related to the software, go to the Volunteer Resource Guide (Tab 3).

What if the taxpayer has excess IRA contributions?

An excess IRA contribution is an amount contributed to a traditional IRA that is more than whichever of the following is the smaller amount:

- The taxable compensation for the year, or
- $5,000 ($6,000 if age 50 or older)

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, the taxpayer will be subject to an additional 6% tax on this amount. This additional tax is covered in Lesson 28, Other Taxes.

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

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 withdrawal was made.

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. This amount is gradually reduced (phased out) or eliminated based on the taxpayer's filing status and MAGI.

These limits are shown under the Adjustments tab of the Volunteer Resource Guide (Tab E).

Display or direct students to the Effect of MAGI on Student Loan Interest Deduction Chart in the Adjustment section (Tab E) of the Volunteer Resource Guide.

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 in 2009. With all adjustments to income (except student loan interest adjustment), his MAGI is $49,000. He can deduct $2,500 of his student loan interest as an adjustment to income.

Ask a volunteer to read the Robert example.

example

Veronica and her husband are filing jointly. Their MAGI is $120,000. She completed her doctoral degree in 2008 and paid $2,400 in student loan interest in 2009. Due to their high MAGI, their deduction must be calculated; it will be less than the full amount of interest that she paid.

Ask a volunteer to read the Veronica example.

Ask what if their MAGI is $100,000? $150,000?

Answers: Deduction not affected for $100K; eliminated for $150K.

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
- It was 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.

Assign the exercise.

Review answer with the class when complete.

EXERCISES (continued)

Question 5: Todd and Janet have a MAGI of $45,000. 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. How much can they deduct from their income?

A. $0

B. $1,000

C. $1,500

D. $2,500

His mother is not their dependent.

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 (for example, 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 web site at http://ope.ed.gov/accreditation/.

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.

Ask a volunteer to read the Jeremy example.

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.

To figure the deduction when preparing a paper return, use the Student Loan Interest Deduction Worksheet in the Form 1040 Instructions. You need 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 (Tab 3), Adjustments to Income.

Ask two volunteers to role-play the sample interview while the class listens for key information.

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...	BRENDA RESPONDS...
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?	Yes, I just graduated a year ago and I'll be paying those loans for a while.
Well, you might be able to take a deduction for that. Since you are filing as Single, and your income before adjustments is not more than $55,000, your income is not more than the limit for your filing status. Can you show me a statement from the lender?	I have two loans, here are the statements.
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?	No, I understand.
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?	My tuition and fees, and my books.
Did you receive any educational assistance, like from your employer or the Veteran's Administration?	No.
How about tax-free withdrawals from a Coverdell educational savings account, another qualified tuition program, or from U.S. savings bonds?	No, none of those.
Did you get any other nontaxable payments, not counting gifts, bequests, or inheritances, which were specifically for educational expenses?	Heavens, no, I wish I had!
It looks like you can claim the maximum deduction of $2,500. [Indicate on the approved intake and interview sheet whether Brenda is eligible for this adjustment.]	

Review with the class the key points they noticed during the interview.

How do I handle tuition and fees?

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 AGI (MAGI), and other factors. See the Volunteer Resource Guide (Tab E), Adjustments, for a table showing how the income limitations apply.

Form 8917, Tuition and Fees Deduction, will help you compute the taxpayer's MAGI for this deduction.

TIP

The definition of qualified education expenses for the tuition and fees deduction is expanded for students attending an eligible educational institution in Midwestern disaster areas. See Publication 970 for additional information.

example

Leonard had a total income of $24,000 this year. He will file as Single and 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 will be able to deduct the maximum amount ($4,000) for his tuition and fees payments.

example

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

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.

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 they are 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 and earns about $5,000 each year, so his parents cannot claim him as a dependent even though he lives at home and goes to school full time. 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 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. It does not matter whether the expenses were paid in cash, by check, credit card, or with borrowed funds.

Qualified education expenses do 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

TIP

The definition of qualified education expenses for the tuition and fees deduction was expanded for students in Midwestern disaster areas. See Publication 970 for more information.

CAUTION

The rules for claiming course-related book expenses are different for the tuition and fees deduction and the American opportunity credit. See Lesson 24, Education Credits, for more information.

Ask the taxpayer if the qualified tuition and expenses were offset by distributions from qualified state tuition programs and from Coverdell ESAs, as well as 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. However, the form only reports "amount billed" or "payments received." You must still 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. If taxpayers do not know if an educational institution is an eligible institution, they should contact the school.

How do I determine the amount of the deduction?

Use Form 8917, Tuition and Fees Deduction, to figure the MAGI and the resulting deduction amount.

Tax Software Hint: To review information related to the software, go to the Volunteer Resource Guide (Tab 3), Adjustments to Income.

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

If taxpayers claim the tuition and fees adjustment to income, they cannot claim the education tax credit. The education credits include the American opportunity and lifetime learning credits, which are discussed in more detail in the Education Credits lesson. 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.

Demonstrate how to use software to compare adjustments to credits.

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.

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, line 21. 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.

What about other adjustments to income?

There are additional adjustments to income on Form 1040. In general, these are beyond the scope of the VITA/TCE program. If you believe a taxpayer could benefit from one of these adjustments, encourage the taxpayer to consult a professional tax preparer.

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, follow the instructions on the Form 1040:

Display or refer students to Form 1040 to follow along.

1. Add the amounts in the far right column of the Income section (lines 7 through 21) and enter the result on line 22. This is the taxpayer’s total income.
2. Add the Adjustments to Income (the amounts in lines 23 through 35) and enter the result on line 36. These are the total Adjustments.
3. Subtract line 36 from line 22. This is the AGI.

Ask two volunteers to role play the sample interview while the class listens for key information.

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 half 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.
Now, did you contribute to an IRA?	I put in $2,000 right after Christmas.
Good for you. You can contribute up to $5,000 this year – will you be contributing any more before April 15? You can put money in your IRA for 2009 right up until 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 2009?	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 approved 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. [On the approved intake and interview sheet, note that you have addressed this adjustment.]	That's great! This program makes it really easy!.

Review with the class the key points they noticed during the interview.

Practice - Vanessa Franklin

Let's take a look at how a volunteer helped our taxpayer, Vanessa Franklin. Go to Appendix A-17 and review the sample interview with Vanessa related to any adjustments to income that she can claim. Return to this lesson after you have reviewed this information.

Direct students to Appendix A-17.

Summary

In this lesson, you learned how to identify and work with these adjustments to income:

- Educator expenses
- One-half of self-employment tax
- Penalty on early withdrawal of savings
- Alimony paid
- IRA deduction
- Student loan interest deduction
- Tuition and fees deduction
- Jury Duty Pay turned over to the taxpayer's employer

Review the lesson summary with the class.

If you believe a taxpayer could benefit from an adjustment that was not covered in this lesson, encourage the taxpayer to consult a professional tax preparer.

In this lesson, you saw that tax software makes it much easier to work with adjustments by providing easy access to electronic worksheets and by doing many calculations for you.

TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem, practice exercise(s), or supplements 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.

Assign the workbook exercise and review as a class when done (optional).

EXERCISE ANSWERS

Answer 1: *C. She can deduct the full $26,345 because it is all required by the divorce instrument.*

Answer 2: *B. He can deduct no more than the $4,000 contribution to the traditional IRA.*

Answer 3: *If Married Filing Separately, Bob can contribute no more than $2,000, the amount of his compensation.*

Answer 4: *They can contribute up to $6,000 to Bob's IRA account. If Married Filing Jointly, they can contribute a maximum of $12,000.*

Answer 5: *A. Because Todd's mother is not their dependent, they can deduct $0 of the interest they paid.*

Lesson 18: Military Moving Expenses

Instructor Notes

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, use the interview techniques and tools discussed in the Screening and Interviewing lesson. Although the approved intake and interview sheet may not list moving expenses, it is important to ask probing questions to see if the taxpayer may have some deductible moving expenses.

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?

☐ Approved Intake and Interview Sheet
☐ Volunteer Resource Guide
☐ Publication 17
☐ Publication 4491-W
☐ Form 3903

Optional:

☐ Publication 3
☐ Publication 521
☐ Form 1040 Instructions

Review objectives with the class.

Point out the resources cited under **What do I need?**

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.

Assign the exercise.

Review answer with the class when complete.

EXERCISES

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

This is defined as a PCS.

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?

Qualifying expenses are military moving expenses that 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 or side trips 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?

You need to determine whether any moving allowances or reimbursements provided by the government should be included in a service person's income, and how to accurately report the deduction on Form 1040.

What is a DITY move?

Typically, Armed Forces members move their own household items, in a personal or rented vehicle. This is called a Do It Yourself (DITY) move; the most common form of military move. The Armed Forces provides an incentive payment equal to 95% of the estimated cost to the government for DITY moves. 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 DITY move?

DITY payments are entered as income on line 7 of Form 1040.

Armed Forces members may not take a moving expense deduction based on the expenses approved by the finance office when settling the DITY move, as they have already been used to reduce taxable income.

example

Captain Jones 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 Jones' actual expenses for the move were $1,750. He receives a payment for $2,375 (95% of the government's estimate) but Box 1 on Form W-2 will show only $625 ($2,375 minus $1,750) for the DITY move. Captain Jones cannot deduct any of his expenses, since he's already been reimbursed.

Ask a volunteer to read the Captain Jones example.

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

EXERCISES (continued)

Assign the exercise.

Review answer with the class when complete.

Question 2: Sgt. Bishop received Form W-2 for $1,000 as a result of a DITY move to a new Permanent Duty Station (PDS). 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 line 7 of Form 1040?

A. $1,500

B. $1,000

C. $300

D. $200

Only the $1,000 DITY payment is taxable as gross income.

How do I calculate the adjustment?

Display or direct students to Form 3903.

Deductions can only be claimed for the amount of expenses *not* covered by a nontaxable reimbursement or moving allowance. If the taxpayer has allowable expenses that exceed the amount they were reimbursed, Form 3903 should be completed. Form 3903 is not needed if all the taxpayer's reimbursements were nontaxable allowances that were greater than their expenses.

Tax Software Hint: For software entries, go to Form 1040, Adjustments to Income in the Volunteer Resource Guide (Tab 3).

Ask two volunteers to role-play the sample interview while the class listens for key information.

Taxpayer Interview and Tax Law Application

Refer to the Military Comprehensive Problem - Fannin in Publication 4491-W for an example of a return with military moving expenses. Here's how a volunteer could help Mrs. Fannin determine if she had any deductible moving expenses:

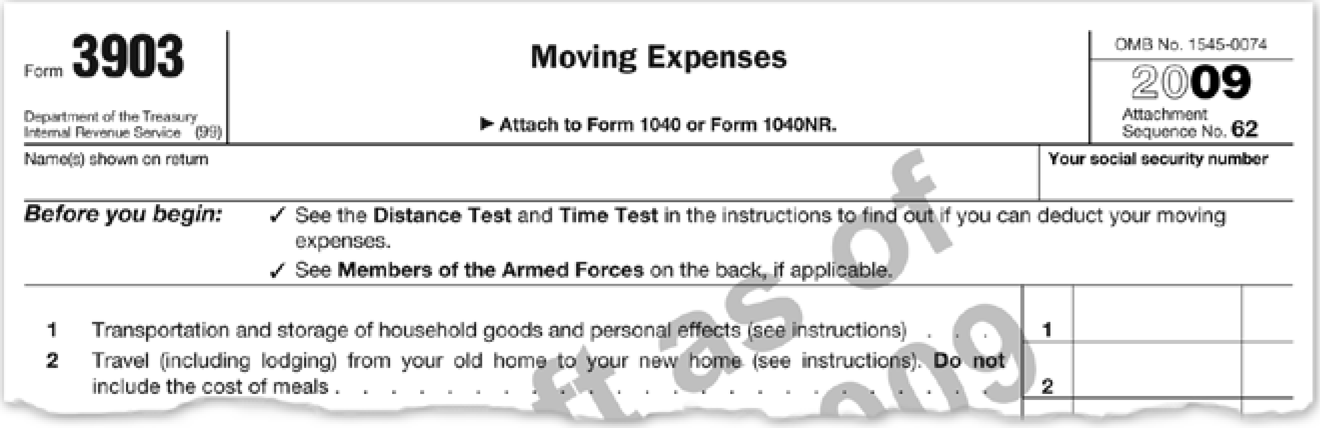
SAMPLE INTERVIEW

VOLUNTEER SAYS...	MRS. FANNIN RESPONDS...
You said you just moved here during June of this year. Was this a PCS move?	Yes, my husband was transferred here shortly before he deployed. I have family close by, so I'd rather stay here while he's overseas.
If your expenses were more than the Armed Forces reimbursed you for, 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?	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 $165 for meals on the way. The military moved our household goods, and we didn't have any overweight.
Did you drive directly here, or did you take any side trips?	We came right here so we could settle in before he deployed.
The IRS will let you take a standard 24 cents a mile, or we can use actual expenses, if you kept track. The standard rate would be $240.	I only kept the gas receipts, so the standard would probably be best.

SAMPLE INTERVIEW (continued)

VOLUNTEER SAYS...	MRS. FANNIN RESPONDS...
The IRS allows lodging costs, but not food. So your total allowable expenses would be $540, which includes $300 for the motels and $240 for your mileage expenses. The travel voucher shows a total of $400 in reimbursements – did you receive any other reimbursements or allowances?	No, that's it.
Then you'll get to deduct $140, the amount you spent that was more than your reimbursements. [On the approved intake and interview sheet, be sure to note that you've addressed this adjustment.]	

Review with the class the key points they noticed during the interview.



Form **3903**

Department of the Treasury
Internal Revenue Service (99)

Moving Expenses

► **Attach to Form 1040 or Form 1040NR.**

OMB No. 1545-0074

2009

Attachment
Sequence No. **62**

Name(s) shown on return

Your social security number

Before you begin: ✓ See the **Distance Test** and **Time Test** in the instructions to find out if you can deduct your moving expenses.

✓ See **Members of the Armed Forces** on the back, if applicable.

1	Transportation and storage of household goods and personal effects (see instructions) . . .	1	
2	Travel (including lodging) from your old home to your new home (see instructions). **Do not** include the cost of meals	2	

When should an Armed Forces member claim the deduction?

Armed Forces members who use the cash method of accounting and who are reimbursed for their expenses can deduct the expenses either in the year they were paid or in the year the reimbursement was received. They can choose to deduct the expenses in the year of reimbursement even if they paid the expenses in a different year.

If expenses are deducted and the reimbursement is received in a later year, the reimbursement must be included in income.

Armed Forces members who use the cash method of accounting (the most common) can deduct moving expenses in the year of reimbursement if the expenses were paid in the year:

- Before the year of reimbursement, or
- Immediately after the year of reimbursement but by the due date, including extensions, for filing the return for the reimbursement year

Assign the exercise.

Review answer with the class when complete.

EXERCISES (continued)

Question 3: In December 2009, 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 month, 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. 2009 only

B. 2010 only

C. Either 2009 or 2010

He can claim the expenses in the year he paid the expenses or the year he was reimbursed.

Ask two volunteers to role-play the sample interview while the class listens for key information.

Taxpayer Interview and Tax Law Application

Greg was relocated to another Air Force base. Here's how a volunteer could help Greg determine if he had any deductible moving expenses:

SAMPLE INTERVIEW

VOLUNTEER SAYS...	GREG 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.	

Review with the class the key points they noticed during the interview.

Summary

This lesson described the types of Armed Forces moves that qualify for tax benefits, what kinds of expenses are deductible, and how to use Form 3903 to compute the moving expense deduction. These expenses are deductible as an adjustment to income on Form 1040, line 26.

Review the lesson summary with the class.

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 covered all the technical topics.

TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem, practice exercise(s), or supplements 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.

Assign the workbook exercise and review as a class when done (optional).

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 DITY 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.*

Notes

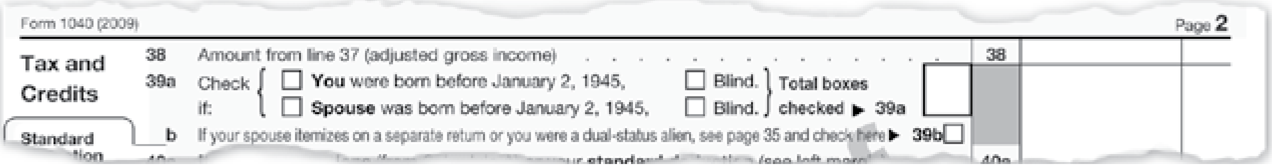
Lesson 19: Standard Deduction and Tax Computation

Instructor Notes

Introduction

This is the first of nine lessons (lessons 19 through 27) covering the Tax and Credits section of the taxpayer's return. After completing this lesson on standard deductions and Lesson 20, Itemized Deductions, you will be able to subtract the appropriate deduction from the taxpayer's adjusted gross income to figure their taxable income.

Most taxpayers can find their standard deduction by looking at the amounts listed under "All others" to the left of Form 1040, line 40a. Some taxpayers may need to use the standard deduction worksheet in the Form 1040 Instructions and others may be required to use Schedule L to figure their standard deduction.



Form 1040 (2009) Page **2**

Tax and Credits

38 Amount from line 37 (adjusted gross income) 38

39a Check if: ☐ **You** were born before January 2, 1945, ☐ Blind. ☐ **Spouse** was born before January 2, 1945, ☐ Blind. Total boxes checked ▶ 39a ☐

Standard

b If your spouse itemizes on a separate return or you were a dual-status alien, see page 35 and check here ▶ 39b☐

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 when Schedule L or the standard deduction worksheet is required to compute the standard deduction
- Identify how taxable income and income tax are computed and reported

What do I need?

☐ Approved Intake and Interview Sheet
☐ Volunteer Resource Guide
☐ Publication 17
☐ Publication 4491-W
☐ Form 1040
☐ Schedule L
☐ ***Optional:*** Publication 501

Review objectives with the class.

Point out the resources cited under **What do I need?**

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 predefined dollar amount based on the taxpayer's filing status. An increased standard deduction is available to taxpayers who are 65 or older, blind, paid real estate taxes, or purchased a new motor vehicle during part of 2009. 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 (Tab F) includes references for calculating the standard deduction.

Display or refer to the Standard Deduction for Most People Chart in the Volunteer Resource Guide (Tab F).

Assign the exercises. Have students use the Standard Deduction for Most People chart to complete them.

Point out the footnote below the chart.

Review answers with the class when complete.

EXERCISES

Use the Standard Deduction for Most People chart in the Volunteer Resource Guide (Tab F) to complete the following exercises. Answers are at the end of the lesson summary.

Question 1: Michael is single, 22, cannot be claimed by another taxpayer, and has no itemized deductions. What is his standard deduction for the tax year?

A. $5,700

B. $7,850

C. $3,000

Question 2: Nicole is 35, has two children and qualifies for the Head of Household filing status. She will not itemize any deductions this tax year. What is her standard deduction for the tax year?

A. $5,700

B. $8,350

C. $11,150

State that itemized deductions will be covered in the next chapter.

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 chapter.

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.

Ask a volunteer to read the Chase example.

example

Chase is 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: Tax software will automatically calculate the standard deduction based on the information collected on the Main Information Sheet. If the taxpayer cannot take the standard deduction, the tax software will prompt the preparer to itemize deductions.

If taxpayers cannot take the standard deduction because they are filing Married Filing Separately and the spouse itemizes or is a nonresident or dual status alien, the box on line 39b on page 2 of Form 1040 must be checked.

How does age or blindness affect the standard deduction?

The standard deduction is higher if the taxpayer and/or spouse is 65 or older. It is also higher if one or both are blind. This information is reported in the checkboxes located on page 2 of Form 1040. The more checkboxes marked, the higher the standard deduction. Be sure to verify the taxpayer's and/or spouse's age and level of blindness as described below.

Tax Software Hint: Tax software will automatically check these boxes based on entries on the Main Information Sheet. For software entries, go to the Volunteer Resource Guide (Tab 1), Main Information Screen.

example

Sherman is 73 years old and blind. He files as Single using Form 1040. On page 2, line 38, you enter his AGI of $37,800 from line 37. Because Sherman is over 65 years old and blind, you should enter a "2" on line 39a.

Refer students to Form 1040, line 39a.

Read the example of Sherman.

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 also considered to be 65 on the day before their 65th birthday. In other words, a person born on January 1 of any calendar year is considered to be 65 on December 31 of the previous calendar year. Therefore, taxpayers are entitled to a higher standard deduction for 2009 if they were born before January 2, 1945.

The standard deduction for a decedent is the same as if the taxpayer had lived the entire year, with one exception: if the taxpayer died before their 65th birthday, the higher standard deduction for being 65 does not apply to the decedent.

example

Armando died on November 24, 2009. He would have been 65 if he had reached his birthday on December 12, 2009. He does not qualify for a higher standard deduction for being 65, even though he was born before January 2, 1945.

Ask a volunteer to read the Armando example.

If a taxpayer dies at any time during the year, the taxpayer is entitled to a full standard deduction and personal exemptions. In Armando's case, he is entitled to a year's standard deduction and personal exemption – as if he had lived through December 31.

Who qualifies as blind?

A taxpayer must be totally or partially blind on the last day of the year to qualify as blind. Taxpayers are entitled to a higher standard deduction if they are considered totally or partially blind and they do not itemize their deductions. A taxpayer who claims to be partially blind must have a certified statement from an eye doctor or registered optometrist that states either of these conditions:

- 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

TIP

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.

Display or refer to the Standard Deduction Chart for People Born Before January 2, 1945 or Who Are Blind in the Volunteer Resource Guide (Tab F).

Point out how to compute the standard deduction by using the chart.

If the eye condition will never improve beyond these limits, the statement should include that fact. Taxpayers should keep the statement in their records.

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 is 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?

Standard deduction amounts for taxpayers who are 65 or older, and/or are blind, increases by $1,100 or $1,400 if single or head of household for each box checked for age or blindness. It can also be computed using the Standard Deduction Chart for People Born Before January 2, 1945 or Who Are Blind in the Volunteer Resource Guide (Tab F).

CAUTION

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.

Ask a volunteer to read the examples.

Ask what if Ivy's filing status was Married Filing Separately.

Answer: Her standard deduction would be $7,900.

example

Robert is 78. He lost his wife 10 years ago, so he 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 $7,100.

example

Rudy and Ivy are both 76. Ivy is blind. They are filing as Married Filing Jointly. Neither can be claimed as a dependent on someone else's return. Their standard deduction is $14,700.

Ask students to break into groups and complete exercises 3-6.

Point out the footnote below the chart used in the exercises.

Ask groups to share their answers with the class when finished.

EXERCISES (continued)

Use the Standard Deduction Chart for People Born Before January 2, 1945 or Who Are Blind in the Volunteer Resource Guide (Tab F) to complete the following exercises. Answers are at the end of the lesson summary.

Question 3: Roderick was born December 30, 1945. Does he qualify as being 65 or older? ☐ Yes ☑ **No**

Roderick is only 64. To qualify for the higher standard deduction, his birthday must be before January 2, 1945.

Question 4: Brianne and her husband Clark are both over the age of 65 and are legally blind. They will file a joint return and will not itemize their deductions. What is their standard deduction?

A. $11,500

B. $13,600

C. $15,800

Calculation: $11,400 + (4 x $1,100) = $15,800

EXERCISES (continued)

Question 5: Leticia died May 1, 2009. Her 65th birthday was on April 3, 2009. Does she qualify as age 65?

☑ **Yes** ☐ No

Question 6: Jason was born in 1967. He is single and legally blind. What is his standard deduction?

A. $7,100

B. $5,700

C. $3,650

Leticia was 65 when she died in 2009. She qualifies for the higher standard deduction given to those 65 or older.

What about individuals who can be claimed as dependents?

The standard deduction is generally lower for an individual who can be claimed as a dependent on another person's tax return. The deduction is generally limited to the greater of:

- $950, or
- The individual's earned income for the year, plus $300 (but not more than the regular standard deduction amount)

Display the approved intake and interview sheet.

Point out the check box for a dependent being claimed by another taxpayer.

Tax Software Hint: Tax software will automatically calculate a dependent's standard deduction, as long as the box indicating that the taxpayer can be claimed as a dependent on another person's tax return has been checked on the Main Information Sheet. For software entries, go to the Volunteer Resource Guide (Tab 1), Main Information Screen.

example

Janet is single, 22, a full-time student, and not blind. Her parents claimed her as a dependent on their 2009 tax return. She has no itemized deductions, so she will take the standard deduction. She has interest income of $120, taxes withheld of $35, and wages of $780. Her standard deduction is $1,080 ($780+$300).

Ask a volunteer to read the Janet example.

What about taxpayers who paid real estate taxes but do not itemize?

For the 2009 tax year, taxpayers who file using the standard deduction will be entitled to an additional standard deduction for paying certain state and local real estate property taxes that would normally be deductible on Schedule A, line 6, if the taxpayer was itemizing deductions. Single taxpayers will be entitled to a maximum of $500 and joint taxpayers will be entitled to a maximum of $1,000.

During your interview, review with the taxpayer and verify their answers to the questions regarding home mortgage interest and real estate taxes in Part V of the approved interview and intake sheet.

NEW Schedule L, Standard Deduction for Certain Filers, was developed for 2009. Schedule L must be completed to calculate the taxpayer's real estate taxes deduction when they are using the standard deduction.

What if the taxpayer purchased a new motor vehicle?

NEW Taxpayers who purchased a new qualified motor vehicle in 2009 may be entitled to deduct state and local sales and excise taxes paid on their income tax returns. A qualified motor vehicle includes a passenger automobile, light truck, or motorcycle with a gross vehicle weight rating of 8,500 pounds or less. A qualified motor vehicle can also be a motor home. To be eligible, the original use of the qualified motor vehicle must begin with the taxpayer. The vehicle must be purchased after February 16, 2009, and before January 1, 2010, to qualify for the deduction.

Taxpayers who live in states that do not have state sales taxes are still entitled to deduct other fees or taxes imposed by the state or local government. The fees or taxes that qualify are for the purchase of a new motor vehicle and are based on the vehicle's sales price or as a per-unit fee.

The deduction is limited to the taxes paid on the first $49,500 of the purchase price of each vehicle. There is no limit on the number of cars for which the taxpayer can claim the deduction, provided each car is a qualified vehicle under the law. The amount of the deduction is phased out for taxpayers whose modified adjusted gross income is between $125,000 and $135,000 for single taxpayers and between $250,000 and $260,000 for joint taxpayers. The deduction may not be taken on 2008 returns and must be claimed on Schedule L.

TIP

Purchases made in states without sales taxes, such as Alaska, Delaware, Hawaii, Montana, New Hampshire, and Oregon, can also qualify for the deduction.

CAUTION

Do not confuse the sales tax deduction on a new vehicle with the "Cash for Clunkers" program. That program, the Car Allowance Rebate System (CARS), is handled through the National Highway Traffic Safety Administration, not on a tax return. For more information go to www.cars.gov.

During your interview, verify if the taxpayer marked the check box for buying a new vehicle in Part III of the approved interview and intake sheet.

Tax Software Hint: All applicable real estate taxes paid and qualified taxes paid on a new motor vehicle must be included on Schedule L. The amounts will carry over to the standard deduction amount if it is more advantageous for the taxpayer to use the standard deduction.

How do I determine which deduction is best for the taxpayer?

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

- Mortgage interest
- Gifts to charity
- Casualty, theft, and certain other miscellaneous deductions

If the taxpayer's expenses qualify, itemizing may be a better choice.

CAUTION

Casualty and theft losses are outside the scope of the VITA/TCE program and are mentioned here for awareness only. Taxpayers with these issues should be referred to a professional tax preparer.

Refer students to the Volunteer Resource Guide (Tab 4) to view how to link to the Schedule A Worksheet.

Tax Software Hint: Tax software automatically calculates the taxpayer's standard deduction and displays the amount on page 2 of the Form 1040 screen. The tax software will automatically select the deduction method that gives the taxpayer the best result. For software entries, go to the Volunteer Resource Guide (Tab 4), Form 1040, Page 2 – Deductions.

How are taxable income and tax determined?

Taxable income and tax are determined by using the taxpayer's adjusted gross income, exemption amount, and standard deduction or itemized deductions.

Emphasize that these amounts play an important role in determining the taxpayer's tax liability and diligent care should be taken to ensure that they be figured correctly.

How is taxable income determined?

Taxable income is determined by subtracting certain items from the adjusted gross income (AGI). These include:

- Personal and dependency exemptions, and
- Standard or itemized deductions

example

Ada is 25 years old and has an adjusted gross income of $14,000. She is entitled to claim an exemption for herself in the amount of $3,650 and her filing status is single. She is not blind. Her taxable income is $4,650. ($14,000 AGI - $3,650 Exemption - $5,700 Standard Deduction)

Read Ada's example.

Ask what if Ada's filing status was Head of Household.

Answer: Her taxable income would be $2,000 if she used the filing status of Head of Household.

Tax Software Hint: Tax software automatically calculates the exemption amount and displays the result on line 42, applying any limitations.

How is the tax determined?

Tax is based on the amount of taxable income. There are several methods for finding the tax amount. Most taxpayers use either the tax tables or the Tax Computation Worksheet.

- If taxable income is less than $100,000, use the tax tables
- If taxable income is $100,000 or more, use the Tax Computation Worksheet

TIP

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.

The tax tables are located in the appendix of Publication 4491-W, VITA/TCE Workbook, Publication 17, Your Federal Income Tax for Individuals, and Form 1040 Instructions.

Ask students to locate the tax tables in Publication 17.

Taxpayers must use the Schedule D Tax Worksheet to figure their taxes if the following applies:

- They have to file Schedule D, and
- Schedule D, line 18 or line 19, is more than zero

Read the example of Mr. and Mrs. Brown.

Ask what if the Browns' taxable income was $29,000.

Answer: Their tax would be $3,519.

example

Mr. and Mrs. Brown are filing a joint return. Their taxable income is $25,300. Find the range that includes their income: $25,300-$25,350. Then read across to the column that applies to their filing status: Married Filing Jointly. Their tax is $2,964.

Tax Software Hint: Regardless of the taxpayer's situation, figuring the tax is easy with tax software. The program has all the information necessary to compute the tax on the return based on previous information that has been input. It is important to enter all income, deduction and credit information correctly in order for the tax software to compute the tax accurately.

CAUTION

If the taxpayer received a qualified dividend or capital gains distribution and you are preparing a paper return, you should figure the taxpayer's total tax using the worksheet in Form 1040 Instructions.

Practice – Vanessa Franklin

Direct students to Appendix A-19.

Take a look at how a volunteer helped our taxpayer, Vanessa Franklin: Go to Appendix A-19 and review the sample interview with Vanessa related to deductions and tax computation.

Summary

Review the lesson summary.

State that itemized deductions is an intermediate topic, and that volunteers must certify at that level to complete returns for taxpayers that itemize. These taxpayers must be referred to a properly certified volunteer.

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, real estate taxes, purchase of a new motor vehicle, 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.

Assign the workbook exercise and review as a class when done (optional).

TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem, practice exercise(s), or supplements 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. $5,700*

Answer 2: *B. $8,350*

Answer 3: *No. Roderick is only 64. To qualify for the higher standard deduction, his birthday must be before January 2, 1945.*

Answer 4: *C. $15,800. This is calculated by multiplying $1,100 by 4 (both are blind, both are 65) to get $4,400, which is then added to the couple's standard deduction of $11,400.*

Answer 5: *Yes. Leticia qualifies for the higher standard deduction given to those 65 or older because she was 65 when she died in 2009.*

Answer 6: *A. $7,100*

Notes

Notes

Lesson 20: Itemized Deductions

Instructor Notes

Introduction

This lesson will assist you in determining if a taxpayer should itemize deductions. Generally, taxpayers should itemize their deductions if their total allowable deductions are higher than the standard deduction amount.

What do I need?

☐ Approved Intake and Interview Sheet
☐ Volunteer Resource Guide
☐ Publication 17
☐ Publication 4012
☐ Publication 4491-W
☐ Form 1040
☐ Schedule A
Optional:
☐ Publication 502
☐ Publication 526
☐ Publication 529
☐ Publication 530
☐ Publication 936

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
- Accurately report itemized deductions on Schedule A, Itemized Deductions
- Explain the recordkeeping requirements for claiming charitable contributions

Review objectives with the class.

Point out the resources cited under **What do I need?**

Who must itemize?

Taxpayers who have a standard deduction of zero should itemize their deductions. Taxpayers who normally fall within this category are taxpayers who 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

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.

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.

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. Use the Interview Tips in the Volunteer Resource Guide (Tab F) to determine if itemizing deductions would be more beneficial for the taxpayer.

Itemized deductions include amounts paid for qualified:

- Medical and dental expenses
- Certain taxes you paid
- Mortgage interest
- Gifts to charity
- Casualty and theft losses and certain miscellaneous deductions

CAUTION

Casualty and theft losses are outside the scope of the VITA/TCE program. Refer taxpayers with these losses to a professional tax preparer.

Review the tip.

TIP

A married taxpayer, filing separately, whose spouse itemizes deductions is not allowed to claim the standard deduction; if one spouse itemizes, the other must itemize (even if the amount is “0”).

Tax Software Hint: For software entries, go to the Volunteer Resource Guide (Tab 4), Form 1040, Page 2 - Deductions.

How do I handle medical and dental expenses?

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 is more than 7.5% of their adjusted gross income (AGI).

Tax Software Hint: Review the Itemized Deductions Detail Worksheet for Schedule A – Itemized Deductions in the Volunteer Resource Guide (Tab 4).

Review the tips for medical and dental expenses.

Which medical and dental expenses are deductible?

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, and
- Dependents claimed at the time the medical services were provided or at the time the expenses were paid

Review Whose Medical Expenses Can You Include? in the Medical and Dental Expenses chapter of Publication 17.

TIP

The standard mileage rate allowed for out-of-pocket expenses for a car when used for medical reasons is 24 cents per mile.

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.

Ask students to review the table of deductible and nondeductible expenses shown in the Medical and Dental Expenses chapter of Publication 17.

Read the Stewart and Carmen example.

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?

Unreimbursed medical and dental expenses and eligible Long-Term Care premiums paid during the tax year are deductible. Be sure the expenses were not paid with pre-tax dollars or reimbursed by an insurance company.

TIP

If you and a taxpayer disagree as to whether a particular expense is deductible, then 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

Assign the exercise.

Review answer with the class when complete.

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 **$3,250**.

Medical Expenses	Amount	Deductible
Unreimbursed doctors' bills	$500	**$500**
Unreimbursed orthodontist bill for braces	$1,200	**$1,200**
Hospital insurance premiums	$300	**$300**
Life insurance premiums	$500	
Unreimbursed prescription medicines	$100	**$100**
Vitamins	$70	
Hospital bill (before insurance company's reimbursement of $1,000)	$2,000	**$1,000**
Smoking-cessation program	$150	**$150**
Total	$4,820	**$3,250**

The total of qualified medical and dental expenses is $3,250, which does not include life insurance premiums, vitamins, or reimbursed hospital expenses.

How do I handle taxes that may be deductible?

Taxpayers can deduct certain taxes if they itemize their deductions. To be deductible, the tax must have been imposed on the taxpayer and paid by the taxpayer during the current tax year. Taxes that are deductible include the following:

Ask students to turn to the Taxes chapter of Publication 17 and review the table, Which Taxes Can You Deduct?

Point out the column on what can be deducted.

- State and local taxes: Taxpayers cannot deduct both state and local income taxes *and* general sales taxes in the same year. They must elect to deduct one or the other.
  - State and local income taxes include withheld taxes, estimated tax payments, or other tax payments such as a prior year refund of a state or local income tax that the taxpayer chose to have credited to their estimated state or local income taxes.
  - General sales taxes can be determined by using the taxpayer's actual expenses or the state and local sales tax tables located in the Form 1040, Schedule A Instructions.

- Real estate taxes
  - State, local, or foreign real estate taxes that are based on the assessed value of the taxpayer’s real property, such as the taxpayer’s house or land, are deductible.
  - Real estate taxes are generally reported on Form 1098, Mortgage Interest Statement, or a similar statement from the mortgage holder. If the taxes are not paid through the mortgage company, the taxpayer should have a record of what they have paid during the year.
  - Some real estate taxes are not deductible, including taxes for local benefits, itemized charges for services, transfer taxes, rent increases due to higher real estate taxes, and homeowners association fees.
- **NEW** Motor vehicle taxes: ARRA provides a deduction for state and local sales and excise taxes paid on the purchase of new cars, light trucks, motor homes, and motorcycles. It also provides for the deduction of other taxes and fees in states with no sales tax. For more information, refer to Lesson 19, Standard Deduction and Tax Computation.
  - Taxpayers who purchased a new qualified passenger vehicle after February 16, 2009 and before January 1, 2010 qualify for the new motor vehicle taxes deduction.
  - Taxpayers who live in states that do not have state sales taxes are still entitled to deduct other fees or taxes imposed by the state or local government. The fees or taxes that qualify are for the purchase of a new motor vehicle and are based on the vehicle’s sales price or as a per-unit fee.
  - The deduction is limited to the taxes paid on a qualified new car, light truck, motor home, or motorcycle with a purchase price of up to $49,500.
  - The amount of the deduction is phased out for taxpayers whose modified adjusted gross income is between $125,000 and $135,000 for single taxpayers, and between $250,000 and $260,000 for married taxpayers filing jointly.
- Foreign income taxes can be deducted on income that is not exempt from U.S. tax under the foreign earned income exclusion or the foreign housing exclusion.
- Other taxes: Any other qualified deductible taxes that are not included above.
- Personal property taxes are deductible if they are state or local taxes that are:
  - Charged on personal property
  - Based only on the value of the personal property, and
  - Charged on a yearly basis, even if collected more or less than once a year

Which expenses are not deductible?

Ask students to review the Publication 17 chapter on Taxes for expenses that are not deductible.

Not all taxes are deductible and some items aren’t actually classified as taxes. See the Taxes chapter in Publication 17.

Ask a volunteer to read the Wayne example.

example

Suppose Wayne brings in records showing the following tax payments: state income tax, $2,000; real estate taxes, $900; sales tax on a new car, $1,600; homeowners’ association fee, $250. Wayne’s total tax deduction is $4,500 ($2,000 + 900 + 1,600 = $4,500). The $250 homeowners’ association fee is not deductible.

How do I deduct the taxes?

State and local income taxes

If the taxpayer can deduct state and local income taxes on Schedule A, include tax withheld, estimated tax payments made in good faith 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.

TIP

Taxpayers who own their home but choose to take the standard deduction are eligible for an additional standard deduction of $500 if filing Single ($1,000 if Married Filing Jointly) for real estate taxes paid.

Real estate taxes

Real estate taxes are reported on Form 1040, Schedule A.

NEW *Motor Vehicle Taxes*

Sales and excise taxes will be calculated on Schedule A, New Motor Vehicle Tax Deduction Worksheet. The amount from line 11 of the worksheet is carried over and reported on line 7 of Schedule A.

CAUTION

If box 5a of Schedule A is checked, complete line 7 to include any deductible new motor vehicle taxes. If box 5b is checked, include the new motor vehicle taxes on that line. Do not complete line 7 *and* check box 5b.

Other taxes

Other taxes, including personal property taxes, are reported on line 8 of Schedule A.

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.

TIP

State and local tax withheld is sometimes shown on Form W-2 in either box 17 or 19.

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

Assign the exercises.

Review answers with the class when complete.

How do I handle interest?

Interest is the amount you pay for the use of borrowed money. Certain types of interest are deductible 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 volunteer program and should be referred to a professional tax preparer.

Ask students to review the amount deductible in the Interest Expense chapter in Publication 17.

Generally, the taxpayer receives Form 1098, Mortgage Interest Statement, which shows the deductibleamount of home mortgage interest paid by the taxpayer. 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.

TIP

Using the flow chart – Is My Home Mortgage Interest Fully Deductible? – in Publication 17 will help you determine if the interest should be included on Schedule A.

TIP

Members of the clergy and military can deduct qualified mortgage interest even if they receive a nontaxable housing allowance.

Ask a volunteer to read the Alfredo and Cindy example.

Answer any student questions.

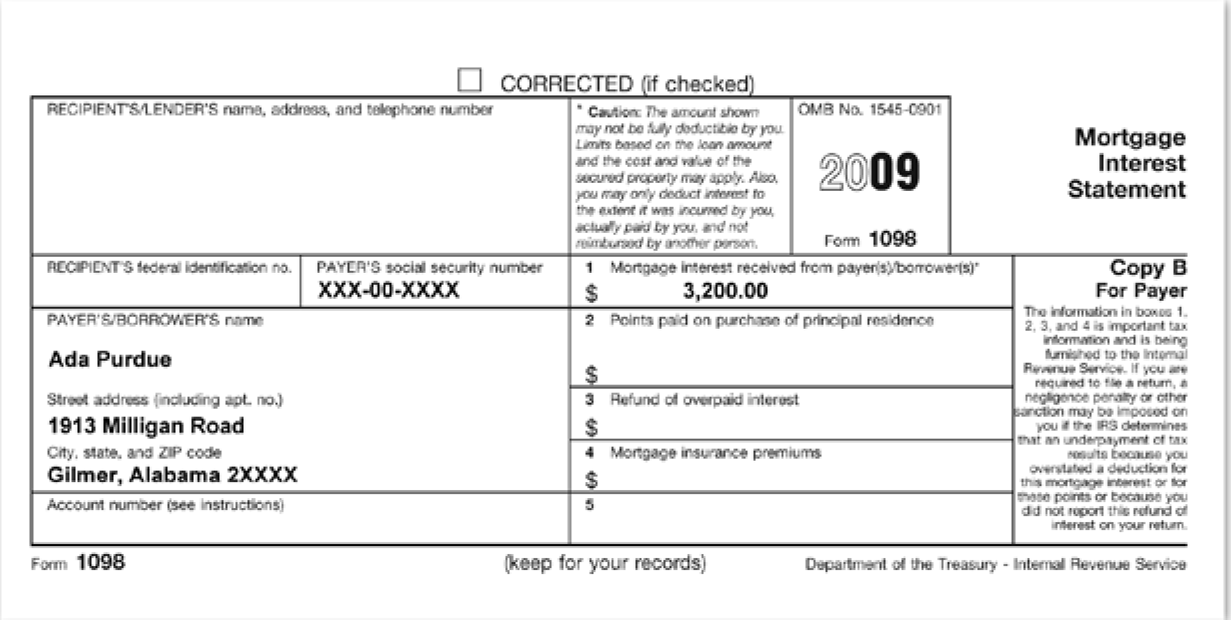
example

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 throughout 2009 ($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)



☐ CORRECTED (if checked)

RECIPIENT'S/LENDER'S name, address, and telephone number

* Caution: The amount shown may not be fully deductible by you. Limits based on the loan amount and the cost and value of the secured property may apply. Also, you may only deduct interest to the extent it was incurred by you, actually paid by you, and not reimbursed by another person.

OMB No. 1545-0901

2009

Form 1098

Mortgage Interest Statement

RECIPIENT'S federal identification no.

PAYER'S social security number XXX-00-XXXX

1 Mortgage interest received from payer(s)/borrower(s)* $ 3,200.00

PAYER'S/BORROWER'S name Ada Purdue

Street address (including apt. no.) 1913 Milligan Road

City, state, and ZIP code Gilmer, Alabama 2XXXX

Account number (see instructions)

2 Points paid on purchase of principal residence $

3 Refund of overpaid interest $

4 Mortgage insurance premiums $

5

Copy B For Payer

The information in boxes 1, 2, 3, and 4 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 the IRS determines that an underpayment of tax results because you overstated a deduction for this mortgage interest or for these points or because you did not report this refund of interest on your return.

Form 1098 (keep for your records) Department of the Treasury - Internal Revenue Service

TIP

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.

What about 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

Only points paid as a form of interest (for the use of money) can be deducted on Schedule A. This interest, even if it qualifies for home mortgage interest, must generally 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 the taxpayer paid them, unless the points are paid in connection with the improvement of a main home and certain conditions are met.

Direct students to the flow chart in the Interest Expense chapter of Publication 17.

When are points fully deductible?

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.

TIP

Use the flow chart in the Interest Expense chapter of Publication 17 to help you determine if the points are fully deductible.

What about qualified mortgage insurance premiums?

Qualified mortgage insurance is provided by the Department of Veterans Affairs, the Federal Housing Administration, the Rural Housing Service, and private mortgage insurance (PMI) companies. Taxpayers can treat qualified mortgage insurance premiums paid or accrued during the tax year as home mortgage interest. The insurance coverage must relate to home acquisition debt, the insurance contract must have been issued after 2006, and the taxpayer must have paid the premiums before 2010 for coverage in effect during 2009. PMI is deductible on line 13 of Schedule A.

What qualifications are required to deduct PMI?

- Paid or accrued January 1, 2009 to December 31, 2009
- Borrowers obtained mortgage to buy, build, or improve their home
- If AGI is more than $100,000 ($50,000 if Married Filing Separately), the amount of mortgage insurance premiums that would otherwise be deductible is reduced or eliminated

TIP

Review the Interest Expense chapter of Publication 17 for special rules and limitations for deducting mortgage insurance premiums as home mortgage interest.

What types of interest are *not* deductible?

Interest that *cannot* be deducted includes:

- Interest on car loans where the car is used for non business 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 non business credit card purchases

EXERCISES (continued)

Assign the exercise.

Review the answer with the class when complete.

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 $ 2,180 .

Refinance points and personal interest are not deductible.

Interest Payments	Amount	Deductible
Qualified interest on their home mortgage, reported on Form 1098	$2,180	**$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	
Total	$4,880	**$2,180**

How do I handle gifts to charity?

Ask students to go to the Contributions chapter in Publication 17 and review the first column in Table 24-1.

A charitable contribution is a donation or gift to a qualified organization. Taxpayers must itemize their deductions to deduct a charitable contribution. Taxpayers can deduct contributions to the following types of **qualifying organizations**:

- 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

TIP

Turn to the table – Examples of Charitable Contributions–A Quick Check – in the chapter Contributions in Publication 17.

TIP

To be deductible, contributions must be made to a qualifying organization, not an individual.

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 and furniture 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 a standard mileage deduction of 14 cents per mile

Review gifts to charity that are deductible.

Ask students to give examples.

Which gifts to charity are *not* deductible?

Organizations that do *not* qualify for deductible contributions include:

- 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

Review gifts to charity that are *not* deductible.

Ask students to give examples.

Ask a volunteer to read the Susan example.

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 total contributions are 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 prove the amount of the cash and noncash contributions they make during the year. Cash, check, and noncash contributions should be reported on Schedule A, line 16 and line 17 respectively. For each contribution, tell taxpayers that they cannot deduct a cash contribution, regardless of the amount, unless one of the following records of the contribution is kept:

- 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

For unreimbursed expenses related to donated services, the taxpayer must have:

- Adequate records of the expenses
- Organization's written acknowledgement and description of the taxpayer's services

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.

What records should the taxpayer keep for noncash contributions?

Review the tips.

Remind students to ask about noncash contributions.

TIP

Effective for contributions made after August 17, 2006, deductions are disallowed for the charitable contribution of clothing and household items if the items are not in good used condition or better.

Noncash Contribution Deductions Less Than $250

For each single contribution of less than $250, tell the taxpayer to keep:

- 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

TIP

If the taxpayer is reducing the fair market value by appreciation, or donating capital gain property, refer the taxpayer to a professional tax preparer.

Noncash Contribution Deductions of At Least $250 but Not More Than $500

For each 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 acknowledgement must state whether the taxpayer received any goods or services in return and a description and good faith estimate of any such items.

Noncash Contribution Deductions of More Than $500

Taxpayers must report noncash contributions of $500 or more on Form 8283 and the taxpayer 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 $**632**.

Bingo, lottery tickets, and donations to individuals in need are not deductible.

Assign the exercise.

Review answer with the class when complete.

What are casualty and theft losses?

The deduction for casualty and theft losses is complex, with many rules and exceptions, so you should refer the taxpayer to a professional tax preparer.

What are miscellaneous deductions?

What types of miscellaneous expenses are deductible?

Miscellaneous itemized deductions are expenses a taxpayer pays in order 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?

Deductions subject to the 2% limit are reported on lines 21 through 27 of Schedule A. Examples include:

- **NEW** 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 a discussion)
- 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
- Fees paid to an IRA custodian

Review the list of deductions.

Answer any student questions.

Tax Software Hint: For software entries, go to the Volunteer Resource Guide (Tab 4), Schedule A - Itemized Deductions.

Which deductions are exempt from the 2% limit?

Deductions that are *not* subject to the 2% limit are reported on line 28 of Schedule A. Examples include:

- Gambling losses to the extent of gambling winnings (taxpayer must have kept a record of their losses)
- Work-related expenses for individuals with a disability that enable 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:

- Political contributions
- The cost of entertaining friends
- Lost or misplaced cash or property
- Travel as a form of education

TIP

An attorney fee for a will is considered a personal legal expense, so it is not deductible.

Refer students to the Publication 17 chapter on Miscellaneous Deductions for additional non-deductible expenses.

EXERCISES (continued)

Question 6: Philip had the expenses shown below. What is the total of Philip's qualified miscellaneous itemized expenses? $ 695 .

Expense	Amount	Deductible
Income tax preparation fee	$100	**$100**
Safe deposit box rental (to store bonds)	$75	**$75**
Life insurance premiums	$300	
Credit card convenience fee for income tax payment	$70	**$70**
Loss on sale of personal home	$1,800	
Investment journals and newsletters	$250	**$250**
Investment expenses	$200	**$200**
Attorney fees for preparation of a will	$100	
Total	$2,895	**$695**

Assign the exercise.

Review answer with the class when complete.

Practice - Vanessa Franklin

Let's take a look at how a volunteer helped our taxpayer, Vanessa Franklin. Go to Appendix A-21 and review the sample interviews with Vanessa related to Lesson 20.

Return to this lesson after you have reviewed this information.

Direct students to Appendix A-21.

Summary

Medical and Dental Expenses

Deductible medical and dental expenses are reported and calculated on lines 1 through 4 of Schedule A.

Qualified medical and dental expenses are those the taxpayer paid during the tax year for the taxpayer, spouse, and dependents.

Review the lesson summary with the class.

Taxes

Deductible taxes are reported on lines 5 through 9 of Schedule A. Taxpayers can deduct the following:

- State and local income taxes
- State, local, or foreign real estate taxes
- State and local personal property tax payments

For 2009, there is an additional deduction for state and local sales and excise tax (including certain fees in states that do not have a sales tax) on the purchase of qualified motor vehicles. A qualified motor vehicle must be new and includes a passenger automobile or light truck, a motorcycle, or a motor home.

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 deductible amount of interest paid by the taxpayer. 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. This interest, even if it qualifies for home mortgage interest, must generally 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 Publication 17 for more information.

Points paid to refinance a mortgage are generally not deductible in full the year the taxpayer paid them, unless the points are paid in connection with the improvement of a main home and certain conditions are met.

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
- 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 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. See Publication 17 for the chapter on Miscellaneous Deductions not subject to the 2% limitation.

TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem, practice exercise(s), or supplements 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.

Assign the workbook exercise and review as a class when done (optional).

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 in full for the tax year, 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.*

Notes

Lesson 21: Military Employee Business Expenses

Instructor Notes

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 that are related to working as a member of the Armed Forces. These expenses, with one exception, may be reported on Form 2106 or Form 2106-EZ and will be deducted on Schedule A as a Miscellaneous Itemized Deduction subject to the 2% limit or in certain cases as an adjustment to income.

TIP

Although the approved intake and interview sheet does not list military employee business expenses, it is important to ensure that service members 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 do I need?

☐ Approved Intake and Interview Sheet
☐ Volunteer Resource Guide
☐ Publication 3
☐ Publication 4491-W
☐ Form 2106
☐ Form 2106-EZ
☐ Schedule A

Optional:

☐ Publication 463
☐ Publication 970
☐ Form 2106 Instructions

Review objectives with the class.

Point out the resources cited under **What do I need?**

What are military employee business expenses?

Military employee business expenses are necessary business-related expenses incurred by active 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 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

For example, although members of the Armed Forces are required to wear uniforms when they are on duty, they are generally allowed to wear their uniforms in place of regular civilian clothing when they are off duty. Therefore, 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 that do not replace regular clothing, such as insignia of rank, corps devices, epaulets, aiguillettes, and swords, can be deducted.

TIP

The same rules apply for active duty personnel and reservists.

Are professional dues deductible?

Professional 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.

Read the Lt. Allen example.

example

Lt. Allen, an electrical engineer at Maxwell Air Force Base, can deduct professional dues paid to the American Society of Electrical Engineers.

Assign the exercises.

Review answers with the class when complete.

EXERCISES

Q1 & 2: Items replacing regular clothing and insignia of rank and epaulets are tax deductible.

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. Clay 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**

Illustrations are not part of official duties and can't be deducted as an employee business expense.

Can service members claim work-related educational expenses?

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.

TIP

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.

Point out that qualified educational expenses can be deducted as an educational credit or as a certain miscellaneous itemized deduction. Students should calculate the various ways and claim these expenses where they are most beneficial.

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

Sgt. Ventura, 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.

Ask a volunteer to read the Sgt. Ventura example.

Ask what if Sgt. Ventura took an advanced aviation course.

Answer: He could deduct the expenses because he met the minimum job qualifications and the course improved his skills in his current position.

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

Q4 & Q5: Educational expenses may be claimed as itemized deductions if it improves the skills used in the service member's current job.

Assign the exercises.

Review answers with the class when complete.

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.

TIP

See Publication 970 for additional information regarding Educational Expenses.

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.

Assign the exercise.

Review answer with the class when complete.

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**

The cost of traveling to Taal cannot be deducted on weekends because the travel is not work-related.

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

TIP

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.

Refer tax preparers to Publication 3 for a listing of deductible “away from home” travel expenses.

TIP

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" (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

Costs of traveling overnight to attend a reservists' meeting can be deducted.

Assign the exercise.

Review answer with the class when complete.

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 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

For 2009, the standard mileage rate for miles driven for business purposes is 55 cents per mile. Any expense in excess of these rates 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.

TIP

Military Reservists include members of the U.S. Armed Forces (Army, Navy, Marine Corps, Air Force, 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.

TIP

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.

Ask a volunteer to read the Mary example.

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 2009, 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 (Tab 4), Schedule A - Itemized Deductions (continued).

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.

TIP

For information on using the standard meal allowance instead of actual expenses, see Publication 463, Travel, Entertainment, Gift, and Car Expenses.

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.

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.

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.

TIP

The standard mileage rate can be found on Form 2106, Part II, Section B, and Form 2106-EZ, Part II.

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

Taxi fare is an allowable transportation expense when used to travel on work-related business.

Assign the exercise.

Review answer with the class when complete.

Are expenses related to temporary work locations deductible?

Expenses incurred while commuting to work are not deductible. However, service members who are assigned to 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.

Ask a volunteer to read the Sgt. Purdue example.

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.

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 reimbursement from the military?
- Did the amount of travel expenses exceed the amount of the reimbursement or allowance?

TIP

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.

For service members who are not required to file Form 2106, enter miscellaneous deductions subject to 2% of AGI directly on Schedule A, line 21.

Read the Capt. Glendale example.

Ask what if he did not return the extra $75.

Answer: If the $75 was not included on his Form W-2, he would have to include it on line 7 of Form 1040.

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.

Tax Software Hint: For software entries, go to the Volunteer Resource Guide (Tab 4), Schedule A - Itemized Deductions (continued).

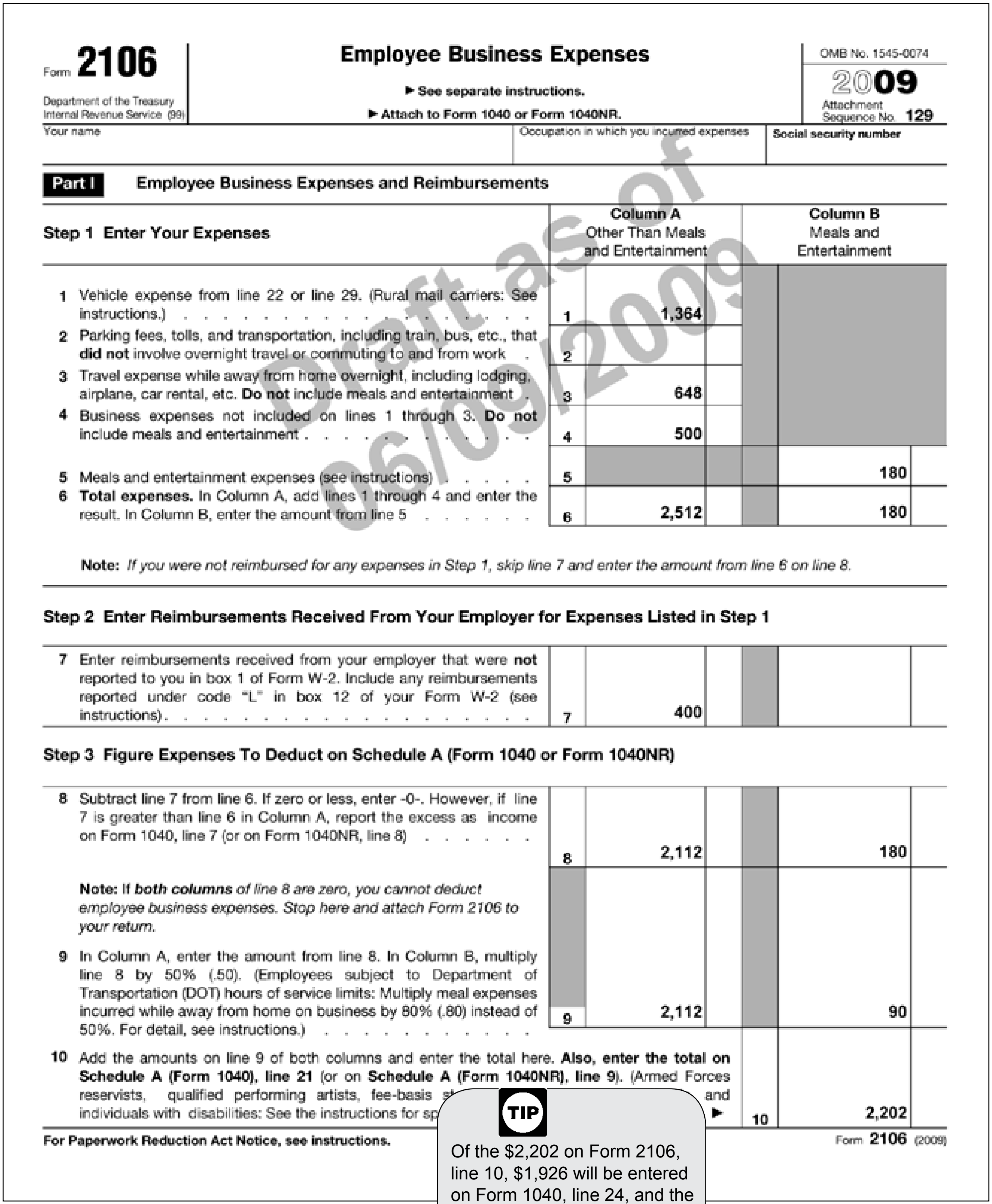
Taxpayer Interview and Tax Law Application

Let's see how a volunteer helps Mary, an Army Reservist, determine how to deduct her employee business expenses:

Ask two volunteers to role-play the sample interview.

SAMPLE INTERVIEW

VOLUNTEER SAYS...	MARY RESPONDS...
You were in the Reserves, as well as working your full-time civilian job. Did you have any expenses associated with that?	Well, my unit usually meets at Anderson, which is about 120 miles from here. I had nine round trips during 2009, plus we met at Baker four times. That's only 40 miles away. Here's my mileage record.
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?	I paid $72 for a hotel room each time, and I ate at the mess for about $20 each trip.
Did you get any reimbursement?	No, I have to pay for it myself.
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. Did you leave from your regular job to go to that base, or would it be on a day off?	No, those were short meetings on weeknights, so I would just drive straight from work.
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?	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.
Did you get reimbursed for any part of that?	The military gives me an allowance, but that only covered $400.
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 $1,188, along with the hotel rooms at $648, and half the meals at $90 totals $1,926 – we'll deduct that right on the front of the return. The other mileage from trips to Baker add up to $176 and the $100 out of pocket for the class will give us a total of $276 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 approved intake and interview sheet, indicate that you've addressed these items.]	



Form **2106**

Department of the Treasury
Internal Revenue Service (99)

Employee Business Expenses

► See separate instructions.

► Attach to Form 1040 or Form 1040NR.

OMB No. 1545-0074

2009

Attachment
Sequence No. 129

Your name	Occupation in which you incurred expenses	Social security number

Part I Employee Business Expenses and Reimbursements

Step 1 Enter Your Expenses		Column A Other Than Meals and Entertainment	Column B Meals and Entertainment
1 Vehicle expense from line 22 or line 29. (Rural mail carriers: See instructions.)	1	1,364	
2 Parking fees, tolls, and transportation, including train, bus, etc., that **did not** involve overnight travel or commuting to and from work	2		
3 Travel expense while away from home overnight, including lodging, airplane, car rental, etc. **Do not** include meals and entertainment	3	648	
4 Business expenses not included on lines 1 through 3. **Do not** include meals and entertainment	4	500	
5 Meals and entertainment expenses (see instructions)	5		180
6 **Total expenses.** In Column A, add lines 1 through 4 and enter the result. In Column B, enter the amount from line 5	6	2,512	180

Note: *If you were not reimbursed for any expenses in Step 1, skip line 7 and enter the amount from line 6 on line 8.*

Step 2 Enter Reimbursements Received From Your Employer for Expenses Listed in Step 1

7 Enter reimbursements received from your employer that were **not** reported to you in box 1 of Form W-2. Include any reimbursements reported under code "L" in box 12 of your Form W-2 (see instructions)	7	400	

Step 3 Figure Expenses To Deduct on Schedule A (Form 1040 or Form 1040NR)

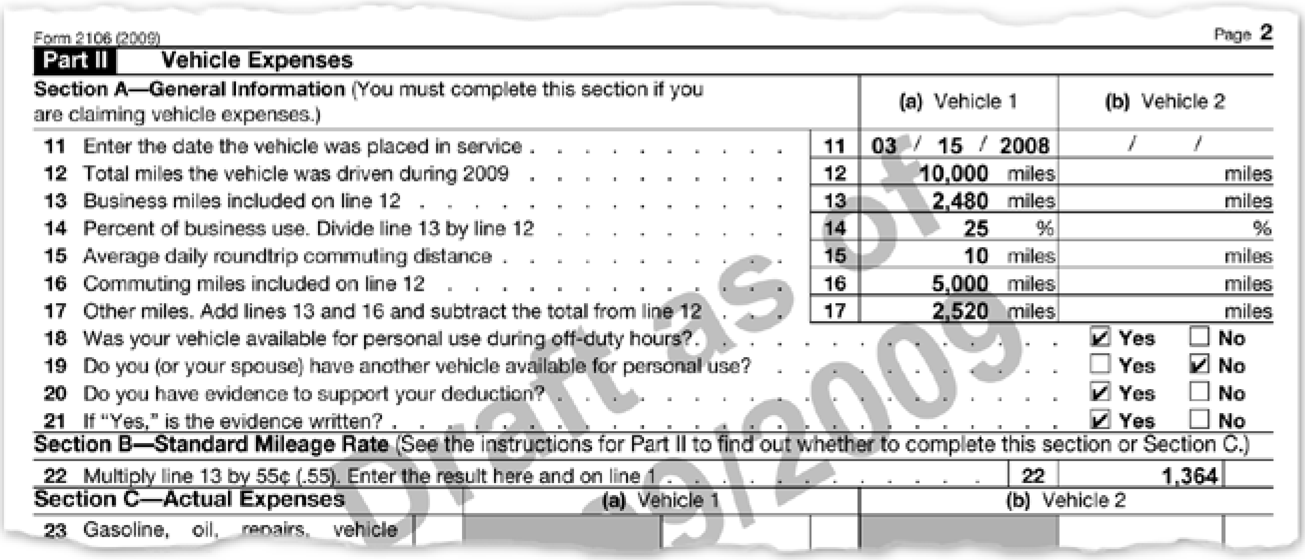
8 Subtract line 7 from line 6. If zero or less, enter -0-. However, if line 7 is greater than line 6 in Column A, report the excess as income on Form 1040, line 7 (or on Form 1040NR, line 8)	8	2,112	180
Note: If *both columns of line 8 are zero, you cannot deduct employee business expenses. Stop here and attach Form 2106 to your return.*			
9 In Column A, enter the amount from line 8. In Column B, multiply line 8 by 50% (.50). (Employees subject to Department of Transportation (DOT) hours of service limits: Multiply meal expenses incurred while away from home on business by 80% (.80) instead of 50%. For detail, see instructions.)	9	2,112	90
10 Add the amounts on line 9 of both columns and enter the total here. **Also, enter the total on Schedule A (Form 1040), line 21** (or on **Schedule A (Form 1040NR), line 9**). (Armed Forces reservists, qualified performing artists, fee-basis st and individuals with disabilities: See the instructions for sp ►	10		2,202

For Paperwork Reduction Act Notice, see instructions.

Form **2106** (2009)

TIP

Of the $2,202 on Form 2106, line 10, $1,926 will be entered on Form 1040, line 24, and the remaining $276 will be entered on Schedule A, line 21.



Form 2106 (2009) Page 2

Part II **Vehicle Expenses**

Section A—General Information (You must complete this section if you are claiming vehicle expenses.)		**(a)** Vehicle 1	**(b)** Vehicle 2
11 Enter the date the vehicle was placed in service	11	03 / 15 / 2008	/ /
12 Total miles the vehicle was driven during 2009	12	10,000 miles	miles
13 Business miles included on line 12	13	2,480 miles	miles
14 Percent of business use. Divide line 13 by line 12	14	25 %	%
15 Average daily roundtrip commuting distance	15	10 miles	miles
16 Commuting miles included on line 12	16	5,000 miles	miles
17 Other miles. Add lines 13 and 16 and subtract the total from line 12	17	2,520 miles	miles

18 Was your vehicle available for personal use during off-duty hours? ☑ Yes ☐ No

19 Do you (or your spouse) have another vehicle available for personal use? ☐ Yes ☑ No

20 Do you have evidence to support your deduction? ☑ Yes ☐ No

21 If "Yes," is the evidence written? ☑ Yes ☐ No

Section B—Standard Mileage Rate (See the instructions for Part II to find out whether to complete this section or Section C.)

22 Multiply line 13 by 55¢ (.55). Enter the result here and on line 1 . . . 22 1,364

Section C—Actual Expenses **(a)** Vehicle 1 **(b)** Vehicle 2

23 Gasoline, oil, repairs, vehicle

Summary

This lesson explained deductions of special interest to the military and how to claim them.

Review the lesson summary with the class.

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, line 21.

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.

Assign the workbook exercise and review as a class when done (optional).

TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem, practice exercise(s), or supplements 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. Clay's 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.*

Lesson 22: Business Travel Expenses

Instructor Notes

Introduction

This lesson provides information on deducting the ordinary and necessary business-related expenses a taxpayer may have for travel, entertainment, gifts, or transportation. An ordinary expense is one that is common and accepted in the taxpayer's field of trade, business, or profession. A necessary expense is one that is helpful and appropriate for a taxpayer's business.

What do I need?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 17
- ☐ Form 1040
- ☐ Form 2106
- ☐ Form 2106 Instructions
- ☐ Form 2106-EZ
- ☐ Schedule A
- ☐ ***Optional:*** Publication 463

Objectives

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

- Compute business-related travel deductions
- Determine if a taxpayer must file Form 2106

Review objectives with the class.

Point out the resources cited under **What do I need?**

What qualifies as a deductible business travel expense?

Deductible travel expenses include ordinary and necessary business expenses associated with a taxpayer's job. These are expenses incurred *while conducting business* and cannot include personal expenses for family members, such as sightseeing or nonbusiness entertainment.

Review list of deductible business travel expenses.

Examples of deductible business travel expenses include:

- Fares for taxis, trains, airplanes, etc.
- Rental car expenses
- Costs of operating and maintaining an automobile
- Baggage charges
- Meals and lodging
- Cleaning and laundry expenses
- Telephone expenses
- Tips and gratuities
- Other necessary and ordinary expenses related to travel

Lodging and transportation connected with overnight travel away from one's tax home are deductible, but the expense of commuting to and from work is not considered a business travel expense.

What is considered a taxpayer's tax home?

Generally, the "tax home" is the entire city or general area where the taxpayer's main place of business or work is located, regardless of where the family home is maintained. If the taxpayer regularly works in more than one place, the tax home is the general area where the main place of business or work is located. One cannot deduct expenses for travel away from one's tax home for any period of temporary employment of more than one year.

example

Barton Pierce lives with his family in Chicago, but works in Milwaukee where he stays in a hotel and eats in restaurants. Although he returns to Chicago every weekend, he may not deduct any of his travel, meals, or lodging in Milwaukee because it is his tax home. His travel on weekends to his family home in Chicago is not for his work, so these expenses are also not deductible.

Who is eligible for home leave?

Section 903 of the Foreign Service Act of 1980 provides that the head of a foreign affairs agency may order a member of the Foreign Service who is a citizen of the United States to take home leave upon completion of 18 months of continuous service abroad, and shall so order as soon as possible after completion of three years of continuous service abroad. Because members of the Foreign Service are required by law to take a leave of absence, they are allowed to deduct amounts paid for travel, meals, and lodging while on home leave as employee business expenses. The taxpayers who are eligible for this leave will deduct these expenses on Form 2106, Employee Business Expenses, just like an employee who is conducting business away from home. As with all deductible employee business expenses, records and receipts must be maintained to support the deductions that are taken. Any expenses paid for on behalf of a Foreign Service member's family are personal expenses and therefore are not deductible.

TIP

United States Foreign Service employees who are on mandatory "home leave" are allowed to deduct amounts paid for travel, meals, and lodging while on home leave. However, amounts paid on behalf of the taxpayer's family while on home leave are personal living expenses and are not deductible.

Ask a volunteer to read the Jocelyn Lane example.

example

Jocelyn Lane's permanent duty station for the U.S. Foreign Service is in Korea. Her husband and children could not accompany her and have remained at their home in the United States. After two years of continuous duty, she comes back to the United States for five weeks of mandatory home leave. She can deduct the cost of her transportation, lodging, and meals while traveling home. She can also deduct her meals and transportation once she is home on leave, and her transportation, lodging, and meals while traveling back to her office in Korea.

Are reimbursements reported?

Taxpayers must report both business travel expenses as well as any employer-provided reimbursement. In some cases, this results in a net expense of zero. In other cases, excess reimbursements may be taxable income. When taxpayers combine personal and business travel, they must strictly separate the expenses.

example

Bob Smith traveled to a conference in Cleveland, Ohio that lasted from Wednesday through Friday. His employer reimbursed him for his transportation to and from the conference, his rental car expenses, and his meals. He postponed his travel home until Sunday afternoon so he could visit a luxury spa in Coshocton, Ohio. He may report the expenses for the conference and the reimbursement, but he cannot claim any costs related to visiting the spa.

Ask a volunteer to read the Bob Smith example.

What records must the taxpayer have?

Taxpayers must keep records in order to deduct travel expenses, which include meals (unless using the standard meal allowance), entertainment, gifts, or use of an automobile or other listed property. The records must document the time, place, business purpose, business relationship (for entertainment and gifts), and amounts of each expense. Generally, taxpayers must have receipts for all lodging expenses, regardless of the amount, and for any other expenses of $75 or more.

CAUTION

Taxpayers who travel for business should keep records of all expenses and any advances received from their employer. A log, diary, notebook, or any other written records are necessary to keep track of expenses.

Are there alternative methods for figuring some expenses?

There are alternative ways of reporting some expenses, such as:

- Vehicle expenses can be reported by using the actual expense method or the standard mileage rate
- Meals and incidental expenses can be reported by using the actual amounts or a standard amount can be used to report these expenses

What are vehicle expenses?

Vehicle expenses are expenses incurred when taxpayers use their vehicles for business purposes. If a taxpayer has qualified vehicle expenses, figure those in Part II of Form 2106.

One of the two following methods can be used to figure a taxpayer's deductible expenses.

- The actual expense method figures the deduction based on a variety of factors including gasoline, oil, repairs, insurance, and rentals. It may even involve depreciation or the value of a vehicle provided by the taxpayer's employer.

TIP

This lesson discusses only the standard mileage rate. If the taxpayer wishes to use the actual method, refer them to a professional tax preparer.

- The standard mileage method is very simple: it multiplies the miles driven for business by a standard cost. For 2009, the standard mileage rate for miles driven for business purposes is 55 cents per mile. Taxpayers may use the standard mileage rate only if they meet one of these requirements:
  - Owned the vehicle and used the standard method the first year the vehicle was put into service
  - Leased the vehicle and is using the standard method for the life of the lease

Refer students to Form 2106, General Information section.

If the taxpayer reports vehicle expenses, regardless of the method used, complete the General Information section in Part II of Form 2106. As with other business expenses, the taxpayer must keep records to prove the time, place, and business purpose of the travel.

How are meals, entertainment, and incidental expenses figured?

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. Alternatively, they may use a standard amount to claim meals and incidental expenses.

In either case, the taxpayer must have records to prove the time, place, and business purpose of the travel.

TIP

See the instructions for Form 2106 to determine if a taxpayer is subject to DOT hours of service.

TIP

See Publication 463 for details on how to figure deductions using the standard meal allowance, including special rules for partial days or travel and for transportation workers.

EXERCISES

Assign the exercises.

Review answers with the class when complete.

Answers are after the lesson summary.

Question 1: Which of the following is true for meals and entertainment expenses?

A. Taxpayers may deduct meal expenses for family members if the travel can be proven to be primarily business related.

B. Taxpayers can deduct 100% of meal and entertainment expenses that are not subject to DOT hours of service.

C. Taxpayers may report the actual amounts for meals and entertainment and for incidental expenses or use the standard method.

D. All of the above.

Question 2: True or False: Taxpayers who can use the standard method for calculating business mileage need not produce records proving the time, place, and business purpose of the travel. ☐ True ☑ **False**

All business expenses must be supported by records.

How do I report business expenses?

Business expenses are reported on Form 2106, Employee Business Expenses, or Form 2106-EZ, Unreimbursed Employee Business Expenses. The result from Form 2106 or 2106-EZ is reported as a miscellaneous itemized deduction on Schedule A of Form 1040.

Tax Software Hint: For software entries, go to the Volunteer Resource Guide (Tab 4), Schedule A - Itemized Deductions (continued).

TIP

The final deduction amount on Form 2106 may be reduced when you apply the 2% AGI limit on Schedule A.

Refer students to Form 2106-EZ to determine who can use that form, and the Who Should File Form 2106 flowchart, in Form 2106 Instructions.

TIP

Special rules apply to figuring the final amount for business travel expense deductions for ministers, armed forces reservists, certain state and local officials, qualified performing artists, and disabled employees. See Form 2106 Instructions to determine if a taxpayer will qualify under any of these categories.

Summary

When you help taxpayers calculate business-related travel expenses, you must identify deductible expenses. These are affected by the taxpayer's "tax home" and other factors. Also, a taxpayer cannot deduct expenses for a family member who accompanies them for pleasure on a business trip.

Review lesson summary with the class.

Not all taxpayers must file Form 2106; some may file Form 2106-EZ and others do not need to file either form. Be sure the taxpayer has proper records for expenses, and correctly reports any reimbursement amounts.

EXERCISE ANSWERS

Answer 1: *C. Taxpayers may report the actual amounts for meals/entertainment and for incidental expenses or use the standard method for one or the other.*

Answer 2: *False. All business expenses must be supported by records.*

Notes

Lesson 23: Credit for Child and Dependent Care Expenses

Instructor Notes

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 taxpayer.

To determine if a taxpayer is eligible for the credit, use the interview techniques and tools discussed in the interview lesson. Whether the taxpayer is filing Form 1040 or Form 1040A, calculate the credit using Form 2441.

CAUTION

Don't confuse this credit with the child tax credit!

What do I need?

☐ Approved Intake and Interview Sheet
☐ Volunteer Resource Guide
☐ Publication 17
☐ Publication 4491-W
☐ Form 2441 and instructions

Optional:

☐ Publication 503
☐ Form 1040 Instructions

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

Review objectives with the class.

Point out the resources cited under **What do I need?**

What is the child and dependent care credit?

The 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:

- Dependent child under 13
- Spouse who is unable to care for himself/herself
- Dependent who is unable to care for himself/herself

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. This type of credit is called a "nonrefundable" credit.

Explain what is meant by "nonrefundable" credit.

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 box 10 of the taxpayer's Form W-2.

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 Part III of Form 2441 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?

Display or refer students to the Child and Dependent Care Expenses – Decision Tree in the Volunteer Resource Guide (Tab G).

The information gathered from an approved intake and interview sheet, along with the decision tree in the Volunteer Resource Guide (Tab G) 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 other 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

Review the eligibility tests with the students.

Use the decision tree questions in the Volunteer Resource Guide (Tab G) 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?

Emphasize to students that only the parent with whom the child lives can take this credit.

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 (Tab G), 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. Only the custodial parent can take the child and dependent care credit. If the child is not being claimed as a dependent by the taxpayer because the noncustodial parent is taking the exemption 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 unable to care for him- or herself and for whom the taxpayer could claim a dependency exemption, except if:
  - the person had $3,650 or more of gross income
  - the person filed a joint return
  - the taxpayer or spouse, if Married Filing Jointly, could be claimed as a dependent on someone else's 2009 return.
- Spouses who were physically or mentally unable to care for themselves and lived with the taxpayer more than half the year.

TIP

See the rules for Qualifying Child and the special rules for children of divorced and separated parents in Publication 17, Personal Exemptions and Dependents.

Ask a volunteer to read the Jim example.

example

Jim paid someone to care for his wife, Janet, so he can 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.

What questions should I ask?

Ask the questions from the decision tree in the Volunteer Resource Guide (Tab G) and the approved intake and interview sheet. The sample interview shown uses these questions.

Ask two volunteers to role-play the sample interview.

SAMPLE INTERVIEW

VOLUNTEER SAYS...	DOROTHY RESPONDS...
I see you indicated on your intake sheet that you had child and dependent care expenses.	Yes, I did.
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?	My daughter.
Now, she is 16 years old, correct?	Yes, but she has what the doctors call profound mental retardation. 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 approved intake and interview sheet is checked.

What is the earned income test?

The taxpayer (and spouse, if married) must 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

Refer to the Earned Income Table in the Volunteer Resource Guide (Tab H) 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 unable to care for himself/herself, 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 student for some part of five calendar months during the year.

Point out the definition of a student.

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 (Tab 5), Form 2441 - Credit for Child and Dependent Care Expenses.

What questions should I ask?

Ask two volunteers to role-play the sample interview.

Ask the questions from the decision tree in the Volunteer Resource Guide (Tab G) and the approved intake and interview sheet. Here is how a volunteer might interview a taxpayer about this test.

SAMPLE INTERVIEW

VOLUNTEER SAYS...	DOROTHY RESPONDS...
I believe you mentioned earlier that you and your husband both work, is that correct?	Yes.
Did you both work while your daughter was in daycare?	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.
So, he was a full-time student for the first six months of the tax year?	Yes. Does that disqualify us?
No. That does not disqualify you.	

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.

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 daycare, 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

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-school and after-school program, so that Roger can go to work. Roger can count the cost of the before and after school program when figuring the credit, but not the cost of the education.

Ask a volunteer to read the Roger example.

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 transporting a qualifying person from the taxpayer's home to the care location and back

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.

Ask a volunteer to read the Krista example.

What about taxes paid for household employees?

Taxpayers who paid someone to come into their homes 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 Employment Taxes for Household Employers in Publication 17 for more information.

Generally, if the household employee earned less than $1,700 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 whom the taxpayer (or spouse, if married) can claim as an exemption, or
- The taxpayer's child who is under age 19 at the end of the year, even if he or she 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.

Display or refer students to the questions on the decision tree in the Volunteer Resource Guide (Tab G).

What questions should I ask?

Ask two volunteers to role-play the sample interview.

Continue asking questions from the decision tree in the Volunteer Resource Guide (Tab G) and the approved intake and interview sheet. Here is how a volunteer might interview a taxpayer about the work-related test.

SAMPLE INTERVIEW

VOLUNTEER SAYS...	DOROTHY RESPONDS...
Did the caregivers assist your daughter only when you and your husband were at work?	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.
Do you pay your mother to care for your daughter?	No, we don't. She just does it because she loves her granddaughter.
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?	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 which was also the main home of the qualifying person for more than half the year

Ask if Married Filing Separately can claim this credit.

Answer: No

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?

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 entitled Due Diligence and Provider Refusal in Publication 17 for more information. Returns that do not include the provider information cannot be filed electronically.

EXERCISES

Assign the exercises.

Review the answers with the class when complete.

Use the decision tree in the Volunteer Resource Guide (Tab G) 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.)

- **The caregiver expense is not work-related**
- Their son is not a qualifying person
- The caregiver's duties do not qualify as work-related
- **They do not pass the earned income test**

The care does not allow them to work or look for work; also, only the husband had earned income.

Taxpayer Interview and Tax Law Application

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. You wonder whether he can take the child and dependent care credit. Bill is claiming his granddaughter as a dependent, as noted in the Family/Dependent Information section of his approved intake and interview sheet. She is 18 and takes care of herself.

Apply the questions from the credit for child and dependent care expenses decision tree in the Volunteer Resource Guide (Tab G) to find out whether Bill can take the credit, as shown in the sample interview to follow.

Ask two volunteers to role-play the sample interview.

SAMPLE INTERVIEW

VOLUNTEER SAYS...	BILL RESPONDS...
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.	Oh, okay.
Why don't you tell me about your wife's illness and care?	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.
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.]	Yes, it is… well, sometimes she has good days, and I'm thankful for that.
Did you pay someone to take care of your wife so that you could go to work?	Yes, I pay my granddaughter Lucy, who just graduated from high school, to take care of Helen.
Oh, I see. Well unfortunately, I was wrong. You won't be able to take the credit for your wife because you are claiming Lucy as a dependent.	Oh, that's okay. Thanks for looking into it for me.
You're welcome. Just trying to help! [On the approved intake and interview sheet, indicate that the taxpayer doesn't qualify for this credit, and why.]	

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?

If preparing a paper return, follow the instructions on Form 2441. To determine the amount of the credit, multiply the work-related expenses (after applying the earned income and dollar limits) by a percentage. 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 (Tab 5), 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, then Part II.

example

Paula has one dependent child, Jenny, who is 6 years old. She paid $2,900 in qualified expenses. Box 10 of Paula's Form W-2 shows she received $1,400 during the year from her employer's dependent care assistance program. Because she received dependent care benefits, Part III of Form 2441 must be completed before completing Part II.

Ask a volunteer to read the Paula example.

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 box 10 of the taxpayer's Form W-2.

Refer students to the Volunteer Resource Guide (Tab 2), Form W-2 Instructions, to see 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.

Tax Software Hint: To review information related to the software, go to the Volunteer Resource Guide (Tab 5), 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

Remind students to apply the limits.

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.

Ask a volunteer to read the Mary example.

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, be sure to complete Part III of Form 2441 before calculating any credit on Part II. The tax software calculates the credit by multiplying the work-related expenses by a percentage determined by the taxpayer’s adjusted gross income.

Direct students to Appendix A-25.

How do I avoid common errors?

When Form 2441 is complete, double-check your entries for the provider’s name, ID number and amounts paid. If the taxpayer had an amount in box 10 of any form W-2, be sure that you have completed Part III of Form 2441.

On the approved intake and interview sheet, make sure the Part V 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.

Practice - Vanessa Franklin

Let’s take a look at how a volunteer helped our taxpayer, Vanessa Franklin. Go to Appendix A-25 and review the sample interview with Vanessa related to Lesson 23.

Summary

The credit for child and dependent care expenses is a nonrefundable credit that allows taxpayers to reduce their tax liability for 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.

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 of both Forms 1040 and 1040A.

Review the lesson summary with the students.

TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem, practice exercise(s), or supplements 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.

Assign the workbook exercise and review as a class when done (optional).

EXERCISE ANSWERS

Answer 1: *No, they do not qualify.*

Answer 2: *The correct answer is "the caregiver expense is not work-related" and "they do not pass the earned income test." 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.*

Notes

Lesson 24: Education Credits

Introduction

This lesson covers two 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 an approved intake and interview sheet, the Volunteer Resource Guide (Tab G), 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?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 17
- ☐ Publication 4491-W
- ☐ Form 8863
- ☐ Form 1040 Instructions
- ☐ ***Optional:*** Publication 970

Instructor Notes

Review objectives with the class.

Point out the resources cited under **What do I need?**

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.

NEW There are two different education credits: the Hope credit and the lifetime learning credit. The Hope credit is being expanded for the 2009 and 2010 tax years, to allow 40% of the Hope credit to be refundable. The modified version of the Hope credit is now referred to as the American opportunity credit. There are general rules that apply to these credits, as well as specific rules for each credit.

TIP

If the credit is being claimed for a student attending school in a Midwestern Disaster Area, refer to Publication 970 for additional information.

Who can take an education credit?

A taxpayer can take education credits for the taxpayer, spouse, and/or dependents (claimed on the tax return) who were enrolled at or attended an eligible post-secondary educational institution during the tax year.

What basic requirements must the taxpayer meet?

Direct students to the Volunteer Resource Guide (Tab G), Education Credits Tips.

In order 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.

Refer to the Volunteer Resource Guide (Tab G), Education Credits, for the basic requirements.

How do I handle dependents?

The taxpayer must claim the dependent on the return in order to claim the credit for the student's qualified expenses. Refer to the Education Credits Tips in the Volunteer Resource Guide (Tab G), demonstrated by the following example:

Ask a volunteer to read the Erma example.

Discuss expenses paid by a third party with the students.

example

Erma Bradley has a grandson named Kevin. He is claimed as a dependent on his parent's joint return. Erma paid Kevin's tuition directly to the university. For purposes of claiming an education credit, Kevin 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 any college, university, vocational school or other post-secondary educational 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.

What are qualifying expenses?

Advise students that books are now qualified expenses for the American opportunity credit.

Define the term *required* for the students.

Qualified education expenses are tuition and certain related expenses required for enrollment or attendance at an eligible educational institution.

NEW New for only the American opportunity tax credit (Hope credit expanded), the definition for certain related expenses has been revised for 2009 and 2010 tax years. The change will be discussed later in the lesson. Ask the taxpayer for details on each person's education expenses. Ask to see documentation, such as receipts or the 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.

Ask a volunteer to read the Janice example.

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.

Ask a volunteer to read the Jackie example.

Are any amounts excluded from qualified expenses?

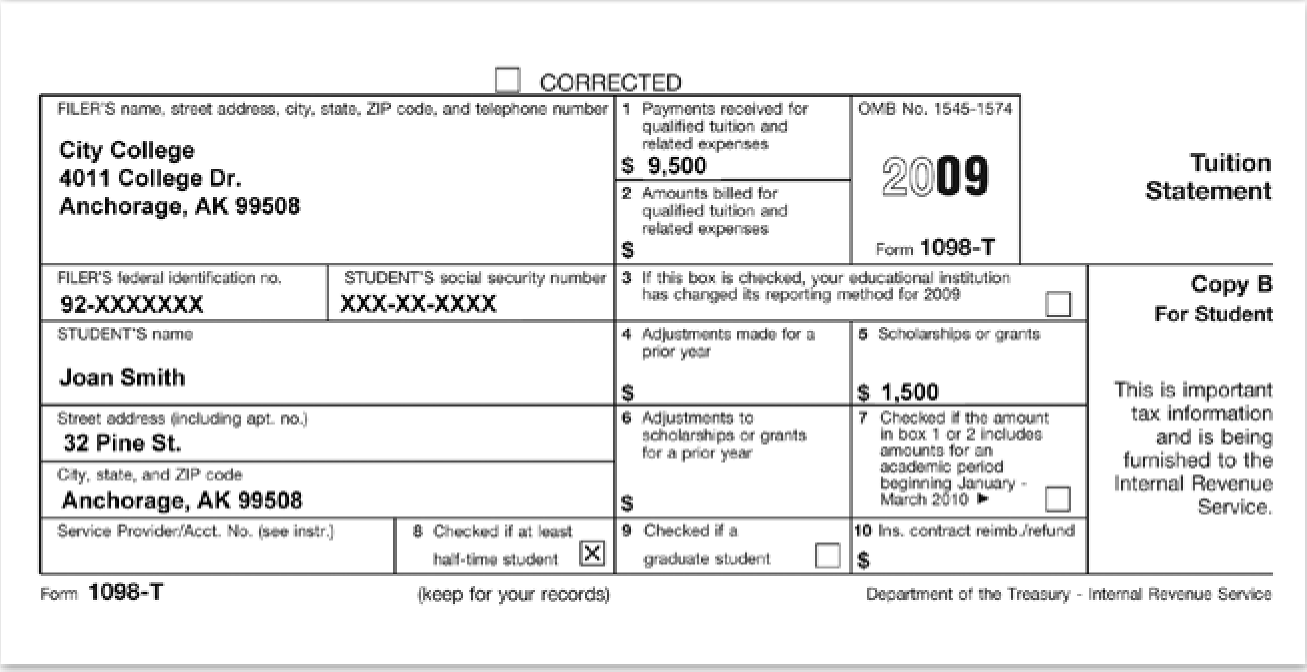
Certain tax-free funds used to pay tuition cannot be used to figure the credit. Once you have identified each person claiming a credit, and their qualified expenses, ask if the student received any of these untaxed educational benefits during the year:

- 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)
- Refunds of the year's qualified expenses paid on behalf of a student (for example, the student dropped a class and received a refund of tuition)

Subtract the tax-free educational assistance, refunds, and benefits from the student's qualified expenses. These tax-free benefits are listed in the Education Credits Interview Tips in the Volunteer Resource Guide (Tab G).

Direct students to the Education Credits Tips in the Volunteer Resource Guide (Tab G).

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 box 1 or 2 of Form 1098-T is actually the amount paid in the current tax year for qualified expenses.



☐ CORRECTED

FILER'S name, street address, city, state, ZIP code, and telephone number
City College
4011 College Dr.
Anchorage, AK 99508

1 Payments received for qualified tuition and related expenses
$ 9,500

2 Amounts billed for qualified tuition and related expenses
$

OMB No. 1545-1574
2009
Form 1098-T

Tuition Statement

FILER'S federal identification no.
92-XXXXXXX

STUDENT'S social security number
XXX-XX-XXXX

3 If this box is checked, your educational institution has changed its reporting method for 2009 ☐

Copy B
For Student

STUDENT'S name
Joan Smith

4 Adjustments made for a prior year
$

5 Scholarships or grants
$ 1,500

This is important tax information and is being furnished to the Internal Revenue Service.

Street address (including apt. no.)
32 Pine St.

City, state, and ZIP code
Anchorage, AK 99508

6 Adjustments to scholarships or grants for a prior year
$

7 Checked if the amount in box 1 or 2 includes amounts for an academic period beginning January - March 2010 ► ☐

Service Provider/Acct. No. (see instr.)

8 Checked if at least half-time student ☒

9 Checked if a graduate student ☐

10 Ins. contract reimb./refund
$

Form **1098-T** (keep for your records) Department of the Treasury - Internal Revenue Service

Ask a volunteer to read the Joan example.

example

Joan Smith received Form 1098-T, shown above, 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).

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 calendar year. Refer to the Volunteer Resource Guide (Tab G), Education Credits.

Ask a volunteer to read the Thomas example.

example

Thomas pays $1,500 in December 2009 for qualified tuition for the winter semester that begins in January 2010. He can use the $1,500 paid in December 2009 to compute his credit for 2009. He cannot count it again in 2010.

What rules apply to each credit?

How do the credits compare?

NEW For tax years 2009 and 2010, there are several new differences between the two credits. The American opportunity credit (Hope expanded):

- Is permitted for the first four years of post-secondary education.
- Has been expanded so that qualified tuition and related expenses now includes 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 now a refundable credit, which means taxpayers can receive up to $1,000 even if they owe no taxes.

Lifetime learning credit:

- There is no limit on the number of years for which the taxpayer can claim the credit based on the same student's expenses.
- Course-related books, supplies, fees, and equipment are included in qualified education expenses only if the fees and expenses must be paid to the institution as a condition of enrollment or attendance.
- No portion of the credit is refundable.

American Opportunity Tax Credit — Hope Expanded

Refer students to the Comparison Chart in the Education Tips of the Volunteer Resource Guide (Tab G).

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 post-secondary study? *Yes*
- Was the student enrolled in 2009 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 2009? *Yes*
- Has the student been convicted of a felony for possessing or distributing a controlled substance? *No*

TIP

If the student doesn't meet all of the conditions for the American opportunity credit, the taxpayer may be able to take the lifetime learning credit for part or all of the student's qualified 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 now a refundable credit, which means the taxpayer can receive up to $1,000 even if no taxes are owed. The American opportunity credit is available for the first four years of college per eligible student (generally, freshman through senior years of college).

TIP

For students attending an eligible educational institution in the Midwestern Disaster Areas, the credits are expanded. Part II of Form 8863 is now renamed Hope credit. See Publication 970 for additional information.

example

Toby amassed many 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. For the 2009 and 2010 tax years, these are qualified expenses for the American opportunity credit.

Ask a volunteer to read the Toby example.

Discuss the fact that these are now qualified expenses because of recent tax law changes.

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 (Tab G), Education Credits Tips, for the basic requirements. 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.

Ask a volunteer to read the Jill example.

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.

Assign the exercises.

Review answers with the class when complete.

EXERCISES

Use the Education Credits Tips in the Volunteer Resource Guide (Tab G) and the Comparison Table in Publication 17 to answer the following questions. Answers are at the end of the lesson summary.

Question 1: Bob is a full-time student and is a fifth year senior. 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 credits?

Taxpayers cannot take multiple credits on the same student's expenses. For example:

- Do not figure the education credits based on expenses that have already been taken on Schedule A, Schedule C-EZ, or tuition and fees deduction.
- Do not take both an American opportunity credit and a lifetime learning credit for the same student in the same year.

Tax Software Hint: To review information related to software entries, go to the Volunteer Resource Guide (Tab 5), Form 8863, Education Credits.

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 requirement discussed earlier.)

2. In the American opportunity or lifetime learning credits sections of Form 8863, enter each qualifying student and social security number. Be sure the student is the taxpayer, spouse, or dependent (and is declared as such on the return).

Review the separate parts of Form 8863.

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

TIP

Part II of Form 8863 is used to claim the Hope credit for taxpayers in the Midwestern Disaster Area.

4. Find the totals for each section and apply the limits, then transfer the amounts to Parts IV and V to determine the refundable and nonrefundable credits. Apply the income test and do the calculations. (Tax software does this step for you.)

Tax Software Hint: When completing the worksheet for an education credit, the software helps you create an accurate claim. The program detects if the taxpayer is entered as a student but can be claimed as a dependent by someone else (as shown on the main information sheet).

CAUTION

The software will not catch other errors, such as taking more than one benefit for the same taxpayer.

Direct students to the Volunteer Resource Guide (Tab 5), Form 8863, Education Credits.

CAUTION

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 all or part of the credit. This is beyond the scope of the VITA/TCE program. Information can be found in Publication 970. Advise the taxpayer to consult a professional tax preparer.

Review the caution about education credits claimed in prior years.

Taxpayer Interview and Tax Law Application

Here is how our volunteer helped taxpayer, Barbara Smith, determine which education credits applied to her family.

Ask two volunteers to role-play the sample interview.

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 post-secondary 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. Did you bring any receipts for education expenses?	Yes, these are for Carla's tuition, fees, and books for the tax year. These are for extra-curricular field hockey.

SAMPLE INTERVIEW (CONTINUED)

VOLUNTEER SAYS...	BARBARA RESPONDS...
This year, we don't just count expenses that have to be paid to the school as a condition of enrollment, so her 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?	Only $5,000 from her grandfather.
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. [On the approved intake and interview sheet, indicate that you've addressed education benefits.]	I'm so glad you were here to help me!

Which education benefit is better for the taxpayer?

Taxpayers have several options for using education expenses to reduce taxes. They are:

- Business expenses on Schedule C-EZ
- Itemized deduction on Schedule A (employee-related expenses only)
- American opportunity credit or lifetime learning credit
- Tuition and fees deduction

Demonstrate how to use the software to quickly compare education benefits.

Compute all of the above to determine which gives the taxpayer the lowest tax. Do not claim multiple deductions for the same education expense, but use the credit most beneficial to the taxpayer.

To ensure that the taxpayer's return is accurate, you will need to compare the tax effects of the various education benefits.

How can I avoid common errors?

If you complete Form 8863, make sure that you have entered the names, SSNs and education expense amount 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 approved intake and interview sheet, make sure that Part V 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 non-taxable scholarship.

Practice – Vanessa Franklin

Direct students to Appendix A, page 27.

Let's take a look at how a volunteer helped taxpayer Vanessa Franklin. Go to Appendix A-27 to review the sample interview with Vanessa related to the Education Credits lesson. Return to the lesson after determining which credit is better for Vanessa.

Summary

Review the lesson summary with the class.

You are now ready to help taxpayers determine which education tax credits are best for them. When you get to this section of the return, always check the approved 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 (Hope credit expanded)
- Lifetime learning credit

Education expenses can be used with those credits or on Schedule C-EZ, tuition and fees deductions, or Schedule A. 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, for tax years 2009 and 2010, 40% of the American opportunity credit is now 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.

TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem, practice exercise(s), or supplements 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.

Assign the workbook exercise and review as a class when done (optional).

EXERCISE ANSWERS

Question 1: *No, Bob does not qualify for the American opportunity credit because he is in his fifth year of post-secondary education*

Question 2: *Lifetime*

Question 3: *Lifetime*

Notes

Lesson 25: Foreign Tax Credit

Instructor Notes

Introduction

This lesson will show you how to help U.S. citizens and resident aliens file a claim for the foreign tax credit. This credit applies to those who have paid or accrued foreign 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, the entire Form 1116 may not need to be completed.

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. In this situation, U.S. Armed Forces members may need to provide additional documents to the military legal assistance officer or seek assistance from a professional tax preparer.

To identify qualifying foreign income and taxes, use the interview techniques and tools discussed in the Screening and Interviewing lesson. Use an approved intake and interview sheet to ask taxpayers questions related to credits that may be reportable. Although the foreign tax credit is not specifically listed on the approved intake and interview 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?

☐ Approved Intake and Interview Sheet
☐ Volunteer Resource Guide
☐ Publication 514
☐ Publication 4491-W
☐ Form 1116
☐ Form 1116 Instructions

Review objectives with the class.

Point out the resources cited under **What do I need?**

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 reported in box 6, indicating that foreign taxes have been paid on their behalf by the issuer of the document. If this is true and the total of these amounts from all documents is not more than $300 (or $600 for filing status Married Filing Jointly), then taxpayers may choose to enter the total amount on the appropriate line of Form 1040, page 2 instead of filing Form 1116. If the amounts are more than $300 (or $600 for filing status Married Filing Jointly) and they do not meet the other conditions to make the election, then taxpayers must file Form 1116.

Some taxpayers may choose the election to claim the foreign tax credit without filing Form 1116, if certain conditions are met. Additional information can be found in Form 1040 Instructions, Form 1116 Instructions, Publication 17, and Publication 514.

The amount of the credit is shown on Form 1040, line 47. The completion of Form 1116 is not required.

Taxpayers who must complete Form 1116 because they cannot qualify for the election, must be referred to a volunteer with an International certification or a professional tax preparer.

Tax Software Hint: To review information related to the software, go to the Volunteer Resource Guide (Tab 5).

Ask a volunteer to read the example about Ryan.

Ask what if Ryan had paid a total of $532 in foreign taxes.

Answer: He would have to complete Form 1116.

example

Ryan, who is single, received Form 1099-DIV that shows $219 of foreign taxes paid (box 6) in 2009. According to Ryan, he paid no other foreign taxes. He is eligible to claim the foreign tax credit and does not have to complete Form 1116.

Assign the exercises.

Review answers with the class when complete.

EXERCISES

Answers are after the lesson summary.

Question 1: True or False? To claim the election, a taxpayer who is filing Single must have 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 $423 of foreign tax paid. Can Clyde make the election? ☐ Yes ☑ **No**

Clyde's foreign taxes exceed $300.

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

Their combined foreign taxes are less than $600.

The remaining sections of this lesson are directed at volunteers seeking an International certification. All others may proceed to Lesson 26, Child Tax Credit.

What is the foreign tax credit (FTC)?

U.S. citizens and residents compute their U.S. taxes based on their worldwide income. This sometimes results in U.S. citizens potentially having to pay tax twice on the same income: once to the government of the foreign country where the income was earned, and again to the U.S. government.

The foreign tax credit (FTC) was created to help taxpayers avoid this double taxation. Taxpayers who paid income, war profits, or excess profits taxes to any foreign country or U.S. possession may be able to take a credit against their U.S. taxes for taxes paid to other countries. Like other nonrefundable credits, the FTC allows taxpayers to take a dollar-for-dollar reduction in the amount of U.S. tax owed. However, there are cases in which not all taxes paid to a foreign government on foreign-sourced income can be used in the computation of the foreign tax credit.

In most cases, it is to the taxpayer's advantage to take the foreign tax credit. In general, if the credit is chosen, you must take the credit for all qualified foreign taxes. However, if the taxpayer paid foreign taxes that do not qualify for the credit, they may be able to take the itemized deduction on the non-qualifying items as "Other Taxes" on Schedule A. In this situation, refer the taxpayer to a professional tax preparer. For more information, see Publication 514, Foreign Tax Credit for Individuals.

TIP

For additional information, see the instructions for Form 1116 and refer to Publication 514.

For a paper return, enter the foreign tax paid directly on line 47 of Form 1040, keeping in mind the $300/$600 limitations.

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 Lesson 15, Income – Other Income)

TIP

The foreign earned income exclusion is different from the foreign tax credit and taxpayers can choose the approach that results in the lowest tax paid overall.

- The exclusion rules allow a portion of the foreign earned income to be excluded from taxable income so it is not taxed
- The credit rules add 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)
- You should try both methods to see which results in the lowest tax

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

TIP

A credit for foreign taxes can be claimed only for foreign tax imposed by a foreign country or U.S. possession.

Point out an example of an "economic benefit" such as health services paid for by the foreign 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 oil-related income
- On foreign mineral income
- On foreign oil and gas extraction income
- For which the taxpayer can take only an itemized deduction
- From international boycott operations, and
- Of U.S. persons controlling foreign corporations and partnerships

TIP

See Publication 514, Foreign Tax Credit for Individuals, for more detailed information.

Ask a volunteer to read the Kendall example.

Ask what if they had no interest income from the French bank.

Answer: They would not be able to claim the credit for taxes paid on the U.S. interest. Only foreign-source income qualifies for the credit.

example

Robb Kendall and his wife are U.S. citizens who reside in France. Their Form 1040, Schedule B, Interest and Ordinary Dividends, lists $500 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.

Read the example about Eva.

Ask what if Eva paid $200 in taxes on income she earned in Hong Kong.

Answer: She could apply for the credit without filing Form 1116, as long as all the foreign-source income is from Forms 1099-DIV or 1099-INT.

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 $300 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 $300 in income taxes paid to Hong Kong.

Note: 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 compute a foreign tax credit on which of the following types 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 compute a foreign tax credit to offset the inheritance tax she paid in Spain?

☐ Yes ☑ **No**

An inheritance does not qualify as income under U.S. tax law.

Assign the exercises.

Review answers with the class when complete.

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

According to Publication 514, Foreign Tax Credit for Individuals, a taxpayer is considered to receive a specific economic benefit if he or she conducts 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.

Ask a volunteer to read the example about Lawrence.

Ask students if they have any questions about the example and “economic benefits.”

Country Restrictions

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

Income taxes paid to governments the U.S. does not recognize are not eligible for the foreign tax credit. At the time of this writing, the following countries are not recognized:

- Cuba
- Iran
- North Korea
- Sudan
- Syria

TIP

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 volunteer program; refer the taxpayer to a professional tax preparer.

Ask students to break into groups and complete the exercises.

Review answers with the class when complete.

EXERCISES (continued)

Question 6: Adele lived and worked in Iran until August 2009, 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 Iran?

☐ Yes ☑ **No**

Income from Iran does not qualify for the credit.

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 non-sanctioned foreign country, and that the tax is being paid to a foreign government on foreign-sourced income.

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 Syria

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 volunteer program:

- Passive category income
- General category income

TIP

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

Passive category income includes passive income and specified passive category income, assuming the income is from another country and the taxpayer has paid taxes on it.

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

TIP

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" below.

Point out the tip on types of income.

For example, a taxpayer who lives in a foreign country and pays taxes on interest income could claim the foreign tax credit and check box a, "Passive category income," on Form 1116.

For additional information on passive income and specified passive category income, see Publication 514, Foreign Tax Credit for Individuals.

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 and did not elect to claim the foreign earned income exclusion. He can claim a foreign tax credit for the taxes paid to Spain on his earnings from Spain.

Ask a volunteer to read the example about Robert.

Ask what if Robert *did* claim the foreign earned income exclusion.

Answer: He could not claim the foreign tax credit on that income.

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. In 2009, the highest U.S. income tax rate was 35% income tax. Therefore, if a taxpayer pays more than 35% income tax on the foreign-sourced passive income for which he or she claimed the credit, the credit is computed under general category income.

Ask a volunteer to read the example about Brenda.

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 can list this income under the "General category income" heading on Form 1116, since the rate of income tax paid on this passive income is higher than the highest U.S. income tax rate.

Assign the exercises.

Review answers with the class when complete.

EXERCISES (continued)

Question 8: Regina lives in Singapore and is a U.S. citizen. She has both dividend income and interest income from countries outside the United States. 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 40%. For the purposes of Form 1116, how should the following types of income be classified?

Interest Income: **A** Dividend Income: **B**

A. Passive category income

B. General category income

40% is more than 35% so the dividend income goes on Form 1116 as "general category income."

Question 9: Bernard is a U.S. citizen who lives in Barbados. In 2009, 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

17% is less than 35% so his interest income is treated as "passive category income."

Taxpayer Interview and Tax Law Application

There are several factors to consider when determining if a tax paid to a foreign government is eligible for the foreign tax credit. You will need to ask the taxpayer questions to determine:

- 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?

Ask two volunteers to role-play the sample interview.

Here's how a volunteer helped Bonnie determine if she qualified for the foreign tax credit:

SAMPLE INTERVIEW

VOLUNTEER SAYS...	BONNIE RESPONDS...
The income you earned in Argentina does not qualify for the foreign earned income exclusion. Let's see if you can claim a credit on the income taxes you paid to Argentina.	Yes, I hope I can avoid paying taxes twice on that income!
That's why the foreign tax credit was created. Since you earned income and paid taxes on that income to Argentina, but did not claim the foreign earned income exclusion, you may qualify for the credit.	That's a relief!
There are a few more requirements. We must determine how much of the foreign tax is similar to U.S. income tax and whether or not you received an economic benefit in exchange for those taxes.	What does that mean?
Wages and bank interest are taxable on your U.S. income tax return. What type of tax does Argentina charge on that income?	It's the same kind of tax, a percentage of your income, except they withhold all of it right from your pay or bank account.
So it's similar to the U.S. tax. Did you receive any kind of benefit, such as goods or services, or the right to use properties, as a result of paying taxes on either your wages or your interest?	None at all.
Then we can include both in the claim for the credit. [On the approved intake and interview sheet, indicate that you have addressed this credit.]	

Do I have to file Form 1116?

If the following three conditions are met, the taxpayer can make the election to report foreign tax on Form 1040, line 47, without filing Form 1116. The total qualified foreign taxes must be:

- $300 or less ($600 or less if Married Filing Jointly), and
- Derived from passive income (interest, dividends, royalties, etc.), and
- Reported on Forms 1099-INT/1099-DIV

Tax Software Hint: To review information related to the software, go to the Volunteer Resource Guide (Tab 5).

How do I complete Form 1116?

If the taxpayer does not qualify for the election, 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 on the tax return to reduce foreign gross income. Some of these situations are complicated, and beyond the scope of the VITA/TCE program, 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 taxpayer has any of these types of deductions, refer them to a professional tax preparer.

Use the following guidelines if you prepare Form 1116 for the taxpayer:

- Top portion: Only report one type of income on each Form 1116. Income from up to three foreign countries may be reported on the same form as long as it is *the same type of income.*
- Part I, line 1a: Enter all foreign income that is taxable by both the foreign countries and the U.S.
- Part I, line 3a: If the taxpayer is not itemizing deductions on Schedule A, enter the standard deduction amount on line 3a. If the taxpayer itemizes, enter the total of medical expenses, real estate taxes and gifts to charity from Schedule A. The tax software will not automatically enter this field.
- Part II: Check the appropriate box, (h) or (i), to indicate whether the foreign tax was actually paid during 2009 (“paid”) or if the tax was billed in one year but paid in another (“accrued”). A taxpayer using the cash basis can choose to use either the cash or accrual method to determine the foreign tax credit. However, if the accrual method is chosen, the taxpayer must continue to use the accrual method for the foreign tax credit on all future returns.
- Part II, column j, enter date taxes were paid or accrued.
- Part II, columns k through n – amounts are entered in foreign currency; columns o through r – amounts are entered in U.S. dollars; column s – total U.S. dollar amounts only. Conversion rates are discussed in the Other Income lesson.
- Part III: Figure the credit in this section. If the taxpayer has a carryback or carryover, refer them to a professional tax preparer.
- Part IV: Only needed if the taxpayer had to use more than one Form 1116 due to more than one type of income and/or reporting funds from more than three countries.
- The tax software performs the calculations in Parts III and IV.

Advise students to enter the date as the last date of the year (e.g., 12/31/2009) if the taxes were withheld throughout the year.

Tax Software Hint: To review information related to the software, go to the Volunteer Resource Guide (Tab 5).

Summary

Taxpayers who paid taxes to any foreign country or U.S. possession may be able to take a nonrefundable foreign tax credit (FTC) for taxes paid. Generally, to claim the FTC, taxpayers are required to file Form 1116, Foreign Tax Credit (Individual, Estate, Trust, or Nonresident Alien Individual).

Review the lesson summary with the class.

However, taxpayers do not have to file Form 1116 if they meet certain requirements. The VITA/TCE Program may help taxpayers who are not required to file Form 1116. (International VITA sites are excepted from this rule.)

To qualify for the foreign tax credit, the taxpayer, income, and taxes must all meet specific requirements. The foreign tax credit is computed and reported on Form 1116. Part I of Form 1116 is used to figure the taxable income from foreign sources in each income category; a separate copy of 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 paid overall.

The foreign tax credit is reported on Form 1040, line 47.

TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem, practice exercise(s), or supplements 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.

Assign the workbook exercise and review as a class when done (optional).

EXERCISE ANSWERS

Answer 1: True. The $300 limitation applies to whether or not a taxpayer has to complete Form 1116. A taxpayer does not have to file Form 1116 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 seek the assistance of a professional tax preparer.

Answer 3: Yes. If the foreign taxes for a married couple who files a joint return are less than or equal to $600, then the couple is not required to complete Form 1116. Judy and Mark do not have to complete Form 1116 because their foreign taxes are less than $600.

Answer 4: C. On Anne's tax return, she can compute a foreign tax credit to offset the taxes she paid to Japan on the 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 Iran. 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 Syria

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 35% (the highest U.S. income tax rate), Bernard's income falls under "passive category income" on Form 1116.

Lesson 26: Child Tax Credit

Instructor Notes

Introduction

This lesson covers a credit that first took effect in 1998. 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 Form 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.

TIP

Don't confuse these credits with the child and dependent care tax credit!

An approved intake and interview sheet and the interview tips in the Volunteer Resource Guide (Tab G), are critical tools needed to determine eligibility for the credit.

What do I need?

☐ Approved Intake and Interview Sheet
☐ Volunteer Resource Guide
☐ Publication 17
☐ Publication 972
☐ Publication 4491-W
☐ Form 8812 and Instructions
☐ ***Optional:*** Form 1040 Instructions

Objectives

Review objectives with the class.

Point out the resources cited under **What do I need?**

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 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 Form 8812, Additional Child Tax Credit, may result in a refund even if the taxpayer doesn't owe any tax.

Who can claim the child tax credit?

Direct students to the Child Tax Credit Interview Tips in the Volunteer Resource Guide (Tab G).

To be eligible to claim the child tax credit, the taxpayer must have at least one qualifying child. Refer to the Volunteer Resource Guide (Tab G) for the definition of a qualifying child for purposes of claiming the child tax credit.

Read the Ed and Jeff example.

example

Ed's son, Jeff, turned 17 on December 30, 2009 and has a valid SSN. He is a citizen of the United States. According to the Child Tax Credit Interview Tips, he is not a qualifying child for the child tax credit because he was not under the age of 17 at the end of 2009.

Does the child have to be the taxpayer's dependent?

NEW To be a qualifying child for the child tax credit for 2009, the child must be claimed as the taxpayer's dependent.

Are there special rules for children of divorced, separated, or never married parents?

There are special rules for children of divorced or separated parents, as well as for children of parents who have never married. In most cases the custodial parent (the parent having custody of the child for the greater part of the year) may claim the dependency exemption for the qualifying child. Custody, for this purpose, means the child lives in the parent's main home. 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 (Tab G) for additional information.

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.

CAUTION

NEW Taxpayers with divorce decrees or divorce agreements executed after 2008 must use Form 8332 or similar statement; they cannot simply substitute pages from the divorce decree.

Ask a volunteer to read the Mary and Ralph example.

example

Mary and Ralph got a divorce in 2002. They have one child together, Amy, who lives with Mary. All are US 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 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

Remind students that using incorrect worksheets will reduce the taxpayers refund.

Review steps 6 and 7 in the Volunteer Resource Guide (Tab G) 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.

Ask a volunteer to read the examples.

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 $75,000 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 of $110,000, they can only claim $954, reducing their tax to zero. As they couldn't claim the maximum child tax credit, May and Bob may also be eligible for the additional child tax credit.

Tax Software Hint: To review information related to the software, go to the Volunteer Resource Guide (Tab 1), Main Information Screen.

What is MAGI?

Typically, the taxpayer's MAGI (Modified Adjusted Gross Income) is the same as their AGI from line 37 of Form 1040, or line 21 of Form 1040A. For more information on MAGI as it applies to the child tax credit, refer to Publication 17.

CAUTION

If the taxpayer's tax liability is zero, they cannot take the credit because there is no tax to reduce. However, the taxpayer may be able to take the additional child tax credit, discussed later in this lesson.

Assign the exercises.

Review answers with the class when complete.

EXERCISES

Use the Child Tax Credit interview tips from the Volunteer Resource Guide (Tab G) 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 $112,000 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

Taxpayers with AGI above the MAGI phaseout can calculate the credit using the CTC Worksheet in the Form 1040 Instructions rather than Publication 972, if preparing a paper return.

EXERCISES (continued)

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

Jack meets the requirements in interview steps 1-4.

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 $60,000

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 $116,000

Nick's MAGI is not affected by the $75,000 limit; his tax liability is more than $1,000 per child.

How do I determine taxpayer eligibility for the credit?

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 the Screening and Interviewing lesson. Begin by reviewing the Family and Dependent Information section of the taxpayer's approved 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 6 months of the year (remember the special rules for divorced, separated, or never married parents)
- 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

Review the rules for eligibility.

If the Family and Dependent 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 (Tab G). It provides helpful probing questions to ask the taxpayer.

Tax Software Hint: The entries for each qualifying child on the Main Information Sheet will help the software determine if the child is eligible for the child tax credit. To review information related to the software, go to the Volunteer Resource Guide (Tab 1), Main Information Screen.

How do I calculate the child tax credit?

To calculate the credit, you must first determine which worksheet to use. Review the Child Tax Credit interview tips in the Volunteer Resource Guide (Tab G) to determine which worksheet the taxpayer must use.

Tax Software Hint: If you are using tax software, the system will automatically calculate the credit, provided you have correctly completed the:

- Dependent section of the Main Information Sheet
- 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?

What is the amount of the 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.

NEW 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. The credit is generally 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)

Review the requirements again with the students.

Who can take the additional child tax credit?

Taxpayers who don’t 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 (Tab G) 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).

Read the May and Bob example.

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 not a factor in this calculation on Form 8812.

How do I calculate the additional child tax credit?

Form 8812, Additional Child Tax Credit, is used to calculate the additional child tax credit. The credit will appear on the additional child tax credit line of the Payment section of Form 1040.

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.

Assign the exercise.

Review answer with the class when complete.

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 AGI is $8,850 and their tax liability is $0. Their social security and Medicare taxes are $677. Their earned income credit amount is $457. Are they eligible to take the additional child tax credit? ☑ **Yes** ☐ No

Their tax liability (0) was less than their allowable child tax credit ($5,000). They may qualify for the additional child tax credit.

How do I avoid common errors?

Remind students to use the correct worksheet.

When considering the child tax credit, it is critical to ensure that the taxpayer has been interviewed thoroughly to correctly identify eligible children. If preparing a paper return, be sure to use the worksheets to figure the credit, and determine if the additional child tax credit should be included.

Tax Software Hint: Once the CTC block on the Main Information Sheet is checked, the software will compute the amount of the credit automatically.

Direct students to Appendix A-28.

Practice - Vanessa Franklin

Take a look at how a volunteer helped our taxpayer, Vanessa Franklin. Go to Appendix A-28 and review the sample interviews with Vanessa related to lesson 26.

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.

Review the lesson summary with the class.

TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem, practice exercise(s), or supplements 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.

Assign the workbook exercise and review as a class when done (optional).

EXERCISE ANSWERS

Answer 1: *A. Paul and Marie's MAGI is over the threshold of $110,000. 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, if preparing a paper return.*

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 2009; he meets the relationship requirement, lived with Laura for at least 6 months of the year; and Laura provided his complete 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 of $75,000 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 couldn't benefit from it because their tax liability (0) was less than their allowable child tax credit ($5,000). Even though their AGI is more than $3,000, they have more than three children and paid social security and Medicare taxes. This makes them eligible to qualify for the additional child tax credit. Keep in mind the Earned Income Credit amount will affect the final calculation.*

Notes

Lesson 27: Miscellaneous Credits

Instructor Notes

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 Intermediate, Advanced, Military, or International Courses.

These credits are reported in the Tax and Credits section of Form 1040, U.S. Individual Income Tax Return.

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 nonbusiness energy property credit by completing Form 5695, Residential Energy Credits
- Calculate the credit for the elderly or the disabled by completing Schedule R (Form 1040 or 1040A) Credit for the Elderly or the Disabled
- Identify the alternative motor vehicle credit and mortgage interest credit as requiring a professional tax preparer

What do I need?

☐ Approved Intake and Interview Sheet
☐ Volunteer Resource Guide
☐ Publication 17
☐ Publication 4491-W
☐ Form 1040
☐ Schedule R, Forms1040 or 1040A
☐ Form 5695
☐ Form 5695 Instructions
☐ Form 8880
☐ ***Optional:*** Form 1040 Instructions

Review objectives with the class.

Point out the resources cited under **What do I need?**

Remember to use the interview techniques and tools discussed in the Screening and Interviewing lesson. Use the information from an approved intake and interview sheet, along with the documents provided by the taxpayer to determine eligibility for these credits.

TIP

Effective for the 2009 tax year, Schedule 3 is obsolete. Schedule R is used with both Form 1040 and Form 1040A.

What is a nonrefundable credit?

A nonrefundable credit is a dollar for dollar reduction of the tax liability. A refundable credit is added to the federal income tax withheld and any estimated tax payments. If the total is more than the total tax, the excess will be refunded to the taxpayer. 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 input. The volunteer tax preparer must make the correct determinations by using an approved intake and interview sheet and resource materials.

What is the retirement savings contributions credit?

The retirement savings contributions credit is a nonrefundable credit a qualifying taxpayer may claim if they made a contribution to a qualified plan.

If the contribution is tax deferred, the taxpayer obtains the benefit of the tax deferral and a credit against their taxes. A "double" benefit such as this is rarely allowed. For example, a taxpayer may be able to claim this credit *and* a deduction for an IRA contribution. The credit is calculated on Form 8880, Credit for Qualified Retirement Savings Contributions, and reported in the Tax and Credits section of Form 1040.

Direct students to this page in the Volunteer Resource Guide.

Who is eligible for the retirement savings contributions credit?

Go to the Volunteer Resource Guide (Tab G), Credits. Review the flowchart for qualifications for the Retirement Savings Contribution - Decision Tree.

What is the modified AGI limit?

NEW For 2009, taxpayers may be able to claim the retirement savings contribution credit if their modified AGI is not more than:

- $55,500 for Married Filing Jointly
- $41,625 for Head of Household
- $27,750 for Single, Married Filing Separately, or Qualifying Widow(er)

What are qualified plans for the purpose of the retirement savings contributions credit?

Point out the types of plans that qualify as listed in Publication 17.

In order to be eligible for the credit, the taxpayer must have contributed to a qualified plan. Plans that qualify are listed in the Other Credits chapter of Publication 17.

How do I know if the taxpayer has made a qualifying contribution?

When you review page 2 of the approved intake and interview sheet, pay special attention to Part V, Expenses and be sure to ask if the taxpayer made a contribution to an IRA or other retirement account. The other qualifying plan contributions will be listed on the taxpayer's Form W-2 in box 12 and preceded by one of the following codes: D, E, F, G, H, AA, BB or S. For Military personnel, there may be an amount in box 14 coded with Q or E.

Tax Software Hint: If Form W-2 is entered into the software correctly and completely, the program will do the credit calculation. If box 14 amounts are contributions to a retirement plan that qualify for the retirement savings contributions credit, check the *qualifies for Form 8880* box. Review the Volunteer Resource Guide (Tab 2), Form W-2 Instructions, for the software entries.

TIP

Some employers allowed employees to contribute after-tax money to a Roth 401(k). These after-tax contributions are listed on Form W-2 in Box 12 with a code AA or BB.

Tax Software Hint: If the taxpayer contributed to a Roth or a traditional IRA, whether it is deductible or not, link to the IRA deduction worksheet and enter the information. Review the Volunteer Resource Guide (Tab 3), Form 1040 - Adjustments to Income, 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:

- Any distribution that is included in the taxpayer's gross income from a qualified retirement plan or from an eligible deferred compensation plan
- Any distribution from a Roth IRA that is not a qualified rollover contribution

The testing period includes:

- The tax year, and
- The two preceding tax years, and
- The period between the end of the tax year and the due date of the return, including extensions

TIP

You must question the taxpayer to determine if there have been any distributions in the testing period.

Married Filing Jointly

For married taxpayers filing a joint return, both spouses may be eligible for a credit on a maximum annual contribution amount of $2,000 each. If either spouse has 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 combined adjusted gross income was $39,000. 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 each eligible for a credit based on the maximum eligible annual contribution amount of $2,000 each.

Ask a student to read the Jose and Lucy example.

example

Joe and Mary are married and filed joint returns for 2007 and 2008, and plan to do so in 2009. Joe received a taxable distribution from a qualified plan in 2007 and a taxable distribution from an eligible deferred compensation plan in 2008. Mary received distributions from a Roth IRA in 2008.

Both Joe and Mary made eligible contributions to an IRA in 2009 and otherwise qualify for the retirement savings credit. They must reduce the amount of their qualifying contributions in 2009 by the total of the distributions they received in 2007 and 2008. This calculation is completed on Form 8880.

Ask a student to read the Joe and Mary example.

Ask what if only Joe had taken a distribution.

Answer: Both Joe and Mary would have to reduce their eligible contributions by the amount of Joe's distribution.

How do I determine the amount of the credit?

Form 8880 is used to figure the amount of the credit.

Tax Software Hint: If the taxpayer meets the age and income requirements and a contribution was indicated on Form W-2 or the IRA worksheet, Form 8880 will display in the forms tree, highlighted in red. You will need to address a few fields before the

Direct students to the page in the Volunteer Resource Guide noted in the Tax Software Hint.

return is completed. Review the Volunteer Resource Guide (Tab 5), Retirement Savings Contributions Credit, for the software entries.

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.

Assign the exercise.

Review the answer with the class when complete.

EXERCISES

Question 1: Which of the following taxpayers, who contributed to their employers' 401(k) plans, is possibly eligible for the retirement savings credit?

A. Ed, who is single and has an adjusted gross income of $35,200

B. Sybil, who is married, files jointly, and has an adjusted gross income of $49,500

C. Bert, who is married, files separately, and has an adjusted gross income of $28,300

D. Carl, who is a qualifying widower with a dependent child, and has a modified AGI of $29,000

Ed, Bert, and Carl do not qualify because their AGIs are over the limit for their filing statuses.

Taxpayer Interview and Tax Law Application

TIP

Refer to Form 8880 in the Volunteer Resource Guide (Tab 5), Retirement Savings Contributions Credit.

Ask two volunteers to read the Ryan interview.

Display Form 8880.

Our volunteer is working with Ryan, a taxpayer at the site. 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. Refer to the Volunteer Resource Guide (Tab G), Retirement Savings Contributions Credit - Decision Tree, as she determines if Ryan is eligible for the credit.

SAMPLE INTERVIEW

VOLUNTEER SAYS...	RYAN RESPONDS...
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?	No, I put all my savings into the 401(k) because my employer matches it.
That's a great benefit. Were you a full-time student during 2009?	No, I've been out of school for several years.
Well, it looks like you qualify for the credit. I will complete Form 8880 to see how much the credit will be.	Great!
Did you receive any distributions from your retirement plan in 2009, 2008 or 2007 – or do you plan to take any distributions before the tax filing deadline?	Well, in 2008 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?
No, loans don't count against you, so you'll get to use the full amount of your contribution in the calculation of your credit. The software shows that your credit is $150. That will reduce your amount of total tax, so you'll end up with a bigger refund.	I'll take every penny!

What are Residential Energy Credits?

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

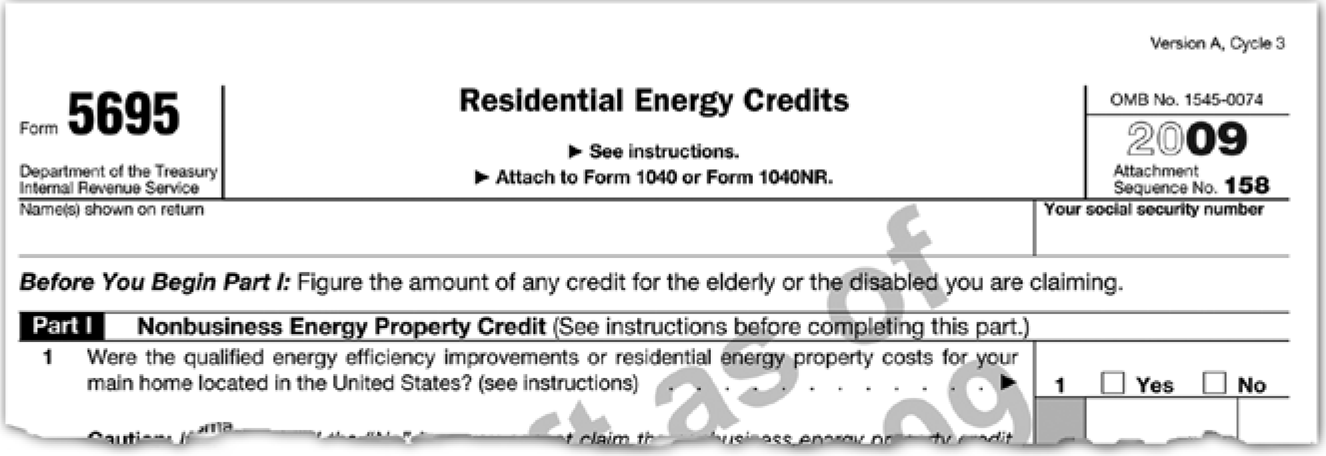
- Nonbusiness energy property credit
- Residential energy efficient property credit

Form 5695 is used to compute the credits.

NEW As a result of ARRA, there are changes to the residential energy credits for 2009. Be sure to take note of these changes to ensure the preparation of an accurate tax return.

Taxpayers must own their home to qualify for these credits. Review Part III, Life Events, of the approved intake and interview sheet, to see if any purchases of energy efficient items are indicated – these items may qualify taxpayers for the nonbusiness energy property credit.

Tax Software Hint: Tax software will do all the math calculations and enter the total on the appropriate line of Form 1040. Remember, any time you need help and want to see the form instructions, click anywhere on the form to access the help feature.



Version A, Cycle 3

Form **5695**
Department of the Treasury
Internal Revenue Service

Residential Energy Credits
► See instructions.
► Attach to Form 1040 or Form 1040NR.

OMB No. 1545-0074
2009
Attachment Sequence No. **158**

Name(s) shown on return

Your social security number

Before You Begin Part I: Figure the amount of any credit for the elderly or the disabled you are claiming.

Part I **Nonbusiness Energy Property Credit** (See instructions before completing this part.)

1 Were the qualified energy efficiency improvements or residential energy property costs for your main home located in the United States? (see instructions) . . . . ► 1 ☐ Yes ☐ No

What is the nonbusiness energy property credit?

This credit, which expired after 2007, has been reinstated. Taxpayers may be able to claim a nonbusiness energy property credit of 30% of the cost of certain energy-efficient property or improvements placed in service in 2009. This property can include high-efficiency heat pumps, air conditioners, and water heaters. It also may include energy-efficient windows, doors, insulation materials, and certain roofs. The credit has been expanded to include certain asphalt roofs and stoves that burn biomass fuel.

TIP

Review Form 5695 and the Form 5695 Instructions to identify the items that qualify for this credit.

The total amount of the credit that can be claimed in 2009 and 2010 is limited to $1,500. The credit is claimed on Part I of Form 5695.

If the taxpayer is eligible for the credit for the elderly or the disabled, compute that credit first.

CAUTION

IRS provides guidance for property that qualifies for the energy credits. Homeowners generally can rely on manufacturers' certifications. Refer to www.irs.gov or www.energystar.gov for more information.

What is the residential energy efficient property credit?

Taxpayers may qualify for an energy credit for qualified solar electric property costs, qualified solar water heating property costs, qualified small wind energy property costs, and qualified geothermal heat pump property costs. This credit is claimed on Part II of Form 5695. This information is out of scope for the VITA/TCE program and is included for your awareness only. Refer taxpayers with these expenses to a professional tax preparer.

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. This credit can also be claimed on Form 1040A.

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 have not reached the mandatory retirement age their company has set

Display or refer to the Volunteer Resource Guide (Tab G). **Point out** the income limits on the page titled, Credit for the Elderly or the Disabled.

TIP

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 workshop setting, however, is not considered substantial, gainful activity.

Besides being a qualified individual, their total income must be within certain limits. The income limits can be found in the Volunteer Resource Guide (Tab G), Credit for the Elderly or the Disabled, Figure B Income Limits.

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.

Few taxpayers qualify for this credit because the credit calculation includes the taxpayer's nontaxable social security, veterans' benefits, or other excludable pension, annuity, or disability benefits. Most taxpayers' social security benefits alone exceed the limit.

Explain that few taxpayers qualify for the credit.

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.

Ask a volunteer to read John's example.

Ask what if John's nontaxable social security benefits were $4800 and he had other nontaxable pension income of $300.

Answer: He would still not be eligible.

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, 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.

CAUTION

Since tax software automatically calculates the credit for the elderly or the disabled, it is critical that all social security and railroad retirement benefits treated as social security be entered on the worksheet for line 20a of Form 1040. Amounts must be entered even if no social security is taxable.

Tax Software Hint: Tax software will complete most of Schedule R based on the data from the Main Information Sheet and income amounts entered on the return. It will determine whether the taxpayer is eligible for the credit and transfer the credit amount to the appropriate line on Form 1040. Go to the Volunteer Resource Guide (Tab 5), Nonrefundable Credits for software entries.

EXERCISES (continued)

Question 2: Which one of the following items would automatically disqualify someone who is under 65 years old from claiming the credit for the elderly or the disabled?

A. Participating in sheltered employment

B. Receiving taxable disability benefits during the year

C. Failing to attach a physician's statement to the tax return

D. Earning at least minimum wage by performing productive work

Someone under 65 and not yet retired on **permanent** and **total** disability is ineligible for the credit.

Assign the exercise.

Review the answer with the class when complete.

Ask two students to role-play the sample interview.

Display the table for the Credit for the Elderly or the Disabled.

Taxpayer Interview and Tax Law Application

Determining Albert's Eligibility

Albert comes into the tax center. He has almost completed his Form 1040A but 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 disability checks and social security.
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.	

Emphasize that Schedule R must be completed to determine if the taxpayer can claim the credit.

Refer to the Volunteer Resource Guide (Tab G), Credit for the Elderly or the Disabled. Figure B shows that Albert's AGI ($15,430) is under the limit for a single filer ($17,500), and his income from nontaxable social security or pension benefits ($4,430) is also within the limit for a single filer ($5,000).

What about the Alternative Motor Vehicle Credit?

Point out that claiming the Alternative Motor Vehicle Credit requires a professional tax preparer.

Form 8910, Alternative Motor Vehicle Credit, is used to claim a credit for alternative motor vehicles that meet certain requirements. This topic is out of scope for the volunteer program and is included for awareness only. Refer taxpayers who choose to claim this credit to a professional tax preparer.

What is the Mortgage Interest Credit?

Point out that claiming the Mortgage Interest Credit requires a professional tax preparer.

Taxpayers who hold qualified 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.

This topic is introduced in the VITA/TCE training for informational purposes only. 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.

Practice – Vanessa Franklin

Go to Appendix A-30, to determine if Vanessa is able to take the Credit for Qualified Retirement Savings Contributions.

Direct students to Appendix A-30.

Summary

Review the lesson summary with the class.

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 pre-tax retirement plan contributions and accurately input the amounts into the tax software. The software calculates the retirement savings credit based on the information that is input.

CAUTION

IRA contributions made by the taxpayer are often overlooked. Be sure to ask taxpayers if they made traditional or Roth IRA contributions. IRA contributions may qualify the taxpayer for the retirement savings contributions credit.

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.

Residential Energy Credits

Residential energy credits are available to taxpayers for making energy-saving improvements to their home. Part I, Form 5695, is used to claim the nonbusiness energy property credit. Remember that Part II, Form 5695, Residential Energy Efficient Property Credit is out of scope for the volunteer program.

Credit for the Elderly or the Disabled

Elderly individuals, age 65 or older, and individuals under age 65 who retired on permanent and total disability, may be able to claim a special nonrefundable credit on their tax returns if they are U.S. citizens or resident aliens. Few taxpayers 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.

Alternative Motor Vehicle Credit

Taxpayers may be able to claim a credit for an alternative motor vehicle placed in service for business or personal use. Refer taxpayers who choose to claim this credit to a professional tax preparer.

Mortgage Interest Credit

The mortgage interest credit is calculated on Form 8396. Refer taxpayers who choose to claim this credit to a professional tax preparer.

Assign the workbook exercise and review as a class when done (optional).

TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem, practice exercise(s), or supplements 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. Sybil qualifies for the credit because her adjusted gross income is under $55,500, which is the threshold limit for Married Filing Jointly.*

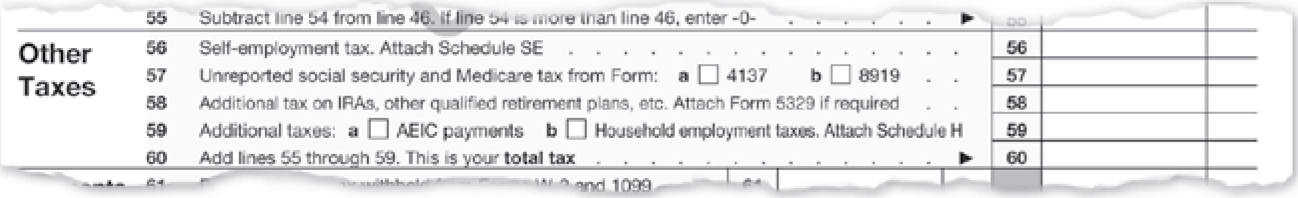
Answer 2: *D. Someone who still engages in substantial, gainful activity and has not yet retired on permanent and total disability is ineligible for the credit. A physician's statement is not required to be attached to the return, but it must be completed and kept with the taxpayer's records. Individuals under 65 must have received taxable disability benefits during the year to qualify for the credit.*

Lesson 28: Other Taxes

Instructor Notes

Introduction

This lesson covers the Other Taxes section of the return. You will determine if the taxpayer owes additional taxes. When you conclude this lesson, your findings will be the taxpayer's total tax.



Other Taxes

55 Subtract line 54 from line 46. If line 54 is more than line 46, enter -0- ▶

56 Self-employment tax. Attach Schedule SE . . . 56

57 Unreported social security and Medicare tax from Form: a ☐ 4137 b ☐ 8919 . . 57

58 Additional tax on IRAs, other qualified retirement plans, etc. Attach Form 5329 if required . . 58

59 Additional taxes: a ☐ AEIC payments b ☐ Household employment taxes. Attach Schedule H 59

60 Add lines 55 through 59. This is your **total tax** . . . ▶ 60

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 do I need?

☐ Approved Intake and Interview Sheet
☐ Volunteer Resource Guide
☐ Publication 17
☐ Publication 4491-W
☐ Form 4137
☐ Form W-2
☐ Schedule SE

Optional:

☐ Publication 334
☐ Publication 531
☐ Form 1040 Instructions
☐ Form 5329 and Instructions
☐ Form W-5

Review objectives with the class.

Point out the resources cited under **What do I need?**

Refer to the Other Taxes section of Form 1040.

What are Other Taxes?

"Other Taxes" are separate from the income tax figured from the tax tables or 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
- Advance earned income credit payments

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.

CAUTION

If you are not certified to prepare a return including additional taxes on IRAs and other qualified retirement plans, refer taxpayers with this issue to a more experienced volunteer or a professional tax preparer.

Emphasize the caution.

Household employment taxes are also included in the Other Taxes section of the tax return. This topic, however, is beyond the scope of the volunteer program. Taxpayers who must file household employment taxes should be referred to a professional tax preparer.

Tax Software Hint: The software makes most of the calculations and displays the resulting tax on Form 1040.

What is self-employment tax?

Self-employment (SE) tax is social security and Medicare tax collected primarily from individuals who work for themselves. It is 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:

Confirm that volunteers understand who must pay self-employment tax.

Display or refer to Schedule SE.

- 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).

Generally, taxpayers who are independent contractors and receive Form 1099-MISC must file Schedule C/C-EZ and Schedule SE. Since the payer does not withhold taxes from independent contractors' pay, it is the taxpayer's responsibility to pay income and SE tax.

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 program, but you should understand both versions.

How do I figure and report this tax?

Demonstrate how to figure the tax using tax software or the schedules.

As a volunteer, you may be qualified to assist self-employed taxpayers who need to complete Schedule C-EZ, Net Profit from Business (covered in an earlier lesson). When assisting a taxpayer with self-employment income, first complete Schedule C-EZ. Then, if preparing a paper return, follow the Schedule SE instructions to calculate the self-employment tax. Finally, enter one-half of the self-employment tax as an adjustment to income on Form 1040, page 1. This is similar to the benefit that employees receive because their employers pay half of the total amount paid to the Social Security Administration.

Tax Software Hint: The software automatically transfers the appropriate information from Schedule C-EZ to Schedule SE, and calculates the self-employment tax and the adjustment of one-half of the self-employment tax.

What about taxes on unreported tip income?

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. This amount is to be included 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.

Display or refer to Form 4137. Direct students to review box 8 on Form W-2.

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.

If a taxpayer is filing a paper return and only has unreported tips of less than $20 per month, Form 4137 is not required since social security and Medicare tax is not applicable.

Tax Software Hint: All tips are reported on Form 4137 because the software calculates social security and Medicare taxes only on the applicable tips. The software will then add unreported tips to Line 7 on Form 1040.

Ask a volunteer to read the Carla example.

Emphasize that both cash and charge tips are taxable and aren't treated differently for tax purposes.

Ask what if Carla worked only 2 months as a waitress and received $15 per month in tips.

Answer: She must report the tip income on her return, but pays no social security or Medicare tax on them.

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.

Direct students to the How to Enter Unreported Tips page in the Volunteer Resource Guide (Tab 2).

How do I figure and report these taxes?

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. Determine if that income was reported on Form 1040; if it wasn't, enter it on the appropriate form.

To figure the tax on a paper return, use Form 4137 and follow the instructions on the form. Report the tax amount on the applicable line on the Form 1040.

TIP

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.

Tax Software Hint: The tax software will compute the correct tax on allocated and unreported tip income. Go to the Volunteer Resource Guide (Tab 2), How to Enter Tips, for software entries.

Assign the exercises and review with the class.

EXERCISES

Answers follow the lesson summary.

Question 1: Jody 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 have to be added to income on line 7 of Jody's Form 1040?

A. $1,418

B. $1,000

C. $418

D. $18

The difference between tips received and tips reported to her employer.

Question 2: What amount of unreported tips does Jody have to pay social security and Medicare taxes on when she files her tax return?

A. $1,418

B. $400

C. $45

D. $18

On all but the tips in May because they amounted to less than $20.

What about taxes on IRAs and other qualified retirement plans?

Contributions to and Distributions from IRAs and Qualified Plans

Traditional IRAs and other “qualified plans” allow individuals to defer paying taxes on money they contribute and on the 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 due plus an additional tax if any of the following apply:

Review the penalty conditions to make sure students understand them.

- A distribution is taken before the individual reaches the age of 59 ½ and is not rolled over into another qualified plan or IRA and no other exception applies
- Minimum distributions are not withdrawn when required
- Excess contributions are not removed by the due date of the return including extensions

TIP

Frequently, taxpayers who receive Form 1099-R with code 1 in box 7 are subject to the 10% additional tax for premature distribution because the money was spent for items that do not meet any of the exceptions.

The additional tax for each situation is outlined on Form 5329, Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts. While completion of Form 5329 is out of scope for the VITA/TCE program, volunteers should be aware of the exceptions to the additional tax for premature distributions. Taxpayers frequently use a premature distribution for household expenses or bills that are not on the list of exceptions. In this case, you can assist them because this does not require completion of Form 5329. Taxpayers who may qualify for an exception must complete Form 5329 and should be referred to a professional tax preparer.

Refer to the approved intake and interview sheet, Part IV – Income, for the question regarding pension or IRA distributions. If the answer is “yes,” ask the taxpayer for any Form 1099-R that reports these payments.

TIP

Refer to the Publication 17 chapters Retirement Plans, Pensions, and Annuities or Individual Retirement Arrangements for the list of exceptions to the additional tax on qualified retirement plans.

TIP

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.

example

John is 39 years old and received Form 1099-R with code 1 in box 7. He used the money to pay for car repairs. For the additional tax, John enters 10% of the taxable amount on the applicable line of Form 1040. John also enters “no” to the left of this line to indicate that Form 5329 is not required.

Review the example with the class.

IRA distributions, pensions, and annuities are covered in the Retirement Income lesson. If you are not certified above the Basic Level, refer taxpayers with these issues to a more experienced volunteer or to a professional tax preparer.

What are Advance Earned Income Credit Payments?

Review the meaning of refundable credit with the class.

When a taxpayer qualifies for the earned income credit (EIC), the amount of the credit is reported in the Payments section of Form 1040. The EIC is a refundable tax credit. It reduces the taxpayer's total tax payment and could result in a tax refund for the taxpayer. The EIC will be discussed in Lesson 30.

Taxpayers can choose to get payments of EIC in advance, as part of their paychecks, instead of waiting to get it all at once when they file their tax return. To receive advance earned income credit (AEIC) payments, the taxpayer must have, or expect to have, a qualifying child and submit Form W-5, Earned Income Credit Advance Payment Certificate, to their employer. The employer will include a portion of the earned income credit in the employee's regular pay. Farm workers are excluded. The amount of advance EIC is reported on the employee's Form W-2, box 9. If advance EIC is received, the taxpayer is required to file a tax return, even if the taxpayer's gross income is below the amount required to file.

Ask a volunteer to read the Claire example.

Ask what if Claire had only $5,000 in income; would she need to file a tax return.

Answer: Yes, because she received the AEIC.

example

Claire lives with her 2 year-old and knows that she qualifies for EIC in 2009. She completes Form W-5 to receive a portion of the credit as part of her paycheck during 2009, rather than waiting to receive the full amount after filing her 2009 return.

How does AEIC affect tax?

AEIC is EIC that was paid to the taxpayer during the tax year. The AEIC amount must be reported on Form 1040 in the Other Taxes section. On the same return, the EIC amount must be reported in the Payments section.

The AEIC is added to the total tax and EIC is subtracted from the total tax. Reporting the numbers in this way ensures that the taxpayer receives all the earned income credit to which they are entitled. If this is the case for a taxpayer you are helping, be sure to explain this and answer any questions. This usually results in the taxpayers receiving an additional amount of EIC when the tax return is filed. However, taxpayers may owe tax if their income changed during the year.

Ask a volunteer to read the Claire example.

example

When the volunteer helped Claire prepare her tax return, the AEIC amount of $550 was reported in the Other Taxes section. The $1,776 in EIC for which she qualified was reported in the Payments section. As a result, her tax return reflected the advance payment of her EIC and she is allowed the remaining $1,226 as part of her 2009 refund.

Tax Software Hint: Be sure that Form W-2 is entered in its entirety. Information from box 9 will automatically display on the applicable line on Form 1040. The AEIC box is checked to reflect that this entry is for advance earned income credit. Go to the Volunteer Resource Guide (Tab 2), Form W-2 Instructions, for software entries.

Review the Tax Software Hint.

EXERCISES (continued)

Assign the exercises and review the answers with the class.

Question 3: Gloria had advance earned income credit (AEIC) paid to her during the year. The amount in box 9 of her Form W-2 was $700.

Gloria qualified for an EIC amount of $1,025. Her income tax was $200 and her withholding was $1,000. There were no other payments, credits or other taxes. What is the final amount on her tax return? Choose the best answer below.

A. Gloria owes tax of $1,125

B. Gloria has an overpayment of $2,025

C. Gloria has an overpayment of $1,125

($1,025+$1000)-($200+$700)=$1,125

D. Gloria has an overpayment of $1,825

Question 4: Ramon has two children and expects to qualify for EIC in 2009. He needed the cash as soon as possible. He arranged to receive advance EIC payments throughout 2009, rather than waiting to file his 2009 return to get the entire EIC amount. In what section of his tax return are the AEIC payments reported?

A. Income

B. Other Taxes

C. Payments

D. Adjustments to Income

What about repayment of the first-time homebuyer credit?

The first-time homebuyer credit is covered in Lesson 29, Payments. However, certain situations may require the credit to be repaid and reported in the Other Taxes section of Form 1040.

If the taxpayer received the first-time homebuyer credit for a home purchased in 2009 and it ceases to be the taxpayer's main home within the 36-month period beginning on the purchase date, the taxpayer generally must repay the credit.

If the taxpayer received the first-time homebuyer credit for a home purchased in 2008, the taxpayer generally must repay the credit over a 15-year period in 15 equal installments. The repayment period begins in 2010 and the taxpayer must include the first installment as additional tax on the 2010 tax return. 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 taxpayer's main home in situations where 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.

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 total tax line on Form 1040.

How do I figure total tax?

Display or refer to the Other Taxes section of Form 1040 so students understand how other taxes affect total tax computation.

The Other Taxes section of Form 1040 provides a total of the taxpayer's income tax plus the other taxes that may apply to the taxpayer. Adding the amounts on these lines together gives the total tax. This amount takes into account the tax on all income, adjustments to income, deductions, nonrefundable tax credits, and other taxes. The next step is entering the tax payments and finding 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 (Tab 6), Form 1040, Page 2 - Other Taxes and Payments, for software entries.

Practice – Vanessa Franklin

Direct students to Appendix A-32.

Let's take a look at how a tax preparer helped our taxpayer, Vanessa Franklin. Go to Appendix A-32 and review to the sample interview with Vanessa related to lesson 28.

Summary

Review the lesson summary.

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
- Advance earned income credit payments

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.

TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem, practice exercise(s), or supplements 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.

Assign the workbook exercise and review as a class when done (optional).

EXERCISE ANSWERS

Answer 1: *C. Jody's combined tips for May, June, July and August were $1,418, and she reported only $1,000 to her employer. She needs to add $418 to line 7 of her tax return.*

Answer 2: *B. Jody does not have to pay Social Security and Medicare on the tips she received in May, because they amounted to less than $20 for the month.*

Answer 3: *C. Gloria has an overpayment of $1,125.*

Answer 4: *B. Other Taxes*

Notes

Lesson 29: Payments

Instructor Notes

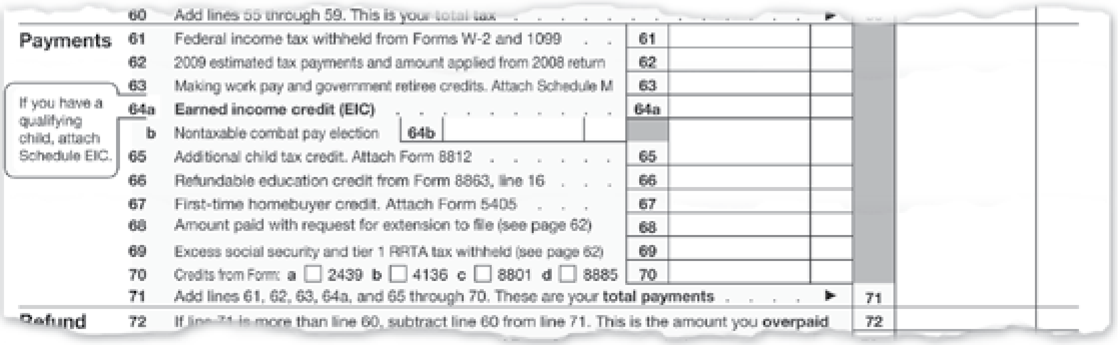
Introduction

This lesson is one of several lessons that cover the Payments section of the return. This part of the return includes additional child tax credit, the refundable education credit, payments, 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 certain refundable credits and payments made by the taxpayer. These include:

- Federal income tax withheld from Forms W-2 and Forms 1099
- Estimated tax payments for the current tax year and amounts applied from the prior year's tax return
- NEW Making work pay and government retiree credits
- NEW First-time homebuyer credit
- Amounts paid with a request for extension to file
- Excess social security and tier 1 RRTA tax withheld

Identify the new tax law provisions in this lesson: making work pay and government retiree credits and the first-time homebuyer credit (amended).

Additional child tax credit and the refundable education credit have already been covered. Earned income credit will be covered in the next lesson.



	60	Add lines 55 through 59. This is your total tax . . . . ▶	
Payments	61	Federal income tax withheld from Forms W-2 and 1099 . .	61
	62	2009 estimated tax payments and amount applied from 2008 return	62
	63	Making work pay and government retiree credits. Attach Schedule M	63
If you have a qualifying child, attach Schedule EIC.	64a	**Earned income credit (EIC)**	64a
	b	Nontaxable combat pay election 64b	
	65	Additional child tax credit. Attach Form 8812	65
	66	Refundable education credit from Form 8863, line 16	66
	67	First-time homebuyer credit. Attach Form 5405 . . .	67
	68	Amount paid with request for extension to file (see page 62)	68
	69	Excess social security and tier 1 RRTA tax withheld (see page 62)	69
	70	Credits from Form: a ☐ 2439 b ☐ 4136 c ☐ 8801 d ☐ 8885	70
	71	Add lines 61, 62, 63, 64a, and 65 through 70. These are your **total payments** . . . . ▶	71
Refund	72	If line 71 is more than line 60, subtract line 60 from line 71. This is the amount you **overpaid**	72

Objectives

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

Review the objectives with the class.

- 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
    - Making work pay and government retiree credits
    - First time homebuyer credit
    - 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 an approved intake and interview sheet will help you determine the payments and credits that should be reported on the taxpayer's return.

Refer to the Other Taxes and Payments section of the Volunteer Resource Guide (Tab 6) to identify and review the Payments section of the return.

TIP

NEW Making work pay and government retiree credits are new. The making work pay credit applies to tax years 2009 and 2010. The government retiree credit is a one-time credit for 2009. Review the rules for these new credits to ensure you prepare an accurate return.

What do I need?

☐ Approved Intake and Interview Sheet
☐ Volunteer Resource Guide
☐ Publication 17
☐ Publication 4491-W
☐ Form W-2
☐ Form 1040
☐ Form 1040 Instructions
☐ Form 1040-ES
☐ Forms 1099
☐ Form 4868
☐ Form 5405
☐ Schedule M
☐ Schedule M Instructions

Optional:

☐ Publication 505
☐ Publication 919

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.

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

TIP

For a household employee, an employer should withhold federal income tax only if the household employee asks the employer to withhold it and the employer agrees.

If the taxpayer has income tax withheld during the current 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 federal income tax withheld is reflected in the Payments section of Form 1040, page 2 on the line for federal income tax withheld.

TIP

The withholding from all income documents is included on the return, but not all income statements are required to be attached. Refer to page 1 of Form 1040 for the following guidance: "Attach Form(s) W-2 here. Also attach Forms W-2G and 1099-R 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).

Ask a volunteer to read the Freda example.

Refer students to the Payments section of Form 1040 to illustrate the Freda example.

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 into the tax software, 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 by the taxpayer. Estimated tax payments are due on a quarterly basis. If estimated 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.

TIP

Estimated tax includes the taxpayer's income tax and self-employment tax. Self-employment tax is the social security and Medicare taxes owed by self-employed workers.

TIP

See Lessons 31 and 33 for more information on estimated taxes.

Where do I get this information?

This lesson covers where to find the information on the approved intake and interview sheet and where these payments are entered on the tax form. Lessons 31 and 33 will provide more details on estimated taxes. On the approved intake and interview sheet, determine if there is income from sources such as self-employment or investment income for which taxes may not have been withheld. When interviewing the taxpayer ask, "Did you pay estimated taxes to the IRS during 2009?" If the answer is "yes," ask to see the taxpayer's record of payments, such as Form 1040-ES, Estimated Tax for Individuals. Look for the taxpayer's response to this question on the approved intake and interview sheet.

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.

TIP

Suggest the taxpayer obtain Form 1040-ES for details about estimated taxes. Forms can be obtained by downloading from www.irs.gov or calling toll-free, 1-800-829-3676.

TIP

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 tax by indicating the amount they want to apply to the next year's estimated taxes.

Where do I get this information?

Ask 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 the 2008 tax return to document the amount of tax applied to 2009. Add this amount to the estimated tax payments and enter the total on the applicable line. You will be confirming information provided by the taxpayer that should be included on the approved intake and interview sheet.

Tax Software Hint: For software entries to record 2009 estimated tax payments, go to the Volunteer Resource Guide (Tab 6) Form ACH 1040/ES and refer to the hint in the margin.

Ask two volunteers to role-play the Ernie sample interview.

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 to your 2009 taxes?	Yes, all of it.
Okay, we'll enter that too. Now we show the total of the withholding from your W-2s, your estimated tax paid and the refund amount from last year's return applied to this year.	Good!

What is the making work pay credit?

Remind students not to confuse the making work pay credit with the recovery rebate that was on the 2008 return.

NEW Making work pay is a new credit that is part of the ARRA legislation. It is available for tax years 2009 and 2010 and cuts taxes for working families. The making work pay provision provides a refundable tax credit of up to $400 for working individuals and $800 for married taxpayers filing joint returns.

The credit is fully refundable, meaning that once it is applied against any tax owed, the remainder is refunded to the taxpayer, unlike many other tax credits.

CAUTION

Some taxpayers may not be entitled to the entire credit. For example: If earned income is less than $6,451 ($12,903 for Married Filing Jointly) the amount of the making work pay credit will be less than $400 (or $800 for joint filers). The calculation is made on Schedule M.

The credit is calculated at a rate of 6.2% of earned income and will phase out for taxpayers with modified adjusted gross income (MAGI) in excess of $75,000 or $150,000 for married couples filing jointly.

TIP

Refer to the Volunteer Resource Guide beginning on page 10 for a quick reference on the 2009 ARRA making work pay credit.

For taxpayers who receive a paycheck and are subject to income tax withholding, the credit was handled by employers through automatically reduced withholding. The IRS issued updated withholding tables that were effective by April 1, 2009. Though all eligible taxpayers will need to claim the credit when they file their 2009 income tax return, the benefit is reflected in reduced income tax withholding in taxpayers' paychecks.

Self-employed taxpayers can claim the credit when they file their return.

For most taxpayers who are employees, the reduced withholding should equal the credit taken on the tax return.

Who is not eligible for the making work pay credit?

Taxpayers must have earned income to qualify for the making work pay credit. Therefore, those who have pension income without earned income are not eligible for this credit. In addition, the following are not eligible for the making work pay credit:

- Individuals who can be claimed as a dependent on someone else's tax return.
- Individuals who do not have a valid social security number.

An exception is made for taxpayers who do not have a social security number and file a joint return, as long as their spouse has a valid social security number.

How does the $250 economic recovery payment affect the making work pay credit?

One of the provisions of ARRA is the $250 payment made to certain recipients of social security benefits, supplemental security income (SSI), railroad retirement benefits, or veterans disability compensation or pension benefits. On a joint return, the amount may be $500 if both spouses received the $250 payment. This payment is made directly from the payer of the benefit, not from IRS.

This $250 economic recovery payment is not taxable income. However, taxpayers who have received this payment and who also have earned income must reduce the making work pay credit by the amount of the $250 economic recovery payment. The calculation is made on the Schedule M.

example

Barry is retired and started receiving social security in January 2007. He works part time at the local hardware store. He received an economic recovery payment of $250 in June 2009. When Barry completes his return for 2009 he must reduce the making work pay credit on Schedule M by the $250 economic recovery payment.

What is the government retiree credit?

NEW The government retiree credit is available for certain federal, state, and local government retirees who receive a government pension or annuity from work not covered by social security. This credit is a one-time $250 credit which can be claimed on the 2009 tax return. If filing a joint return and both spouses are government retirees, the credit is $500.

Taxpayers must have a valid social security number in order to be eligible for this credit. An exception is made for taxpayers who do not have a social security number and file a joint return, as long as their spouse has a valid social security number.

The making work pay credit must be reduced by any government retiree credit. This calculation is made on Schedule M.

Direct students to Schedule M in the Volunteer Resource Guide, page 10, under the ARRA section - making work pay credit.

How are these credits claimed on the tax return?

A new form, Schedule M, Making Work Pay and Government Retiree Credits, was developed for the 2009 tax year and will be used to calculate the credits. The amount of the credits is entered in the Payments section of Form 1040.

How will the making work pay credit affect taxpayers?

Certain taxpayers need to check their withholding to see if enough is being withheld.

Some taxpayers are not eligible for the making work pay credit. However, the income tax withholding on their pay is based on the reduced withholding tables issued in the spring of 2009. This may result in a smaller refund or in some cases the taxpayer may owe money on their return. You can assist the taxpayer to avoid this situation for the 2010 tax year by helping them adjust their withholding. See Lesson 31, Refund and Amount of Tax Owed, for more information.

What is the first-time homebuyer credit?

NEW The prior law for the first-time homebuyer credit has been amended. The first-time homebuyer credit increased to a maximum of $8,000 ($4,000 for Married Filing Separately). Generally, for homes purchased in 2009, the repayment requirement has been removed. This is a refundable credit which means that even if the taxpayer does not owe any tax, the money will be refunded to the taxpayer.

Generally, the credit is the smaller of:

- $8,000 ($4,000 if Married Filing Separately), or
- 10% of the purchase price of the home

Direct students to review the term "refundable credit" and explain how it affects a taxpayer's tax return.

Display or refer students to Form 5405.

The credit is reduced or eliminated for higher-income taxpayers. It is phased out based on modified adjusted gross income (MAGI). For Married Filing Jointly taxpayers, the phase-out begins at $150,000. For other taxpayers, the phase-out range starts at $75,000. This means that the full credit is available for married couples filing a joint return with a MAGI of $150,000 or less and for other taxpayers with a MAGI of $75,000 or less.

TIP

Review the approved intake and interview sheet to determine if the taxpayer (and spouse, if married) qualifies for this credit.

Form 5405, First-Time Homebuyer Credit and Repayment of the Credit, is used to claim the credit.

Which home purchases qualify for the first-time homebuyer credit?

To be considered a first-time homebuyer, the taxpayer cannot have owned a home in the last 3 years, and, once they buy the home, they must live in it for 3 years to avoid repayment of the credit.

Also, for homes bought in 2009, taxpayers can make an election to claim the credit on their original or amended 2008 tax return or their 2009 tax return.

Only the purchase of a main home located in the United States qualifies and only for a limited time. A main home is where the taxpayer lives most of the time. It can be a house, houseboat, house trailer, cooperative apartment, condominium, or other type of residence. Vacation homes and rental property are not eligible. A taxpayer must buy the home during the period after December 31, 2008 and before December 1, 2009. For a home that a taxpayer constructs, the purchase date is the first date the taxpayer occupies the home.

Who is not eligible for the credit?

If any of the following describe the taxpayer, the credit cannot be taken, even if the taxpayer buys a main home:

- Taxpayer's income exceeds the phase-out range. This means Married Filing Jointly taxpayers with MAGI of $170,000 and above and other taxpayers with MAGI of $95,000 and above.
- Taxpayer buys the home from a close relative, including the taxpayer's spouse, parent, grandparent, child or grandchild.
- Taxpayer buys the home from a related entity, including a corporation or partnership in which the taxpayer directly or indirectly owns more than a 50% interest.
- Taxpayer sells the home, or it ceases to be the taxpayer's main home, before the end of 2009.
- Taxpayer is a nonresident alien.
- The home purchased is located outside the United States.
- Taxpayer acquired the home by gift or inheritance.
- Taxpayer owned another main home at any time during the three years prior to the date of purchase.

CAUTION

Taxpayers (including spouse if married) who owned a principal residence at any time during the three years prior to the date of purchase, are not eligible for the credit.

What more should I know about this credit?

Under certain circumstances, the full amount of the credit must be repaid.

Taxpayers must repay the credit in full if the home ceases to be their main home within the 36-month period beginning on the purchase date. This includes situations where the taxpayer sells the home, converts the home to business or rental property, or the home is destroyed, condemned, or disposed of under threat of condemnation. Taxpayers must repay the credit by including it as additional tax on the return for the year the home ceases to be their main home.

Foreclosure of a home is considered a sale or disposition requiring repayment of the credit if it occurs within the three year period. Refer to Publication 523, Selling Your Home or www.irs.gov for more information.

The reference to condemnation is for awareness only. The topic of condemnation is out of scope for the volunteer program. Taxpayers with this issue should be referred to a professional tax preparer.

example

Terry purchased his first home on March 5, 2009. In November 2009 he decided to sell the home. Terry does not qualify for the first-time homebuyer's credit since he did not own the home for the three-year period after purchase.

example

James and Kathy purchased their first home on June 2, 2009 and qualify for the first-time homebuyer's credit. If James and Kathy convert their home to rental property in August 2010 they would have to repay the credit on their 2010 tax return, the year it ceased being their principal residence.

Refer to Lesson 28, Other Taxes, and Form 5405 and Instructions for the procedures for repaying the credit.

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 the tax due by April 15, 2010, they will owe interest and may be charged penalties.

Later, when taxpayers file their return, they report the payment made with Form 4868 on the applicable line in the Payments section of Form 1040.

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 in the Payments section of Form 1040.

Ask a student to read the Bernice example.

How can taxpayers file the extension?

Taxpayers may file the extension on paper or electronically. The extension must be mailed or transmitted by the due date of the return.

You can help taxpayers file for an extension using the tax software.

Tax Software Hint: For software entries, go to the Volunteer Resource Guide (Tab 6) to review the step-by-step procedures for filing for an extension using the tax software.

Refer students to the Filing for an Extension Using the Tax Software section in the Volunteer Resource Guide (Tab 6). Walk through the steps for filing an extension in tax software.

What are other payments?

What other types of payments are there?

You will notice that the Payments section of Form 1040 also lists these credits:

- Form 2439, Notice to Shareholder of Undistributed Long-Term Capital Gains
- Form 4136, Credit for Federal Tax Paid on Fuels
- Form 8801, Refundable Credit for Prior Year Minimum Tax
- Form 8885, Health Coverage Tax Credit

Refer taxpayers who choose to claim any of these credits to a professional tax preparer. These topics are out of scope for the volunteer program.

Inform students that the payments listed are not the typical types of payments for people who qualify for assistance in the VITA/TCE program, thus they are beyond the scope of volunteer training.

What is excess social security and tier 1 RRTA tax withholding?

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. The Form 1040 Instructions include a worksheet to calculate the excess amount. This excess amount is entered on the applicable line in the payment section of Form 1040 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, it is important to accurately enter all the information from each Form W-2 into the software.

How do I find the total payments?

Figuring the total tax payments is easy. Add the lines in the Payments section. Enter the total on the total payments line of Form 1040.

Tax Software Hint: The software totals all payments automatically.

Practice - Vanessa Franklin

Direct students to Appendix A- 35.

Let's take a look at how a volunteer helped our taxpayer, Vanessa Franklin. Go to Appendix A-35 and review the sample interview with Vanessa related to Lesson 29. Review the Payments section of Vanessa's return in Appendix B-5. Return to this lesson after you have reviewed this information.

Summary

Review the lesson summary.

The Payments section of the tax return is critical to an accurate return. It lists all the tax 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.

Assign the workbook exercise and review as a class when done (optional).

TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem, practice exercise(s) or supplements 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.

Notes

Lesson 30: Earned Income Credit (EIC)

Instructor Notes

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 approved intake and interview sheet are critical tools in avoiding these mistakes.

What do I need?

☐ Approved Intake and Interview Sheet
☐ Volunteer Resource Guide
☐ Publication 17
☐ Publication 596
☐ Publication 4491-W
☐ Form 1040
☐ Form 1040 Instructions
☐ Schedule EIC

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

Review objectives with the class.

Point out the resources cited under **What do I need?**

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 of this credit, even if they have no filing requirement, owe no tax, and had no income tax withheld.

NEW The EIC can be a very valuable credit. For 2009, the Earned Income Credit expands to allow families to claim credit for three or more children, up to a maximum of $5,657. The EIC amounts are adjusted for inflation every year.

Taxpayers with at least one qualifying child may choose to receive part of their Earned Income Credit in advance. They can do this by filling out Form W-5 with their employer. A part of the credit is given to them in their paychecks during the year. This is referred to as the Advance Earned Income Credit. This amount is reported on Form W-2, box 9. Turn to the Volunteer Resource Guide (Tab 2), Form W-2 Instructions. Locate box 9 on the sample Form W-2 in the box marked “Advance EIC payment.”

Direct students to the sample Form W-2 in the Volunteer Resource Guide (Tab 2).

If the taxpayer received advance EIC as shown in box 9 on Form W-2, a return must be filed to report the advanced payment and claim any additional EIC.

You can learn more about Advance EIC in the Other Taxes lesson.

The EIC is entered in the Payments section of the tax return. In the Volunteer Resource Guide (Tab 6), turn to the page titled Other Taxes and Payments. Find the lines on Form 1040 where the AEIC and the EIC are entered on the 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?

Direct students to the Summary of EIC Eligibility Requirements chart in the Volunteer Resource Guide (Tab H).

Review the rules with the students.

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 (Tab H). Review Part A, Rules for Everyone, and Part D, Earned Income and AGI Limitations.

CAUTION

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.

TIP

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 valid social security numbers. However, if a valid number is obtained later and the taxpayer meets all the qualifications, an amended return may be filed claiming the EIC.

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 (Tab H) for examples of earned income.

One type of payment considered earned income is "taxable long-term disability benefits received prior to minimum retirement age." Disabled taxpayers can sometimes receive a disability pension from the company 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 company if they are not disabled.

TIP

There is a limit to the amount of investment income a person can receive and still qualify for the EIC. For 2009, the amount is $3,100. Investment income includes such items as taxable interest and dividends, tax-exempt interest, capital gain net income, and income from residential rental property.

Taxpayers usually receive Form 1099-R reporting the pension.

Direct students to Form 1099-R in the Volunteer Resource Guide (Tab 2).

Turn to the Volunteer Resource Guide (Tab 2), 1099-R Pension and Annuity Income. Find the page showing a picture of Form 1099-R. A distribution code of "3" in box 7 indicates this is a disability pension.

Ask if the taxpayer is still under the plan's minimum retirement age. If they are, report this income on line 7 of Form 1040 or Form 1040A. If they are at or above the company's minimum retirement age, report this as you would a regular pension. Sometimes the company never changes the code 3 in box 7 to indicate that this is now regular pension income.

Tax Software Hint: To review information related to the software, go to the Volunteer Resource Guide (Tab 2), 1099-R Pension and Annuity Income.

What about combat pay?

Combat pay is never taxable to the soldier. 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 only. 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.

TIP

Nontaxable combat pay is shown in box 12 of Form W-2, designated with code Q.

Tax Software Hint: To review information related to the software, go to the Volunteer Resource Guide (Tab 6), Schedule EIC - Worksheet.

CAUTION

VITA volunteers preparing paper returns should be sure to use the EIC worksheets (in Form 1040 Instructions) and compare which method would provide the taxpayer with the most beneficial credit.

What about self-employment income?

Net earnings from self-employment are considered earned income. For most taxpayers within the scope of the volunteer program, "net earnings" for EIC purposes will be the amount reported on line 12 of Form 1040, minus the deduction for one-half of 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 deduction for one-half of his self-employment tax, which is recorded in the adjustments section of Form 1040, is $141.

His income for EIC purposes is $2,000-$141=$1,859.

Ask a volunteer to read the Jeff example.

Reminder: Non-wage 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 should be reported on Schedule C-EZ, Net Profit from Business. Since the VITA program only instructs preparers on how to file Schedule C-EZ, taxpayers with a loss or other reason to file Schedule C will need to seek the assistance of a professional tax preparer.

TIP

Volunteers must remember to include all allowable expenses when completing Schedule C-EZ.

What about household employee income?

Domestic employees such as maids are only issued Form W-2 if their earnings are more than $1,700. The income should be added to line 7 on Form 1040 and Form 1040A and line 1 of Form 1040EZ. If there is no Form W-2, you should write HSH next to the amount on the corresponding line. This income should also be included in the computation of 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 in a penal institution (including work performed while in a work release program or while in a halfway house). When preparing a paper return, refer to the Volunteer Resource Guide (Tab H) to find this listed in the Earned Income Table. Make a note in the Volunteer Resource Guide that this particular income is *subtracted* from other earned income on the EIC worksheet in the section titled Earned Income. Enter the initials **PRI** and the amount on the dotted line next to Form 1040 line 7.

Tax Software Hint: To review information related to the software, go to the Volunteer Resource Guide (Tab 6), Schedule EIC Worksheet.

Assign the exercises.

Review answers with the class when complete.

EXERCISES

Use the Summary of EIC Eligibility Requirements Chart in the Volunteer Resource Guide (Tab H) to answer the following questions. Answers follow the lesson summary.

Question 1: A taxpayer is filing as Married Filing Separately. Can this taxpayer qualify for the EIC? ☐ Yes ☑ **No**

Married Filing Separately does not qualify for the EIC.

Question 2: A taxpayer has interest income of $3,200. 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**

His investment income exceeds $3,100 for 2009.

What are the rules for taxpayers with qualifying children?

Review these rules with the students.

Remind students of the new tax law change allowing earned income credit for three or more qualifying children.

The taxpayer must file Form 1040 or Form 1040A 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 (Tab H). 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.

Read the **Robyn** example.

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.

Direct students to the EIC with a Qualifying Child Interview Tips in the Volunteer Resource Guide (Tab H).

Using the Interview Tips (EIC with a Qualifying Child) from the Volunteer Resource Guide (Tab H), based on what we have learned so far about Robyn and her family:

Step 1 is YES

Step 2 is YES

Step 3 is YES

Step 4 is NO

Step 5 is YES

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.

Direct students to Qualifying Child of More than One Person in the Volunteer Resource Guide (Tab H).

What are the rules for a qualifying child of more than one person?

NEW Only one taxpayer can claim a child that meets the conditions to be a qualifying child of more than one person. Review the Qualifying Child of More than One Person rules in the Volunteer Resource Guide (Tab H).

CAUTION

If the child meets the conditions to be the qualifying child of more than one person, only one person can claim the child as a qualifying child.

Ask the students if they understand the new rule regarding a qualifying child.

TIP

For EIC purposes, a qualifying child does not have to be the taxpayer's dependent unless the child is married. For example, the custodial parent (the parent the child lived with for more than half the year) can qualify for the EIC. The noncustodial parent cannot qualify for EIC because the child did not live with that parent for more than half of the year. It does not matter that the custodial parent does not claim the dependency exemption for the child in the case of divorced or separated parents.

Tax Software Hint: To review information related to the software, go to the Volunteer Resource Guide (Tab 1), Main Information Sheet.

TIP

List the children from youngest to oldest in the software.

What are the rules for taxpayers without qualifying children?

Taxpayers can file Form 1040EZ, Form 1040A, or Form 1040 to claim the EIC without a qualifying child. Review the rules in the Volunteer Resource Guide (Tab H), under Part C, Rules If You Do Not Have a Qualifying Child.

TIP

Review the question on the approved intake and interview sheet: Can your parents or someone else claim you or your spouse on their tax return? Did the taxpayer check yes or no?

TIP

For a couple filing a joint return, only one taxpayer has to meet the age requirement.

Clarify the age requirement for joint filers.

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.

Read the Tom and Martha example.

Assign the exercises.

Review answers with the class when complete.

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

She meets all the eligibility tests to be a qualifying child.

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

She is a descendent of Sam's stepson and meets the other eligibility requirements.

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**

Twila fails the relationship test; Chez fails the residency test; Dwight fails the age test.

Question 6: A married couple is filing jointly. They are raising their 10-year-old granddaughter because their daughter is serving a long prison term. They are also caring for an unrelated 8-year-old boy who was placed with them as a foster child by the State Department for Family and Dependent Children. They have wages and an AGI of $41,463. Assuming they meet all other tests, can they claim the EIC? ☑ **Yes** ☐ No

Both children meet the relationship, age, and residency tests.

Question 7: Imagine that the married couple in the previous question was in a different situation: What if they were only caring for their granddaughter? Would they be able to claim the EIC? ☐ Yes ☑ **No**

With just one qualifying child, their income would be more than $40,463; they could not claim the EIC.

Question 8: 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 $29,231. Assuming that she and her daughter pass all other tests, can Margie claim the EIC? ☑ **Yes** ☐ No

Margie meets the general eligibility requirements and Aimee meets the Qualifying Child rules.

Question 9: 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**

Dawn fails the residency test; she is the qualifying child of Laura. Form 8332 has no relevance to EIC.

The approved intake and interview sheet asks a volunteer if the taxpayer was previously disallowed the EIC. The volunteer would answer the question based on their explanation of the question during their conversation.

TIP

Special rules apply if the taxpayer was previously denied EIC. See the Volunteer Resource Guide (Tab H), Disallowance of the Earned Income Credit.

How do I answer the question, "Based on the interview, is the taxpayer qualified for the EIC?"

You answer this question after you have collected all the facts using the interview tips in the Volunteer Resource Guide (Tab H).

Optional Class Exercise

Mark and Evelyn Bell are married and file a joint return. They have an 8-year-old child, Jennifer Bell, who lived with them the entire year and whom they claim as a dependent. The Bells have adjusted gross income of $21,250, which consists of wages of $21,211 and interest income of $39.

You have already verified their identities and social security information. Mark and Evelyn are both age 32 and no one is permanently and totally disabled.

Do Mark and Evelyn qualify for the EIC? ☑ **Yes** ☐ No

They meet the general requirements and their daughter meets all the qualifying child tests.

How is the correct Earned Income Credit amount calculated?

The credit is determined using worksheets and the Earned Income Credit tables.

You will already have determined if your taxpayer qualifies for the EIC from the information you gathered to answer questions on the approved intake and interview sheet.

The EIC worksheets can be found in Form 1040, 1040A or 1040EZ Instructions. Every tax preparer or their site should have at least one set of instruction booklets.

Combat Pay Election

If a taxpayer has combat pay listed in box 12 of Form W-2 marked with code Q, and you are preparing a paper return, you may need to prepare two EIC worksheets to determine if the combat pay should or should not be added to your taxpayer's income.

If this election is chosen, write the combat pay amount by the EIC line of the payment section of the tax return. You can see this entry in the Volunteer Resource Guide (Tab 6), Form 1040 – Other Taxes and Payments.

Where are the EIC tables and how do I use them?

The EIC tables are located in the appendix of Publication 4491-W. Additional tables are in Publication 596, Form 1040 and Form 1040A. The Form 1040EZ Instructions only contain information for taxpayers with no children.

Let's look at those tables now. Turn to the first page of the EIC tables.

CAUTION

Double-check that the heading on your page says "Earned Income Credit (EIC) Table." It is common to mistake the Tax Tables for the Earned Income Credit tables.

Ask students to find the EIC tables in Publication 596 or in the Form 1040 Instructions.

Walk through the Class Exercise or assign it and review it with the class when complete.

Class Exercise

A taxpayer is filing Head of Household and has one qualifying child. The earned income and AGI is $19,000. How much is the EIC this person is entitled to?

Display or direct students to the EIC checkbox on the Main Information Sheet in the Volunteer Resource Guide (Tab 1).

Notice at the top of the table you find your amount in the "At least - But less than" column. Then go across and find the correct filing status column: Single, Head of Household and Qualifying Widow(er), or in a separate column, Married Filing Jointly. Sub-columns break it down to "No children, One child, Two children, Three children." The EIC should be $2,627. If you didn't get this answer, try again.

You would enter the amount 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 (Tab 1), Main Information Sheet "Dependents/ Nondependents" entries and (Tab 6), Schedule EIC Worksheet.

Do I need to attach Schedule EIC or the Schedule EIC worksheets to the return?

If the taxpayer has at least one qualifying child, complete Schedule EIC, Earned Income Credit Qualifying Child Information, and attach it to the tax return. Taxpayers with no children make a direct entry on the EIC line.

Tax software will print Schedule EIC to be attached to the taxpayer's copy of the return. If you are not using a software program, be sure to attach Schedule EIC to the taxpayer's return and give them a copy also.

Do not attach the worksheets to the return. Give them to the taxpayer with his/her copy of the return.

Practice – Vanessa Franklin

Direct students to Appendix A-35.

Take a look at how a volunteer helped our taxpayer, Vanessa Franklin. Go to Appendix A-35 and review the sample interviews with Vanessa related to this lesson. You will also find an optional exercise of completing her EIC worksheet.

Summary

Review the lesson summary with the class.

The Earned Income Credit computation is based on filing status, number of qualifying children (1-3), earned income, and adjusted gross income. Certain individuals with no children may also qualify.

By using the approved 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.

Taxpayers who received advance EIC payments will have the amount entered in box 9 of their Form W-2. They are required to file a tax return.

The EIC is entered in the Payments section of the return. See Vanessa's completed worksheets in Appendix B.

TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem, practice exercise(s), or supplements 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.

Assign the workbook exercise and review as a class when done (optional).

EXERCISE ANSWERS

Answer 1: *No. Married Filing Separately does not qualify for the EIC.*

Answer 2: *No. His investment income exceeds $3,100 for 2009.*

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. Both children meet the relationship, age and residency tests.*

Answer 7: *No. With just one qualifying child, the married couple's income would be more than the limit of $41,463 for 2009, so they cannot claim the EIC.*

Answer 8: *Yes. Margie meets the general eligibility requirements and Aimee meets the Qualifying Child rules.*

Answer 9: *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. If you are filing a paper return, be sure to write Dawn's information on Schedule EIC.*

Optional Class Exercise Answer: Yes, Mark and Evelyn Bell both meet the general eligibility requirements and their daughter meets all the qualifying child tests.

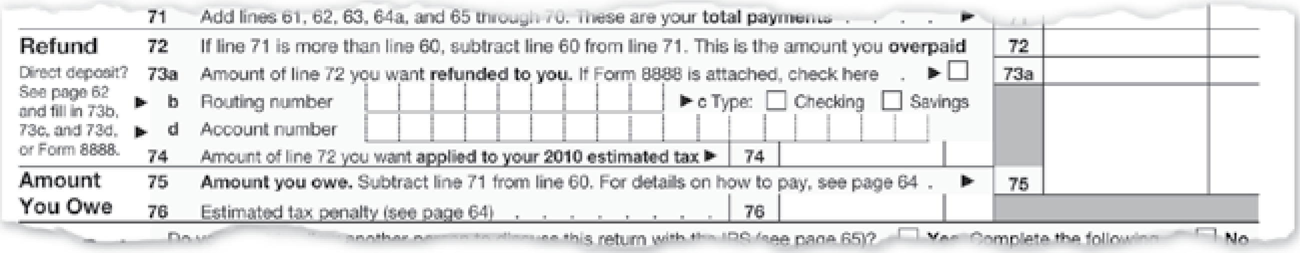
Notes

Lesson 31: Refund and Amount of Tax Owed

Instructor Notes

Introduction

This lesson covers the Refund and Amount You Owe sections of the taxpayer's return. After completing this lesson, you will determine if the taxpayer has overpaid (a refund is due) or has underpaid their tax (balance is due to the government).This part of the return is a summary of the tax, credits, and payments.



	71	Add lines 61, 62, 63, 64a, and 65 through 70. These are your **total payments** . . . . ▶		
Refund	72	If line 71 is more than line 60, subtract line 60 from line 71. This is the amount you **overpaid**		72
Direct deposit? See page 62 and fill in 73b, 73c, and 73d, or Form 8888.	73a	Amount of line 72 you want **refunded to you.** If Form 8888 is attached, check here . ▶ ☐		73a
	▶ b	Routing number ▶ c Type: ☐ Checking ☐ Savings		
	▶ d	Account number		
	74	Amount of line 72 you want **applied to your 2010 estimated tax** ▶	74	
Amount You Owe	75	**Amount you owe.** Subtract line 71 from line 60. For details on how to pay, see page 64 . ▶		75
	76	Estimated tax penalty (see page 64)	76	

To complete these sections of the taxpayer's return, you will need to confirm answers provided during your initial interview to Part III, Item 1 and 2 regarding direct deposit and direct debit from the taxpayer's approved intake and interview sheet. Also, review the Volunteer Resource Guide (Tab 6) and (Tab 13).

Objectives

Review objectives with the class.

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
- Describe the different payment options for the amount owed
- Identify the Third Party Designee portion of the tax return and determine its purpose

Point out the resources cited under **What do I need?**

What do I need?

☐ Approved Intake and Interview Sheet
☐ Volunteer Resource Guide
☐ Publication 17
☐ Publication 4491-W
☐ Form 1040
☐ Form 8888
☐ Form 9465
☐ Form W-4
☐ Form W-4P

Optional:

☐ Publication 594
☐ Publication 4541
☐ Publication 4542
☐ Form 2210 and Instructions

How do I know if the taxpayer is due a refund?

Display or refer to this section of Form 1040 so the tax preparers can see how the overpayment is shown and the options for the overpayment.

The taxpayer's total tax appears on the applicable line in the Other Taxes section of Form 1040.

The taxpayer's total tax payments already made, which includes refundable credits, appears on the applicable line in the Payments section of Form 1040.

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.

What are the options for an overpayment?

Taxpayers can choose to:

- Apply any portion of their overpayment to the following tax year
- Receive their refund using direct deposit
- Receive their refund as a check

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."

Tax Software Hint: The tax software shows the entire refund amount on the amount to be refunded line

Ask students to find Direct Deposit of Refunds in the Volunteer Resource Guide (Tab 13), Finishing the Return. **Review** the main points.

Refund checks are usually mailed within 6 to 8 weeks after the return is filed. However, instead of getting a paper check, taxpayers may choose to have their refund deposited directly into their account at a bank, credit union, or other financial institution. 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.

NEW For the 2010 filing season, taxpayers can use their 2009 tax refund to buy U.S. savings bonds, even without a bank account or an existing account with Treasury. Check www.irs.gov for the latest information and a list of questions and answers.

Encourage taxpayers to use direct deposit, which is much faster, safer, and more efficient. With an e-filed return, a direct deposit is usually received within 10 to 14 days.

How do I enter the information for direct deposit?

Tax Software Hint: Make sure the taxpayer shows you proof of this bank information. Bank deposit slips are not a reliable source for routing and account numbers for direct deposit. For software entries, go to the Volunteer Resource Guide (Tab 1) Main Information Screen on Direct Deposit.

Go to the Volunteer Resource Guide (Tab 13), Pointers for Direct Deposit of Refunds, which includes a diagram showing where to find the routing transit number (RTN) and depositor account number (DAN) information on a check.

CAUTION

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: Go to the Volunteer Resource Guide (Tab 1), Main Information Screen, for software entries related to direct deposit. For direct deposit into one account, the software makes sure the information was entered properly. If the information does not match, the program will give you a warning during diagnostics in the completion phase of the return.

CAUTION

If the routing and account numbers are not valid, the refund will be delayed 4-6 weeks. If the direct deposit is rejected, a paper check will automatically be mailed to the address on the return.

Ask a student to read the Tax Software Hint.

Can the refund be deposited into more than one account?

Taxpayers can choose to divide their direct deposit refund among up to three accounts. For example, a person expecting a refund of $500 could choose to deposit $200 into a checking account, $200 into a savings account, and $100 into an IRA account.

Tax Software Hint: Use Form 8888, Direct Deposit of Refund to More Than One Account, 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 (Tab 6), Split Refund Option page for the software entries.

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.

TIP

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.

Review the tip for adjustments to split refund requests. Remind volunteers that the IRS issues a notice to the taxpayer explaining the adjustment.

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

Ask a volunteer to read the Joan example.

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.

Ask a volunteer to read the examples.

Point out how each example illustrates the bottom-up rule.

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.

Review the rules for refund adjustments and Form 8888.

example

Melanie is due a refund of $1,000. $700 of the refund is an Earned Income Credit. 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. $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, Financial Management Service (FMS) will reduce the payment designated for the account that appears next.

TIP

Publications 4541 and 4542 provide information on split refunds, and are available electronically on www.irs.gov.

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. The taxpayer 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.

Review the caution.

CAUTION

Financial institutions generally disallow 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: Although direct deposit saves postage, it is no faster than receiving a refund through the mail. ☐ True ☑ **False**

Direct deposit is faster.

Question 2: When entering an account number for direct deposit, make sure to include all spaces and hyphens. ☐ True ☑ **False**

Enter the number from left to right; leave out all spaces and special characters.

Assign the exercises.

Review answers with the class when complete.

How do I know if an amount is owed?

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 (Tab 6), Form 1040, page 2, Other Taxes and Payments. Review the line for Amount You Owe.

Display or refer to this section of Form 1040.

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.

CAUTION

Explain to taxpayers who have an amount owed that the return must be filed by the due date even if the full amount cannot be paid. A separate penalty for filing a return after the due date may be applied.

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
- Electronic Federal Tax Payment System (EFTPS)

TIP

If the taxpayer pays their income tax (including estimated tax) by credit or debit card, they can deduct the convenience fee charged by the card processor as a miscellaneous itemized deduction (subject to the 2% AGI floor).

Ask students to find Balance Due Returns in the Volunteer Resource Guide (Tab 13), Finishing the Return.

Point out that credit card payments are made to a private service provider, and a convenience fee will be charged.

Tax Software Hint: Go to the Volunteer Resource Guide (Tab 13), 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. If using Electronic Funds Withdrawal, located at the bottom of page 2 of Form 1040, indicate that the taxpayer wants to pay all or part of their taxes electronically. Refer to Volunteer Resource Guide (Tab 6) for electronic funds withdrawal software entries.

TIP

The paper Form 1040-V includes instructions and a table of IRS Service Center addresses.

CAUTION

Taxpayers should not mail cash with their returns.

Emphasize the main points, Tips, and Cautions in this section. Volunteers *must* understand the payment options available to taxpayers on returns with an amount owed.

What if the taxpayer cannot pay?

Taxpayers who cannot pay the full amount owed, shown on the applicable line in the Amount You Owe section of Form 1040, may request the following:

- Pay in full within 60 or 120 days with no fee; interest and penalties charged on payments after April 15
- Make monthly installment payments by filing Form 9465, Installment Agreement Request

TIP

If paying the tax would cause the taxpayer an undue hardship, the taxpayer can ask for an extension of time to pay by filing Form 1127 by April 15. For more information, see Form 1127.

How do I handle Form 9465, Installment Agreement Request?

Display or refer to Form 9465. The form and the instructions provide specific details on the process of requesting an installment agreement.

Emphasize to volunteers that they can provide a valuable service to the taxpayer if they are thoroughly familiar with the form and procedures.

Point out that, even if taxpayers are granted an installment agreement, interest and penalties continue to accrue until the balance is paid.

The following outlines key information related to an installment agreement.

- If the return is being filed electronically, Form 9465 can also be included in 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 the request is granted, the taxpayer must also pay a fee of $105 or $52, if payments are made by electronic funds withdrawal. If the taxpayer's 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 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.
- Instead of completing Form 9465, the taxpayer can file an Online Payment Agreement (OPA) at the IRS web page. For more information, go to www.irs.gov and search for the term "OPA" or, on the "I need to…" list, click "Set Up a Payment Plan."

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 (Tab 6), Form 1040, page 2 and refer to the line Amount You Owe and software entries for Form 9465.

EXERCISES (continued)

Assign the exercise.

Review answer with the class when complete.

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

The automated system tells users the fee they will be charged, which covers the costs of credit card processing.

Taxpayer Interview and Tax Law Application

Seymour's paper Form 1040 shows his total tax is $450. His tax payments come to just $200. Therefore, Seymour owes $250.

Ask two volunteers to role-play the sample interview.

SAMPLE INTERVIEW

VOLUNTEER SAYS...	SEYMOUR RESPONDS...
The amount of tax you owe for 2009 is $250. You can either mail in a check or money order with the payment voucher, use electronic funds withdrawal, or call in a credit card payment. You'll have to pay an additional convenience fee for using a credit card.	Hmm. How does electronic funds withdrawal work? Does it come out of my account right away?
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.	And there's no charge?
Right. And it saves you the trouble of mailing in the voucher with your payment.	Sounds good to me. But I don't have my checking account information with me. Maybe I should just mail in my 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 "2009 Form 1040" on the front of your check. Then mail the payment with the voucher. I'll get the mailing address for you.	That doesn't seem too hard.
Just make sure it gets postmarked no later than April 15. 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.	

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 the Amount You Owe section of Form 1040. While completion of Form 2210 is out of the scope of the VITA/TCE program, it is important for volunteers to have an awareness of the estimated tax penalty provisions.

Refer to or display this section of Form 1040.

What is the Estimated Tax Penalty?

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 to be less than the smaller of:

- 90% of the tax shown on the current tax return, or
- 100% of the tax shown on the prior year's tax return (110% 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.

NEW For 2009, qualified individuals with small businesses may be eligible to make smaller estimated tax payments. See Form 2210, Underpayment of Estimated Tax by Individuals, Estates, and Trusts, for more information.

There are special situations when a taxpayer will not have to pay a penalty. See Form 2210 and Instructions or Publication 17 for more information.

Ask a volunteer to read the Mark example.

Ask what if Mark's previous year's tax was $300.

Answer: The penalty may be waived since his withholding was more than was due the year before.

example

Mark's total tax is $1,657 for 2009. His withholding is $417. He owes $1,240. His 2008 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% of his 2009 tax or 100% of his 2008 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. If necessary, the taxpayer can complete the Form 2210 that will be included with the notice.

Review the Tax Software Hint.

Tax Software Hint: For 2009, Form 2210 will be defaulted in the software and $0 will be reflected on line 9. This will prevent volunteer preparers from calculating the estimated tax penalty. Volunteer preparers need to inform taxpayers with a balance due who are meeting the estimated penalty requirements that they may receive a notice from the IRS.

Assign the exercise.

Review answer with the class when complete.

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**

The tax Dion owes is less than $1,000, so she does not have to pay a penalty.

How can taxpayers make sure the correct amount of tax is withheld?

Form W-4, Employee's Withholding Allowance Certificate, 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 taxpayer 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.

TIP

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 919, How Do I Adjust My Income Tax Withholding?, has more information on this topic. Taxpayers can go to the withholding calculator on 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 (general used for certain government payments)

TIP

It is very important to help taxpayers who need assistance revising their withholding. If taxpayers did not have enough tax withheld in 2009, advise them to submit a revised withholding form to increase the amount of income tax withheld.

Which categories of taxpayers may need a withholding “check up” due to making work pay provisions of ARRA?

Taxpayers in one of the following categories may need a withholding “check up” due to ARRA tax law changes:

- An employee with multiple jobs
- A married couple and both husband and wife work
- A retiree who receives a pension and does not have any wage income
- An employee who does not have a valid social security number
- An employee who can be claimed as a dependent on someone else’s return
- An employee who receives social security benefits, SSI, railroad retirement or veteran’s disability payments

These taxpayers may receive a smaller refund or in some cases have a balance due. Revising the withholding should be done to avoid having an amount owed. Volunteers should be able to provide assistance to someone who needs help changing their withholding. Helpful resources include the withholding calculator on www.irs.gov and Publication 919.

TIP

Refer to the Volunteer Resource Guide (Tab 13), Balance Due Returns, on how to avoid a balance due. Remember to advise taxpayers to use the withholding calculator on www.irs.gov as a way to check their withholding for next year.

example

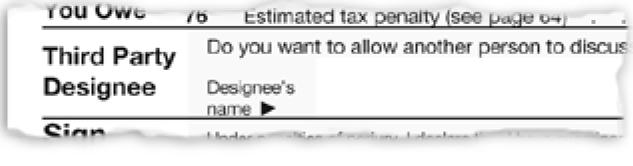
Gary is a college student and is claimed by his parents as a dependent. He had a part-time job and files a return. Gary is not eligible for the making work pay credit since he can be claimed as a dependent. However his withholding was reduced when the new tables went into effect. It is very likely Gary will have an amount owed when he files his 2009 income tax return. He should submit a revised Form W-4 to his employer so they will withhold more tax from his pay in 2010.

example

Pierre is single, has an ITIN, and works as an employee in the U.S. He earned $25,000. Pierre is not eligible for the making work pay credit because he has an ITIN. However, his withholding was reduced based on the new withholding tables. Pierre should revise Form W-4 to have his employer take out more withholding so he will not owe tax on his 2010 tax return.

What is the Third Party Designee?

For taxpayers who want to allow a friend, family member, or another person to discuss their 2009 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, 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 designee chooses as their personal identification number (PIN).



You Owe 76 Estimated tax penalty (see page 64)

Third Party Designee Do you want to allow another person to discus

Designee's name ▶

Sign

CAUTION

Volunteer preparers may *not* be designated as a “Third Party Designee.”

TIP

See Publication 17 for information on what the taxpayer is authorizing when designating a third-party designee.

How can I avoid common errors?

Double- and triple-check the routing number and account numbers for direct deposit and electronic funds withdrawal. Have the taxpayer compare the numbers to their check or account card. If an error is made in the bank information, the taxpayer must work with the bank to resolve any misdirected funds.

Practice – Vanessa Franklin

Let's see how a volunteer helped our taxpayer, Vanessa Franklin. Go to Appendix A-37 and review the sample interview with Vanessa related to Lesson 31.

Direct students to Appendix A-37.

Return to this lesson after you have reviewed this information.

Summary

Refunds

Review the lesson summary with the class.

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, enter the routing transit number (RTN) and depositor account number (DAN) on the Main Information Sheet and page 2 of Form 1040. Use a check as proof of account. When the return is printed, this information will appear on the applicable lines in the Refund section of Form 1040.

For the 2010 filing season, taxpayers can use their 2009 tax refund to buy U.S. savings bonds, even without a bank account or an existing account with Treasury.

Amount Owed

If the payment total is less than the amount of tax owed, the tax software shows the amount of tax owed 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.

Explain to taxpayers that the tax return can be electronically filed now but that they must submit their payment of taxes due no later than April 15. They can pay with a check or money order, with Form 1040-V, electronic funds withdrawal, or a credit card.

If taxpayers are unable to pay, they may request an installment agreement by submitting Form 9465. This can be done with the return, whether filed electronically or on paper. Taxpayers can also use the Online Payment Agreement feature on www.irs.gov.

Interest and penalty is charged on amounts not paid by the due date. There are fees associated with certain payment options.

Estimated Tax Penalty

If it appears the taxpayer owes an estimated tax penalty, advise the taxpayer that the IRS will calculate the penalty and send a bill.

Adjusting Tax Withholding

Taxpayers may need a withholding “check up” due to making work pay provisions of ARRA. Help taxpayers who need assistance revising their withholding. If taxpayers did not have enough tax withheld in 2009, advise them to submit a revised Form W-4 (to their employer) or Form W-4P (to a pension payer). Available resources include the withholding calculator on www.irs.gov and Publication 919.

Third Party Designee

Taxpayers can authorize a friend, family member, or another person to discuss their return with the IRS. Volunteers should *never* designate themselves as a Third Party Designee.

Assign the workbook exercise and review as a class when done (optional).

TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem, practice exercise(s), or supplements 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. Taxpayers will receive their refund faster if they use direct deposit.*

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.*

Lesson 32: Quality Review of the Tax Return

Instructor Notes

Introduction

This lesson covers the final steps in the return preparation process which includes confirming the accuracy of the taxpayer's return (before obtaining their signature). If you take the steps identified in this lesson, you will prevent or at least minimize taxpayer interaction with the IRS about their return.

CAUTION

Quality Reviewers must be certified at the Intermediate level or above.

Objectives

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

- Identify the three methods of quality review
- Perform a quality review using an approved quality review sheet
- Perform the final steps for completing a return

What do I need?

☐ Approved Intake and Interview Sheet
☐ Approved Quality Review Sheet or Form 8158
☐ Volunteer Resource Guide
☐ Publication 17
☐ Publication 4491-W
☐ Form 8879

Optional:

☐ Form 8283
☐ Form 8332
☐ Form 8453

Review objectives with the class.

Point out the resources cited under **What do I need?**

How is a quality review of a return completed?

All tax returns prepared at volunteer tax preparation sites must be quality reviewed. The preferred method is to review a paper copy of the tax return, along with all source documents, even if the return was prepared electronically. The taxpayer should be present for the quality review.

To perform a quality review of a tax return, use Form 8158, Quality Review Sheet or an approved alternative, or Form 13614-C and the tools in the Volunteer Resource Guide. Depending on the site, one of three methods of quality review may be used by an individual certified at the Intermediate level or above:

- A certified designated reviewer (designated quality review) – the preferred method
- Certified preparers review each other's work (peer review)
- Certified preparers review their own work (self-review)

The approved quality review sheet is a list of items that must be verified when reviewing tax forms. Reviewing these items prevents common errors from occurring, such as incorrect names, transposed social security numbers, incorrect income, or incorrect credits.

TIP

Volunteers should always review their work, even if it is to be reviewed by another party.

How do I conduct a quality review of a return?

First, make sure you fully understand the taxpayer's tax situation. If the intake sheet is not complete, the quality reviewer should either complete it with the assistance of the taxpayer or return it to the preparer to be completed with the taxpayer. All approved partner-created quality review sheets should have a similar checklist.

The taxpayer's section can be completed by the taxpayer, but should be validated prior to the return preparation and during the quality review process. Review the tax return with the taxpayer to ensure the items on the intake sheet were correctly marked by the taxpayer and correctly transferred to the return.

TIP

Corrections must be marked on the intake sheet by the preparer or quality reviewer.

If the intake sheet does not validate what is listed on the return, either make the appropriate changes or follow-up with additional questions to the return preparer.

CAUTION

Check returns for accuracy – review social security numbers, double-check math, verify amounts transferred from schedules and tax tables.

Perform the review with the taxpayer immediately after completing the return and *before* the taxpayer signs it. Simply compare the questions on the approved quality review sheet with the information shown in the return.

Use Check Your Work - The Quality Review (Tab 13) and the Job Aid for Volunteers in the Volunteer Resource Guide to conduct the review.

TIP

Always include the taxpayer in the quality review process.

When should the taxpayer sign the return?

Remind the students that both spouses must sign and date a Married Filling Jointly return.

Taxpayers who file paper returns must sign and date the return in the Sign Here section of Form 1040. **A return is not considered to be valid, and refunds are not issued, unless the return is signed**.

The Volunteer Resource Guide has complete instructions on signature procedures for different types of situations. Please review Finishing the Return in the Volunteer Resource Guide (Tab 13). Return Signature and PIN Guidelines provides detailed guidelines for obtaining taxpayer signatures.

CAUTION

Members of the Armed Forces may have different rules for signing joint returns. See Publication 3.

Direct students to the signature procedures in the Volunteer Resource Guide (Tab 13).

Publication 17 also contains information on signature processes. Be sure to review information on when someone can sign for the taxpayer. Rules for a return signed by a power of attorney are very specific.

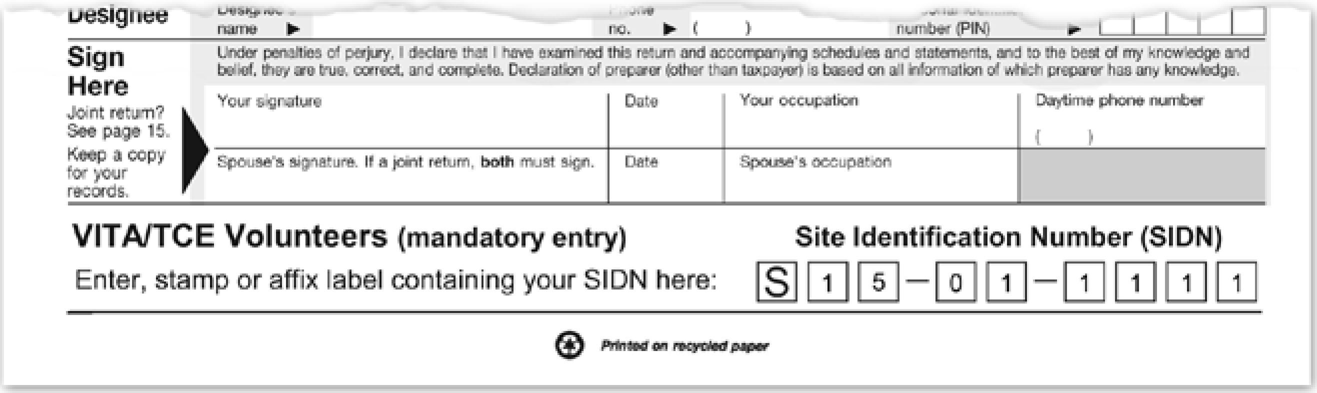
TIP

Returns prepared by volunteer tax preparers should be signed by the taxpayer after the quality review is complete.

Do I have to enter a site number?

The IRS captures a wide range of important statistical information from tax returns, including which returns were prepared at VITA/TCE tax preparation sites. Therefore, it is important that all returns be identified with the site identification number.

You must ensure that the site's identification number (SIDN) has been entered in the box "Preparer's SSN or PTIN." **Do not complete any other information in the Paid Preparer's Use Only section.**


Designee name ▶ no. ▶ ( ) number (PIN) ▶

Sign Here
Joint return? See page 15.
Keep a copy for your records.

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Your signature	Date	Your occupation	Daytime phone number ( )
Spouse's signature. If a joint return, **both** must sign.	Date	Spouse's occupation	

VITA/TCE Volunteers (mandatory entry) **Site Identification Number (SIDN)**

Enter, stamp or affix label containing your SIDN here: S 1 5 – 0 1 – 1 1 1 1

Printed on recycled paper

Some VITA/TCE tax preparation sites provide you with paper return forms that are pre-printed with the site's identification number (SIDN), which is an eight-digit figure starting with the letter "S," in the Paid Preparer Section of the return. Some sites may provide labels or stamps with the SIDN. Your Site Coordinator provides this number along with other necessary guidelines for completing the return.

If your site does not use forms with the pre-printed SIDN, you must print your site's entire identification number in the Preparer's SSN or PTIN field. At sites using tax preparation software, this information is usually programmed to automatically print on each return.

Once you have obtained the taxpayer's signature and entered the SIDN, you are ready to assemble the return. Refer to Lesson 33, Concluding the Interview for these steps.

Provide the SIDN (if available) and suggest that students write it in the Volunteer Resource Guide.

EXERCISES

Answers follow the lesson summary.

Question 1: A joint return requires the signature of:

A. At least one spouse

B. Both spouses

C. The spouse with the highest income

Both spouses must sign a joint return, even if only one spouse had income.

Question 2: What is the form number of the IRS quality review sheet used by most volunteers for quality review?

Form 8158, Quality Review Sheet, which is contained in Form 13614-C.

Assign the exercises.

Review the answers with the class when complete.

What are the final steps in the quality review process?

Once the tax return has gone through the established site quality review process, assemble the return and ensure that all necessary documentation is complete.

If the taxpayer has chosen not to use a Self-Select PIN, print two copies of Form 8879, and obtain the taxpayer's signatures. If the return is a joint return, make sure both signatures are included on the form, otherwise the return will not be electronically transmitted. Review the Volunteer Resource Guide (Tab 13), Check Your Work - The Quality Review, for the final steps in the process.

CAUTION

For members of the Armed Forces who are signing joint returns, refer to Publication 3. Electronic transmission is not always possible.

Point out "Distributing Copies of Returns" in the Volunteer Resource Guide (Tab 13).

Assign the exercises.

Review the answers with the class when complete.

EXERCISES (continued)

Question 3: Sandra, who is 17, is eligible to use a Self-Select PIN to sign her return using tax software. She did not file a tax return for the previous year. Can she still file an electronic tax return for the 2009 tax year? ☑ **Yes** ☐ No

She must enter 0 for her prior year AGI then use the Self-Select PIN or use the Practitioner PIN and sign Form 8879 to file electronically.

Question 4: What are the three methods of quality review?

Designated quality reviewer (the preferred method), peer review, and self-review.

Practice - Vanessa Franklin

Direct students to Appendix A-39.

Let's take a look at how a volunteer helped our taxpayer, Vanessa Franklin. Go to Appendix A-39 and review the sample interview with Vanessa related to the quality review and e-filing. Return to this lesson after you have reviewed the sample interview.

Summary

Review lesson summary with the class.

This lesson explained the steps involved in the quality review process for paper and electronic returns. To perform a quality review of a tax return, use Form 13614-C, Form 8158, Quality Review Sheet, or an approved alternative, and the tools in the Volunteer Resource Guide.

It may help to think of these "check sections" of Form 13614-C in terms of how they relate to sections of the tax return:

- *Taxpayer Identity* section: Have the taxpayer verify that the name, date of birth, SSN, and address are correct, and that supporting documentation is present.
- *Spouse and Dependent Identity* section: Have the taxpayer verify that the name, date of birth, SSN, are correct, and that supporting documentation is present.
- *Filing Status:* Have the taxpayer verify that the filing status is correct. Have you asked all the questions to determine this correctly?
- *Exemptions:* Verify that the dependents claimed meet the tests to qualify.
- *Income:* Verify that the taxpayer's wages are accurate and that all income from Form(s) W-2 and other income documents, such as Form(s) 1099, have been included. Make sure that all Form(s) W-2 are attached.
- *Adjusted Gross Income, Tax and Credits, and Other Taxes:* Verify that all adjustments, deductions, and credits are supported by the taxpayer's documentation and that all of the adjustments, deductions, and credits noted on the approved intake and interview sheet have been addressed.
- *Standard, Additional, or Itemized Deductions:* Ensure that all information is correct and support forms or documentation is present.
- *Credits:* Ensure that all appropriate credits have been reported and support forms or documentation is present.

- *Payments:* Verify that any withholding listed from Form(s) W-2 and other source documents has been included and added correctly. Make sure that all Form(s) W-2G and 1099 are attached if tax was withheld.
- *Refund* and *Amount You Owe* sections: Check that the direct deposit and/or split deposit information is correct. Did you explain to the taxpayer how to pay taxes that are due?
- *Sign Here* section: Remind the taxpayer to sign and date the appropriate forms based on the filing method (e-file or paper-prepared) used at the site. For joint returns, both spouses must sign the documents.
- *Paid Preparer's Use Only* section: Make sure the correct Site Identification Number (SIDN) is entered. The SIDN is the letter "S" followed by an eight-digit site identification number that represents your particular site.

In addition, for electronic filing, you and/or the designated quality reviewer should make sure that Forms 8879 are signed when the Practitioner PIN signature option is used. Use of the Self-Select PIN signature option does not require Forms 8879.

EXERCISE ANSWERS

Answer 1: *B. Both spouses must sign a joint return, even if only one spouse had income.*

Answer 2: *Form 13614-C or Form 8158, Quality Review Sheet.*

Answer 3: *Yes. Sandra will need to enter zero ("0") for her prior year's AGI in order to use the Self-Select PIN, or she may sign Form 8879 in order to file her 2009 tax return electronically.*

Answer 4: *Designated quality reviewer (the preferred method), peer review, and self-review.*

Notes

Lesson 33: Concluding the Interview

Instructor Notes

Introduction

In this lesson, you will receive insights and information for concluding your interview with the taxpayer.

Using the interview techniques and tools discussed in the Screening and Interviewing lesson, such as active listening and building rapport, share the following with the taxpayers:

- Which records/documentation they should keep and why
- What documentation about them is maintained at the site – why, how long, etc.
- What they need to know and do if they overpaid their taxes (i.e., refund due dates, increasing the number of exemptions on Form W-4 to avoid overpayments, etc.)
- What they need to know and do if they owe additional taxes (i.e., payment due dates and estimated tax payments, reducing the number of exemptions on Form W-4 to avoid additional payments, etc.)

These are important tasks to accomplish after the tax return is completed, quality checked, 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:

- Prepare the tax packet for filing
- Identify the records the site maintains
- Explain to taxpayers which records they should maintain
- Estimate when refunds will be paid to the taxpayer
- Explain to taxpayers what they should do when they owe money and what they can do to avoid owing taxes in the future
- Explain to taxpayers how to adjust withholding
- Explain to taxpayers how and when they can make estimated payments
- End the interview

What do I need?

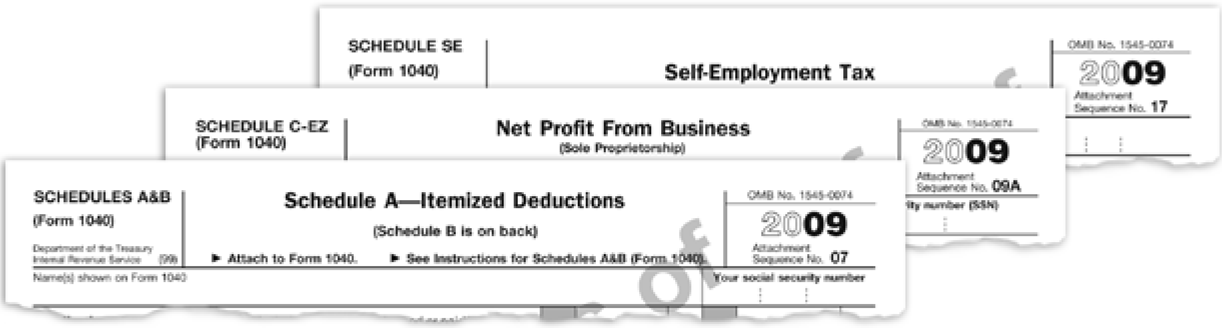
☐ Volunteer Resource Guide
☐ Publication 17
☐ Publication 4491-W
☐ Publication 730
☐ Form 1040-V
☐ Form 9465

Optional:

☐ Publication 505
☐ Publication 919
☐ Form 1040-ES
☐ Form 8332
☐ Form 8879
☐ Form W-4
☐ Form W-4P
☐ Form W-4V

Review objectives with the class.

Point out the resources cited under **What do I need?**



How do I prepare the e-filing packet?

Direct students to the Finishing the Return tab in the Volunteer Resource Guide (Tab 13) and review the steps for completing a return using the tax software.

Emphasize that every taxpayer must receive a complete copy of their return before leaving.

Most 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 (Tab 13) 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(s) name(s) and social security number(s) are legible on every sheet
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

Who keeps the records?

What forms should the taxpayer keep?

Advise the taxpayer 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 Form(s) W-2 and Form(s) 1099
- If applicable:
  - Form 8332, Release of Claim to Exemption for Child of Divorced or Separated Parents (or similar statement)
  - Original Power of Attorney
- For e-file returns, the taxpayer must also keep a copy of the signed Form 8879, IRS e-file Signature Authorization. This form is not needed if the self-select personal identification number (PIN) method is used.

Emphasize that it will be important for taxpayers to bring this year's return to next year's appointment.

If Publication 730, Important Tax Records Envelope, or an alternative is available, place the taxpayer's copies into that envelope.

TIP

Remind taxpayers to bring the envelope to the site with them next year.

What tax return data will the site keep?

If a paper return is filed, the volunteer site will **not** keep copies of taxpayers' returns or any other taxpayer-related documentation. Taxpayers should keep copies of their records.

For e-file returns, the site will keep the following data confidential and in a secure location until December 31 of the current year, except as noted:

- A master backup disk containing all electronically transmitted returns
- One signed Form 8879 (which will be held for 3 years) for each return transmitted (unless Self-Select PIN procedures were followed)
- One copy of Form(s) W-2 and/or Form(s) 1099 showing federal tax withheld
- A copy of the IRS Acknowledgement Report for transmitted federal returns
- A copy of the Declaration Control Report (DCR) for transmitted returns may be kept

TIP

If your site does not have storage capability or will not be open after April 15th, make storage arrangements with your local IRS SPEC contact.

Ask students to name the data that the site will keep without looking at their study guide.

What should I tell the taxpayer about refunds or balances due?

For taxpayers who are due a refund:

- Review the 2010 IRS E-file Refund Cycle Chart in the Volunteer Resource Guide (Tab 14) and provide the expected date they may receive it. (The cycle chart will provide you with dates for direct deposit and paper checks.)
- Make sure the taxpayer realizes that this is not a guaranteed date, since delays can occur.

Advise the students to tell the taxpayers not to spend the refund until they actually get it.

For taxpayers who owe money to the IRS (also known as having a balance due):

- Electronic Funds Withdrawal can be set up to have payments electronically withdrawn from an account. This may be set up using tax software and e-filed with the return; see the Volunteer Resource Guide (Tab 6).
- Remind taxpayers to send Form 1040-V to the appropriate address if they wish to mail a payment; for e-file returns, Form 1040-V, Payment Voucher, will be generated by the e-file software when the tax return results in a balance due.
- Remind taxpayers that payment must be made by April 15, 2010 to avoid penalties and interest.
- If taxpayers request an installment agreement, remind them to submit Form 9465, Installment Agreement Request, as soon as possible.
- If taxpayers can pay a portion of the amount owed by the due date, they won't be charged interest and penalties on that portion.

Review Tab 13, Balance Due Returns, with the students.

CAUTION

Make the taxpayer aware that the IRS charges a fee for setting up an installment agreement.

How can the taxpayer avoid a balance due next year?

There are several ways to pay taxes during the year in order 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 or pensions can adjust their withholding.
- Taxpayers whose income is mostly from self-employment or investments can make or increase their estimated payments.
- A combination of increased withholding and estimated tax payments may work best for some taxpayers.

How can taxpayers adjust their withholding?

Taxpayers receiving wage income can adjust their withholding by providing their employer with a new Form W-4, Employee's Withholding Allowance Certificate. By decreasing the number of allowances claimed on Form W-4, the amount withheld from each paycheck will increase.

Display (if possible) the online withholding calculator and walk through an example.

To help taxpayers adjust their withholding using Form W-4, the IRS Web site provides a helpful withholding calculator at www.irs.gov – keyword: calculator. More information can be found in the Form W-4 Instructions, Publication 17, Tax Withholding and Estimated Taxes, or in Publication 919, How Do I Adjust My Tax Withholding?

Taxpayers can also use Form W-4 to request an additional dollar amount be withheld. Form W-4 can also be used to decrease the amount of tax withheld. This may be useful for taxpayers who received large refunds due to excessive withholding.

Withholding from pension income is voluntary, not automatic, as it is for wages. As a result, many retirees do not have tax withheld from their retirement payments and are unpleasantly surprised by a balance due at the end of the year. Taxpayers can request withholding from pension and annuity payments by submitting Form W-4P, Withholding Certificate for Pension and Annuity Payments to the payer.

Withholding can be requested from certain government payments, such as social security and unemployment compensation, by submitting Form W-4V, Voluntary Withholding Request to the paying agency.

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, Tax Withholding and Estimated Taxes can help determine if the taxpayer should make estimated tax payments. See Lesson 29, Payments, 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. Her tax last year, while she was still working full time, was $2,760. When you complete her return this year, her tax totals $1,300. Maria should make estimated payments, since her tax after withholding and credits will be more than $1,000, and her withholding is less than $1,170 (90% of this year's tax). If Maria doesn't want to make estimated payments, she could submit Form W-4P to request withholding from her pension instead.

Ask a volunteer to read the Maria example.

Ask what if next year Maria expects to owe far less than $1,000 after tax withheld and credits.

Answer: She does not need to make estimated tax payments unless she wants to.

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 the taxpayer 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.

Estimated tax payments are due four times a year. If any due date falls on a Saturday, Sunday, or legal holiday, the payment is due the next business day. Each due date covers a specific time period:

For the period…	Due date:
January 1 through March 31	April 15
April 1 through May 31	June 15
June 1 through August 31	September 15
September 1 through December 31	January 15 next year

Most of the taxpayers you will assist will pay their estimated tax in four equal installments. However, a taxpayer can choose to make payments for each period based on the actual amount of income received during that period. If taxpayers do not pay enough each payment period, they may be charged a penalty even if they are due to receive a refund when the tax return is filed. Generally, the simplest and safest procedure is to make sure that each payment is at least one-fourth of the prior year's total tax, less tax withheld during the period. For more information about estimated tax payments, refer to Publication 17, Tax Withholding and Estimated Taxes, or Publication 505, Tax Withholding and Estimated Tax.

How is estimated tax paid?

Estimated tax payments can be sent electronically to the IRS by direct debit payment from the taxpayer's checking or savings account, by credit card, or by check or money order with Form 1040-ES, payment voucher. Each voucher is numbered and inscribed with its due date. Remind taxpayers to be sure to use the correct voucher for each payment. Advise taxpayers to write their social security number and "2009 Form 1040-ES" on the check or money order payable to the "United States Treasury."

Point out that all payments sent to the IRS should be made payable to United States Treasury, never to IRS.

For more information, see the Form 1040-ES instructions.

How do I close the contact?

Before seeing the taxpayer off, show as much concern and interest as you did at the start of your time together:

- Explain what will happen next.
- Ask the taxpayer, “Do you have any questions before you leave?”
- Advise the taxpayer how to get answers to questions that may come up later.
- If the taxpayer seems interested in learning more about tax preparation, encourage them to consider volunteering. 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 the taxpayer in case there are any problems with the e-filing of the return.
- Thank the taxpayer for using the service.

Emphasize the importance of having good contact information to resolve problems if there are issues with the e-filing process.

Does the taxpayer have to do anything else?

If the return will be e-filed, give the taxpayer a brief explanation of how the process works:

- The Site Coordinator or designee will transmit all the e-file returns.
- The next day, the Site Coordinator or designee will receive an acknowledgement 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 may need to contact the taxpayer to resolve the problem.
- If the return is not being e-filed, the taxpayer must mail the signed copy of the tax return, along with copy B of all Form(s) W-2, and one copy of any Form 1099-R that shows federal withholding. The taxpayer may need another copy of the return and Form(s) W-2 if filing a state return. Make sure the taxpayer knows the correct address for mailing the return(s). Remind the taxpayer that the return must be postmarked by the filing deadline of April 15, 2010.

Practice – Vanessa Franklin

Direct students to Appendix A-41.

Let’s conclude our interview with Vanessa. Go to Appendix A-41 and review the sample interview related to this lesson. Return to this lesson after you have reviewed this information.

Summary

Concluding the interview properly ensures that each taxpayer has a complete record of the return, understands what will happen next, and knows 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.

Review the lesson summary with the class.

You should know how to assemble the tax packet and how to end the interview.
The taxpayer should leave with instructions on:

- Which records the site is maintaining
- Which tax records to maintain
- When (approximately) to expect the refund
- How to avoid having a balance due in the future

TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem, practice exercise(s), or supplements 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.

Assign the workbook exercise and review as a class when done (optional).

Notes

Lesson 34: Military Finishing and Filing the Return

Instructor Notes

Introduction

This lesson will help you address special filing concerns of United States service members. 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?

- ☐ Approved Intake and Interview Sheet
- ☐ Volunteer Resource Guide
- ☐ Publication 3
- ☐ Publication 17
- ☐ Publication 525
- ☐ Publication 4491-W
- ☐ Form 1040
- ☐ Form 4868
- ☐ Form 8822

Review objectives with the class.

Point out the resources cited under **What do I need?**

What type of identifying information should members of the Armed Forces enter on their tax returns?

Members of the Armed Forces should enter their names, social security numbers, and permanent home addresses on their return. However, taxpayers who are due a refund and do not want it mailed to their permanent home address should enter a current mailing address on the return. A military person living overseas should use an APO or FPO address.

Direct Deposit is a fast, simple, safe, and secure way to receive a refund and is ideal for taxpayers who do not want refunds to be mailed to their permanent home address. Taxpayers enter their bank routing and account numbers in the Refund section of the return. The taxpayer must still provide a permanent home address.

TIP

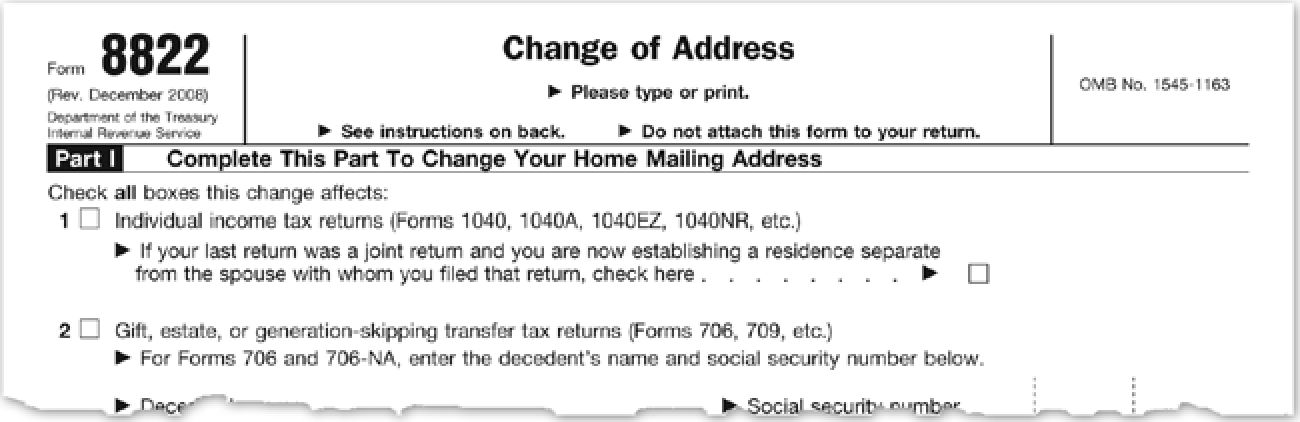
If the postal service does not deliver to the taxpayer's street address and the taxpayer has a post office box, enter the post office box number on the line for the present home address.

Review the tip with the class.

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.



Form **8822** (Rev. December 2008) Department of the Treasury Internal Revenue Service

Change of Address

▶ Please type or print.

▶ See instructions on back. ▶ Do not attach this form to your return.

OMB No. 1545-1163

Part I **Complete This Part To Change Your Home Mailing Address**

Check **all** boxes this change affects:

1 ☐ Individual income tax returns (Forms 1040, 1040A, 1040EZ, 1040NR, etc.)

▶ If your last return was a joint return and you are now establishing a residence separate from the spouse with whom you filed that return, check here . . . . ▶ ☐

2 ☐ Gift, estate, or generation-skipping transfer tax returns (Forms 706, 709, etc.)

▶ For Forms 706 and 706-NA, enter the decedent's name and social security number below.

▶ Dece ▶ Social security number

Assign the exercise.

Review answer with the class when complete.

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

He must submit the form to the service center for his previous address.

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 paper-filed federal returns to the service center for where they currently live.

If the military member is stationed overseas and has an APO or FPO address, file the paper tax return with the IRS Service Center in Austin, Texas, 73301-0215, USA.

TIP

Many military facilities have a Volunteer Income Tax Assistance center that will e-file tax returns.

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 **April 15** of the following year.

Taxpayers who have a balance due can pay by check, money order, electronic funds withdrawal, or credit card.

TIP

If April 15 falls on a weekend or holiday, then the due date is the next business day.

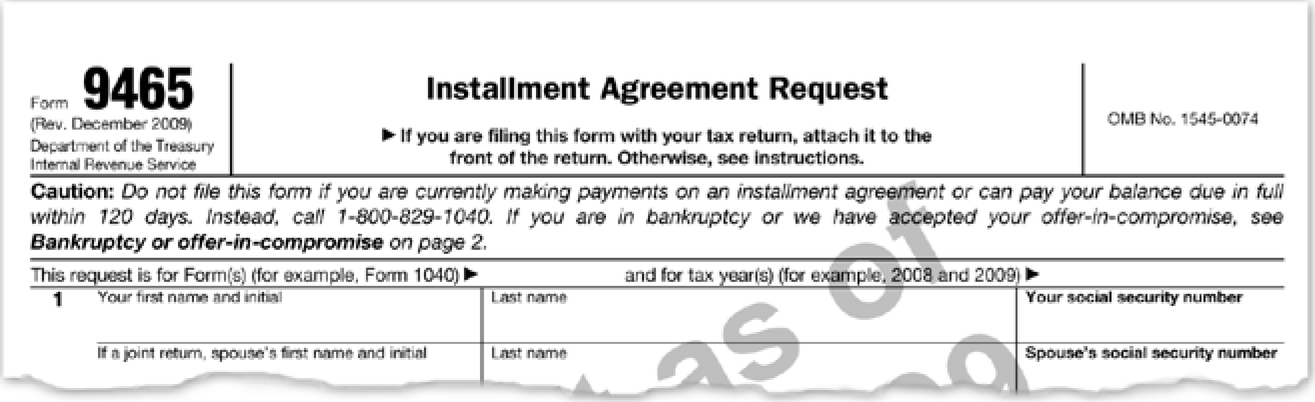
What can members of the Armed Forces do if they are unable to pay the tax due?

Display or direct students to Form 9465.

Taxpayers who cannot pay the tax due with their tax return should attach Form 9465, Installment Agreement Request.

The IRS will try to arrange an installment payment agreement that reflects the taxpayer's ability to pay the tax owed. However, taxpayers should pay as much as possible with their return to reduce the amount of interest and penalties that will be added to the unpaid balance.

Taxpayers can now complete an Online Payment Agreement (OPA) application via the Internet at www.irs.gov. This application will allow the taxpayer or an authorized representative (Power of Attorney) to self-qualify, apply for an installment/payment agreement, and receive immediate notification of approval.



Form **9465**
(Rev. December 2009)
Department of the Treasury
Internal Revenue Service

Installment Agreement Request

▶ **If you are filing this form with your tax return, attach it to the front of the return. Otherwise, see instructions.**

OMB No. 1545-0074

Caution: *Do not file this form if you are currently making payments on an installment agreement or can pay your balance due in full within 120 days. Instead, call 1-800-829-1040. If you are in bankruptcy or we have accepted your offer-in-compromise, see* ***Bankruptcy or offer-in-compromise*** *on page 2.*

This request is for Form(s) (for example, Form 1040) ▶ and for tax year(s) (for example, 2008 and 2009) ▶

1	Your first name and initial	Last name	**Your social security number**
	If a joint return, spouse's first name and initial	Last name	**Spouse's social security number**

EXERCISES (continued)

Question 2: Taxpayers who attach Form 9465, to their tax return will avoid interest charges on any tax balance they cannot pay by the due date. ☐ True ☑ **False**

The IRS-arranged payment plan will include interest payments.

Assign the exercise.

Review answer with the class when complete.

What are the extension requirements for taxpayers within the U. S.?

Display or direct students to Form 4868.

Deadline extensions are available to members of the Armed Forces who served in a combat zone. 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.

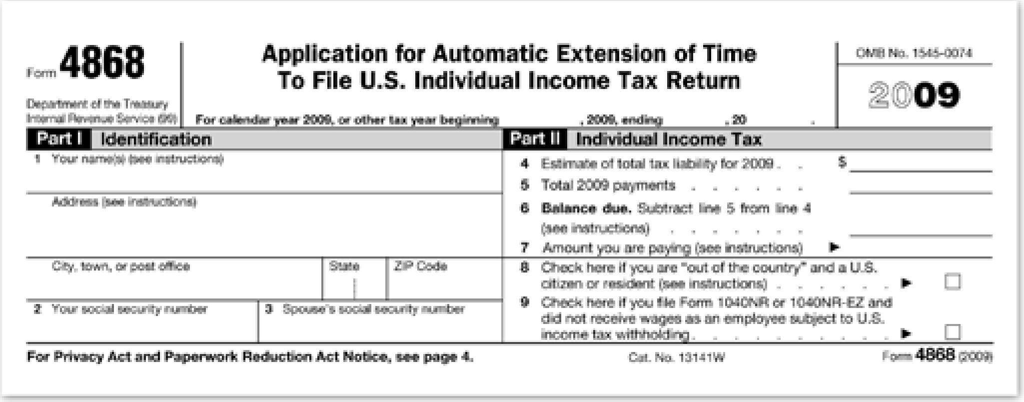
TIP

See Publication 3, Armed Forces Tax Guide, for extensions of deadlines and deferrals of taxes due that may apply to 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.



Form **4868**

Department of the Treasury
Internal Revenue Service (99)

Application for Automatic Extension of Time To File U.S. Individual Income Tax Return

OMB No. 1545-0074

2009

For calendar year 2009, or other tax year beginning , 2009, ending , 20 .

Part I Identification

1 Your name(s) (see instructions)

Address (see instructions)

City, town, or post office | State | ZIP Code

2 Your social security number

3 Spouse's social security number

Part II Individual Income Tax

4 Estimate of total tax liability for 2009 . . $

5 Total 2009 payments . . . .

6 **Balance due.** Subtract line 5 from line 4 (see instructions) . . . .

7 Amount you are paying (see instructions) ▶

8 Check here if you are "out of the country" and a U.S. citizen or resident (see instructions) . . . . ▶ ☐

9 Check here if you file Form 1040NR or 1040NR-EZ and did not receive wages as an employee subject to U.S. income tax withholding . . . . ▶ ☐

For Privacy Act and Paperwork Reduction Act Notice, see page 4. Cat. No. 13141W Form **4868** (2009)

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 their tax due when submitting Form 4868, they will owe interest on any tax not paid by the original due date. Interest will be charged from the due date to the date of payment.

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 request for an extension will be denied, and the IRS will inform the taxpayer that the request was denied.

TIP

For more details on penalties, refer to filing information in Publication 17.

Assign the exercise.

Review answer with the class when complete.

EXERCISES (continued)

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

Benton filed Form 4868 by the return's due date.

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?

When the tax return is actually filed, any payment that was submitted with Form 4868 should be added to the total on the total payments line of Form 1040A or Form 1040EZ.

To the left of the line, enter “Form 4868” and show the amount paid in order to receive credit for the payment.

Enter the amount on the Amount paid with request for extension to file line, if filing Form 1040.

What are the extension requirements for taxpayers outside the U.S. and Puerto Rico?

Extension requirements for taxpayers who live in the United States differ from those who live outside 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 and 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 15 due date to the date the tax is paid. In this instance, Form 4868 is not required.

TIP

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.

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 box on line 8.

Point out line 8 on Form 4868.

The due date will then be extended to **October 15.**

Assign the exercises.

Review answers with the class when complete.

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, 2009 through January 31, 2010.

D. None of the above

Weston and Sheila file jointly so only one must meet the requirement.

Lilly's main business location is in Texas and not Mexico.

Dwayne does not qualify for the automatic two-month extension because he was back in the U.S. on the due date.

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

D. June 16

Puerto Rico is not a foreign country.

What are the tax options for combat zone participants?

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.

Review these rules with students to ensure they understand their application.

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, 2007. She remained there through March 31, 2009, when she departed for the U.S. She was not injured and did not return to the combat zone. Her deadlines for filing 2007, 2008, and 2009 returns are:

- 2007 tax return deadline is January 10, 2010. 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, 2008).
- 2008 tax return deadline is January 10, 2010; the deadline is extended by 285 days (180 plus 105).
- 2009 tax return deadline is not extended because the 180-day extension period after March 31, 2009, ends on September 27, 2009 (which is before the start of the next filing period, January 1 – April 15, 2010).

Ask a volunteer to read the Captain Jones example.

Publication 3 will provide additional information for combat zone extension of deadlines.

TIP

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.

Point out the tip about obtaining Publication 3.

EXERCISES (continued)

Question 6: If a member of the Armed Forces served in a combat zone from December 30, 2007 through May 31, 2009 and was not injured, the deadline for filing a 2007 tax return would be extended by how many days?

For 2007, (180 days + 105)

Assign the exercise.

Review answer with the class when complete.

What are other tax options for combat zone participants?

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

When can taxes be deferred?

Reservists called to active duty or regular Armed Forces members not in a combat zone may still qualify to defer the payment of back taxes by:

- Serving their initial period of service (the period of active duty following recall to active duty from an inactive reserve or national guard unit or for regular military, the period following induction or first enlistment), or
- Showing that the ability to pay back taxes has been materially impaired because income has dropped as a result of going into military service

Review the rules for combat zone participants and reservists to ensure students understand their application.

What are rules for deferment?

Armed Forces members who have a current payment agreement or receive a notice requesting payment must make a written request for deferment to the IRS. The IRS will review each request and advise the taxpayer in writing of its decision.

Can other parties assist with a tax return?

Display or direct students to the third-party designee section of Form 1040.

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."

You Owe 76 Estimated tax penalty (see page 64) 76

Third Party Designee Do you want to allow another person to discuss this return with the IRS (see page 65)? ☐ **Yes.** Complete the following. ☒ **No**

Designee's name ▶ Phone no. ▶ Personal identification number (PIN) ▶ ☐☐☐☐☐

A power of attorney Form 2848 may also be used to grant authority to an individual to represent the taxpayer before the IRS and to receive tax information. A copy must be attached to the return.

Emphasize the importance of using caution when allowing a representative to sign for someone.

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 the 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 the combat zone. The statement must be signed by the spouse who is not serving in the 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 incurred while serving in a combat zone, or
- From wounds or injuries incurred in a terrorist or military action while working for the U.S. government

The combat zone tax forgiveness provision applies for the year of death and any prior year ending on or after the first day that the individual served in a combat zone. Any forgiven tax liability that has already been paid, will be refunded.

TIP

Only the decedent's part of the joint income tax liability is eligible for the refund or tax forgiveness.

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 2009 as a result of injuries he suffered during a terrorist attack in 2007. What years are Mr. Morris' income liabilities forgiven?

A. 2007 through 2008

B. 2007 through 2009

C. 2006 through 2009

Assign the exercise.

Review answer with the class when complete.

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:

- Form 1040EZ, Form 1040A, or Form 1040 for each year an income 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 2009. His 2008 tax return – due on April 15, 2009 – is not the final tax return. The final tax return would be the 2009 Form 1040, due April 15, 2010.

Ask a volunteer to read the Bob example.

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 (Tab 1), Main Information Sheet pages (first 2 pages).

For information on signing a joint return if one spouse has died or cannot sign the return, see Publication 17 Index, keyword: Signatures.

Summary

Review the lesson summary with the class.

This lesson will help you determine special filing concerns for members of the U.S. Armed Forces.

- Like all taxpayers, 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.
- Taxpayers who changed their mailing address should notify the IRS of the change on Form 8822, Change of Address.
- Taxpayers who cannot pay the tax due with their tax return should attach Form 9465, Installment Agreement Request.
- The extension rules vary depending on whether the taxpayer lives in the U.S. or outside the U.S.
- 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

Assign the workbook exercise and review as a class when done (optional).

To gain a better understanding of the tax law, complete the comprehensive problem, practice exercise(s), or supplements 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: *False. Taxpayers who cannot pay the tax due with their tax return should attach Form 9465, Installment Agreement Request. The IRS will try to arrange an installment payment agreement that reflects the taxpayer's ability to pay the tax owed. Maximum payments should be made to limit applicable interest and penalty charges on the unpaid tax.*

Answer 3: *B. To get the extension, taxpayers must file Form 4868 by the return's due date. They don't 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. 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*

Answer 6: *The deadline for filing the 2007 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 2007 is extended 285 days (180 plus 105) after leaving the combat zone, to March 12, 2010. The 105 additional days are the number of days in the 3-1/2 month filing period that were left when the taxpayer entered the combat zone on December 30th (January 1 - April 15, 2008).*

Answer 7: *C. 2006, 2007, 2008, 2009*

Notes

Lesson 35: Amended Returns

Instructor Notes

Introduction

This lesson will help you determine how to amend a 2009 return that was originally prepared at the same VITA/TCE site. To amend a federal income tax return, use the latest revision of Form 1040X.

These are several reasons taxpayers may need to amend a return, for example:

- Additional Forms W-2, Wage and Tax Statement, or Forms 1099-INT, Interest Income, are received after a taxpayer has filed a return at your VITA/TCE site.
- Taxpayers realize, after claiming a personal exemption, that they can be claimed as a dependent on another person's tax return.

If a taxpayer requests your help in filing an amended return, first review the original return to correspond with the scope of VITA/TCE regarding amendments. Examine the return carefully, looking for obvious errors. Then ask the taxpayer to identify and explain the errors. Try to determine if the original return is, in fact, in error.

Ask probing questions, using the interview techniques and tools discussed in the Screening and Interviewing lesson.

Tax Software Hint: You can prepare an amended return using tax software. However, an amended return cannot be filed electronically; it must be mailed to the IRS.

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, Amended U.S. Individual Income Tax Return
- Determine the time limits for filing Form 1040X
- Identify how to assemble and submit Form 1040X

What do I need?

☐ Approved Intake and Interview Sheet
☐ Volunteer Resource Guide
☐ Publication 17
☐ Publication 4491-W
☐ Form 1040X
☐ Form 1040X Instructions

Optional:

☐ Form 1040 Instructions
☐ Form 8379

Review objectives with the class.

Point out the resources cited under **What do I need?**

When is an amended return required?

Taxpayers should file amended returns to correct any errors or omissions on a return they have already filed. Use Form 1040X to prepare an amended return.

Point out that math errors are more frequent with paper returns than e-file returns.

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 the taxpayer receives a notice from the Internal Revenue Service, refer the taxpayer 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

Ask a volunteer to read the Bernard example.

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.

Review the tips.

TIP

If the federal return has to be amended, often the state return must also be amended.

TIP

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 other spouse who is not obligated for the debt can be considered an "injured spouse." The couple should have filed injured spouse Form 8379 with their original return. This form can be e-filed. 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?

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 that the change requested by the taxpayer is correct. Review the approved intake and interview 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.
- 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 the taxpayer has amended the return for another issue. You will need this information to properly amend the return. 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.

Let's look at the format of a Form 1040X, Amended U.S. Individual Income Tax Return.

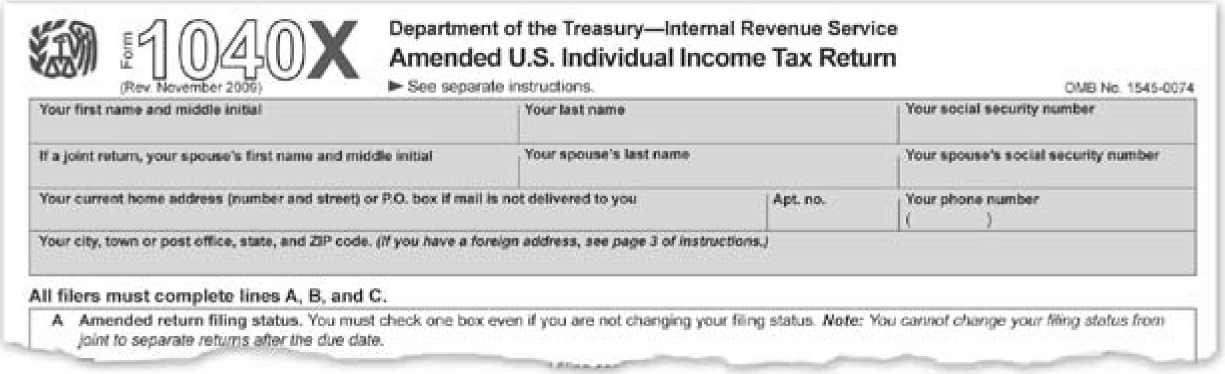
What is Form 1040X?

Form 1040X is not year specific. You must specify the year for which the amended return is being prepared. When preparing a paper Form 1040X, be sure you are using the latest version of the form. The revision date is in the upper left corner. When this training material was printed, the latest revision date of Form 1040X was November 2009.

This form has been completely redesigned. One major difference is that the three columns have been replaced with just one column. The amount entered is the "correct amount."

Display or direct students to the top portion of Form 1040X. Reiterate that this is a new form, updated within the past year.

Point out the column on Form 1040X.



Form 1040X

(Rev. November 2009)

Department of the Treasury—Internal Revenue Service

Amended U.S. Individual Income Tax Return

► See separate instructions.

OMB No. 1545-0074

Your first name and middle initial | Your last name | Your social security number

If a joint return, your spouse's first name and middle initial | Your spouse's last name | Your spouse's social security number

Your current home address (number and street) or P.O. box if mail is not delivered to you | Apt. no. | Your phone number ( )

Your city, town or post office, state, and ZIP code. *(If you have a foreign address, see page 3 of instructions.)*

All filers must complete lines A, B, and C.

A **Amended return filing status.** You must check one box even if you are not changing your filing status. ***Note:*** *You cannot change your filing status from joint to separate returns after the due date.*

Form 1040X, Line A, Amended Return Filing Status (on page 1), is used to change the filing status on the taxpayer's original return.

If the taxpayer is adding new forms or changing existing forms, those forms must be attached to Form 1040X.

TIP

The starting point in the column is the corrected amounts with the updates if another amended return was previously filed or if the IRS changed something on the original return.

Review the Form 1040X Instructions for all line items.

Optional activity: If a flipchart or white board is available, illustrate the one-column approach with possible numbers, showing how you come up with the figures.

Display or direct students to the sections of Form 1040X.

Line B asks the taxpayer to select the calendar years 2009, 2008, 2007, or 2006; to write in the calendar year (if it is before 2006); or to write in the fiscal year (month and year ended).

The taxpayers served by the VITA/TCE program are calendar-year taxpayers. That is, they report income received from January 1 through December 31. They claim allowable deductions paid from January 1 through December 31. If you are preparing a paper return, select the appropriate calendar year. If you are using tax software and the original return is on the computer, the program will enter the year automatically.

Form 1040X, Line C, Explanation of Changes, (on page 1) is 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 the 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."

Lines 23-31, Exemptions, are used only if the taxpayer is increasing or decreasing the:

- Number of exemptions claimed on line 6d of the return being amending, or
- Exemption amount of housing individuals displaced by Hurricane Katrina or a Midwestern Disaster Area.

What are the time frames related to amended returns?

What is the time limit on refunds?

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 from 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.

Ask a volunteer to read the Robert example.

example

Robert's 2006 tax return was due April 16, 2007. He filed it on March 20, 2007. He amends the 2006 return, expecting the correction to result in a refund. If he gets it postmarked on or before April 15, 2010, it will be within the three-year limit and the return will be accepted. But if the amended 2006 return is postmarked after April 15, 2010, 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." It is, however, very rare that a taxpayer qualifies for that status. You can read the definition of financial disability in Publication 17 in the Filing Information chapter.

There are a few exceptions to the three-year limit rule. For example, a taxpayer may be able to claim a loss on a debt or securities that became worthless in a prior year, an injured spouse claim may be filed for up to seven prior years, and certain military issues may go beyond the three-year limit. If you think the taxpayer may qualify for an exception to the three-year time limit rule, refer the taxpayer to a professional tax preparer.

Point out these exceptions in Publication 17 for awareness only.

What if taxpayers are due a refund on their amended return?

If the amended return indicates that the taxpayer is due a refund, be sure to advise the taxpayer that:

- The taxpayer must wait until the original return is processed (up to 8 weeks after filing the original return).
- 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 of the original return or the date the original return was filed, whichever is later, to the date the amended return is filed. (This interest will be taxable on the tax return for the year in which it is received.)
- Generally, it takes 8-12 weeks to process an amended tax return.

CAUTION

Guidance issued on Form 1040X dated July 2009 stated that the current processing time for amended returns is 12-16 weeks. Since this may change, check with your instructor or Site Coordinator for the latest information.

What if the taxpayer owes money on the amended return?

If the amended return indicates that the taxpayer owes money, file Form 1040X and instruct the taxpayer to pay any tax due by the April due date to avoid any interest and penalties.

Even if the taxpayer is filing Form 1040X and cannot pay the balance in full by the April due date, be sure to have them file the return anyway. The IRS will calculate interest on the balance due and send the taxpayer a bill. Interest is calculated based on the amount of tax owed. Interest rates can change every 3 months. The interest is calculated for each day the balance due is not paid in full. Encourage the taxpayer to pay as much as possible to reduce interest and penalties. Refer to Form 1040X Instructions for more information on payment options.

TIP

Show the taxpayer the Form 1040X Instructions for how to include all the correct information on the check or money order.

Assign the exercises.

Review answers with the class when completed.

EXERCISES

Answers are after the lesson summary.

Question 1: John e-filed his 2007 Form 1040 on March 29, 2008. The next year, while preparing his 2008 return, John discovered an error in his 2007 return which resulted in a higher refund. John mailed an amended 2007 return on April 19, 2009. Is this too late to qualify for the refund?

☐ Yes ☑ **No**

He mailed within the three-year period allowed for refunds.

Question 2: On May 6, 2011, Brenda discovers an error on her timely filed 2007 tax return. Correction of this error would result in a refund. She mails an amended return on May 6, 2011. Is this too late for Brenda to claim a refund?

☑ **Yes** ☐ No

Must be postmarked three years from the due date of the return.

How do I complete the amended return using tax software?

The scope of preparing amended returns in the VITA/TCE program is limited. Generally you will prepare amended returns in situations where the original return was prepared at that same volunteer site, using tax software.

Direct students to the Volunteer Resource Guide.

Tax Software Hint: For software entries, go to Amended Returns in the Volunteer Resource Guide (Tab 14) to review the step-by-step procedures for preparing Form 1040X.

Remember to follow the interview process and use the research tools to prepare an accurate return.

Review the tip with the class.

TIP

The Refund or Amount You Owe section on Form 1040X must be filled out carefully. Look at line 17, “Overpayment, if any, shown on original return.” The original refund is entered here. However, if the IRS adjusted the refund, enter that amount instead of the original amount.

How do I assemble and submit Form 1040X?

What should be attached?

Remember, Form 1040X can be prepared using tax software but cannot be e-filed. Once the amended return is complete, follow these steps to assemble the return for mailing and for the taxpayer’s records:

1. From the tax software, print two copies of the federal amended return and, if there is a state return, two copies of that form: one for the taxpayer’s records and one to mail in.
2. Have the taxpayer (and spouse if Married Filing Jointly) sign and date the bottom of the second page of Form 1040X. Check the state return for where to sign and where to mail the state return.
3. Attach all additional or corrected Form(s) W-2 or Form(s) 1099 that the taxpayer received after filing their original return. Be sure you have included any additional Federal income tax withheld.
4. Attach any additional forms or schedules needed to explain the changes. Document the explanations for amending the return in Section C of Form 1040X.

Explain that normal processing time for an amended return is generally 8-12 weeks. Also tell the taxpayers that, if they owe money and they 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. If taxpayers indicate they are unable to pay the total amount due, encourage them to pay as much as possible. Refer to the Form 1040X Instructions for more information on payment options.

Tax Software Hint: Refer to the white tabs in the Volunteer Resource Guide for software entries and more information on amended returns.

Summary

Review the lesson summary with the class.

You can help taxpayers file an amended tax return for the *current year* using tax software. In the VITA/TCE program, you can assist taxpayers if they filed the original return at the same volunteer site. Amended returns should be filed if any of the following were reported incorrectly:

- Filing status
- Total income
- Deductions or credits

Remember to use the interview process and research tools to prepare an accurate amended return.

An amended return must be mailed; it cannot be filed electronically.

A refund check on an amended return cannot be direct deposited; a paper check is mailed to the taxpayer.

If you are amending the federal return, you usually have to amend the state return.

Assign the workbook exercise and review as a class when done (optional).

TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem, practice exercise(s), or supplements 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 answer is no – it is not too late. John mailed the amended return before April 15, 2011. That is within the three year period allowed for refunds.*

Answer 2: *The answer is yes – it is too late. The postmark must be three years from the due date of the return (extended to the next business day). 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.*

Notes

Appendix A: Vanessa Franklin Taxpayer Scenario

In this appendix, you will practice tax return preparation by assisting our taxpayer, Vanessa Franklin. You will review Vanessa's documents, interview her to clarify issues, and then complete her tax return, using the processes taught in each of the following lessons. You can review Vanessa's completed tax return in Appendix B.

Let's get started! Vanessa comes to your site and requests assistance with her return. She has many of the documents listed at the top of page 1 of the intake and interview sheet and she has completed the first two pages.

Using the job aid in the Volunteer Resource Guide, your tax law knowledge, and your screening and interview skills, you're ready to assist Mrs. Franklin.

Instructor Notes

Lesson 3: Filing Basics

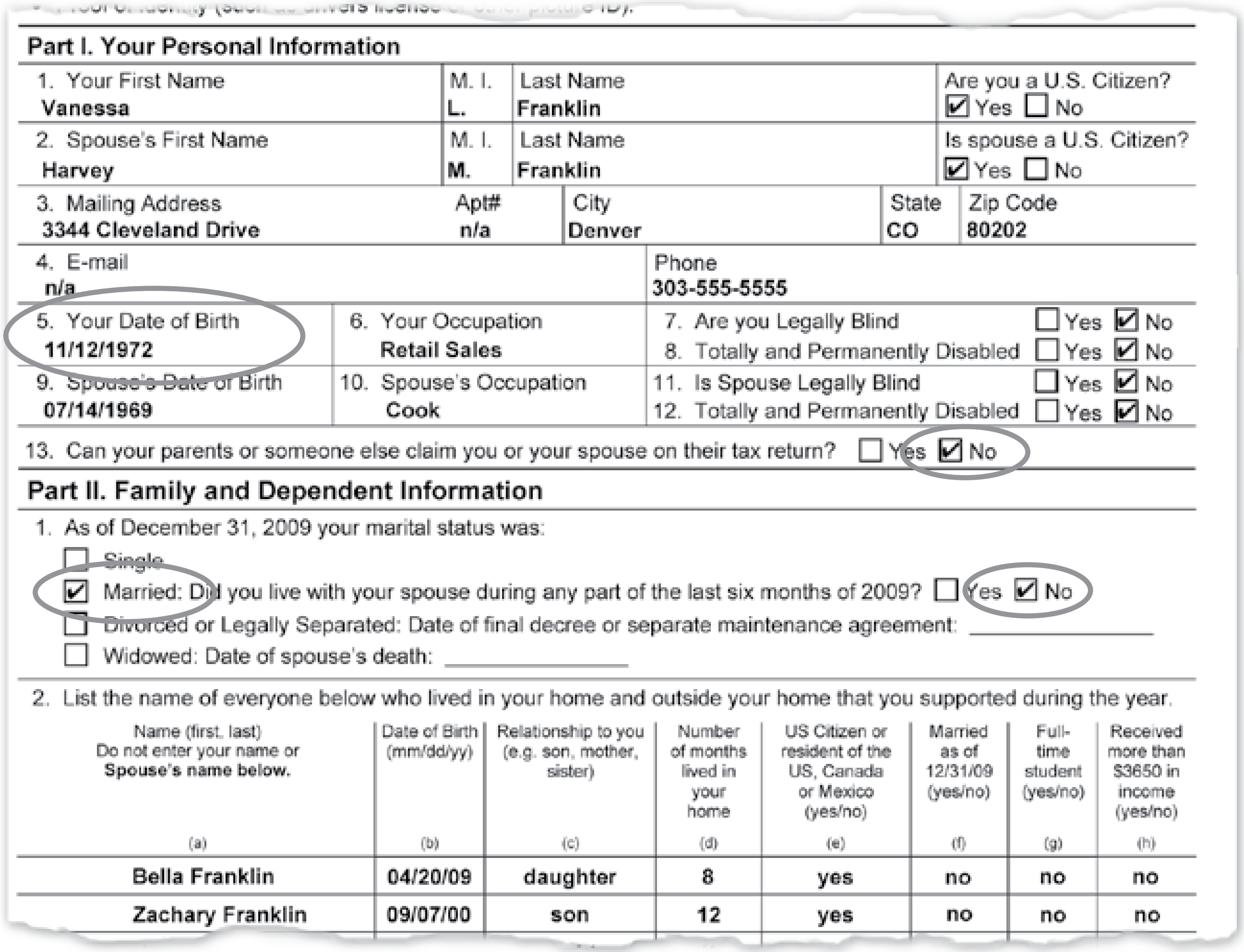
Must Vanessa file a return?

To determine if a taxpayer has a filing requirement, you need their age, possible filing status(es), and gross income.

Ask students Vanessa's age and marital status. She is 37 and legally married.

__Vanessa's Age and Marital Status__

Start by reviewing Parts I and II of her approved intake and interview sheet.



Part I. Your Personal Information

1. Your First Name **Vanessa**	M. I. **L.**	Last Name **Franklin**	Are you a U.S. Citizen? ☑ Yes ☐ No
2. Spouse's First Name **Harvey**	M. I. **M.**	Last Name **Franklin**	Is spouse a U.S. Citizen? ☑ Yes ☐ No

3. Mailing Address **3344 Cleveland Drive**	Apt# **n/a**	City **Denver**	State **CO**	Zip Code **80202**

4. E-mail **n/a**   Phone **303-555-5555**

5. Your Date of Birth **11/12/1972**	6. Your Occupation **Retail Sales**	7. Are you Legally Blind ☐ Yes ☑ No 8. Totally and Permanently Disabled ☐ Yes ☑ No
9. Spouse's Date of Birth **07/14/1969**	10. Spouse's Occupation **Cook**	11. Is Spouse Legally Blind ☐ Yes ☑ No 12. Totally and Permanently Disabled ☐ Yes ☑ No

13. Can your parents or someone else claim you or your spouse on their tax return? ☐ Yes ☑ No

Part II. Family and Dependent Information

1. As of December 31, 2009 your marital status was:

☐ Single

☑ Married: Did you live with your spouse during any part of the last six months of 2009? ☐ Yes ☑ No

☐ Divorced or Legally Separated: Date of final decree or separate maintenance agreement: ____________

☐ Widowed: Date of spouse's death: ____________

2. List the name of everyone below who lived in your home and outside your home that you supported during the year.

Name (first, last) Do not enter your name or **Spouse's name below.** (a)	Date of Birth (mm/dd/yy) (b)	Relationship to you (e.g. son, mother, sister) (c)	Number of months lived in your home (d)	US Citizen or resident of the US, Canada or Mexico (yes/no) (e)	Married as of 12/31/09 (yes/no) (f)	Full-time student (yes/no) (g)	Received more than $3650 in income (yes/no) (h)
Bella Franklin	**04/20/09**	**daughter**	**8**	**yes**	**no**	**no**	**no**
Zachary Franklin	**09/07/00**	**son**	**12**	**yes**	**no**	**no**	**no**

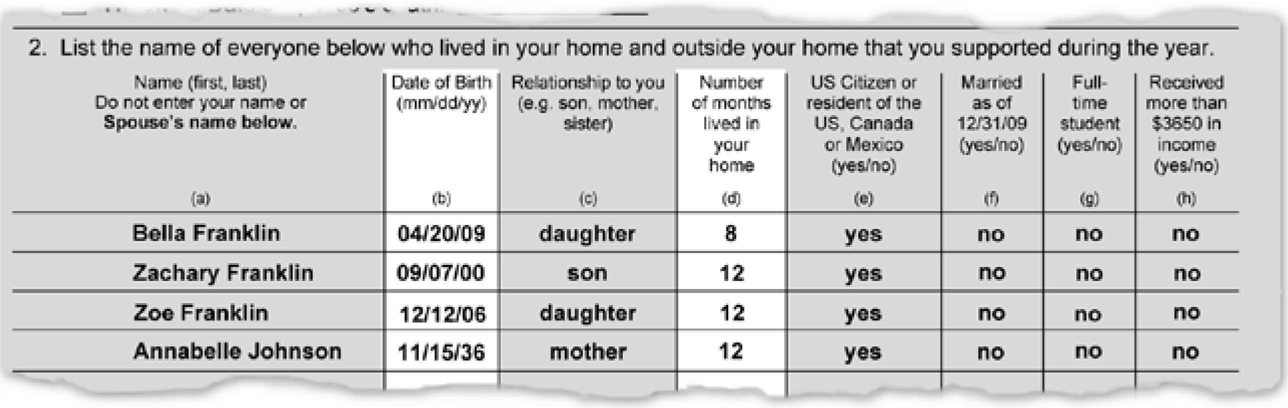
Vanessa's possible filing statuses

Explain why the last six months is relevant.

On her approved intake and interview sheet, Vanessa indicated that she is married, but has not lived with her spouse during any part of the last six months.

Vanessa's Family and Dependent Information

To determine Vanessa's possible filing statuses, you need to also look at her family and dependent information. She has indicated four potential dependents in Part II of her approved intake and interview sheet.



2. List the name of everyone below who lived in your home and outside your home that you supported during the year.

Name (first, last) Do not enter your name or **Spouse's name below.** (a)	Date of Birth (mm/dd/yy) (b)	Relationship to you (e.g. son, mother, sister) (c)	Number of months lived in your home (d)	US Citizen or resident of the US, Canada or Mexico (yes/no) (e)	Married as of 12/31/09 (yes/no) (f)	Full-time student (yes/no) (g)	Received more than $3650 in income (yes/no) (h)
Bella Franklin	04/20/09	daughter	8	yes	no	no	no
Zachary Franklin	09/07/00	son	12	yes	no	no	no
Zoe Franklin	12/12/06	daughter	12	yes	no	no	no
Annabelle Johnson	11/15/36	mother	12	yes	no	no	no

Ask two volunteers to role-play the sample interview.

You decide to ask some questions to confirm and clarify her information.

Sample interview clarifying dependents

SAMPLE INTERVIEW

VOLUNTEER SAYS...	VANESSA RESPONDS...
I've reviewed your intake sheet and, to start off with, I want to make sure that you need to file a return based on your filing status, age, and income. So let me verify a few things. You were born on November 12, 1972, correct?	Yes.
Okay, that makes you 37. I see that you checked "Married" but answered "No" to living with your spouse during the past six months.	Yes, Harvey moved out in February 2009.
But you were still married on December 31st of last year, correct?	Yes, that's right.
Do you and your husband plan to file jointly?	I think I want to file Married Filing Separately, but I'm not sure.
And you have three children you may be claiming as dependents, and possibly your mother as a fourth dependent?	Yes, that's right.
Based on this initial information, there are three filing statuses you may qualify for: Married Filing Separately, Head of Household, or Married Filing Jointly, although you expressed that you don't want to use the Married Filing Jointly status.	I'd rather not if I don't have to.

What are Vanessa's most likely filing statuses?

Vanessa may qualify for Married Filing Separately, Head of Household, or Married Filing Jointly.

Point out to students that Vanessa does *not* want to file jointly with her spouse.

Vanessa's Gross Income

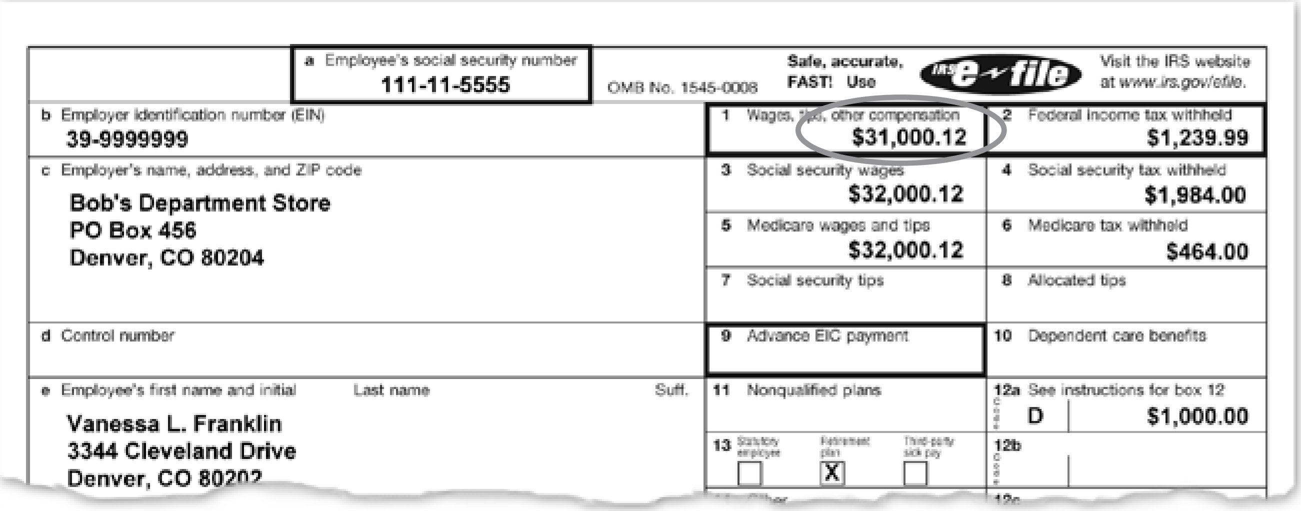
The next step is to make sure her gross income for the tax year is more than the gross income limit. Review the Volunteer Resource Guide (Tab A), Who Must File?

Remember, at this point, we're determining if Vanessa has a filing requirement so we will do a general review of her income documentation.

Vanessa's Form W-2

Briefly review Vanessa's Form W-2 and Part IV of her approved intake and interview sheet to determine her income for the tax year. Vanessa's W-2 indicates she has wages of $31,000.

Point out Vanessa's wages on her Form W-2.



a Employee's social security number 111-11-5555

OMB No. 1545-0008

Safe, accurate, FAST! Use IRS e-file

Visit the IRS website at www.irs.gov/efile.

b Employer identification number (EIN) 39-9999999

c Employer's name, address, and ZIP code

Bob's Department Store
PO Box 456
Denver, CO 80204

d Control number

e Employee's first name and initial Last name Suff.

Vanessa L. Franklin
3344 Cleveland Drive
Denver, CO 80202

1 Wages, tips, other compensation $31,000.12

2 Federal income tax withheld $1,239.99

3 Social security wages $32,000.12

4 Social security tax withheld $1,984.00

5 Medicare wages and tips $32,000.12

6 Medicare tax withheld $464.00

7 Social security tips

8 Allocated tips

9 Advance EIC payment

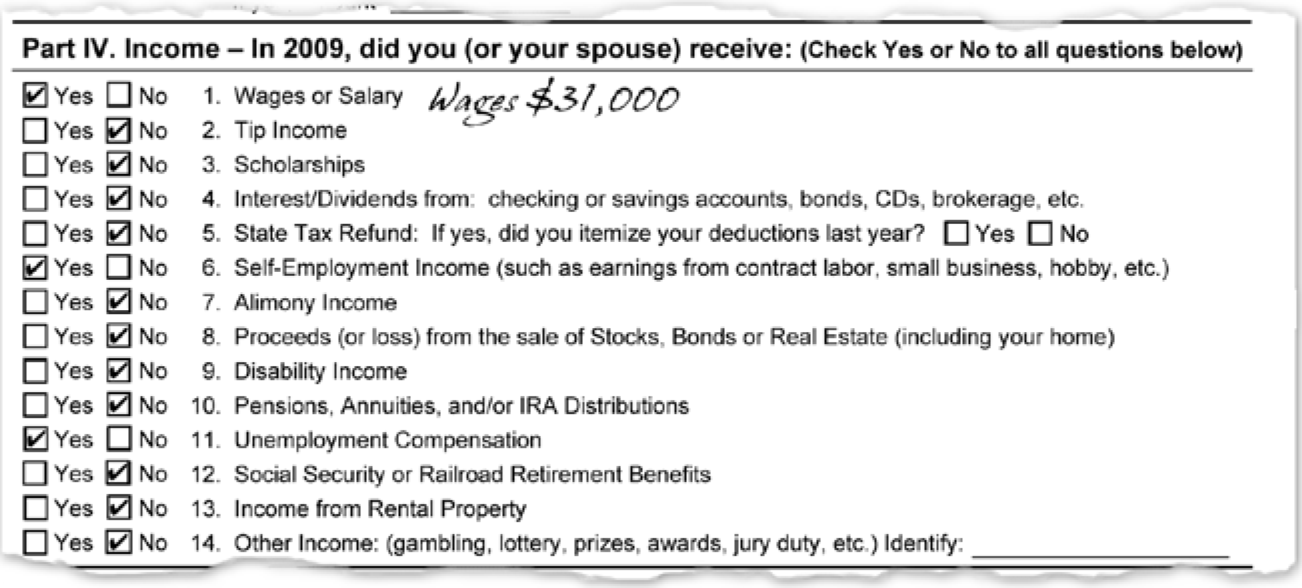
10 Dependent care benefits

11 Nonqualified plans

12a See instructions for box 12 D $1,000.00

13 Statutory employee ☐ Retirement plan ☒ Third-party sick pay ☐

12b



Part IV. Income – In 2009, did you (or your spouse) receive: (Check Yes or No to all questions below)

☑ Yes ☐ No 1. Wages or Salary Wages $31,000
☐ Yes ☑ No 2. Tip Income
☐ Yes ☑ No 3. Scholarships
☐ Yes ☑ No 4. Interest/Dividends from: checking or savings accounts, bonds, CDs, brokerage, etc.
☐ Yes ☑ No 5. State Tax Refund: If yes, did you itemize your deductions last year? ☐ Yes ☐ No
☑ Yes ☐ No 6. Self-Employment Income (such as earnings from contract labor, small business, hobby, etc.)
☐ Yes ☑ No 7. Alimony Income
☐ Yes ☑ No 8. Proceeds (or loss) from the sale of Stocks, Bonds or Real Estate (including your home)
☐ Yes ☑ No 9. Disability Income
☐ Yes ☑ No 10. Pensions, Annuities, and/or IRA Distributions
☑ Yes ☐ No 11. Unemployment Compensation
☐ Yes ☑ No 12. Social Security or Railroad Retirement Benefits
☐ Yes ☑ No 13. Income from Rental Property
☐ Yes ☑ No 14. Other Income: (gambling, lottery, prizes, awards, jury duty, etc.) Identify: ____________________

Direct students to the Volunteer Resource Guide (Tab D), Income.

Ask two volunteers to role-play the sample interview.

On her approved intake and interview sheet, Vanessa also indicated that she had self-employment income. You next confirm and clarify this and any other income sources. Refer to the Income section of the Volunteer Resource Guide (Tab D) for other income sources you should consider.

Sample interview probing for other income

SAMPLE INTERVIEW

VOLUNTEER SAYS...	VANESSA RESPONDS...
Your Form W-2 shows $31,000 as your wages for the tax year. Tell me about your self-employment income.	I sell cosmetics on the side. I schedule makeup workshops in people's homes in the evenings and on weekends.
How much did you earn doing that?	Not much at all, after I paid my expenses, it was about $2,400.
Okay. That is close enough for what we are doing now, but we will need the exact amount later. You indicate that you received unemployment compensation.	Actually, my husband was the one on unemployment for a couple of months.
Since you're not going to file a joint return, we won't put any of his income or expenses on your return. Okay, any other sources of income, for example, bonuses at your job, or any interest reported on a Form 1099?	No, just the wages and business income.
Okay, so your gross income is about $33,400 based on your W-2 and income from your business.	

Make notes on Vanessa's approved intake and interview sheet to capture what she has told you; for example, indicate that the "Yes" on the question about unemployment compensation actually refers to her estranged husband.

Direct students to the table in the Volunteer Resource Guide (Tab A).

Point out that Vanessa's $33,400 exceeds the gross income amounts for the filing statuses she may use.

Chart A – For Most People Who File

Consult Chart A – 2009 Filing Requirement Chart For Most People Who File in the Volunteer Resource Guide (Tab A). Find Vanessa's likely filing status(es), age, and income on the chart.

We have now determined Vanessa's age, her possible filing statuses, and have reviewed her preliminary income information. Because she is under 65 years old and her gross income on her Form W-2 exceeds the income limits listed for each of her possible filing statuses, we know that Vanessa has a filing requirement.

Since Vanessa is required to file a return, the tax software's Main Information Sheet or the "Label" section of the return must be completed with name, address, and social security number. If Vanessa is filing by herself, only her information will be included.

Tax Software Hint: Since it is necessary to use the primary taxpayer's social security number to start a new return in the tax software, you should not begin this process until you finish the initial interview.

Verify Vanessa's Identity

Before completing the tax software Main Information Sheet or the Label section of Vanessa's tax return, make sure you verify her identity. Vanessa presents you with her driver's license and the social security cards for all the individuals listed on her intake sheet.

SOCIAL SECURITY
111-11-5555
THIS NUMBER HAS BEEN ESTABLISHED FOR
Vanessa Lesley Franklin
Vanessa Lesley Franklin
SIGNATURE

SOCIAL SECURITY
111-11-9999
THIS NUMBER HAS BEEN ESTABLISHED FOR
Zachary Franklin
Zachary Franklin
SIGNATURE

SOCIAL SECURITY
111-11-7777
THIS NUMBER HAS BEEN ESTABLISHED FOR
Zoe Franklin
Zoe Franklin
SIGNATURE

SOCIAL SECURITY
111-11-0000
THIS NUMBER HAS BEEN ESTABLISHED FOR
Bella Franklin
Bella Franklin
SIGNATURE

SOCIAL SECURITY
111-11-6666
THIS NUMBER HAS BEEN ESTABLISHED FOR
Annabelle Johnson
Annabelle Johnson
SIGNATURE

Using the Tax Software in Training

Refer to Publication 4491-W, Introduction: Use of Software in Training, for social security format requirements and other requirements for using the Practice Lab during the training.

Ask two volunteers to role-play the sample interview.

Explain why Vanessa's entries **must** match the information on the cards.

Sample interview to verify identity

SAMPLE INTERVIEW

VOLUNTEER SAYS...	VANESSA RESPONDS...
By the way, thanks for taking the time to complete our intake sheet. It looks like we can assist you with your return. I need proof of your identity and your social security card, as well as social security cards for your children and your mother.	No problem! Here's my driver's license. I wrote everyone's name on the intake sheet, just as they appear on the cards.
Thanks, I'll just confirm your entries. First, is all the information on your driver's license current and correct? We want to make sure you receive all your tax benefits and that your return is processed smoothly.	Yeah, I haven't moved since getting that license.
Okay then, let's continue reviewing the intake sheet.	Sounds good.

You have now completed these filing basics:

- Determining if there is a filing requirement
- Verifying the identity of the taxpayer and confirming her social security number

Return to lesson 3.

TIP

The name(s) and number(s) on the taxpayer's return must match the information on the social security card(s). If they do not, the return processing will be delayed.

Restate the importance of confirming the taxpayer's identity and verifying that the SSN names and numbers match.

Lesson 4: Filing Status

Which filing status should Vanessa use?

Taxpayer Vanessa Franklin comes to your site and requests assistance with her return. Parts I and II of her approved intake and interview sheet indicate that she is married but lives apart from her husband. She has four potential dependents, her three children and her mother. Based on this information, her possible filing statuses are:

Ask students to explain why she qualifies for the three filing statuses.

- Married Filing Jointly
- Married Filing Separately
- Head of Household

Vanessa does not want to use the Married Filing Jointly status, but if she chooses to file Married Filing Separately, it may result in a higher tax.

Direct students to the Interview Tips for Filing Status (Tab B).

Ask two volunteers to role-play the sample interview.

To determine if Vanessa qualifies for Head of Household, which may result in a lower tax than Married Filing Separately, you decide to ask some questions based on the Filing Status Interview Tips in the Volunteer Resource Guide (Tab B).

Sample interview clarifying filing status

SAMPLE INTERVIEW

VOLUNTEER SAYS...	VANESSA RESPONDS...
I'm going to ask you a few questions that will help us determine the best filing status for you. First of all, you were married at the end of the tax year, but did not live with your spouse during the last 6 months. Is this correct?	That's right. We're still married, but we are separated.
Have you obtained a legal separation?	No, I haven't been to a lawyer yet.
And you don't plan to file a joint return with him.	Right. I was thinking of filing separately.
There are other options. For now, let's just assume that you won't file Married Filing Jointly, and I'll ask you a few more questions. I see that you have three children. I see that they lived in your home for the entire tax year, is that correct?	Yes, they lived with me.
Did you pay more than half the cost of keeping up your home last year?	Well, I paid for everything if that's what you mean. Once in a while, Harvey sent some money, but it wasn't enough to help much.
Okay… Now, I need to clarify the number of months you and your husband actually lived apart. Your intake sheet indicates that he has not lived with you during the last six months of the year, is this correct?	Yes, he moved out in February and we've been apart ever since.
Your children may qualify you for the Head of Household status. In order to qualify, they must be your dependents. It looks like they are, but we will be getting to that in a minute. If you qualify for the Head of Household status, it may result in a lower tax for you than Married Filing Separately.	That sounds good to me!

Vanessa's filing status is Head of Household

Ask what facts qualify Vanessa to file Head of Household? (See Interview Tips.)

Vanessa qualifies as Head of Household because she is legally married, but lived apart from her husband during the last six months of the tax year. She is "considered unmarried for head of household purposes" and at least one of her children must be her dependent to use this filing status.

Tax Software Hint: Now that you have determined Vanessa's filing status, you can "Start a New Return" in the tax software. Refer to the Volunteer Resource Guide, Tab 1, for detailed instructions about this process.

Complete all the required information up to the Dependents/Nondependents section. Confirm each entry with Vanessa and make any corrections on Vanessa's approved intake and interview sheet.

In the Filing Status section, check the box for Head of Household. Leave the remaining blocks in this area blank until you have discussed the status of her children.

Return to Lesson 4.

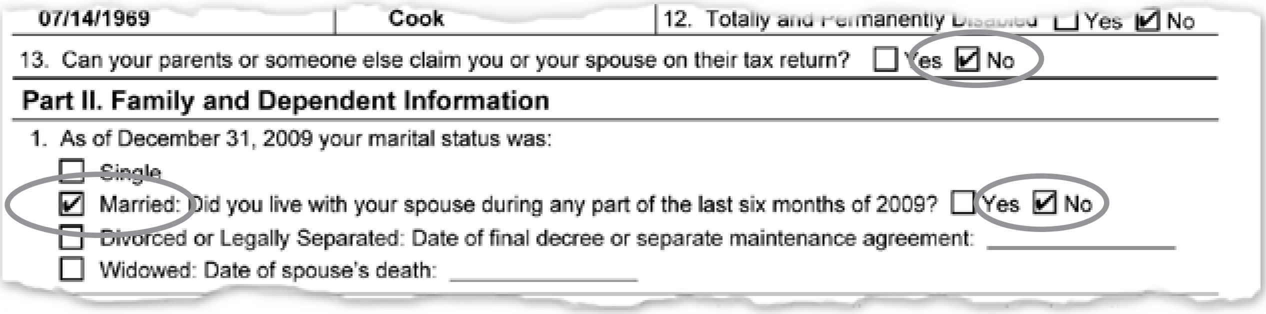
Lesson 5: Personal Exemptions

What personal exemptions can Vanessa claim?

Let's determine if Vanessa can claim any personal exemptions. Remember, she is married but lives apart from her husband. Personal exemptions are allowed for the taxpayer and for their spouse if they meet certain requirements.

Ask if either Vanessa or her husband can be claimed as a dependent.

First review Part I, Your Personal Information, on her approved intake and interview sheet to see if Vanessa or her husband can be claimed as a dependent on someone else's tax return.



07/14/1969 | Cook | 12. Totally and Permanently Disabled ☐ Yes ☑ No

13. Can your parents or someone else claim you or your spouse on their tax return? ☐ Yes ☑ No

Part II. Family and Dependent Information

1. As of December 31, 2009 your marital status was:

☐ Single

☑ Married: Did you live with your spouse during any part of the last six months of 2009? ☐ Yes ☑ No

☐ Divorced or Legally Separated: Date of final decree or separate maintenance agreement: __________

☐ Widowed: Date of spouse's death: __________

Direct students to the Interview Tips for Personal Exemptions.

Ask two volunteers to role-play the sample interview.

Next, ask questions to determine if Vanessa can claim an exemption for her spouse. To do this, use the Interview Tips for Personal Exemptions in the Volunteer Resource Guide (Tab C).

Sample interview clarifying personal exemptions

SAMPLE INTERVIEW

VOLUNTEER SAYS...	VANESSA RESPONDS...
Let's see if you can claim an exemption for your spouse. I'm going to ask you a few more questions. First of all, we already know that you were married during part of the tax year. So, does that include December 31st?	Yes, that's right. Even though we don't live together anymore, we're still married.
You have already indicated that you do not plan to file with your husband.	Right.
Did he have income of his own last year?	Yes, he was employed as a cook for most of the tax year, and collected some unemployment compensation.
Well, there's our answer. Because you're not filing a joint return, and because he had income, you cannot claim an exemption for your husband.	

Because Vanessa cannot claim her husband as an exemption, you will leave him off her return, leaving the box on Form 1040, **line 6b** unchecked.

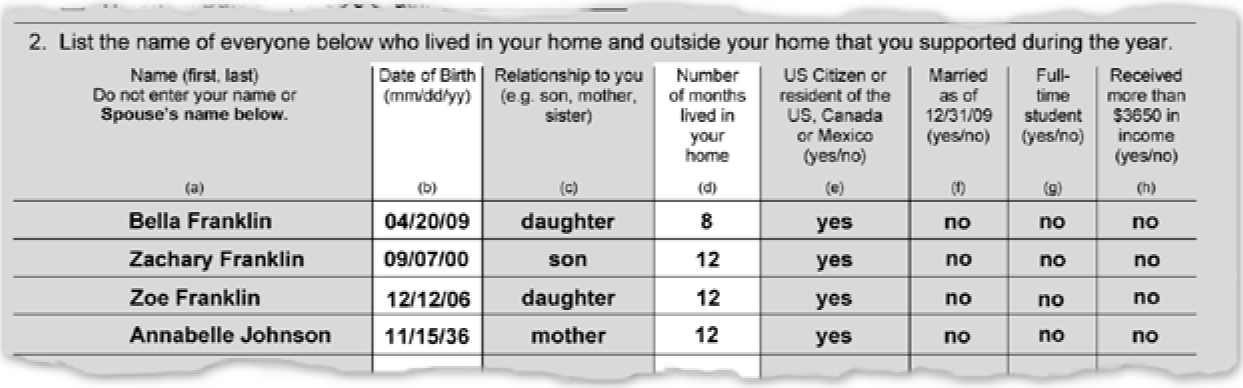
Tax Software Hint: Based on the filing status, Head of Household, the software automatically enters "1" for "Number of boxes checked on 6a and 6b."

Return to Lesson 5.

Lesson 6: Dependency Exemptions

Which dependency exemptions can Vanessa claim?

Let's determine which dependency exemptions Vanessa can claim. Dependents can be the taxpayer's children or relatives. Begin by reviewing Part II, Family and Dependent Information, item 2, on Vanessa's approved intake and interview sheet. She listed four potential dependents.



2. List the name of everyone below who lived in your home and outside your home that you supported during the year.

Name (first, last) Do not enter your name or Spouse's name below. (a)	Date of Birth (mm/dd/yy) (b)	Relationship to you (e.g. son, mother, sister) (c)	Number of months lived in your home (d)	US Citizen or resident of the US, Canada or Mexico (yes/no) (e)	Married as of 12/31/09 (yes/no) (f)	Full-time student (yes/no) (g)	Received more than $3650 in income (yes/no) (h)
Bella Franklin	04/20/09	daughter	8	yes	no	no	no
Zachary Franklin	09/07/00	son	12	yes	no	no	no
Zoe Franklin	12/12/06	daughter	12	yes	no	no	no
Annabelle Johnson	11/15/36	mother	12	yes	no	no	no

You see that her children are under 10 years of age and her mother is 73 years old. All four lived with Vanessa for 12 months during the tax year and are U.S. citizens. (A baby born any time during the year is considered to have lived with the taxpayer for the entire tax year.)

Are Vanessa's children her dependents?

To determine if her children Bella, Zoe, and Zachary qualify as dependents on Vanessa's tax return, use the Interview Tips for Dependency Exemption for Qualifying Child in the Volunteer Resource Guide (Tab C).

Based on Vanessa's answers to the interview tips, you conclude that all three children qualify as her dependents. However, because she and her husband are separated, you need to gather more information.

TIP

When using the interview tips, you may find it helpful to substitute the child's name for the word "person." Ask interview questions individually for each child; as you gain experience with these questions, you will learn to obtain this information for each child at the same time.

Direct students to the Interview Tips for Dependency Exemption for Qualifying Child (Tab C).

Review steps in the interview tips that may apply to Vanessa's children.

Sample interview clarifying dependency exemptions

The special rules of divorced, separated, or never married parents may apply in this situation. They are listed in Publication 17, in the Personal Exemptions and Dependents chapter.

SAMPLE INTERVIEW

VOLUNTEER SAYS...	VANESSA RESPONDS...
It looks like you should be able to claim your children as dependents. Is there a court document or an agreement that you have signed to allow their father to claim them?	You've got to be kidding. He better not try to claim them.

Direct students to the Interview Tips for Children of Divorced or Separated Parents. (Tab C).

To help determine if Vanessa's husband (the noncustodial parent) can claim the children as dependents on his tax return, use the Interview Tips for Children of Divorced, Separated or Never Married Parents in the Volunteer Resource Guide (Tab C).

After completing the interview using the interview tips in the Volunteer Resource Guide, you determine that Vanessa can claim the dependency exemption for all three children on her tax return.

Is Vanessa's mother her dependent?

Direct students to the Interview Tips for Dependency Exemption for Qualifying Relative in the Volunteer Resource Guide (Tab C).

Review steps 1, 3, 4, and 5 as applied to Vanessa's mother.

Now, determine if Vanessa's mother is her qualifying relative for a dependency exemption by using the Interview Tips for Dependency Exemption for Qualifying Relative in the Volunteer Resource Guide (Tab C). This time, substitute Annabelle's name for "the person."

Using the interview tips, you learn that, although Vanessa's mother receives nontaxable social security, her taxable income (from a small pension) is less than the exemption amount ($3,650 for 2009). Therefore, Vanessa's mother meets the gross income test (step 5).

To answer step 6 in the interview tips, you need to help Vanessa make a list of each valid expense she paid for her mother during the tax year, and compare the total amount with her mother's total income for the year. The Personal Exemptions and Dependents chapter of Publication 17 provides a worksheet for determining support.

Ask two volunteers to role-play the sample interview.

Sample interview clarifying dependency exemptions for "qualifying relative"

SAMPLE INTERVIEW

VOLUNTEER SAYS...	VANESSA RESPONDS...
Let's see if we can add up the monthly expenses that count as support for your mother and figure out if you covered more than half of them, okay?	Yes, I've got a list of the expenses here.
All right, for each item we'll write down the amount you contributed in one column, and the amount your mother contributed in the other column. Let's start with the fair share rental value of her living in your home…	Okay, my pencil's ready.

Ask students if Vanessa covered more than half her mother's expenses.

During the interview, you and Vanessa come up with the numbers listed below.

Annabelle's Monthly Expenses	Provided by Vanessa	Provided by Annabelle
Share of food	$420	$0
Clothing	$0	$200
Share of rent, utilities	$680	$0
Medical, dental	$0	$1,200
Education expenses	$0	$0
Recreation and transportation	$800	$700
Furniture, appliances, automobile	$0	$0
Share of support	**$1,900**	**$2,100**

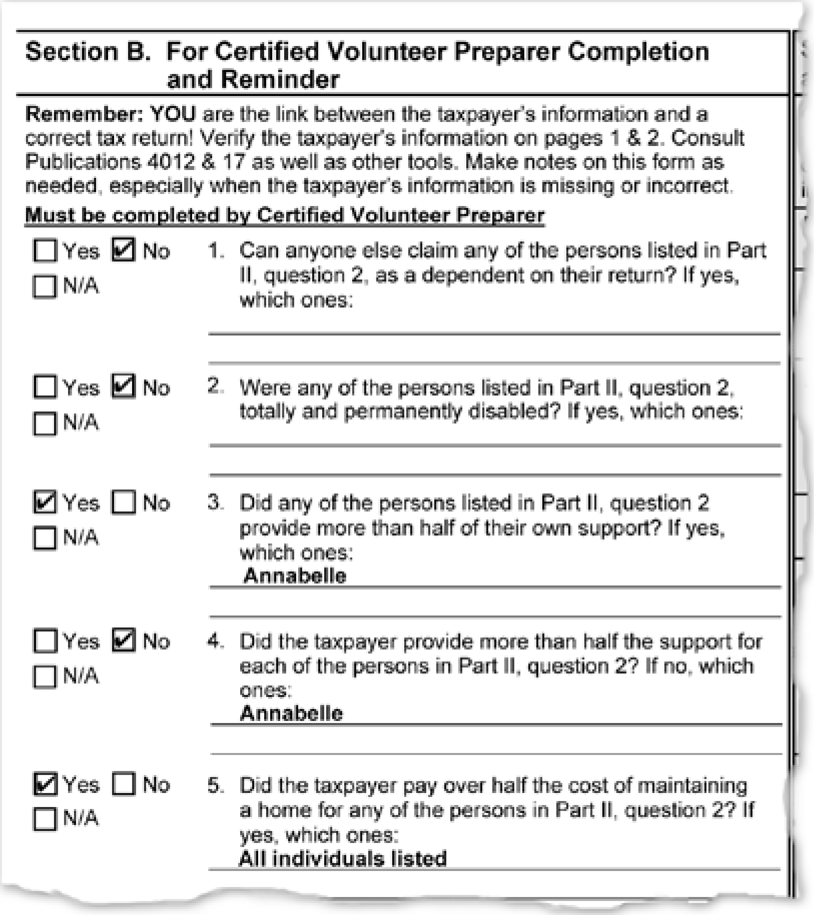
The numbers show that Vanessa did not cover more than half of her mother's (Annabelle's) monthly expenses. Annabelle did *not* pass all five qualifying relative tests, so Vanessa cannot claim an exemption for her mother. Remember to document that Vanessa did not provide more than 50% of her mother's support in Section B:

For Certified Volunteer Preparer Completion and Reminder, on her approved intake and interview sheet.

Volunteer Preparer Determinations

Now, you can complete the dependent questions in Section B. Check off the applicable yes/no responses and make annotations as needed.

Ask students how they would answer questions 1-5 in Section B.



Section B. For Certified Volunteer Preparer Completion and Reminder

Remember: YOU are the link between the taxpayer's information and a correct tax return! Verify the taxpayer's information on pages 1 & 2. Consult Publications 4012 & 17 as well as other tools. Make notes on this form as needed, especially when the taxpayer's information is missing or incorrect.

Must be completed by Certified Volunteer Preparer

☐ Yes ☑ No ☐ N/A 1. Can anyone else claim any of the persons listed in Part II, question 2, as a dependent on their return? If yes, which ones:

☐ Yes ☑ No ☐ N/A 2. Were any of the persons listed in Part II, question 2, totally and permanently disabled? If yes, which ones:

☑ Yes ☐ No ☐ N/A 3. Did any of the persons listed in Part II, question 2 provide more than half of their own support? If yes, which ones: **Annabelle**

☐ Yes ☑ No ☐ N/A 4. Did the taxpayer provide more than half the support for each of the persons in Part II, question 2? If no, which ones: **Annabelle**

☑ Yes ☐ No ☐ N/A 5. Did the taxpayer pay over half the cost of maintaining a home for any of the persons in Part II, question 2? If yes, which ones: **All individuals listed**

The children are the grandmother's qualifying children, but the grandmother does not pass the Qualifying Child of More Than One Person rule because her adjusted gross income (AGI) is less than Vanessa's.

Based on the interview, Vanessa can claim dependency exemptions for her three children, but not for her mother. Vanessa's children are the qualifying children of both Vanessa and her mother, Annabelle. Vanessa is entitled to claim the children, because she is their parent. Annabelle could only claim them if Vanessa chose not to claim them, and if Annabelle's AGI was higher than both parents.

Vanessa's husband cannot claim the children on his return because the children don't meet the residency requirement, and he does not meet the tests to claim them as dependents under either the qualifying child or qualifying relative rules. He also doesn't have a divorce decree or written agreement in effect that would allow him to claim the children.

A copy of the completed Section B of Vanessa's approved intake and interview sheet is in Appendix B. If you have any incorrect entries, use the job aid to determine your mistakes or ask your instructor for assistance.

Preparing Vanessa's Return

At this point, you can complete the Filing Status and Exemptions sections of Vanessa's tax return or enter the information in the Main Information Sheet in the tax software. You will need valid social security numbers for everyone listed on her return.

Tax Software Hint: The software will calculate Vanessa's exemption deduction. The completed Exemptions section of Vanessa's Form 1040 is in Appendix B.

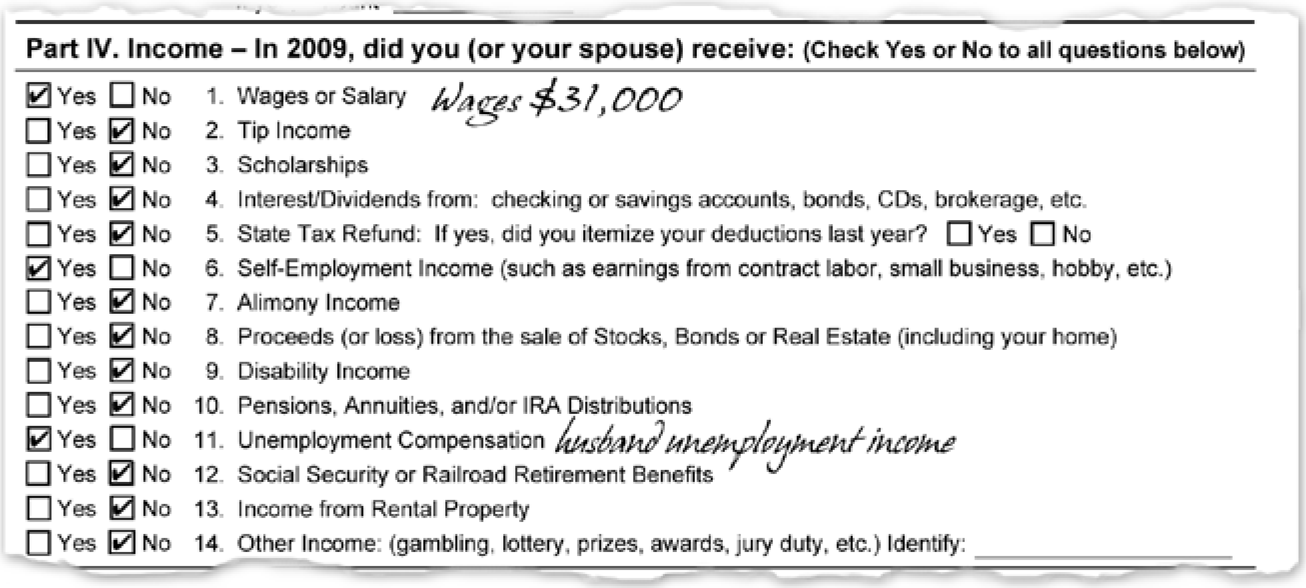
Return to lesson 6.

Lesson 8: Income – Wages, Interest, Etc.; Form 1040, Lines 7-11

What are Vanessa's sources of income?

Let's determine Vanessa's sources of income by reviewing Part IV, Income, of Vanessa's approved intake and interview sheet. Before beginning the interview, review the Income section in the Volunteer Resources Guide (Tab D) for examples of income sources not listed in Part IV that may be mentioned during the interview.

Vanessa answered "yes" to income from wages and salary, self-employment, and unemployment compensation. In an earlier part of the interview, you learned that the unemployment compensation was her husband's, not hers.



Part IV. Income – In 2009, did you (or your spouse) receive: (Check Yes or No to all questions below)

☑ Yes ☐ No 1. Wages or Salary Wages $31,000
☐ Yes ☑ No 2. Tip Income
☐ Yes ☑ No 3. Scholarships
☐ Yes ☑ No 4. Interest/Dividends from: checking or savings accounts, bonds, CDs, brokerage, etc.
☐ Yes ☑ No 5. State Tax Refund: If yes, did you itemize your deductions last year? ☐ Yes ☐ No
☑ Yes ☐ No 6. Self-Employment Income (such as earnings from contract labor, small business, hobby, etc.)
☐ Yes ☑ No 7. Alimony Income
☐ Yes ☑ No 8. Proceeds (or loss) from the sale of Stocks, Bonds or Real Estate (including your home)
☐ Yes ☑ No 9. Disability Income
☐ Yes ☑ No 10. Pensions, Annuities, and/or IRA Distributions
☑ Yes ☐ No 11. Unemployment Compensation husband unemployment income
☐ Yes ☑ No 12. Social Security or Railroad Retirement Benefits
☐ Yes ☑ No 13. Income from Rental Property
☐ Yes ☑ No 14. Other Income: (gambling, lottery, prizes, awards, jury duty, etc.) Identify: ____________________

Sample interview clarifying wage and interest income

Ask two volunteers to role-play the interview.

Because the approved intake and interview sheet does not list detailed information about wages and taxable interest, you ask some probing questions to learn more about her wage and interest income.

SAMPLE INTERVIEW

VOLUNTEER SAYS...	VANESSA RESPONDS...
Now that we have determined your filing status and who you can claim as a dependent on your return, let's talk about your income. Did you work in 2009?	Yes, I've been working for the same store for years and I have my own cosmetics business.
I see, based on your Form W-2, that's Bob's Department Store. Did you work for anyone else last year?	Just myself.
Great! I wish I could work for myself! So, Bob's was your only source of wages?	Yes.
Did you have any interest income, such as interest from a checking account, savings account, or certificate of deposit?	No, I went with a couple of free checking accounts that don't pay interest, one for personal use and one for my cosmetics business.
Interest income is reported on Form 1099-INT. Did you receive any of those forms?	No, I'm sure you have everything.

SAMPLE INTERVIEW (continued)

VOLUNTEER SAYS...	VANESSA RESPONDS...
Did you cash in any U.S. savings bonds?	No.
Did you receive a state tax refund in 2009?	No.
We've identified your total wages as $31,000.	What about my cosmetics business and unemployment?
We will account for those earnings later.	

The volunteer and Vanessa continued reviewing the entries on Vanessa's approved intake and interview sheet, as well as Tables A and B in the Volunteer Resource Guide (Tab D). Vanessa's responses during the interview did not change any of her answers.

So far you have learned that Vanessa was employed as a sales associate in a retail department store for the entire tax year. She earned no taxable interest from bank accounts. She stated that she owns a cosmetics business but you will ask her questions about that when you explore her self-employment income.

See Appendix B to review the entries in the Income section of Vanessa's Form 1040.

Tax Software Hint: The software automatically computes the taxpayer's total income based on entries on Form 1040.

Return to Lesson 8.

Lesson 9: Income – Business; Form 1040, Line 12

Can Vanessa file Schedule C-EZ?

In Part IV, Income, of Vanessa's approved intake and interview sheet, she answered "yes" to self-employment income. You learned that this came from her cosmetics business.

Direct students to the Volunteer Resource Guide (Tab D).

Familiarize yourself with the requirements for filing Form 1040, Schedule C-EZ, which is found in Part I of the schedule. Refer to the Volunteer Resource Guide (Tab 2) for a facsimile of the schedule. Also, review the instructions for filing Form 1040, Schedule C-EZ, before beginning the interview.

You need to ask additional questions about her business income to determine if she can report it on Schedule C-EZ. If she cannot, you will need to refer her to a professional tax preparer.

Ask two volunteers to role-play the sample interview.

Sample interview on use of Schedule C-EZ

SAMPLE INTERVIEW

VOLUNTEER SAYS...	VANESSA RESPONDS...
Let's talk about your income from your personal cosmetics business.	OK, I have all my stuff right here.
You may be able to file Schedule C-EZ. If you can't, then I'll have to refer you to a professional tax preparer. First, during 2009, were your business expenses $5,000 or less?	Yes, it's right here. I made a summary of all my income and expenses from my business bank account. This account is purely for my business.
Okay. And clearly you use the cash method of accounting. Did you carry any inventory during the year?	No, the only things I have are the samples for parties and individual consultations. When I get an order, I send it through the supplier and the products go directly to the customer or I deliver them personally.
Am I correct that the bank statement shows you did not have a loss on the business in 2009?	That's right. I sold $2,990 last year and my expenses were $590.
Did you have any employees?	No, I did it all myself.
And you aren't taking any kind of depreciation or amortization on equipment or property owned by the business?	No, I don't have anything like that!
Do you intend on deducting expenses for using your home as your office?	No, not at all.
Have you always been the only person involved in this business?	Yes.
Good, then we can prepare Schedule C-EZ for you!	Great!

Ask students what key facts determine that Vanessa can use Schedule C-EZ.

You learned key facts that determined that Vanessa can file Schedule C-EZ. She had self-employment income of $2,990 and expenses of $590 from her business. She has met all the requirements for the use of a Schedule C-EZ, which is within the scope of the VITA/TCE program.

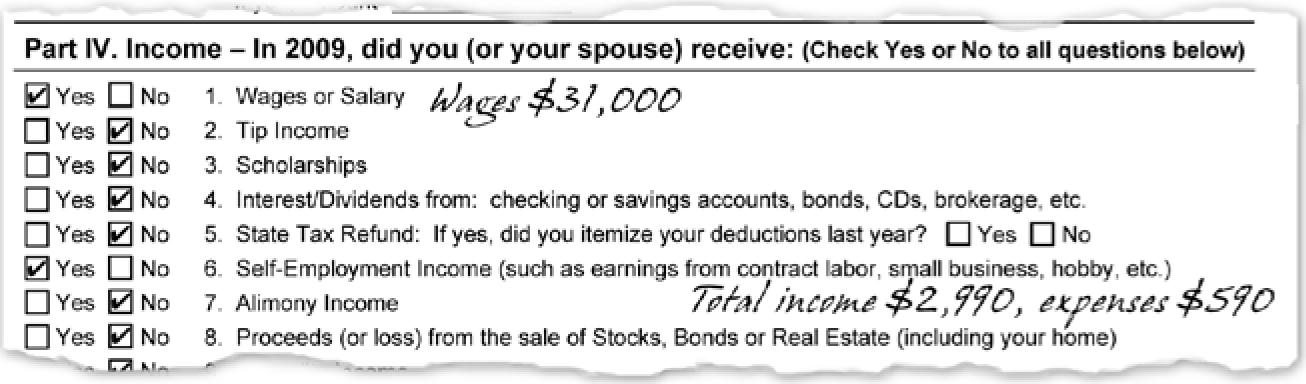
Next, you ask probing questions to gather information about business expenses you will enter on Schedule C-EZ.

Ask two volunteers to role-play the sample interview.

SAMPLE INTERVIEW (continued)

VOLUNTEER SAYS...	VANESSA RESPONDS...
Do you have any Forms 1099-MISC for income from your cosmetics business?	No, all my clients just write me personal checks or pay in cash. But I keep this business account separate from my personal account – it's a lot easier that way!
Good! Does this year-end summary for your business account list all the deposits and expenses for your business?	Yes, it does.
This makes it easy. We will enter this information into the tax software and it will calculate your net business income or loss. By the way, do you use your vehicle to conduct your business?	Yes, for parties and deliveries, that sort of thing.
Did you keep track of the mileage that went only for your business?	No.
Well, that is a deductible expense. If you do drive anywhere for the business, try keeping a pad of paper in the car and always record your odometer reading, and document the business purpose of the trip.	I sure will!

Before you continue the interview, be sure to indicate Vanessa's responses to these questions on page 2 of the approved intake and interview sheet. In the margins of Part IV, item 6, enter "Total income $2,990, expenses $590."



Part IV. Income – In 2009, did you (or your spouse) receive: **(Check Yes or No to all questions below)**

☑ Yes ☐ No 1. Wages or Salary Wages $31,000
☐ Yes ☑ No 2. Tip Income
☐ Yes ☑ No 3. Scholarships
☐ Yes ☑ No 4. Interest/Dividends from: checking or savings accounts, bonds, CDs, brokerage, etc.
☐ Yes ☑ No 5. State Tax Refund: If yes, did you itemize your deductions last year? ☐ Yes ☐ No
☑ Yes ☐ No 6. Self-Employment Income (such as earnings from contract labor, small business, hobby, etc.)
☐ Yes ☑ No 7. Alimony Income Total income $2,990, expenses $590
☐ Yes ☑ No 8. Proceeds (or loss) from the sale of Stocks, Bonds or Real Estate (including your home)

Vanessa's completed Schedule C-EZ is shown in Appendix B. Also see Appendix B, Form 1040, Income section, for her income entries.

Tax Software Hint: The software completes Schedule C-EZ and Form 1040 based on your entries on the Net Profit from Business section.

Return to Lesson 9.

Lesson 13: Income – Unemployment Compensation; Form 1040, Line 19

What “other income” must Vanessa report?

Recall that taxpayer Vanessa Franklin is married, but lives apart from her husband. You have already identified her income from wages and from self-employment. On her approved intake and interview sheet she checked “Yes” for unemployment compensation, but in an earlier part of the interview she indicated that her husband had received that income.

Direct students to the Volunteer Resource Guide (Tab D).

Vanessa may have received other income that must be reported. A list of possible sources of other income is found in the Income section of the Volunteer Resource Guide (Tab D).

Ask two volunteers to role-play the sample interview.

Based on the approved intake and interview sheet, you ask additional probing questions to validate her unemployment entry.

Sample interview clarifying other income

SAMPLE INTERVIEW

VOLUNTEER SAYS...	VANESSA RESPONDS...
I recall that your husband received unemployment compensation during the tax year, but that the two of you were living apart. Is that correct?	Yes, that’s right.
As I may have mentioned before, because you are filing as Head of Household, instead of a joint return, you won’t need to report any of his income. He’ll do that on his own return.	Well, I should tell you that my husband has sent me a couple of checks to take care of the kids. Should we declare that?
No, you don’t need to report child support payments.	I’m glad to know that!
Did you receive any other income in 2009? Here is a list of things that are considered income. Did you receive any of these in 2009? [Volunteer shows Vanessa Table A, Examples of Income, in the Volunteer Resource Guide, Tab D.]	I don’t think so. No, I’m sure I didn’t.
Okay, that finishes up the Income section. If you’ll look at the screen, this is your total income. Next, we’ll discuss any adjustments to your income.	

After such an interview, be sure to record any additional information you gained from the taxpayer’s responses on page 2 or 4 of Form 13614-C or other approved intake and interview sheet.

Completing the return

Enter Vanessa’s income from wages on Form 1040, line 7; enter her business income (from Schedule C-EZ) on line 12. Vanessa does not have any other income entries.

Return to Lesson 13.

Lesson 17: Adjustments to Income

Can Vanessa claim any adjustments to her income?

“Adjustments to income” are amounts that Vanessa can subtract from her total income. Before interviewing Vanessa about possible adjustments to her income, review the Adjusted Gross Income section of her tax return; Publication 17, Adjustments to Income section; and the Adjustments section of the Volunteer Resource Guide (Tab E).

Direct students to the Volunteer Resource Guide (Tab E).

Also, review Vanessa’s approved intake and interview sheet, particularly items 4 and 6 in Part IV (Income), and items 1, 2, and 3 in Part V (Expenses).

Direct students to Vanessa’s approved intake and interview sheet.

In Part IV, Vanessa indicates that she had self-employment income. She can deduct one-half of her self-employment tax as an adjustment to her income. (This adjustment is calculated on Form 1040 Schedule SE and will be covered in Lesson 28, Other Taxes.)

Tax Software Hint: To review information related to the software, go to the Volunteer Resource Guide (Tab 3).

Because the approved intake and interview sheet does not list all the possible opportunities for adjustments to her income, you may find it helpful to ask Vanessa about each entry in the Adjusted Gross Income section of Form 1040. At a minimum, you must validate the responses she gave on her approved intake and interview sheet.

During the interview, Vanessa indicates that she neither paid nor received alimony. You ask her probing questions about possible IRA contributions.

Ask two volunteers to role-play the sample interview.

Sample interview about IRA contributions

SAMPLE INTERVIEW

VOLUNTEER SAYS...	VANESSA RESPONDS...
I see from box 12 of your W-2 that you put $1,000 into your 401k account. Did you make any contributions to an IRA or any other retirement account?	Yes, I put $600 into my IRA.
Okay. When did you make the contribution and what type of IRA was it, traditional or Roth?	It’s a traditional IRA. I did it last May, I think. Yes, here’s the statement. I always try to put part of my tax refund into my IRA.
Great. It looks like your income is within the limits, so you can deduct the entire IRA contribution.	Thanks!
Did you ever make IRA contributions that you didn’t deduct?	No, I just have this one account, and I’ve always taken the deduction.
Okay. Now, until April 15, you can still make deductible contributions up to a total of $5,000 and deduct them for this tax year. Are you planning on contributing any more to your IRA account?	I’ll save part of my refund again, but I want to put that toward next year’s deduction.
Sounds like you’ve thought about it and have a plan.	Yes, I have.

Vanessa states she contributed $600 to an IRA during the tax year. This amount is entered in the Adjusted Gross Income section on her tax return, along with the one-half of her self-employment tax from her Schedule SE (Lesson 28). The $1,000 401K contribution on her Form W-2 will not result in an adjustment to her income; it has already been subtracted from the Box 1 Wages on her W-2.

Based on Vanessa's approved intake and interview sheet, she indicates that she had educational expenses. You probe further by asking about her education-related expenses.

Ask two volunteers to role-play the sample interview.

Sample interview about Vanessa's education expenses.

SAMPLE INTERVIEW

VOLUNTEER SAYS...	VANESSA RESPONDS...
Let's talk about your education-related expenses. Were they for you or your children?	They were for me. I took one class in the fall.
You're filing as Head of Household and your income is below the limit for taking the full deduction. Do you have a receipt for the tuition payment?	Yes, these are the receipts from City College.
I see $450 for tuition and $80 for 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?	Yes, the EAP provided $100.
Did you make any tax-free withdrawals from a Coverdell educational savings account or another a qualified tuition program, or from U.S. savings bonds?	No.
Did you get any other nontaxable payments, not counting gifts, bequests, or inheritances, that were specifically for educational expenses?	Well, my mom gave me $100 to help with tuition.
The $100 was a gift, so we don't count it. Your total payments were $530. We must subtract the $100 employer benefit. That lets you deduct $430 for tuition and fees. Do you have any questions about all this?	No, I'm really glad I can deduct that.
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 might ask you some more questions to figure out if the credit would be better for you than this deduction.	Okay, I'd appreciate that.

[On the Intake and Interview Sheet, note that Vanessa qualifies for the tuition and fees credit. Later, you will determine if she will take advantage of this benefit, since she may also be eligible for an education credit.]

Return to Lesson 17.

Lesson 19: Standard Deduction and Tax Computation

Can and should Vanessa take the standard deduction?

As you recall, Vanessa qualifies to file as Head of Household and was employed as a sales associate in a retail department store for the entire tax year. She was also self-employed with her own cosmetics business.

Direct students to the Volunteer Resource Guide (Tab F).

Let's determine if it would be more beneficial for Vanessa to itemize or to take the standard deduction. The deductions section of the Volunteer Resource Guide (Tab F) contains helpful charts and interview tips for completing this section of the tax return.

Ask two volunteers to role-play the sample interview.

Sample interview exploring standard deduction

SAMPLE INTERVIEW

VOLUNTEER SAYS...	VANESSA RESPONDS...
Based on your filing status as Head of Household, your standard deduction is $8,350.	Should I itemize this year?
Your intake sheet indicates that you did not have any home mortgage payments such as interest or taxes.	That's correct. We currently live in an apartment. I may purchase a home next year.
Did you pay any state or local sales or excise taxes in 2009 for a new motor vehicle with a gross vehicle rating of 8,500 pounds or less?	Yes, I did purchase a new car and the salesperson informed me that the car weighed less than 8,500 pounds. I needed a more reliable car to build my cosmetics business.
When did you purchase the car? Were you the original owner?	I purchased the car on October 22, 2009. Yes, I'm the original owner of the car. It only had five miles on the odometer!
What was the purchase price of your car before taxes?	I paid $15,965 before taxes.
What was the total amount you paid in taxes for your car?	I have the receipt here in my files. I paid a total of $1,233 in taxes.
You also indicated you had medical expenses and charitable contributions last year. Tell me about your medical expenses.	Well, I did have some medical and dental expenses, but insurance covered most of them. I only spent about $1,500. That amount includes the expenses for delivering Bella.
Did you make any charitable contributions?	I made donations totaling $200. I have the receipts in this envelope.
So at this point, the total amount of your medical expenses and charitable contributions is $1,700. I think we should try itemizing deductions to see if that gives you a higher deduction. No matter how we handle deductions, we still have tax credits to work out and those may reduce your tax.	I hope you're right!
We'll do our best!	

As a result of the interview, you realize Vanessa's new car purchase may increase her standard deduction. You also found out she lives in an apartment.

After completing Schedule L, Standard Deduction for Certain Filers, for the new car that Vanessa purchased, you see that she qualifies for an additional standard deduction of $1,233. Vanessa's total standard deduction is $9,583. See the Tax and Credits section of Vanessa's Form 1040 in Appendix B for the proper location of the standard deduction entry and the completion of Schedule L.

Point out the tax software hint.

Tax Software Hint: The tax software will automatically compute the taxpayer's standard deduction based on your entries on the Main Information Sheet and Schedule L (if applicable).

Should Vanessa itemize her deductions?

If a taxpayer's real estate taxes, home mortgage interest, and charitable contributions exceed the standard deduction amount, probe further using the itemized deductions worksheet in Tab 4 and the interview tips in Tab F of the Volunteer Resource Guide.

Since it does not appear that Vanessa's $1,700 medical and charitable contributions will exceed her standard deduction amount, it seems more advantageous for Vanessa to take the standard deduction.

Ask students to review Lesson 20 if you are not teaching the lesson as part of the course.

19 Return to Lesson 19.

Lesson 20: Itemized Deductions

Let’s determine if Vanessa should itemize her deductions. Vanessa incurred expenses that may increase her deductions. She currently qualifies for the standard deduction of $9,583 for the tax year.

Vanessa stated she paid medical and/or dental expenses and donations, so you decided to probe further using the Volunteer Resource Guide (Tab F) – Itemized Deductions Interview Tips.

Direct students to the Interview Tips for Itemized Deductions (Tab F).

Tax Software Hint: You may enter Vanessa’s responses on Schedule A in the tax software as you conduct the interview.

Ask two volunteers to role-play the sample interview.

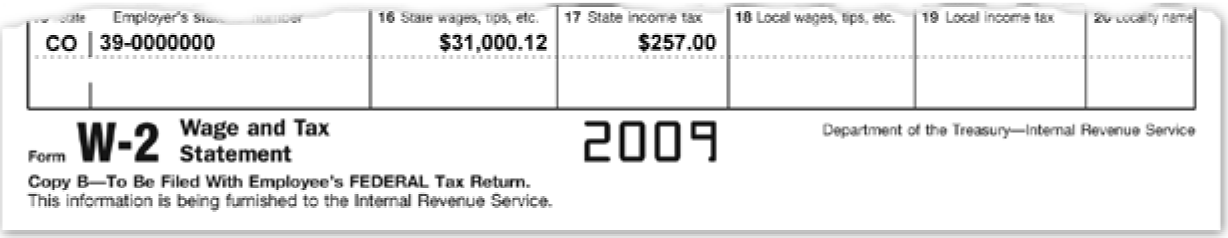
Sample interview clarifying medical deductions

SAMPLE INTERVIEW

VOLUNTEER SAYS...	VANESSA RESPONDS...
Let’s enter all qualified medical deductions for you and your dependents. How much did you pay in health care premiums?	Well, I didn’t have any health insurance last year, so I had to pay for all our check-ups and my kids’ allergy medication prescriptions and dental fillings. Here are my receipts. If I get health insurance this year, will my payments be deductible on my next tax return?
Yes, health insurance premiums are deductible as long as they aren’t pre-taxed. For this year, we’ll enter each of your medical and dental expenses separately. The total of your receipts comes to $585 so far. Now, let’s see if we can deduct some transportation costs. Can you determine how far you drove for your medical and dental care?	All my dental and medical appointments were in the same center. Each round trip was 20 miles, and I have receipts for the five trips I took during the year for a total of 100 miles. I paid about $1,500 when I had my daughter Bella.
Well, the reimbursement rate for qualified medical travel for the months you traveled in 2009 was 24 cents per mile. When I enter your mileage here, it comes to $24.	What about the $1,500 I spent when I had Bella?
We’ll include that amount as well! That brings your total to $2,109. However, in order to claim medical expenses, you need to have paid more than $2,447 in expenses, which is 7.5% of your adjusted gross income. Let’s complete Schedule A and see what happens!	

Vanessa’s Tax Deductions

During the tax year, Vanessa had some state income tax withheld as shown on her Form W-2.



Employer's	16 State wages, tips, etc.	17 State income tax	18 Local wages, tips, etc.	19 Local income tax	Locality name
CO | 39-0000000	$31,000.12	$257.00			

Form **W-2** Wage and Tax Statement **2009** Department of the Treasury—Internal Revenue Service

Copy B—To Be Filed With Employee's FEDERAL Tax Return.
This information is being furnished to the Internal Revenue Service.

Sample interview clarifying state and local income tax deductions

SAMPLE INTERVIEW

VOLUNTEER SAYS...	VANESSA RESPONDS...
You can itemize the state and local income tax. Your Form W-2 shows you had some state income tax withheld, so that amount will go on Schedule A. Did you pay any state or local sales tax?	No, just what they take from my paycheck. Why do you ask?
Because, if you itemize you can deduct either state and local sales taxes or state or local income taxes, whichever is larger. You paid $1,233 in sales tax on your new car. Did you pay any other sales tax?	No I didn’t.
In that case, we’ll use the amount you paid in state and local sales taxes and include the sales tax you paid on your new car. Once I complete this section, we can move on to the amount of interest you paid for the year.	That sounds great.

Sample interview clarifying interest deductions

SAMPLE INTERVIEW

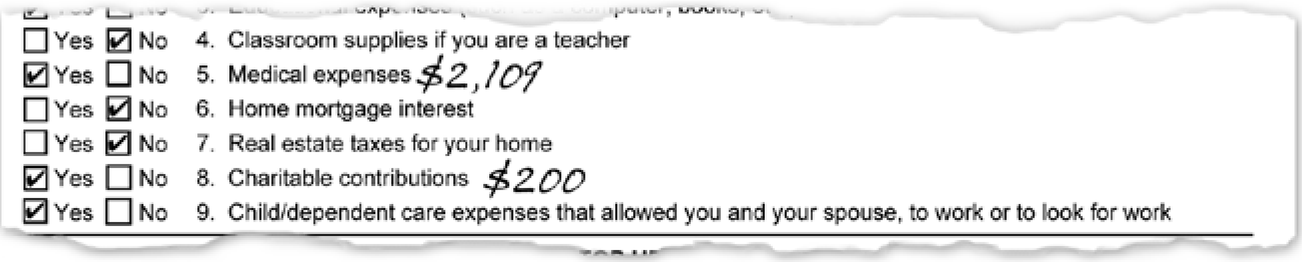
VOLUNTEER SAYS...	VANESSA RESPONDS...
Did you pay any interest?	Just the interest on my credit card and my car payments. Is that deductible?
I’m sorry, but it isn’t.	

Vanessa’s Gifts to Charity Deductions

During the tax year, Vanessa gave a total of $200 in contributions to her church. She gives you a copy of the letter she received from her church. She can itemize this deduction.

Tax Software Hint: Because $200 is less than 20% of Vanessa’s AGI of $32,630, you don’t need to be concerned about indicating whether the contributions are limited. Simply enter the cash and noncash donations separately under “50% Limit Organizations.”

Based on your findings during the interview, you make the following notes on Vanessa’s approved intake and interview sheet. In Part V, Item 5 you write $2,109 and by Item 8, you write $200.



☐ Yes ☑ No 4. Classroom supplies if you are a teacher
☑ Yes ☐ No 5. Medical expenses $2,109
☐ Yes ☑ No 6. Home mortgage interest
☐ Yes ☑ No 7. Real estate taxes for your home
☑ Yes ☐ No 8. Charitable contributions $200
☑ Yes ☐ No 9. Child/dependent care expenses that allowed you and your spouse, to work or to look for work

Vanessa's Miscellaneous Expense Deductions

You read the balance of the Schedule A entries to Vanessa from the form or the tax software. She stated she paid her bank $35 for her safe deposit box. The box was used to store her investment documents which makes this a deductible expense.

Since the $35 she paid is less than 2% of her AGI of $32,630 she doesn't get the deduction for miscellaneous expenses.

Itemized Deductions Summary

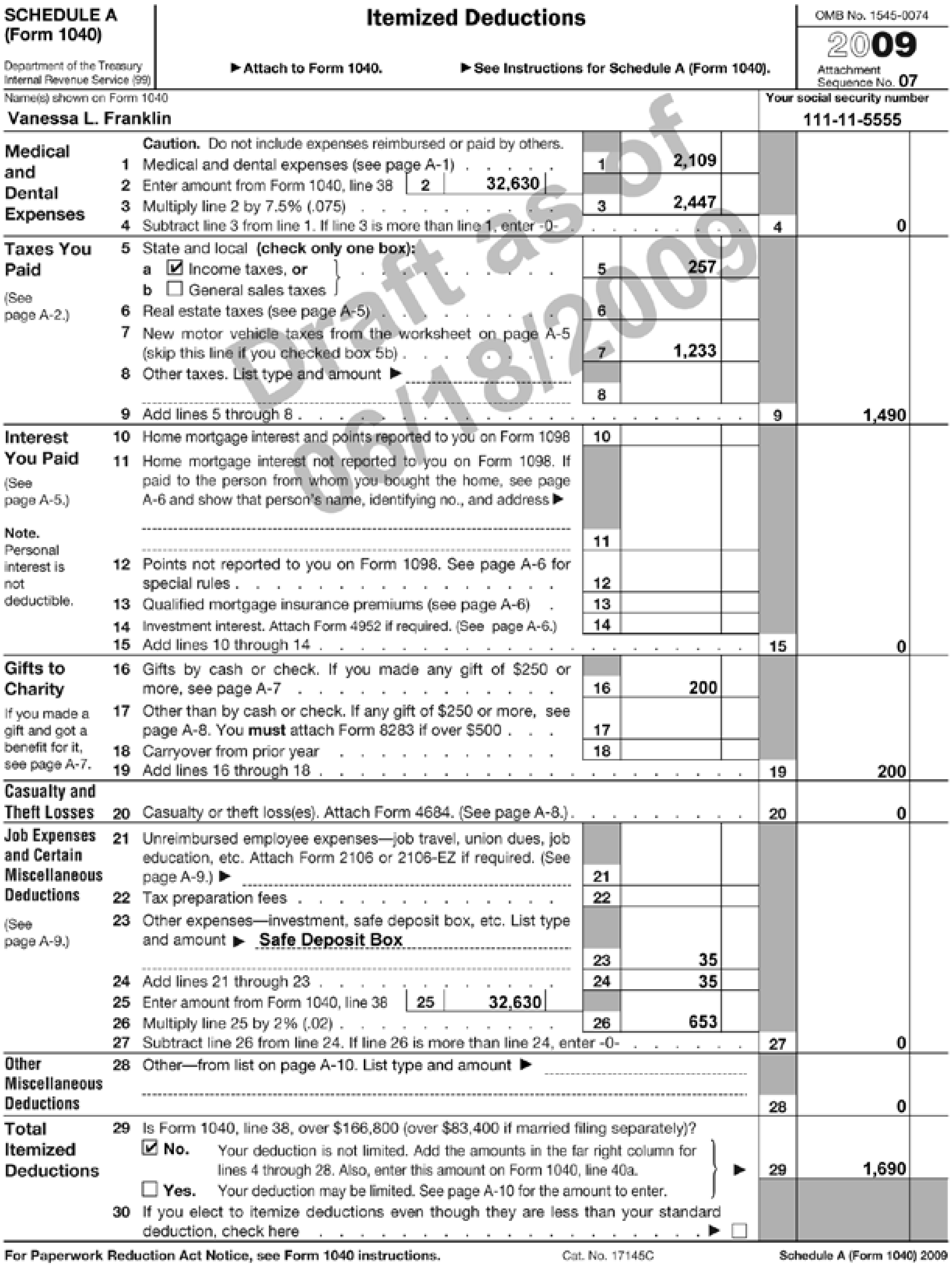
Vanessa's Form 1040, Schedule A (next page) depicts her total itemized deductions. During the tax year, Vanessa paid medical and dental expenses, state income taxes, and a fee for her safe deposit box. She also contributed money to her church. The total of all her itemized deductions shown on Schedule A is $1,690, which is less than her standard deduction amount of $9,583, after including the vehicle sales tax. Vanessa will take the standard deduction.

Tax Software Hint: On Vanessa's Form 1040, you see that:

Line 40 shows the standard deduction for Head of Household ($9,583) because that amount is greater than the total of Vanessa's itemized deductions ($1,690).

Line 41 shows Vanessa's AGI reduced by her standard deduction.

Line 42 shows Vanessa's deduction for her four exemptions ($14,600).



SCHEDULE A (Form 1040)

Department of the Treasury
Internal Revenue Service (99)

Itemized Deductions

► Attach to Form 1040. ► See Instructions for Schedule A (Form 1040).

OMB No. 1545-0074
2009
Attachment Sequence No. 07

Name(s) shown on Form 1040: **Vanessa L. Franklin**

Your social security number: **111-11-5555**

Medical and Dental Expenses		**Caution.** Do not include expenses reimbursed or paid by others.				
	1	Medical and dental expenses (see page A-1)	1	2,109		
	2	Enter amount from Form 1040, line 38 | 2 | 32,630				
	3	Multiply line 2 by 7.5% (.075)	3	2,447		
	4	Subtract line 3 from line 1. If line 3 is more than line 1, enter -0-			4	0
Taxes You Paid (See page A-2.)	5	State and local **(check only one box):** a ☑ Income taxes, **or** b ☐ General sales taxes	5	257		
	6	Real estate taxes (see page A-5)	6			
	7	New motor vehicle taxes from the worksheet on page A-5 (skip this line if you checked box 5b)	7	1,233		
	8	Other taxes. List type and amount ►	8			
	9	Add lines 5 through 8			9	1,490
Interest You Paid (See page A-5.) **Note.** Personal interest is not deductible.	10	Home mortgage interest and points reported to you on Form 1098	10			
	11	Home mortgage interest not reported to you on Form 1098. If paid to the person from whom you bought the home, see page A-6 and show that person's name, identifying no., and address ►	11			
	12	Points not reported to you on Form 1098. See page A-6 for special rules	12			
	13	Qualified mortgage insurance premiums (see page A-6)	13			
	14	Investment interest. Attach Form 4952 if required. (See page A-6.)	14			
	15	Add lines 10 through 14			15	0
Gifts to Charity If you made a gift and got a benefit for it, see page A-7.	16	Gifts by cash or check. If you made any gift of $250 or more, see page A-7	16	200		
	17	Other than by cash or check. If any gift of $250 or more, see page A-8. You **must** attach Form 8283 if over $500	17			
	18	Carryover from prior year	18			
	19	Add lines 16 through 18			19	200
Casualty and Theft Losses	20	Casualty or theft loss(es). Attach Form 4684. (See page A-8.)			20	0
Job Expenses and Certain Miscellaneous Deductions (See page A-9.)	21	Unreimbursed employee expenses—job travel, union dues, job education, etc. Attach Form 2106 or 2106-EZ if required. (See page A-9.) ►	21			
	22	Tax preparation fees	22			
	23	Other expenses—investment, safe deposit box, etc. List type and amount ► Safe Deposit Box	23	35		
	24	Add lines 21 through 23	24	35		
	25	Enter amount from Form 1040, line 38 | 25 | 32,630				
	26	Multiply line 25 by 2% (.02)	26	653		
	27	Subtract line 26 from line 24. If line 26 is more than line 24, enter -0-			27	0
Other Miscellaneous Deductions	28	Other—from list on page A-10. List type and amount ►			28	0
Total Itemized Deductions	29	Is Form 1040, line 38, over $166,800 (over $83,400 if married filing separately)? ☑ **No.** Your deduction is not limited. Add the amounts in the far right column for lines 4 through 28. Also, enter this amount on Form 1040, line 40a. ☐ **Yes.** Your deduction may be limited. See page A-10 for the amount to enter. ►			29	1,690
	30	If you elect to itemize deductions even though they are less than your standard deduction, check here ► ☐				

For Paperwork Reduction Act Notice, see Form 1040 instructions. Cat. No. 17145C **Schedule A (Form 1040) 2009**

FOR ILLUSTRATION PURPOSES ONLY

Return to Lesson 20.

Lesson 23: Credit for Child and Dependent Care

Does Vanessa qualify for the Child and Dependent Care credit?

Bella, Zoe, and Zachary are Vanessa's three dependent children. Let's determine if Vanessa is eligible for the child and dependent care credit by using the Can You Claim the Credit for Child and Dependent Care Expenses? decision tree in the Volunteer Resource Guide (Tab G).

Direct students to the Volunteer Resource Guide (Tab G), Can You Claim the Credit for Child and Dependent Care Expenses? decision tree.

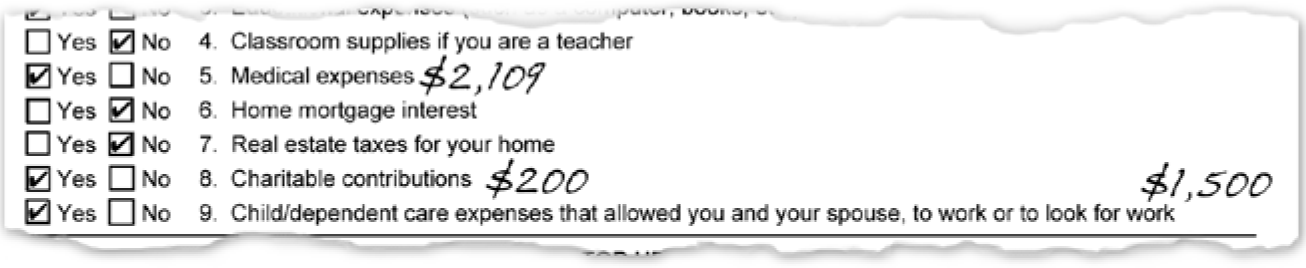
Ask two volunteers to role-play the sample interview.

Sample interview clarifying Child and Dependent Care credit

SAMPLE INTERVIEW

VOLUNTEER SAYS...	VANESSA RESPONDS...
Did you pay for child care during the tax year?	Zach attends a free after-school program. My mom watches Bella all day and she watches Zoe most of the time; Zoe goes to preschool one day a week.
You may be able to take the credit for child and dependent care expenses. Let me go over a couple of things with you. I already know that your three dependent children are under 13, so they qualify.	Okay.
And I know that you have earned income because you work in a department store. Did you pay for child care so that you could go to this job?	Yes.
And Zoe's day care provider is not a relative, correct?	The preschool is not. I don't have to pay my mom.
We already know that you are filing as Head of Household, and meet the conditions of "unmarried" for tax purposes. Did you bring the name, address, and tax identification number of the provider with you?	Yes, I did.
What were your child care expenses for the year?	Well, I pay the preschool $125 a month, so that would be $1,500 for the year.
Does your company provide any dependent care benefits?	No.
Well, your expenses definitely qualify. Now all we have to do is figure out the amount of your child and dependent care credit.	Great! Thanks for your help!

Based on your findings during the interview, you make the following note on Vanessa's approved intake and interview sheet. In Part V, Item 9 you write $1,500.



☐ Yes ☑ No 4. Classroom supplies if you are a teacher
☑ Yes ☐ No 5. Medical expenses $2,109
☐ Yes ☑ No 6. Home mortgage interest
☐ Yes ☑ No 7. Real estate taxes for your home
☑ Yes ☐ No 8. Charitable contributions $200
☑ Yes ☐ No 9. Child/dependent care expenses that allowed you and your spouse, to work or to look for work $1,500

How do I compute the child and dependent care credit?

Ask students to complete Parts I and II of Form 2441 using the tax software or Form 2441.

TIP

Vanessa's employer did not provide any dependent care benefits for her child. Therefore, you do not have to complete Part III of Form 2441 for Vanessa. Vanessa brought the daycare provider's information.

Vanessa qualifies for the child and dependent care credit. Use Form 2441, available on www.irs.gov, to calculate the amount of the credit. Vanessa paid Koala Bears Day Care (EIN 82-1111111) $1,500 for the tax year. Koala Bears is located at 456 Chapman Avenue in Denver, Co 80202.

Based on Vanessa's Adjusted Gross Income, her maximum credit is computed at 26% (.26) of her allowable expenses, so her credit can be as high as $390. This amount is compared to Vanessa's tax. Since her tax is greater than the child and dependent care credit in this scenario, the tax software has calculated Vanessa's child and dependent care credit as $390. This amount is entered on her Form 1040. Vanessa's completed Form 2441 is in Appendix B.

Tax Software Hint: To review information related to the software, go to the Volunteer Resource Guide (Tab 5).

Return to Lesson 23.

Lesson 24: Education Credits

Does Vanessa qualify for any of the education credits?

Vanessa may be able to reduce the amount of tax due if she has education expenses that qualify for the American opportunity (Hope credit expanded) or lifetime learning education credits. Review the information in the Volunteer Resource Guide (Tab G) regarding these credits.

Direct students to the Volunteer Resource Guide (Tab G), Education Credits.

Sample interview clarifying education credits

In the Adjustments to Income lesson, we determined that Vanessa was eligible for the tuition and fees deduction for a class she took in the fall. Now, you must determine if an education credit would be a better choice.

Ask two volunteers to role-play the sample interview.

SAMPLE INTERVIEW

VOLUNTEER SAYS...	VANESSA RESPONDS...
Now that the rest of the return is completed, let's go back and see if the tuition and fees deduction was really the way to go, or if an education credit would be better. Do you know about the education credits?	I've heard a little about them.
Instead of deducting an amount from your income and making your tax smaller that way, a credit is subtracted right from the total tax. But the credits are only based on a part of your expenses, instead of the whole amount.	I understand that.
So, Vanessa, why did you take the course?	The Employee Assistance Program recommended the course to my boss to improve my job skills.
Then you are only eligible for the lifetime learning credit. I've already figured your allowable expenses, so I just have to take off the deduction and try the credit instead. It will just take a minute.	Did my refund go up?
Yes, the lifetime learning credit works better for you. [On the Intake and Interview Sheet, indicate that the education credit was used instead of the tuition and fees deduction.]	Thanks for checking.

Based on the interview, Vanessa meets the requirements for the lifetime learning credit. Make a note on page 4 of Vanessa's approved intake and interview sheet with your findings.

Computing the education credit

Both the American opportunity credit (Hope credit expanded) and the lifetime learning credit are calculated on Form 8863. Vanessa's completed form is shown in Appendix B.

Tax Software Hint: To review information related to the software, go to the Volunteer Resource Guide (Tab 5).

Return to Lesson 24.

Lesson 26: Child Tax Credit

Is Vanessa eligible for the full child tax credit?

Vanessa's responses in the Family and Dependent Information of the approved intake and interview sheet indicate that her children may qualify for the child tax credit. If she qualifies, the credit reduces her tax liability by up to $1,000 for each qualifying child.

Direct students to the Tips for the Child Tax Credit (Tab G).

Using the Child Tax Credit and Additional Child Tax Credit Interview Tips in the Credits section of the Volunteer Resource Guide (Tab G), you can conclude that all three children:

- Are under the age of 17
- Are children of Vanessa
- Are U.S. citizens
- Lived in her home for more than 6 months

You also conclude that you can use the Child Tax Credit Worksheet from the Form 1040 instructions to calculate Vanessa's credit.

Ask two volunteers to role-play the sample interview.

She made contributions to a retirement savings account and may be eligible to complete Form 8880 for another credit.

Sample interview clarifying the child tax credit

SAMPLE INTERVIEW

VOLUNTEER SAYS...	VANESSA RESPONDS...
You probably qualify for the child tax credit, but let me ask you a few questions just to be sure.	Okay.
Let's see, Zachary, Zoe, and Bella are under age 17, correct?	Yes.
And we know that they are all U.S. citizens.	That's correct.
They lived with you for the entire year?	Yes.
And we've already established they did not provide any of their own support.	No, of course not, they're just little kids!
Well, since you are claiming all three of your children as dependents and they meet the status of a qualifying child for the child tax credit, you qualify for this credit.	

Computing the Child Tax Credit

Earlier Vanessa took the child and dependent care credit and the education credit. Since her remaining tax is less than the $3,000 credit allowed for three qualifying children, she cannot take the full child tax credit.

Tax Software Hint: Since this credit is calculated automatically based on the information about dependents and income already entered on the return, the volunteer does not need to make any additional tax software entries. The tax software will display the credit on the Nonrefundable Credits screen.

Ask two volunteers to role-play the sample interview.

Sample interview explaining Vanessa's partial child tax credit

SAMPLE INTERVIEW

VOLUNTEER SAYS...	VANESSA RESPONDS...
Let's see if you are able to take the full credit. Your modified adjusted gross income of $32,630 qualifies. It is less than the $75,000 limit.	Great!
Let's take a look at your tax. I see your tax on line 46 is $843. After applicable credits, you are still left with a tax amount that is less than the full $3,000 credit for three children.	What does that mean?
Well, this credit is limited to the amount of your tax. But you may be eligible for the additional child tax credit. For now, let's take a look at your Child Tax Credit Worksheet in the tax software and I can show you how this works.	

The paper version of Vanessa's Form 1040, Child Tax Credit Worksheet is very similar to what you see in the tax software. It may help you understand how the software calculates the child tax credit. See the completed worksheet in Appendix B.

Direct students to Vanessa's Form 1040, Child Tax Credit Worksheet.

Explanation of Additional Child Tax Credit

Make a note on page 4 of Vanessa's approved intake and interview sheet that she does not qualify for the full nonrefundable child tax credit because the credit was more than her tax liability. Next, determine if she is eligible for the additional child tax credit.

Direct students to the Tip for the Additional Child Tax Credit (Tab G).

The Additional Child Tax Credit criteria are shown as a Tip in the Credits section of the Volunteer Resource Guide (Tab G).

Because Vanessa did not use the entire amount of the child tax credit to offset her tax, and her earned income was more than $3,000, she is eligible to claim the additional child tax credit.

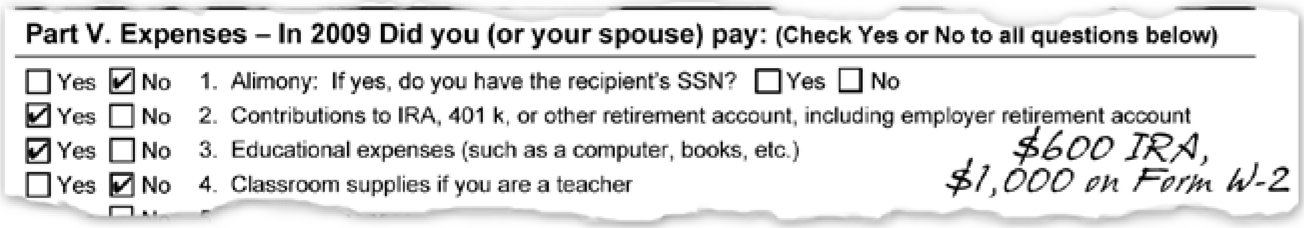
Tax Software Hint: To review information related to the software, go to the Volunteer Resource Guide (Tabs 5 and 6).

Vanessa's additional child tax credit is $2,793 To review information related to the software, go to the Volunteer Resource Guide (Tabs 5 and 6). as indicated on Form 1040.

Return to Lesson 26.

Does Vanessa qualify for the credit for qualified retirement savings contributions?

Vanessa may be able to reduce her tax liability if she is able to take this credit. In Part V, Expenses, of her approved intake and interview sheet, Vanessa answered "yes" to the question about contributions to an IRA or other retirement account. Based on her Form W-2, we know Vanessa contributed $1,000 into her 401K plan at work. In a previous interview, she stated that she also put $600 into her IRA. Be sure to record this information on her approved intake and interview sheet, as shown here.



Part V. Expenses – In 2009 Did you (or your spouse) pay: (Check Yes or No to all questions below)

☐ Yes ☑ No 1. Alimony: If yes, do you have the recipient's SSN? ☐ Yes ☐ No
☑ Yes ☐ No 2. Contributions to IRA, 401 k, or other retirement account, including employer retirement account
☑ Yes ☐ No 3. Educational expenses (such as a computer, books, etc.)
☐ Yes ☑ No 4. Classroom supplies if you are a teacher

$600 IRA,
$1,000 on Form W-2

Direct students to the the Retirement Savings Contributions Credit Decision Tree in the Volunteer Resource Guide (Tab G).

Ask for two volunteers to role-play the sample interview.

Vanessa's retirement savings may qualify her for the credit for retirement savings contributions. Go to the Volunteer Resource Guide (Tab G) and review the Retirement Savings Contributions Credit - Decision Tree. You decide to ask Vanessa additional probing questions to determine if she is eligible.

Sample interview clarifying the retirement savings contribution

SAMPLE INTERVIEW

VOLUNTEER SAYS...	VANESSA RESPONDS...
Since you put money into an IRA and your retirement account at work, let's see if you're eligible for the saver's credit. Your AGI isn't too high. And you were born before January 2, 1992?	Yes, that's right.
We know that you can't be claimed as a dependent by someone else. And, even though you did take a class; you were not considered a full-time student.	That's correct.
During 2007, 2008 or the current tax year, did you take any money out of your IRA account or your 401(k) plan at work, or do you plan to take any distributions before the tax filing deadline?	No. I try to forget all about them. Once you start taking it out, it's too hard to put it back.
Good, Now I have all the information I need to make the calculation. Let me finish this up and see how much credit you can get.	

Computing the Credit for Qualified Retirement Savings Contributions

Vanessa qualifies for the saver's credit. Use Form 8880, available in the tax software or on www.irs.gov, to calculate the amount of the credit.

Vanessa's completed Form 8880 is in Appendix B.

Tax Software Hint: You will need to complete a few entries on Form 8880. Go to the Volunteer Resource Guide (Tab 5), Retirement Savings Contributions Credit, for software entries. The software automatically calculates the amount of the credit based on entries from Form W-2, the IRA worksheet, and the Main Information Sheet.

Return to Lesson 27.

Lesson 28: Other Taxes

Does Vanessa have any additional taxes?

Vanessa answered "yes" to self-employment income earlier in the interview process. Let's determine if she has any additional taxes. As you recall, Vanessa has her own cosmetics business.

TIP

You may find it helpful to review information in Publication 17, How to Figure Your Tax, when completing the Other Taxes section of the return especially if you're not using tax software.

Ask two volunteers to role-play the sample interview.

Sample interview clarifying additional taxes

SAMPLE INTERVIEW

VOLUNTEER SAYS...	VANESSA RESPONDS...
We are almost finished with your return. We already reported your self-employment income. Did you know self-employment income is subject to social security and Medicare taxes?	No, but that is good to know.
We can use the short version of Schedule SE since you meet the requirements.	Okay.
Your Schedule SE takes your net profit from your Schedule C-EZ and calculates the amount of social security and Medicare tax on that income. That amount goes on the line for self-employment tax on Form 1040.	I see my self-employment income here… and it just calculates the tax here.
That's right. Schedule SE also calculates one half of the self-employment tax, which is entered into the Adjustments section of Form 1040.	I see.
The next tax is for unreported tip income. Do you receive tips at your regular job or as part of your self-employment?	No, not at all.
We'll leave that zero. When we discussed the saver's credit, you said that you didn't receive any distributions from an IRA or a retirement plan, is that correct?	Yes, that's right.
When I entered your Form W-2 information, I didn't put anything in box 9, for advance EIC Payment. Let's double check. Did you receive any advance payments of EIC during 2009?	No, none.
Did you know that you may choose to receive advance payments of the EIC throughout the year rather than waiting until you file your tax return to receive the full amount?	No, I didn't. How do I do that?
You need to fill out Form W-5 and give it to your employer. Then you can receive a portion of the credit in your regular paychecks.	That sounds like it could help out with the monthly budget. I'll have to check into that.

SAMPLE INTERVIEW (continued)

VOLUNTEER SAYS...	VANESSA RESPONDS...
Now for the last tax: Did you have any household employees in 2009?	I sure didn't – unless you count me!
Yes, but you do that for free! The Other Taxes section is done. Based on your income, adjustments to income, tax and credits, and other taxes, this amount represents your total tax.	Oh, do I owe that?
No, actually, because of your withholding and your Earned Income Credit, you are due a refund. Shall we go over that now?	Gladly!

Vanessa's completed Schedule SE in Appendix B shows that she must pay $339 in self-employment tax on her income from her cosmetics business. This amount is entered in the Other Taxes section of her Form 1040, and the deduction for one-half of self-employment tax is entered in the Adjustments section on page 1 of Form 1040.

Point out that the self employment tax is reported in the Other Taxes section of Form 1040 (page 2).

Tax Software Hint: The software completes Schedule SE automatically and calculates any other taxes.

Return to Lesson 28.

Lesson 29: Payments

Does Vanessa qualify for any additional credits?

Display the Payments section in the tax software.

Vanessa has earned income and the total is less than the phase-out amount for the making work pay credit. She has a valid SSN and she cannot be claimed as a dependent by someone else. Since all the requirements are met she is eligible for the making work pay credit. Schedule M, Making Work Pay and Government Retiree Credits, is completed for Vanessa.

Vanessa checked “no” on item 12 in Part III of her approved intake and interview sheet regarding estimated tax payments. Let’s see what payments Vanessa made during the year and if she will qualify for any additional credits that will reduce her tax liability. Her Form W-2 reveals her tax withholding.

Ask two volunteers to role-play the sample interview.

Sample interview clarifying payments

SAMPLE INTERVIEW

VOLUNTEER SAYS...	VANESSA RESPONDS...
We are in the Payments section. The tax software shows the withholding tax from your Form W-2 of $1,240.	Okay.
I know you had a little self-employment income. Did you pay estimated tax during 2009?	No, I did not.
Looking at your self-employment income and your last year’s return, you probably weren’t required to pay any.	That’s a relief!
You meet all the requirements for a new credit this year, making work pay. The software calculates it automatically and the credit is $400.	I am glad I qualify for the credit. Thanks.
Let me skip the earned income credit entry for now. We decided earlier that you qualify for the additional child tax credit in the amount of $2,793.	That’s correct.
We’re not finished yet. Bella, Zoe, and Zachary may qualify you for the earned income credit. The EIC may increase your refund or decrease your tax liability.	That’s good!
You indicated you did not purchase a home this year. Is that right?	That is right.
Since you did not purchase a home this year, the first-time homebuyer credit does not apply to you.	Okay, I see. Now I know why I had to answer that question on the form I filled out.

Computing the credit

Based on her earned income and other requirements, Vanessa is entitled to the new making work pay credit.

Tax Software Hint: Vanessa’s EIC amount is automatically computed along with the federal income tax withheld entry from her Form W-2 and her additional child tax credit amount from Form 8812. The making work pay credit is calculated on Schedule M.

Return to Lesson 29.

Direct students to the EIC General Eligibility Interview Tips in the Volunteer Resource Guide (Tab H).

Ask two volunteers to role-play the sample interview.

Does Vanessa qualify for the EIC?

To determine if Vanessa qualifies for the EIC, you would ask questions based on the EIC General Eligibility Interview Tips found in the Volunteer Resource Guide (Tab H). You may find it helpful to review these tips before starting the interview.

Sample interview clarifying EIC

SAMPLE INTERVIEW

VOLUNTEER SAYS...	VANESSA RESPONDS...
Are you familiar with the EIC?	Yes, I got it last year.
I need to ask you two questions. Has your request for the credit ever been denied, or the amount reduced by the IRS?	Let me think. “No” to both questions.
Good! Since your income is less than $43,279, you could qualify for the earned income credit again this year. Let’s see. I already checked and you and the kids all have valid social security cards. And you will file as Head of Household.	That’s right.
Okay. And you are a U.S. citizen, so you weren’t a nonresident alien during the tax year?	No, that’s for sure!
Did you have any income from outside the United States?	No, my only income was from my job and my cosmetics sales.
Very good. Now, because the Income section of your tax return shows that you had no interest, dividend, or capital gains income, we don’t have to worry about your investment income being too high.	Unfortunately not.
And we know that you are not someone else’s qualifying child.	Yes.

Based on the interview, we know that Vanessa meets the general eligibility requirements. Next, you need to determine if any of her children is a “qualifying child” for EIC.

Direct students to the Interview Tips for EIC.

Ask two volunteers to role-play the sample interview.

Do Vanessa’s children qualify her for the EIC?

To determine if Vanessa’s children Bella, Zoe, and Zachary are qualifying children for the EIC, you should question her based on the Interview Tips for EIC with a Qualifying Child in the Volunteer Resource Guide (Tab H).

Sample interview clarifying EIC with Qualifying Child credit

SAMPLE INTERVIEW

VOLUNTEER SAYS...	VANESSA RESPONDS...
Lets see, we already know the kids have valid social security numbers, that they are your children and they are under the age of 19.	Yes, that's correct.
I am guessing none of them are married?	[Laughs] No, they're not even dating yet.
They lived with you in the U.S. for the entire year, so they meet the half-year requirement. To claim children for the EIC, they have to meet age and relationship tests, and live with you in the U.S. for more than half the year. Since your mother lives with you, the kids would also pass those tests for her, although there is a new test for 2009 that she would have to pass to claim the kids.	No, that's okay, I always take the kids.
Great. If you both accidentally claimed the same kids, the IRS would decide who was entitled according to the qualifying child of more than one person rule. As the parent, you would win the tie.	

Tax Software Hint: The tax software has already calculated Vanessa's EIC computation based on the entries in the Main Information Sheet in the Payment section of her return.

Volunteer Preparer Determination

Based on the interview, Vanessa meets the EIC requirements with qualifying children. Make your notes on Page 4 of her approved intake and interview sheet. Also, complete Section B, Item 6 of her intake sheet. See Appendix B for the completed forms.

Optional: **Assign** optional exercise or walk through it with students.

Optional Exercise

Using Vanessa's information and the worksheets from www.irs.gov, complete her Schedule EIC and compute her earned income tax credit. Compare your work to the completed forms in Appendix B.

Return to Lesson 30.

Lesson 31: Refund and Amount of Tax Owed

Will Vanessa receive a refund or pay additional tax?

Whether Vanessa receives a refund or owes taxes depends on two entries on her Form 1040: the Total Tax listed in the Other Taxes Section and the Total Payments listed in the Payments Section.

If her total payments are more than her total tax, she will receive a refund; if her total payments are less than her total tax, she will owe an amount. As you can see from her Form 1040, Vanessa overpaid her taxes and will receive the refund.

To help you complete this part of the return, including the Direct Deposit and balance due guidance, refer to Pointers for Direct Deposit of Refunds and Balance Due Returns in the Volunteer Resource Guide (Tab 13).

Tax Software Hint: The software automatically calculates the taxpayer's refund or amount owed.

Ask two volunteers to role-play the sample interview.

Sample interview on refund options

SAMPLE INTERVIEW

VOLUNTEER SAYS...	VANESSA RESPONDS...
Your payments exceeded your tax liability for the year by $6,211. You can receive the entire amount as a refund, or apply any portion of it to your 2010 estimated taxes.	I think I'd like to take the refund. Zoe and Zachary need some new clothes.
Okay, then we'll leave the line for Applying Your Refund to Next Year's Estimated Taxes blank. Now, would you like to receive your refund via direct deposit? It's much faster than by mail, and there's no charge.	Yes, I'd like that.
Great. The IRS will deposit the refund directly to your account, or as many as three different accounts if you want.	Really? I'm trying to put a little of each tax refund in my IRA every year. It's easier to save if I don't really see it. Can I put $1,000 in my IRA and the rest in checking?
As long as you have the routing number and account numbers for each separate account.	I have them right here.
Great. Now just to make sure we get the numbers right, I'm going to have you look at them on the screen, and then check them again when the return prints out. So keep those numbers handy.	Sure.
OK, that should do it. $1,000 in the IRA account and the rest in checking. If your refund changes for any reason, you will receive a notice of explanation from the IRS.	That was easy. Thank you.

Because Vanessa does not want any of the refund applied to her 2010 estimated taxes, you would leave that line blank. If Vanessa wanted to direct deposit her refund into one account you would fill in the appropriate lines in the Refund section of the return. When a taxpayer requests a direct deposit into only one account, the information must be entered twice: on Form 1040 and also in the Bank Account Information section of the Main Information Sheet.

However, since Vanessa states she is splitting her refund with part going to her IRA and the other part going into checking, Form 8888 must be completed. When Form 8888 is completed, do not enter any direct deposit information on Page 2 of Form 1040.

Tax Software Hint: To complete Form 8888 for Vanessa, add the form to her return. Complete the information for both of her routing and account numbers and for the amount that goes into each account. Be sure the two amounts total the refund amount. You can print the form for the client's review before submitting the return to the IRS.

Direct students to Appendix B and review Vanessa's Form 1040, direct deposit items, and Form 8888.

If, instead of a refund, Vanessa owed money and could not pay it by April 15, she could pay by credit card, or she could request a payment plan with the IRS. There may be applicable fees, penalties, and interest to consider. The Volunteer Resource Guide (Tab 13) Balance Due Returns outlines the options.

To review these parts of Vanessa's return, go to Appendix B and examine the Refund and Amount You Owe sections of her Form 1040 and her Form 8888.

Return to Lesson 31.

Vanessa's Quality Review

Vanessa Franklin's tax return is ready for the final quality check to ensure that her tax return is correct and complete. Begin by explaining to her the purpose of the quality review, along with the steps in the process. Next, conduct the review or send Vanessa to your site's quality reviewer.

Use the quality review sheet in Form 13614-C (page 3), or other approved quality review sheet. The Volunteer Resource Guide (Tab 13), offers assistance with this process. See the section, Check Your Work – The Quality Review.

Finally, if Vanessa chooses to e-file, guide her through the process of signing the return electronically.

Direct students to the Check Your Work page in the Volunteer Resource Guide (Tab 13).

Direct students to the Finishing the Return section of the Volunteer Resource Guide (Tab 13).

Ask two volunteers to role-play the sample interview.

Sample interview during quality review and e-filing

SAMPLE INTERVIEW

VOLUNTEER SAYS...	VANESSA RESPONDS...
It looks like we are finished here. If you will just give me a couple of minutes to check the work that we have done, we will get this return quality checked and then we will be ready to file your return.	OK, that sounds good to me.
All right, I checked my work. Now I'm going to ask our Quality Reviewer, George, to sit down with you and do the final check. We want this return to be perfect before we send it to the IRS. At this site we always have someone else check each return to make sure you are getting all the credits you deserve and there are no surprises later.	Oh, I like that.
Vanessa this is George, our designated Quality Reviewer. George this is Vanessa Franklin.	Nice to meet you. I'm really impressed that you are making all this effort for me.

SAMPLE INTERVIEW (continued)

QUALITY REVIEWER SAYS...	VANESSA RESPONDS...
We want to have the most accurate return possible. We always do a final check on each return we prepare.	Thank you.
Let me review my job aid to make sure that I got everything correct. [Opens the Volunteer Resource Guide to the 13164-C Job Aid and continues the interview]. *OK, now let's look at the intake sheet that the two of you have been working from, and your return. I will need to confirm some of the information and then check the return to ensure that we have properly utilized all the information.*	OK.
I see that your address on the return matches your ID. You're claiming three dependents and yourself on this return. I see that we have the social security cards for each. Let's talk a minute about your filing status and then we'll check your income.	Thank you for making sure everything is correct.

SAMPLE INTERVIEW (continued)

QUALITY REVIEWER SAYS...	VANESSA RESPONDS...
[The review continues.] *I see that you have chosen to take direct deposit and your account numbers match. One last thing, yes the SIDN is on the return. Everything looks good. Thank you for assisting me with this.*	
I'll let Maria finish with the rest of the process with you. It was nice to meet you.	Nice meeting you, too.

SAMPLE INTERVIEW (continued)

VOLUNTEER SAYS...	VANESSA RESPONDS...
Just a couple more things to take care of and we will have you on your way.	OK. Do you want me to sign the return now?
Well, here at our site we use a Practitioner PIN. You just sign Form 8879, right here. This will authorize me to electronically file the return for you.	Wow, that's it? I just have to sign the one form?
That does it! Now I'll print you a copy of the tax return for your records.	Wonderful, thank you for your help!

Vanessa should leave the site with all of her documents in addition to a copy of the return and all of the schedules, forms, and worksheets.

Return to Lesson 32

Lesson 33: Concluding the Interview

How do I conclude the process with the taxpayer?

Based on the interview tips for the five-step interview process found at the front of the Volunteer Resource Guide, you're ready to conclude the interview with Vanessa. The final step includes advising Vanessa of the requirements for maintaining her records, how she should address an overpayment, when she will receive her refund, and how to avoid paying additional tax in future tax years.

Before parting, ask Vanessa if she has any final questions. You can find many answers on the inside back cover of the Volunteer Resource Guide; look for "Frequent Taxpayer Inquiries."

TIP

Ask your Site Coordinator if you may provide taxpayers with an envelope (Publication 730) they can use to store their tax documents. The envelope includes important information such as how to check the status of the refund.

Direct students to the "Frequent Taxpayer Inquiries" on the inside back cover of the Volunteer Resource Guide.

Ask two volunteers to role-play the sample interview.

Sample interview concluding the tax preparation process

SAMPLE INTERVIEW

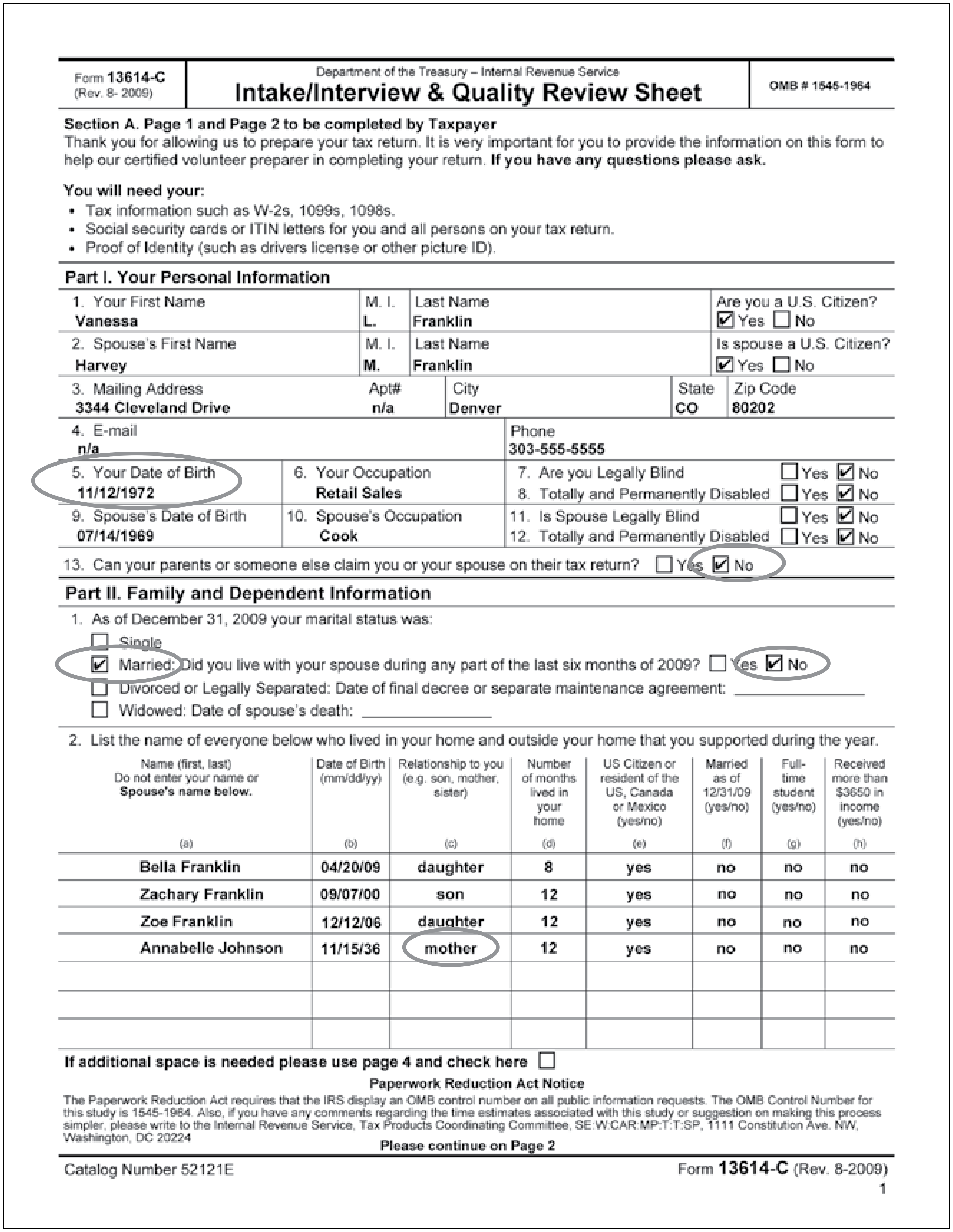
VOLUNTEER SAYS...	VANESSA RESPONDS...
Here's a full copy of the tax return to keep for your records.	What about my W-2?
We keep copy B of your Form W-2 until December 31, and then we shred it. I'll staple the other copies of the W-2 to your copy of the return. We can put everything in this envelope, and you can put your other records and receipts in there too. If you ever need to review the return, everything will be in one place.	That's convenient.
If you bring this copy back with you next year, it will help the volunteer preparer who does your return.	Okay.
I've created the e-file of your return. Later tonight, the Site Coordinator will transmit it to the IRS. If there are any problems with the e-file, she usually finds out the next day. If she needs to call you tomorrow, will you be at one of the phone numbers you gave me earlier?	I'll be at my work number during the day, and there's an answering machine at home.
Great. She'll only call if she needs information from you to resolve a problem. See this chart in your packet? If everything goes as expected, you can start looking for your direct deposits by this date. [Show Vanessa the 2010 IRS e-file Refund Cycle chart in the Volunteer Resource Guide, Tab 14.]	That's pretty fast. What should I do if it's not there?
Give it at least one more week – direct deposits always show up on a Friday. If it's still not there, you can call the IRS Refund Hotline. The number is right here on your envelope. There are some other IRS numbers on there, too, if you ever need them. Do you have any other questions?	No, this was pretty easy.
I'm glad I got to meet you. Thanks for coming in!	

Thank Vanessa for coming to your site and remind her of where and how to check the status of her return on www.irs.gov.

33 Return to Lesson 33.

Notes

Appendix B: Vanessa’s Tax Documents



Form **13614-C**
(Rev. 8- 2009)

Department of the Treasury – Internal Revenue Service

Intake/Interview & Quality Review Sheet

OMB # 1545-1964

Section A. Page 1 and Page 2 to be completed by Taxpayer

Thank you for allowing us to prepare your tax return. It is very important for you to provide the information on this form to help our certified volunteer preparer in completing your return. **If you have any questions please ask.**

You will need your:

- Tax information such as W-2s, 1099s, 1098s.
- Social security cards or ITIN letters for you and all persons on your tax return.
- Proof of Identity (such as drivers license or other picture ID).

Part I. Your Personal Information

1. Your First Name: **Vanessa** | M. I.: **L.** | Last Name: **Franklin** | Are you a U.S. Citizen? ☑ Yes ☐ No

2. Spouse’s First Name: **Harvey** | M. I.: **M.** | Last Name: **Franklin** | Is spouse a U.S. Citizen? ☑ Yes ☐ No

3. Mailing Address: **3344 Cleveland Drive** | Apt#: **n/a** | City: **Denver** | State: **CO** | Zip Code: **80202**

4. E-mail: **n/a** | Phone: **303-555-5555**

5. Your Date of Birth: **11/12/1972** | 6. Your Occupation: **Retail Sales**

7. Are you Legally Blind ☐ Yes ☑ No

8. Totally and Permanently Disabled ☐ Yes ☑ No

9. Spouse’s Date of Birth: **07/14/1969** | 10. Spouse’s Occupation: **Cook**

11. Is Spouse Legally Blind ☐ Yes ☑ No

12. Totally and Permanently Disabled ☐ Yes ☑ No

13. Can your parents or someone else claim you or your spouse on their tax return? ☐ Yes ☑ No

Part II. Family and Dependent Information

1. As of December 31, 2009 your marital status was:

☐ Single
☑ Married: Did you live with your spouse during any part of the last six months of 2009? ☐ Yes ☑ No
☐ Divorced or Legally Separated: Date of final decree or separate maintenance agreement: ______________
☐ Widowed: Date of spouse’s death: ______________

2. List the name of everyone below who lived in your home and outside your home that you supported during the year.

Name (first, last) Do not enter your name or **Spouse’s name below.** (a)	Date of Birth (mm/dd/yy) (b)	Relationship to you (e.g. son, mother, sister) (c)	Number of months lived in your home (d)	US Citizen or resident of the US, Canada or Mexico (yes/no) (e)	Married as of 12/31/09 (yes/no) (f)	Full-time student (yes/no) (g)	Received more than $3650 in income (yes/no) (h)
Bella Franklin	04/20/09	daughter	8	yes	no	no	no
Zachary Franklin	09/07/00	son	12	yes	no	no	no
Zoe Franklin	12/12/06	daughter	12	yes	no	no	no
Annabelle Johnson	11/15/36	mother	12	yes	no	no	no

If additional space is needed please use page 4 and check here ☐

Paperwork Reduction Act Notice

The Paperwork Reduction Act requires that the IRS display an OMB control number on all public information requests. The OMB Control Number for this study is 1545-1964. Also, if you have any comments regarding the time estimates associated with this study or suggestion on making this process simpler, please write to the Internal Revenue Service, Tax Products Coordinating Committee, SE:W:CAR:MP:T:T:SP, 1111 Constitution Ave. NW, Washington, DC 20224

Please continue on Page 2

Catalog Number 52121E

Form **13614-C** (Rev. 8-2009)

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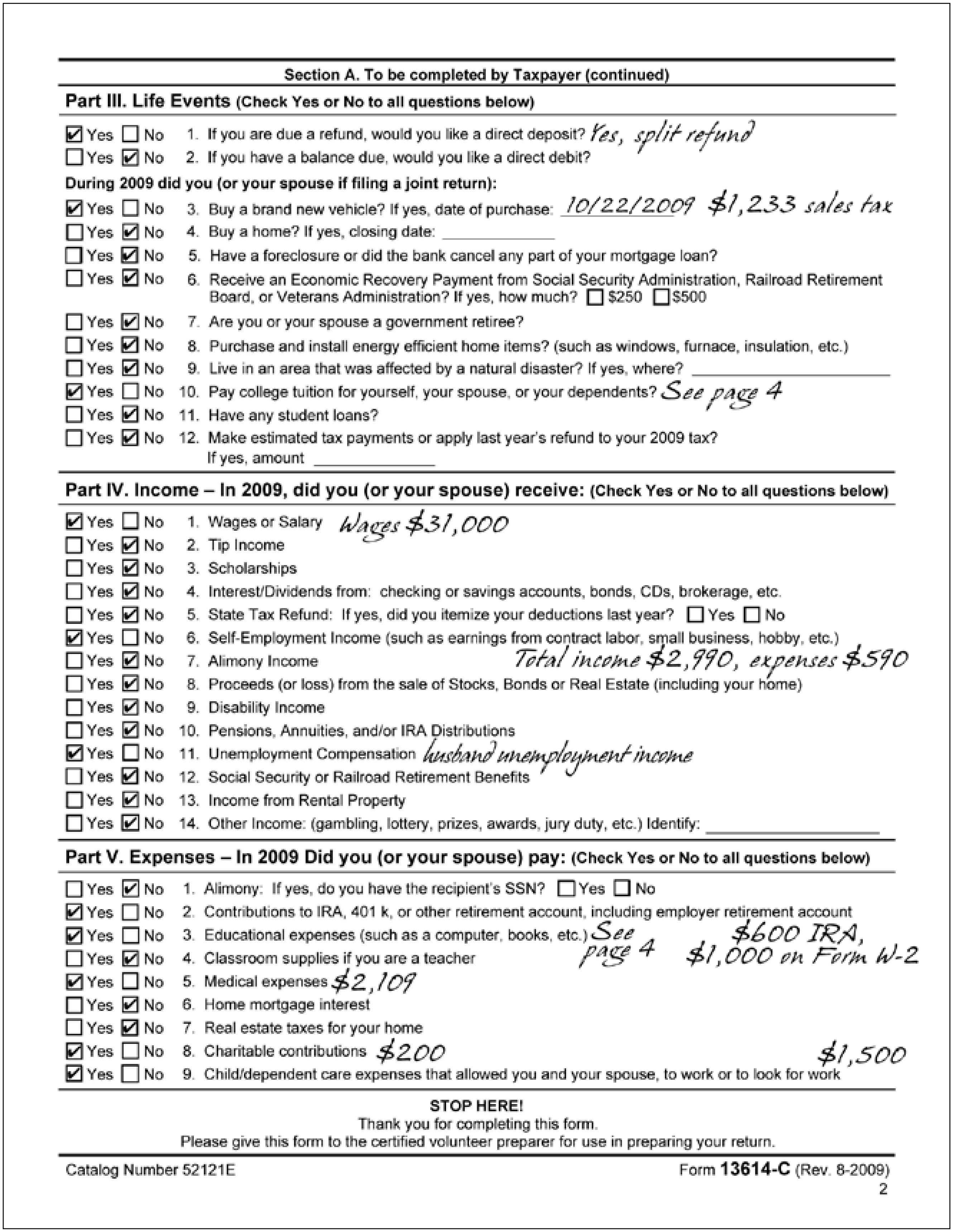


Section A. To be completed by Taxpayer (continued)

Part III. Life Events (Check Yes or No to all questions below)

☑ Yes ☐ No 1. If you are due a refund, would you like a direct deposit? Yes, split refund
☐ Yes ☑ No 2. If you have a balance due, would you like a direct debit?

During 2009 did you (or your spouse if filing a joint return):

☑ Yes ☐ No 3. Buy a brand new vehicle? If yes, date of purchase: 10/22/2009 $1,233 sales tax
☐ Yes ☑ No 4. Buy a home? If yes, closing date: ______________
☐ Yes ☑ No 5. Have a foreclosure or did the bank cancel any part of your mortgage loan?
☐ Yes ☑ No 6. Receive an Economic Recovery Payment from Social Security Administration, Railroad Retirement Board, or Veterans Administration? If yes, how much? ☐ $250 ☐ $500
☐ Yes ☑ No 7. Are you or your spouse a government retiree?
☐ Yes ☑ No 8. Purchase and install energy efficient home items? (such as windows, furnace, insulation, etc.)
☐ Yes ☑ No 9. Live in an area that was affected by a natural disaster? If yes, where? ______________
☑ Yes ☐ No 10. Pay college tuition for yourself, your spouse, or your dependents? See page 4
☐ Yes ☑ No 11. Have any student loans?
☐ Yes ☑ No 12. Make estimated tax payments or apply last year's refund to your 2009 tax? If yes, amount ______________

Part IV. Income – In 2009, did you (or your spouse) receive: (Check Yes or No to all questions below)

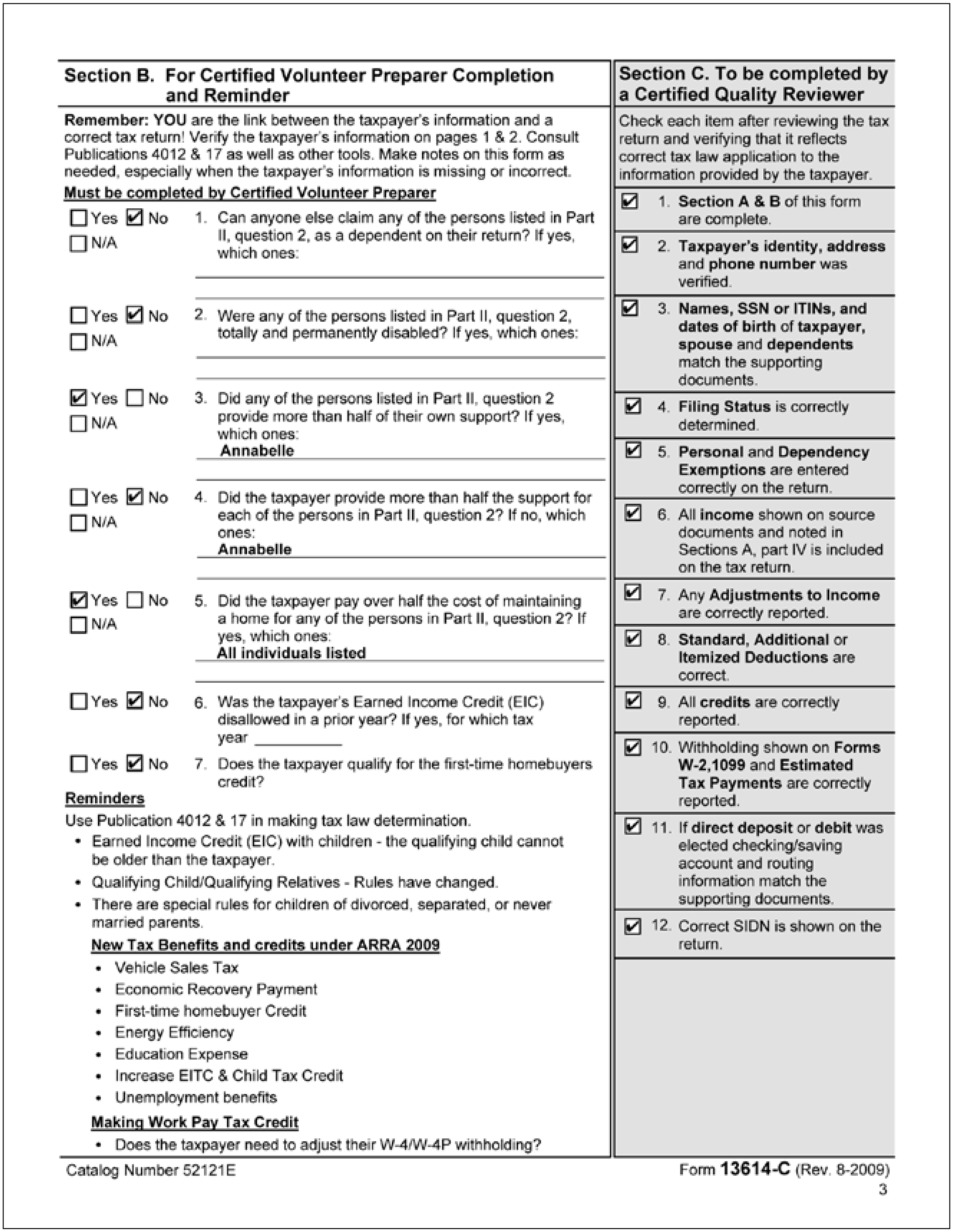
☑ Yes ☐ No 1. Wages or Salary Wages $31,000
☐ Yes ☑ No 2. Tip Income
☐ Yes ☑ No 3. Scholarships
☐ Yes ☑ No 4. Interest/Dividends from: checking or savings accounts, bonds, CDs, brokerage, etc.
☐ Yes ☑ No 5. State Tax Refund: If yes, did you itemize your deductions last year? ☐ Yes ☐ No
☑ Yes ☐ No 6. Self-Employment Income (such as earnings from contract labor, small business, hobby, etc.)
Total income $2,990, expenses $590
☐ Yes ☑ No 7. Alimony Income
☐ Yes ☑ No 8. Proceeds (or loss) from the sale of Stocks, Bonds or Real Estate (including your home)
☐ Yes ☑ No 9. Disability Income
☐ Yes ☑ No 10. Pensions, Annuities, and/or IRA Distributions
☑ Yes ☐ No 11. Unemployment Compensation husband unemployment income
☐ Yes ☑ No 12. Social Security or Railroad Retirement Benefits
☐ Yes ☑ No 13. Income from Rental Property
☐ Yes ☑ No 14. Other Income: (gambling, lottery, prizes, awards, jury duty, etc.) Identify: ______________

Part V. Expenses – In 2009 Did you (or your spouse) pay: (Check Yes or No to all questions below)

☐ Yes ☑ No 1. Alimony: If yes, do you have the recipient's SSN? ☐ Yes ☐ No
☑ Yes ☐ No 2. Contributions to IRA, 401 k, or other retirement account, including employer retirement account
☑ Yes ☐ No 3. Educational expenses (such as a computer, books, etc.) See page 4 $600 IRA, $1,000 on Form W-2
☐ Yes ☑ No 4. Classroom supplies if you are a teacher
☑ Yes ☐ No 5. Medical expenses $2,109
☐ Yes ☑ No 6. Home mortgage interest
☐ Yes ☑ No 7. Real estate taxes for your home
☑ Yes ☐ No 8. Charitable contributions $200
☑ Yes ☐ No 9. Child/dependent care expenses that allowed you and your spouse, to work or to look for work $1,500

STOP HERE!
Thank you for completing this form.
Please give this form to the certified volunteer preparer for use in preparing your return.

Catalog Number 52121E
Form **13614-C** (Rev. 8-2009)
2



Section B. For Certified Volunteer Preparer Completion and Reminder

Remember: YOU are the link between the taxpayer's information and a correct tax return! Verify the taxpayer's information on pages 1 & 2. Consult Publications 4012 & 17 as well as other tools. Make notes on this form as needed, especially when the taxpayer's information is missing or incorrect.

Must be completed by Certified Volunteer Preparer

☐ Yes ☑ No ☐ N/A 1. Can anyone else claim any of the persons listed in Part II, question 2, as a dependent on their return? If yes, which ones:

☐ Yes ☑ No ☐ N/A 2. Were any of the persons listed in Part II, question 2, totally and permanently disabled? If yes, which ones:

☑ Yes ☐ No ☐ N/A 3. Did any of the persons listed in Part II, question 2 provide more than half of their own support? If yes, which ones: **Annabelle**

☐ Yes ☑ No ☐ N/A 4. Did the taxpayer provide more than half the support for each of the persons in Part II, question 2? If no, which ones: **Annabelle**

☑ Yes ☐ No ☐ N/A 5. Did the taxpayer pay over half the cost of maintaining a home for any of the persons in Part II, question 2? If yes, which ones: **All individuals listed**

☐ Yes ☑ No 6. Was the taxpayer's Earned Income Credit (EIC) disallowed in a prior year? If yes, for which tax year ___________

☐ Yes ☑ No 7. Does the taxpayer qualify for the first-time homebuyers credit?

Reminders

Use Publication 4012 & 17 in making tax law determination.

- Earned Income Credit (EIC) with children - the qualifying child cannot be older than the taxpayer.
- Qualifying Child/Qualifying Relatives - Rules have changed.
- There are special rules for children of divorced, separated, or never married parents.

New Tax Benefits and credits under ARRA 2009

- Vehicle Sales Tax
- Economic Recovery Payment
- First-time homebuyer Credit
- Energy Efficiency
- Education Expense
- Increase EITC & Child Tax Credit
- Unemployment benefits

Making Work Pay Tax Credit

- Does the taxpayer need to adjust their W-4/W-4P withholding?

Section C. To be completed by a Certified Quality Reviewer

Check each item after reviewing the tax return and verifying that it reflects correct tax law application to the information provided by the taxpayer.

☑ 1. **Section A & B** of this form are complete.

☑ 2. **Taxpayer's identity, address** and **phone number** was verified.

☑ 3. **Names, SSN or ITINs, and dates of birth** of **taxpayer, spouse** and **dependents** match the supporting documents.

☑ 4. **Filing Status** is correctly determined.

☑ 5. **Personal** and **Dependency Exemptions** are entered correctly on the return.

☑ 6. All **income** shown on source documents and noted in Sections A, part IV is included on the tax return.

☑ 7. Any **Adjustments to Income** are correctly reported.

☑ 8. **Standard, Additional** or **Itemized Deductions** are correct.

☑ 9. All **credits** are correctly reported.

☑ 10. Withholding shown on **Forms W-2,1099** and **Estimated Tax Payments** are correctly reported.

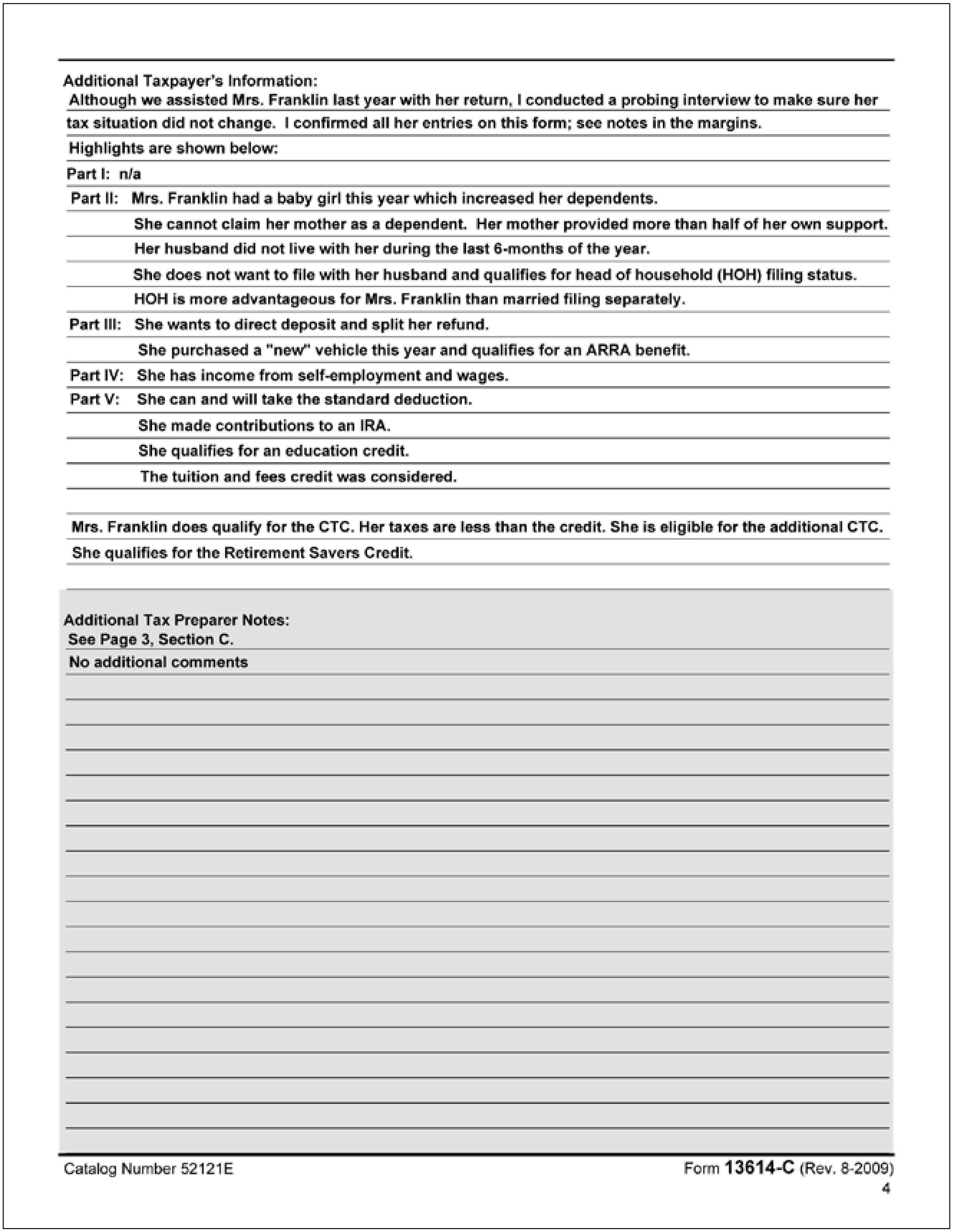
☑ 11. If **direct deposit** or **debit** was elected checking/saving account and routing information match the supporting documents.

☑ 12. Correct SIDN is shown on the return.

Catalog Number 52121E

Form **13614-C** (Rev. 8-2009)

3



Additional Taxpayer's Information:

Although we assisted Mrs. Franklin last year with her return, I conducted a probing interview to make sure her tax situation did not change. I confirmed all her entries on this form; see notes in the margins.

Highlights are shown below:

Part I: n/a

Part II: Mrs. Franklin had a baby girl this year which increased her dependents.

She cannot claim her mother as a dependent. Her mother provided more than half of her own support.

Her husband did not live with her during the last 6-months of the year.

She does not want to file with her husband and qualifies for head of household (HOH) filing status.

HOH is more advantageous for Mrs. Franklin than married filing separately.

Part III: She wants to direct deposit and split her refund.

She purchased a "new" vehicle this year and qualifies for an ARRA benefit.

Part IV: She has income from self-employment and wages.

Part V: She can and will take the standard deduction.

She made contributions to an IRA.

She qualifies for an education credit.

The tuition and fees credit was considered.

Mrs. Franklin does qualify for the CTC. Her taxes are less than the credit. She is eligible for the additional CTC.

She qualifies for the Retirement Savers Credit.

Additional Tax Preparer Notes:

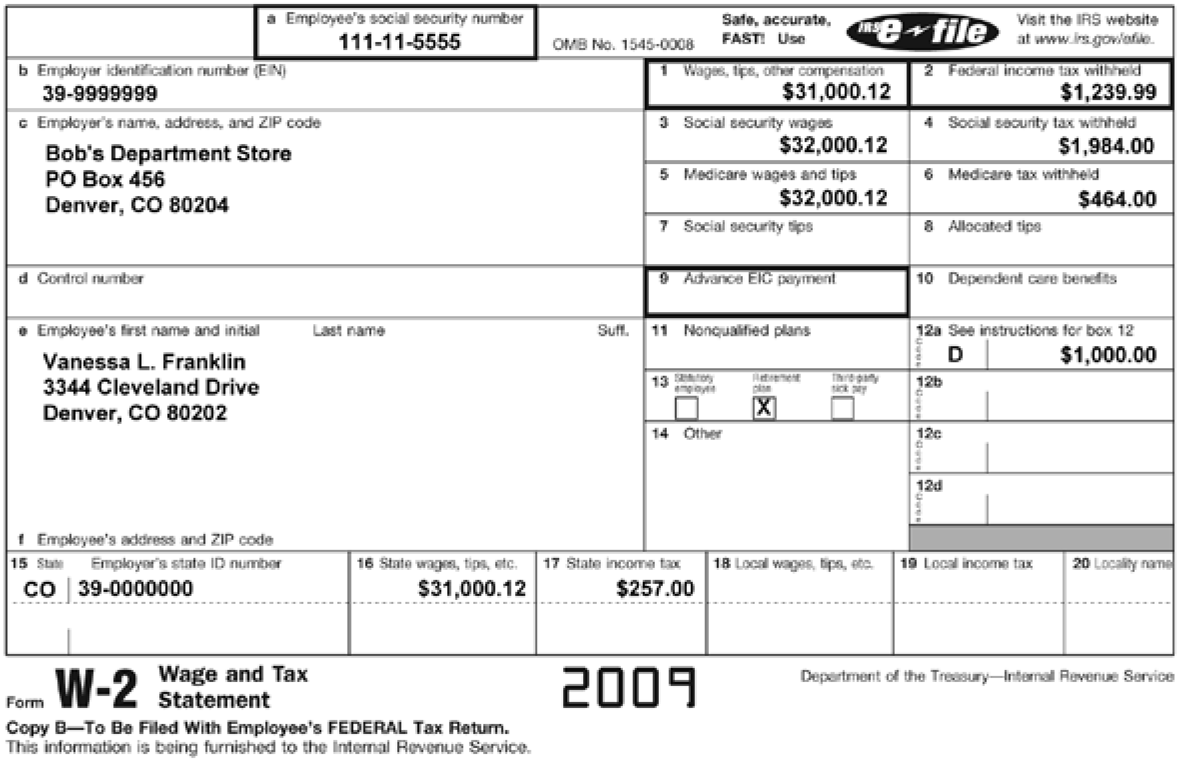
See Page 3, Section C.

No additional comments

Catalog Number 52121E

Form **13614-C** (Rev. 8-2009)

4



a Employee's social security number **111-11-5555**

OMB No. 1545-0008

Safe, accurate, FAST! Use IRS e-file

Visit the IRS website at www.irs.gov/efile.

b Employer identification number (EIN) **39-9999999**

c Employer's name, address, and ZIP code

Bob's Department Store
PO Box 456
Denver, CO 80204

d Control number

e Employee's first name and initial Last name Suff.

Vanessa L. Franklin
3344 Cleveland Drive
Denver, CO 80202

f Employee's address and ZIP code

1 Wages, tips, other compensation **$31,000.12**

2 Federal income tax withheld **$1,239.99**

3 Social security wages **$32,000.12**

4 Social security tax withheld **$1,984.00**

5 Medicare wages and tips **$32,000.12**

6 Medicare tax withheld **$464.00**

7 Social security tips

8 Allocated tips

9 Advance EIC payment

10 Dependent care benefits

11 Nonqualified plans

12a See instructions for box 12 Code **D** **$1,000.00**

13 Statutory employee ☐ Retirement plan ☒ Third-party sick pay ☐

12b Code

14 Other

12c Code

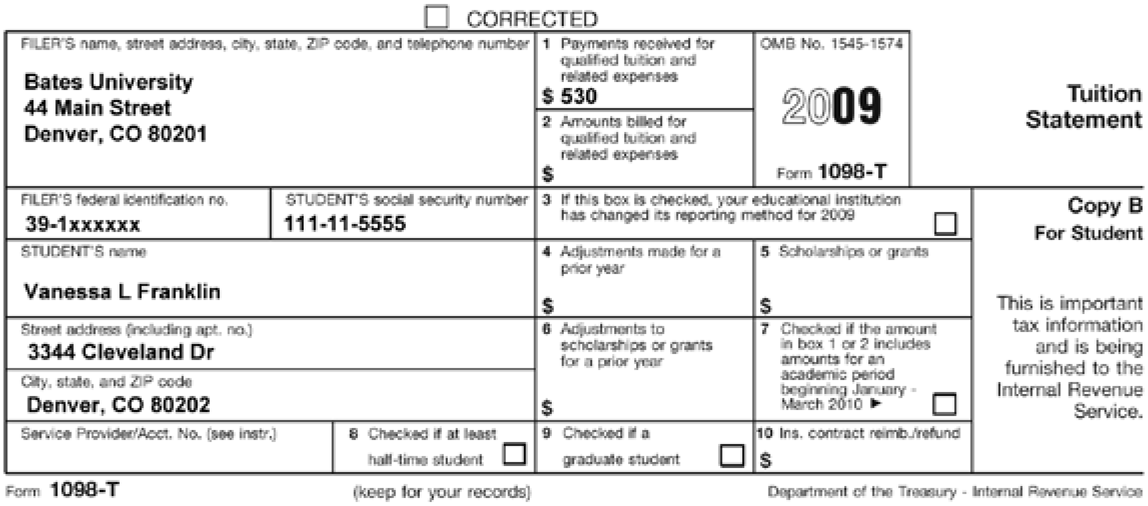
12d Code

15 State	Employer's state ID number	16 State wages, tips, etc.	17 State income tax	18 Local wages, tips, etc.	19 Local income tax	20 Locality name
CO	**39-0000000**	**$31,000.12**	**$257.00**			

Form **W-2** **Wage and Tax Statement** **2009**

Department of the Treasury—Internal Revenue Service

Copy B—To Be Filed With Employee's FEDERAL Tax Return.
This information is being furnished to the Internal Revenue Service.



☐ CORRECTED

FILER'S name, street address, city, state, ZIP code, and telephone number

Bates University
44 Main Street
Denver, CO 80201

1 Payments received for qualified tuition and related expenses **$ 530**

2 Amounts billed for qualified tuition and related expenses $

OMB No. 1545-1574

2009

Form **1098-T**

Tuition Statement

FILER'S federal identification no. **39-1xxxxxx**

STUDENT'S social security number **111-11-5555**

3 If this box is checked, your educational institution has changed its reporting method for 2009 ☐

Copy B
For Student

STUDENT'S name **Vanessa L Franklin**

4 Adjustments made for a prior year $

5 Scholarships or grants $

Street address (including apt. no.) **3344 Cleveland Dr**

City, state, and ZIP code **Denver, CO 80202**

6 Adjustments to scholarships or grants for a prior year $

7 Checked if the amount in box 1 or 2 includes amounts for an academic period beginning January - March 2010 ► ☐

This is important tax information and is being furnished to the Internal Revenue Service.

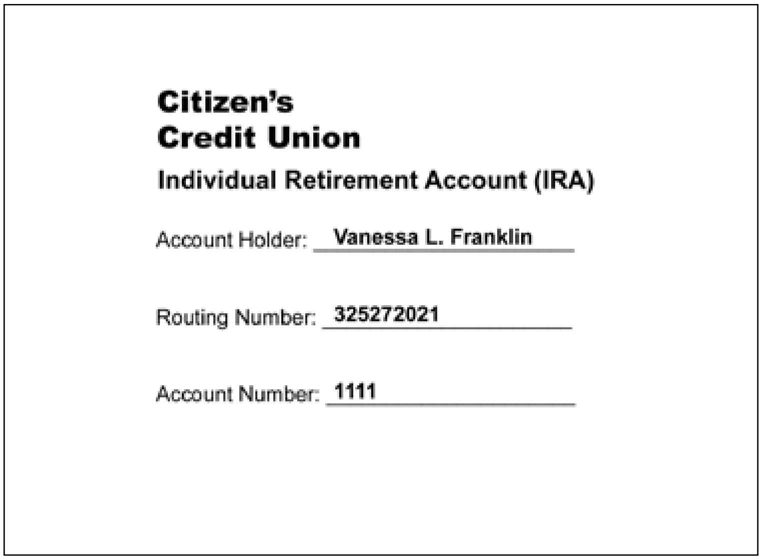
Service Provider/Acct. No. (see instr.)

8 Checked if at least half-time student ☐

9 Checked if a graduate student ☐

10 Ins. contract reimb./refund $

Form **1098-T** (keep for your records) Department of the Treasury - Internal Revenue Service



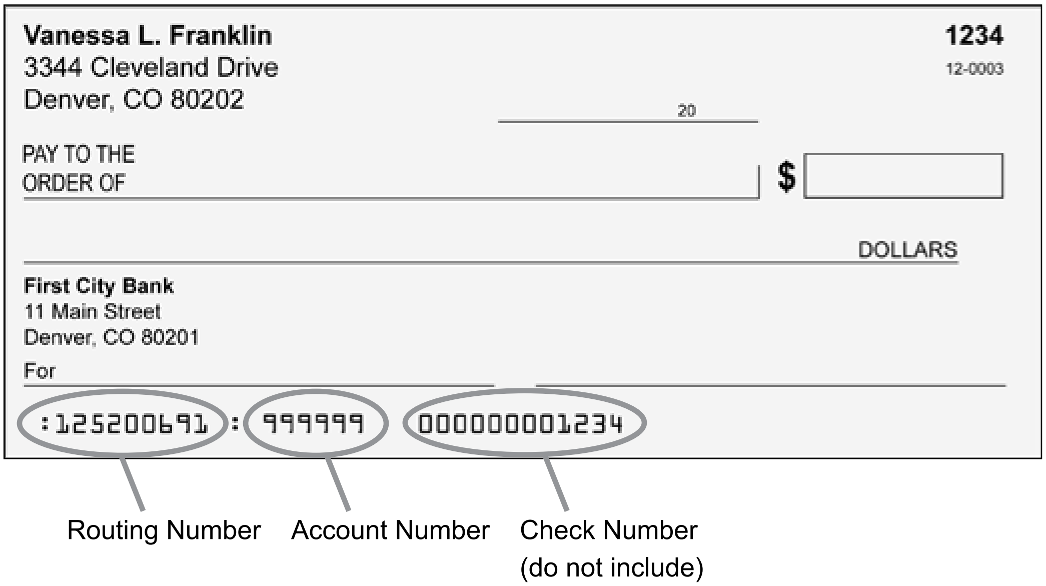
Citizen's Credit Union

Individual Retirement Account (IRA)

Account Holder: Vanessa L. Franklin

Routing Number: 325272021

Account Number: 1111



Vanessa L. Franklin
3344 Cleveland Drive
Denver, CO 80202

1234
12-0003

20

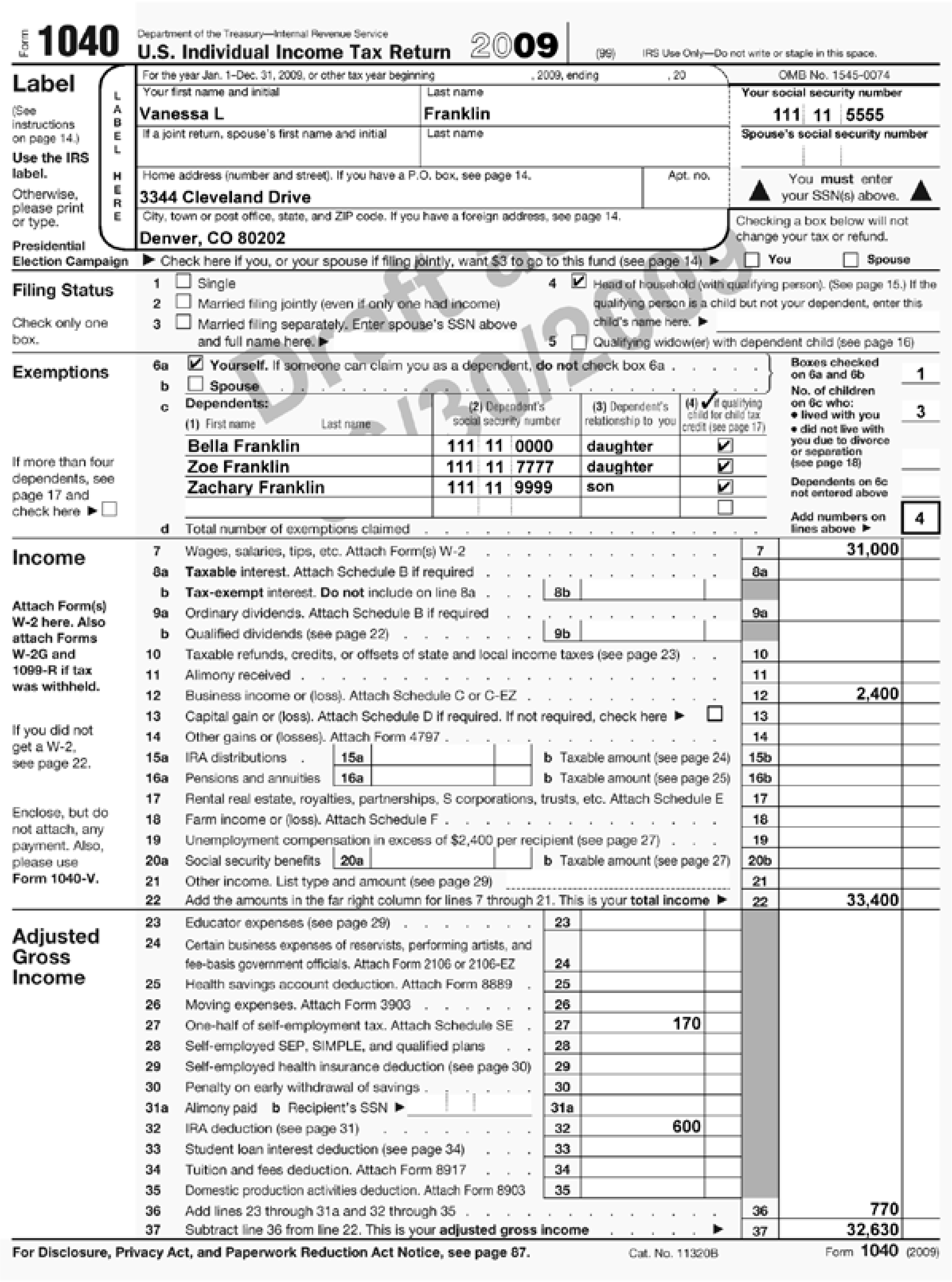
PAY TO THE ORDER OF $

DOLLARS

First City Bank
11 Main Street
Denver, CO 80201

For

:125200691 :999999 000000001234



Form **1040** Department of the Treasury—Internal Revenue Service
U.S. Individual Income Tax Return **2009** (99) IRS Use Only—Do not write or staple in this space.

Label (See instructions on page 14.) **Use the IRS label.** Otherwise, please print or type.
LABEL HERE

For the year Jan. 1–Dec. 31, 2009, or other tax year beginning , 2009, ending , 20
OMB No. 1545-0074

Your first name and initial **Vanessa L**	Last name **Franklin**	**Your social security number** **111 11 5555**
If a joint return, spouse's first name and initial	Last name	**Spouse's social security number**
Home address (number and street). If you have a P.O. box, see page 14. **3344 Cleveland Drive**	Apt. no.	▲ You **must** enter your SSN(s) above. ▲
City, town or post office, state, and ZIP code. If you have a foreign address, see page 14. **Denver, CO 80202**		Checking a box below will not change your tax or refund.

Presidential Election Campaign ▶ Check here if you, or your spouse if filing jointly, want $3 to go to this fund (see page 14) ▶ ☐ You ☐ Spouse

Filing Status

Check only one box.

1 ☐ Single
2 ☐ Married filing jointly (even if only one had income)
3 ☐ Married filing separately. Enter spouse's SSN above and full name here. ▶
4 ☑ Head of household (with qualifying person). (See page 15.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶
5 ☐ Qualifying widow(er) with dependent child (see page 16)

Exemptions

6a ☑ **Yourself.** If someone can claim you as a dependent, **do not** check box 6a
b ☐ **Spouse**

Boxes checked on 6a and 6b: 1

c **Dependents:**

(1) First name Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) ✓ if qualifying child for child tax credit (see page 17)
Bella Franklin	**111 11 0000**	**daughter**	☑
Zoe Franklin	**111 11 7777**	**daughter**	☑
Zachary Franklin	**111 11 9999**	**son**	☑
			☐

If more than four dependents, see page 17 and check here ▶ ☐

No. of children on 6c who:
- lived with you: 3
- did not live with you due to divorce or separation (see page 18):

Dependents on 6c not entered above:

d Total number of exemptions claimed

Add numbers on lines above ▶ 4

Income

Attach Form(s) W-2 here. Also attach Forms W-2G and 1099-R if tax was withheld.

If you did not get a W-2, see page 22.

Enclose, but do not attach, any payment. Also, please use **Form 1040-V.**

7	Wages, salaries, tips, etc. Attach Form(s) W-2			7	31,000
8a	**Taxable** interest. Attach Schedule B if required			8a	
b	**Tax-exempt** interest. **Do not** include on line 8a	8b			
9a	Ordinary dividends. Attach Schedule B if required			9a	
b	Qualified dividends (see page 22)	9b			
10	Taxable refunds, credits, or offsets of state and local income taxes (see page 23)			10	
11	Alimony received			11	
12	Business income or (loss). Attach Schedule C or C-EZ			12	2,400
13	Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ ☐			13	
14	Other gains or (losses). Attach Form 4797			14	
15a	IRA distributions	15a	b Taxable amount (see page 24)	15b	
16a	Pensions and annuities	16a	b Taxable amount (see page 25)	16b	
17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E			17	
18	Farm income or (loss). Attach Schedule F			18	
19	Unemployment compensation in excess of $2,400 per recipient (see page 27)			19	
20a	Social security benefits	20a	b Taxable amount (see page 27)	20b	
21	Other income. List type and amount (see page 29)			21	
22	Add the amounts in the far right column for lines 7 through 21. This is your **total income** ▶			22	33,400

Adjusted Gross Income

23	Educator expenses (see page 29)	23			
24	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ	24			
25	Health savings account deduction. Attach Form 8889	25			
26	Moving expenses. Attach Form 3903	26			
27	One-half of self-employment tax. Attach Schedule SE	27	170		
28	Self-employed SEP, SIMPLE, and qualified plans	28			
29	Self-employed health insurance deduction (see page 30)	29			
30	Penalty on early withdrawal of savings	30			
31a	Alimony paid **b** Recipient's SSN ▶	31a			
32	IRA deduction (see page 31)	32	600		
33	Student loan interest deduction (see page 34)	33			
34	Tuition and fees deduction. Attach Form 8917	34			
35	Domestic production activities deduction. Attach Form 8903	35			
36	Add lines 23 through 31a and 32 through 35			36	770
37	Subtract line 36 from line 22. This is your **adjusted gross income** ▶			37	32,630

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see page 67. Cat. No. 11320B Form **1040** (2009)

Form 1040 (2009) Page **2**

Tax and Credits	38	Amount from line 37 (adjusted gross income)			38	32,630
	39a	Check if: ☐ **You** were born before January 2, 1945, ☐ Blind. ☐ **Spouse** was born before January 2, 1945, ☐ Blind. } **Total boxes checked** ▶ **39a** ☐				
Standard Deduction for— • People who check any box on line 39a, 39b, or 40b **or** who can be claimed as a dependent, see page 35. • All others: Single or Married filing separately, $5,700 Married filing jointly or Qualifying widow(er), $11,400 Head of household, $8,350	b	If your spouse itemizes on a separate return or you were a dual-status alien, see page 35 and check here ▶ 39b ☐				
	40a	**Itemized deductions** (from Schedule A) **or** your **standard deduction** (see left margin)			40a	9,583
	b	If you are increasing your standard deduction by certain real estate taxes, new motor vehicle taxes, or a net disaster loss, attach Schedule L and check here (see page 35) ▶ 40b ☑				
	41	Subtract line 40a from line 38			41	23,047
	42	**Exemptions.** If line 38 is $125,100 or less and you did not provide housing to a Midwestern displaced individual, multiply $3,650 by the number on line 6d. Otherwise, see page 37			42	14,600
	43	**Taxable income.** Subtract line 42 from line 41. If line 42 is more than line 41, enter -0-			43	8,447
	44	**Tax** (see page 37). Check if any tax is from: a ☐ Form(s) 8814 b ☐ Form 4972			44	843
	45	**Alternative minimum tax** (see page 40). Attach Form 6251			45	0
	46	Add lines 44 and 45 ▶			46	843
	47	Foreign tax credit. Attach Form 1116 if required	47	0		
	48	Credit for child and dependent care expenses. Attach Form 2441	48	390		
	49	Education credits from Form 8863, line 29	49	86		
	50	Retirement savings contributions credit. Attach Form 8880	50	160		
	51	Child tax credit (see page 42)	51	207		
	52	Credits from Form: a ☐ 8396 b ☐ 8839 c ☐ 5695	52			
	53	Other credits from Form: a ☐ 3800 b ☐ 8801 c ☐	53			
	54	Add lines 47 through 53. These are your **total credits**			54	843
	55	Subtract line 54 from line 46. If line 54 is more than line 46, enter -0- ▶			55	0
Other Taxes	56	Self-employment tax. Attach Schedule SE			56	339
	57	Unreported social security and Medicare tax from Form: a ☐ 4137 b ☐ 8919			57	
	58	Additional tax on IRAs, other qualified retirement plans, etc. Attach Form 5329 if required			58	
	59	Additional taxes: a ☐ AEIC payments b ☐ Household employment taxes. Attach Schedule H			59	
	60	Add lines 55 through 59. This is your **total tax** ▶			60	339
Payments	61	Federal income tax withheld from Forms W-2 and 1099	61	1,240		
	62	2009 estimated tax payments and amount applied from 2008 return	62			
If you have a qualifying child, attach Schedule EIC.	63	Making work pay and government retiree credits. Attach Schedule M	63	400		
	64a	**Earned income credit (EIC)**	64a	2,117		
	b	Nontaxable combat pay election 64b				
	65	Additional child tax credit. Attach Form 8812	65	2,793		
	66	Refundable education credit from Form 8863, line 16	66	0		
	67	First-time homebuyer credit. Attach Form 5405	67	0		
	68	Amount paid with request for extension to file (see page 62)	68	0		
	69	Excess social security and tier 1 RRTA tax withheld (see page 62)	69	0		
	70	Credits from Form: a ☐ 2439 b ☐ 4136 c ☐ 8801 d ☐ 8885	70	0		
	71	Add lines 61, 62, 63, 64a, and 65 through 70. These are your **total payments** ▶			71	6,550
Refund	72	If line 71 is more than line 60, subtract line 60 from line 71. This is the amount you **overpaid**			72	6,211
Direct deposit? See page 62 and fill in 73b, 73c, and 73d, or Form 8888.	73a	Amount of line 72 you want **refunded to you.** If Form 8888 is attached, check here ▶ ☑			73a	
▶	b	Routing number ▶ c Type: ☐ Checking ☐ Savings				
▶	d	Account number				
	74	Amount of line 72 you want **applied to your 2010 estimated tax** ▶	74			
Amount You Owe	75	**Amount you owe.** Subtract line 71 from line 60. For details on how to pay, see page 64 ▶			75	
	76	Estimated tax penalty (see page 64)	76			

Third Party Designee Do you want to allow another person to discuss this return with the IRS (see page 65)? ☐ **Yes.** Complete the following. ☑ **No**

Designee's name ▶ Phone no. ▶ Personal identification number (PIN) ▶

Sign Here Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

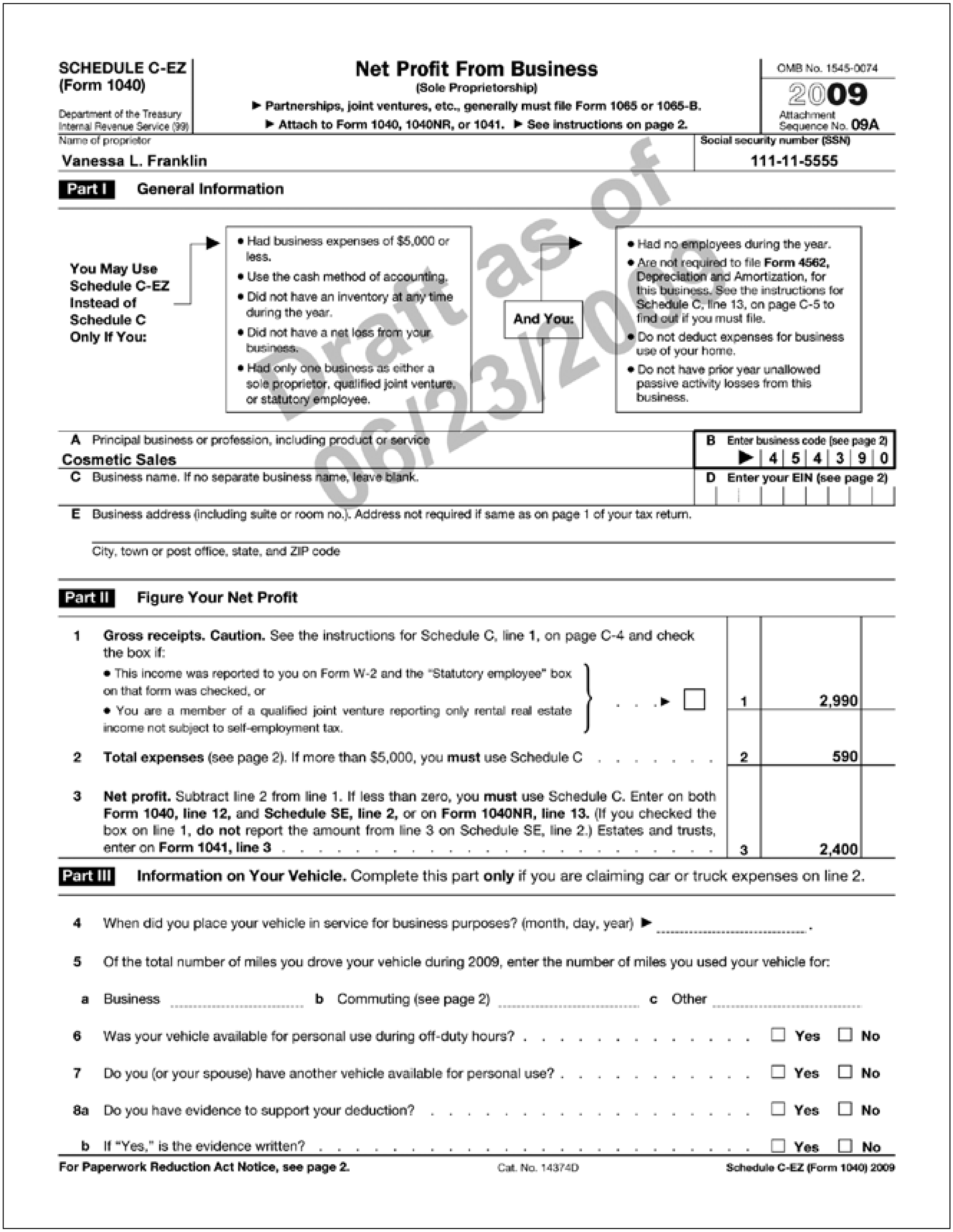
Joint return? See page 15. Keep a copy for your records.

Your signature	Date	Your occupation	Daytime phone number
Spouse's signature. If a joint return, **both** must sign.	Date	Spouse's occupation	

Paid Preparer's Use Only

Preparer's signature ▶	Date	Check if self-employed ☐	Preparer's SSN or PTIN SXXXXXXXX
Firm's name (or yours if self-employed), address, and ZIP code ▶		EIN	
		Phone no.	

Form **1040** (2009)



SCHEDULE C-EZ
(Form 1040)

Department of the Treasury
Internal Revenue Service (99)

Net Profit From Business

(Sole Proprietorship)

► Partnerships, joint ventures, etc., generally must file Form 1065 or 1065-B.

► Attach to Form 1040, 1040NR, or 1041. ► See instructions on page 2.

OMB No. 1545-0074

2009

Attachment Sequence No. **09A**

Name of proprietor	Social security number (SSN)
Vanessa L. Franklin	111-11-5555

Part I General Information

You May Use Schedule C-EZ Instead of Schedule C Only If You:

- Had business expenses of $5,000 or less.
- Use the cash method of accounting.
- Did not have an inventory at any time during the year.
- Did not have a net loss from your business.
- Had only one business as either a sole proprietor, qualified joint venture, or statutory employee.

And You:

- Had no employees during the year.
- Are not required to file **Form 4562,** Depreciation and Amortization, for this business. See the instructions for Schedule C, line 13, on page C-5 to find out if you must file.
- Do not deduct expenses for business use of your home.
- Do not have prior year unallowed passive activity losses from this business.

A Principal business or profession, including product or service
Cosmetic Sales

B Enter business code (see page 2) ► 4 5 4 3 9 0

C Business name. If no separate business name, leave blank.

D Enter your EIN (see page 2)

E Business address (including suite or room no.). Address not required if same as on page 1 of your tax return.

City, town or post office, state, and ZIP code

Part II Figure Your Net Profit

1	**Gross receipts. Caution.** See the instructions for Schedule C, line **1**, on page C-4 and check the box if: • This income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked, or • You are a member of a qualified joint venture reporting only rental real estate income not subject to self-employment tax. . . . ► ☐	1	2,990
2	**Total expenses** (see page 2). If more than $5,000, you **must** use Schedule C	2	590
3	**Net profit.** Subtract line 2 from line 1. If less than zero, you **must** use Schedule C. Enter on both **Form 1040, line 12,** and **Schedule SE, line 2,** or on **Form 1040NR, line 13.** (If you checked the box on line 1, **do not** report the amount from line 3 on Schedule SE, line 2.) Estates and trusts, enter on **Form 1041, line 3**	3	2,400

Part III Information on Your Vehicle. Complete this part **only** if you are claiming car or truck expenses on line 2.

4 When did you place your vehicle in service for business purposes? (month, day, year) ► ______________.

5 Of the total number of miles you drove your vehicle during 2009, enter the number of miles you used your vehicle for:

a Business ______________ **b** Commuting (see page 2) ______________ **c** Other ______________

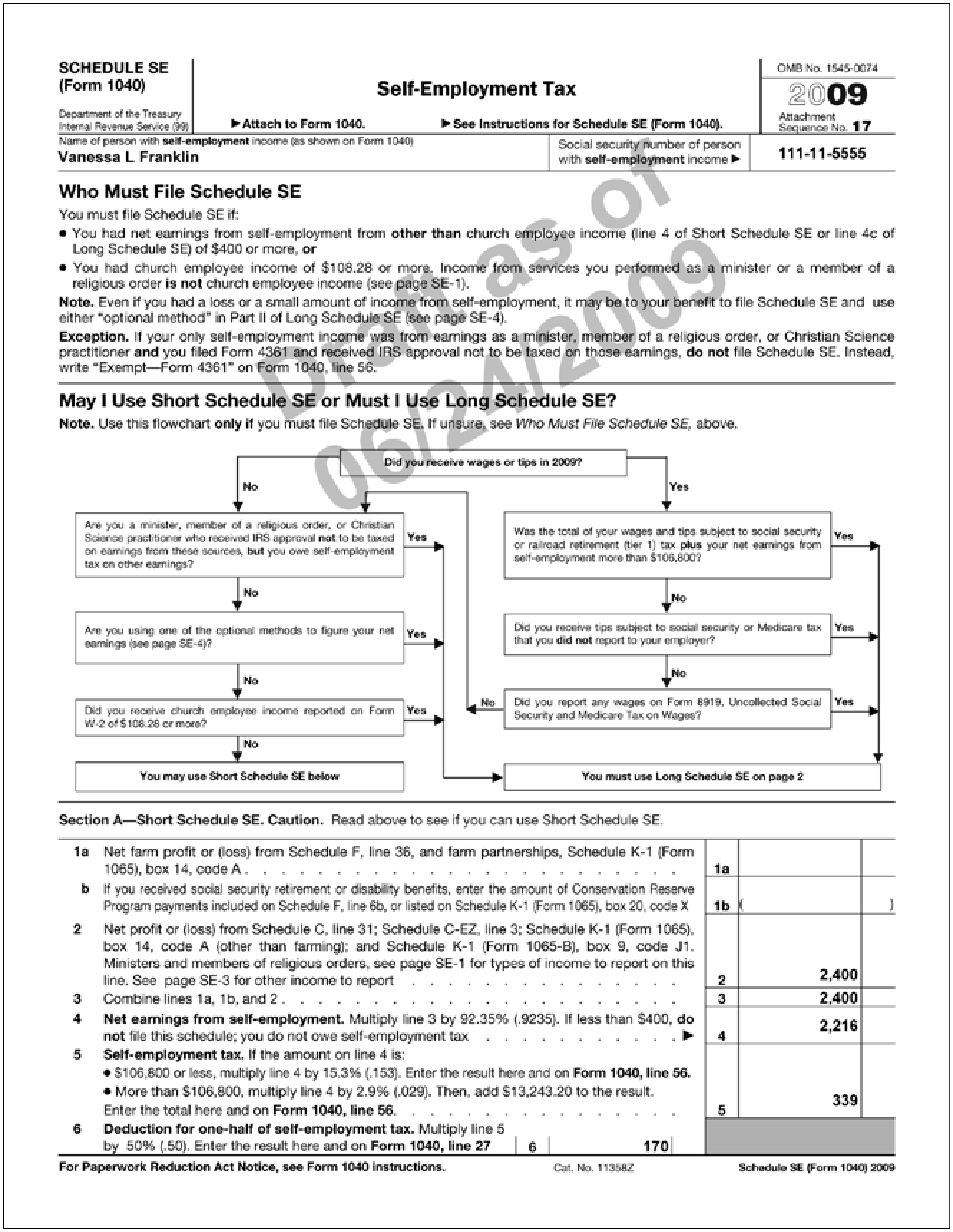
6 Was your vehicle available for personal use during off-duty hours? . . . . ☐ **Yes** ☐ **No**

7 Do you (or your spouse) have another vehicle available for personal use? . . . . ☐ **Yes** ☐ **No**

8a Do you have evidence to support your deduction? . . . . ☐ **Yes** ☐ **No**

b If "Yes," is the evidence written? . . . . ☐ **Yes** ☐ **No**

For Paperwork Reduction Act Notice, see page 2. Cat. No. 14374D **Schedule C-EZ (Form 1040) 2009**



SCHEDULE SE (Form 1040)

Department of the Treasury
Internal Revenue Service (99)

Self-Employment Tax

▶ Attach to Form 1040. ▶ See Instructions for Schedule SE (Form 1040).

OMB No. 1545-0074

2009

Attachment Sequence No. 17

Name of person with **self-employment** income (as shown on Form 1040): **Vanessa L Franklin**

Social security number of person with **self-employment** income ▶ **111-11-5555**

Who Must File Schedule SE

You must file Schedule SE if:

- You had net earnings from self-employment from **other than** church employee income (line 4 of Short Schedule SE or line 4c of Long Schedule SE) of $400 or more, **or**
- You had church employee income of $108.28 or more. Income from services you performed as a minister or a member of a religious order **is not** church employee income (see page SE-1).

Note. Even if you had a loss or a small amount of income from self-employment, it may be to your benefit to file Schedule SE and use either "optional method" in Part II of Long Schedule SE (see page SE-4).

Exception. If your only self-employment income was from earnings as a minister, member of a religious order, or Christian Science practitioner **and** you filed Form 4361 and received IRS approval not to be taxed on those earnings, **do not** file Schedule SE. Instead, write "Exempt—Form 4361" on Form 1040, line 56.

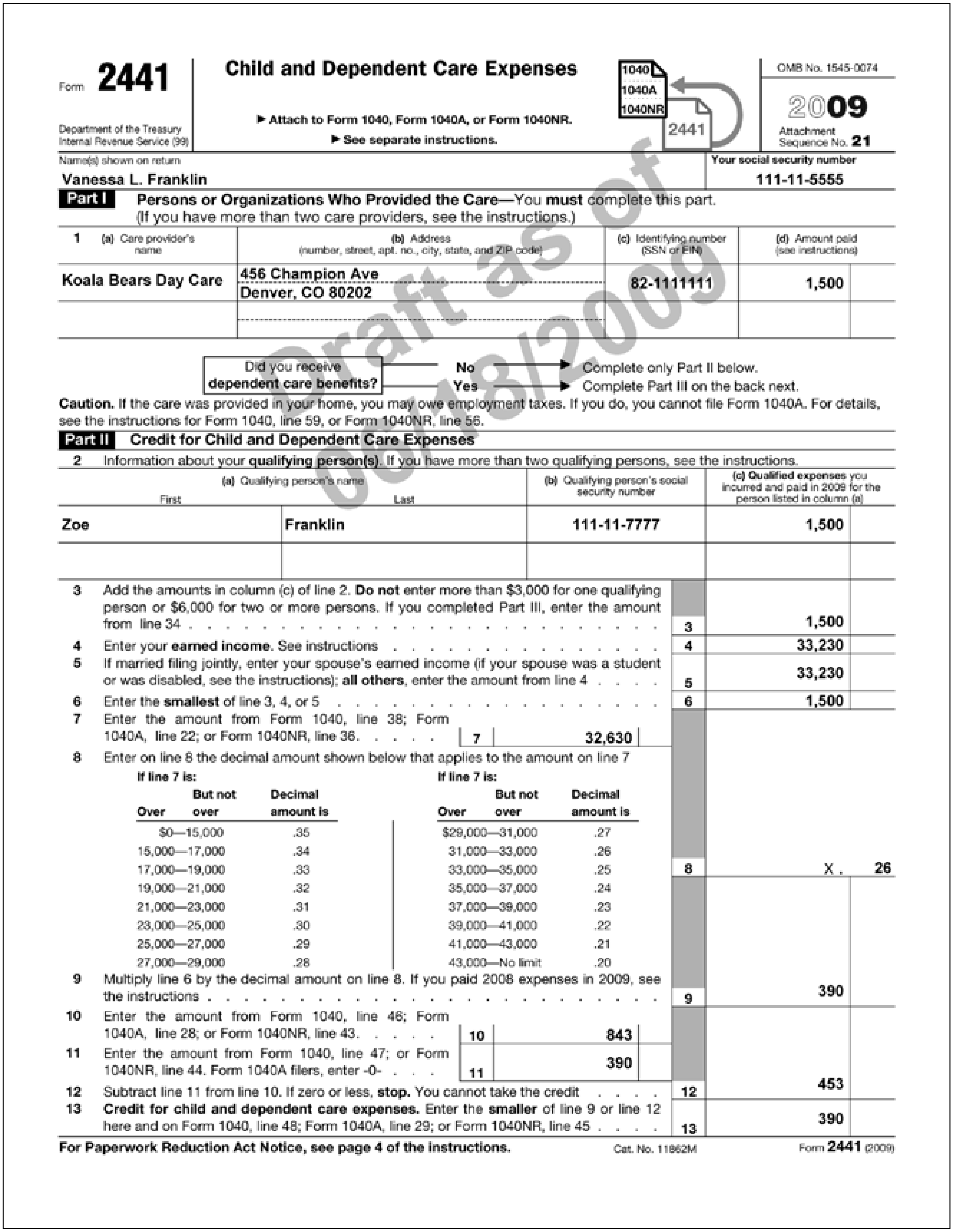
May I Use Short Schedule SE or Must I Use Long Schedule SE?

Note. Use this flowchart **only if** you must file Schedule SE. If unsure, see *Who Must File Schedule SE,* above.

Section A—Short Schedule SE. Caution. Read above to see if you can use Short Schedule SE.

1a	Net farm profit or (loss) from Schedule F, line 36, and farm partnerships, Schedule K-1 (Form 1065), box 14, code A	1a	
b	If you received social security retirement or disability benefits, enter the amount of Conservation Reserve Program payments included on Schedule F, line 6b, or listed on Schedule K-1 (Form 1065), box 20, code X	1b	( )
2	Net profit or (loss) from Schedule C, line 31; Schedule C-EZ, line 3; Schedule K-1 (Form 1065), box 14, code A (other than farming); and Schedule K-1 (Form 1065-B), box 9, code J1. Ministers and members of religious orders, see page SE-1 for types of income to report on this line. See page SE-3 for other income to report	2	2,400
3	Combine lines 1a, 1b, and 2	3	2,400
4	**Net earnings from self-employment.** Multiply line 3 by 92.35% (.9235). If less than $400, **do not** file this schedule; you do not owe self-employment tax ▶	4	2,216
5	**Self-employment tax.** If the amount on line 4 is: • $106,800 or less, multiply line 4 by 15.3% (.153). Enter the result here and on **Form 1040, line 56.** • More than $106,800, multiply line 4 by 2.9% (.029). Then, add $13,243.20 to the result. Enter the total here and on **Form 1040, line 56.**	5	339
6	**Deduction for one-half of self-employment tax.** Multiply line 5 by 50% (.50). Enter the result here and on **Form 1040, line 27** | 6 | 170		

For Paperwork Reduction Act Notice, see Form 1040 instructions. Cat. No. 11358Z **Schedule SE (Form 1040) 2009**



Form **2441**

Department of the Treasury
Internal Revenue Service (99)

Child and Dependent Care Expenses

▶ Attach to Form 1040, Form 1040A, or Form 1040NR.
▶ See separate instructions.

OMB No. 1545-0074
2009
Attachment Sequence No. **21**

Name(s) shown on return	**Your social security number**
Vanessa L. Franklin	111-11-5555

Part I **Persons or Organizations Who Provided the Care**—You **must** complete this part.
(If you have more than two care providers, see the instructions.)

1 (a) Care provider's name	(b) Address (number, street, apt. no., city, state, and ZIP code)	(c) Identifying number (SSN or EIN)	(d) Amount paid (see instructions)
Koala Bears Day Care	456 Champion Ave Denver, CO 80202	82-1111111	1,500

Did you receive **dependent care benefits?** — **No** ▶ Complete only Part II below. — **Yes** ▶ Complete Part III on the back next.

Caution. If the care was provided in your home, you may owe employment taxes. If you do, you cannot file Form 1040A. For details, see the instructions for Form 1040, line 59, or Form 1040NR, line 56.

Part II **Credit for Child and Dependent Care Expenses**

2 Information about your **qualifying person(s)**. If you have more than two qualifying persons, see the instructions.

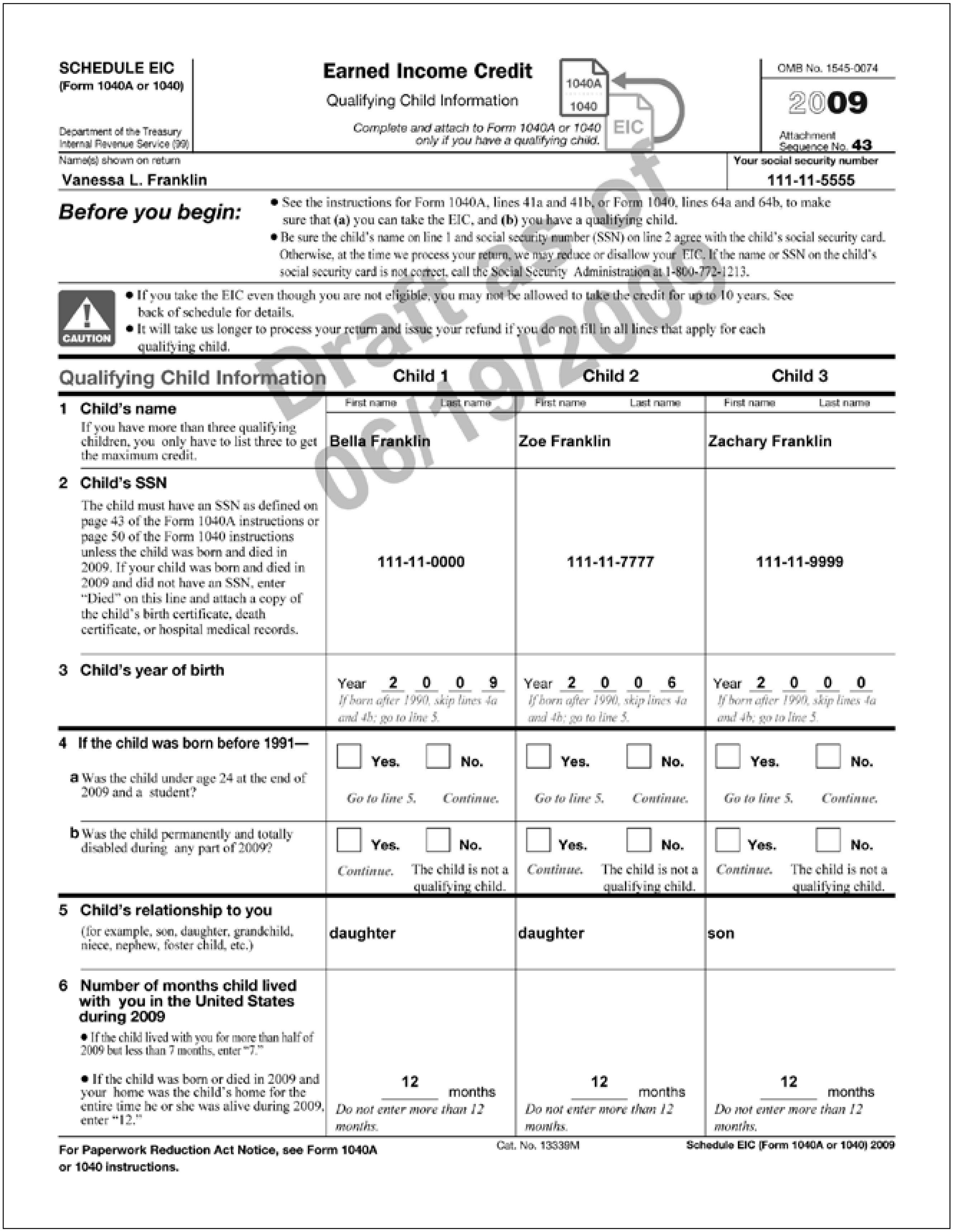
(a) Qualifying person's name — First	Last	(b) Qualifying person's social security number	(c) **Qualified expenses** you incurred and paid in 2009 for the person listed in column (a)
Zoe	Franklin	111-11-7777	1,500

3	Add the amounts in column (c) of line 2. **Do not** enter more than $3,000 for one qualifying person or $6,000 for two or more persons. If you completed Part III, enter the amount from line 34	3	1,500
4	Enter your **earned income.** See instructions	4	33,230
5	If married filing jointly, enter your spouse's earned income (if your spouse was a student or was disabled, see the instructions); **all others**, enter the amount from line 4	5	33,230
6	Enter the **smallest** of line 3, 4, or 5	6	1,500
7	Enter the amount from Form 1040, line 38; Form 1040A, line 22; or Form 1040NR, line 36. — 7 — 32,630		
8	Enter on line 8 the decimal amount shown below that applies to the amount on line 7	8	X . 26

If line 7 is: Over	But not over	Decimal amount is	If line 7 is: Over	But not over	Decimal amount is
$0	15,000	.35	$29,000	31,000	.27
15,000	17,000	.34	31,000	33,000	.26
17,000	19,000	.33	33,000	35,000	.25
19,000	21,000	.32	35,000	37,000	.24
21,000	23,000	.31	37,000	39,000	.23
23,000	25,000	.30	39,000	41,000	.22
25,000	27,000	.29	41,000	43,000	.21
27,000	29,000	.28	43,000	No limit	.20

9	Multiply line 6 by the decimal amount on line 8. If you paid 2008 expenses in 2009, see the instructions	9	390
10	Enter the amount from Form 1040, line 46; Form 1040A, line 28; or Form 1040NR, line 43. — 10 — 843		
11	Enter the amount from Form 1040, line 47; or Form 1040NR, line 44. Form 1040A filers, enter -0- — 11 — 390		
12	Subtract line 11 from line 10. If zero or less, **stop.** You cannot take the credit	12	453
13	**Credit for child and dependent care expenses.** Enter the **smaller** of line 9 or line 12 here and on Form 1040, line 48; Form 1040A, line 29; or Form 1040NR, line 45	13	390

For Paperwork Reduction Act Notice, see page 4 of the instructions. Cat. No. 11862M Form **2441** (2009)



SCHEDULE EIC
(Form 1040A or 1040)

Department of the Treasury
Internal Revenue Service (99)

Earned Income Credit

Qualifying Child Information

Complete and attach to Form 1040A or 1040 only if you have a qualifying child.

OMB No. 1545-0074

2009

Attachment Sequence No. **43**

Name(s) shown on return: **Vanessa L. Franklin**

Your social security number: **111-11-5555**

Before you begin:

- See the instructions for Form 1040A, lines 41a and 41b, or Form 1040, lines 64a and 64b, to make sure that **(a)** you can take the EIC, and **(b)** you have a qualifying child.
- Be sure the child's name on line 1 and social security number (SSN) on line 2 agree with the child's social security card. Otherwise, at the time we process your return, we may reduce or disallow your EIC. If the name or SSN on the child's social security card is not correct, call the Social Security Administration at 1-800-772-1213.

CAUTION

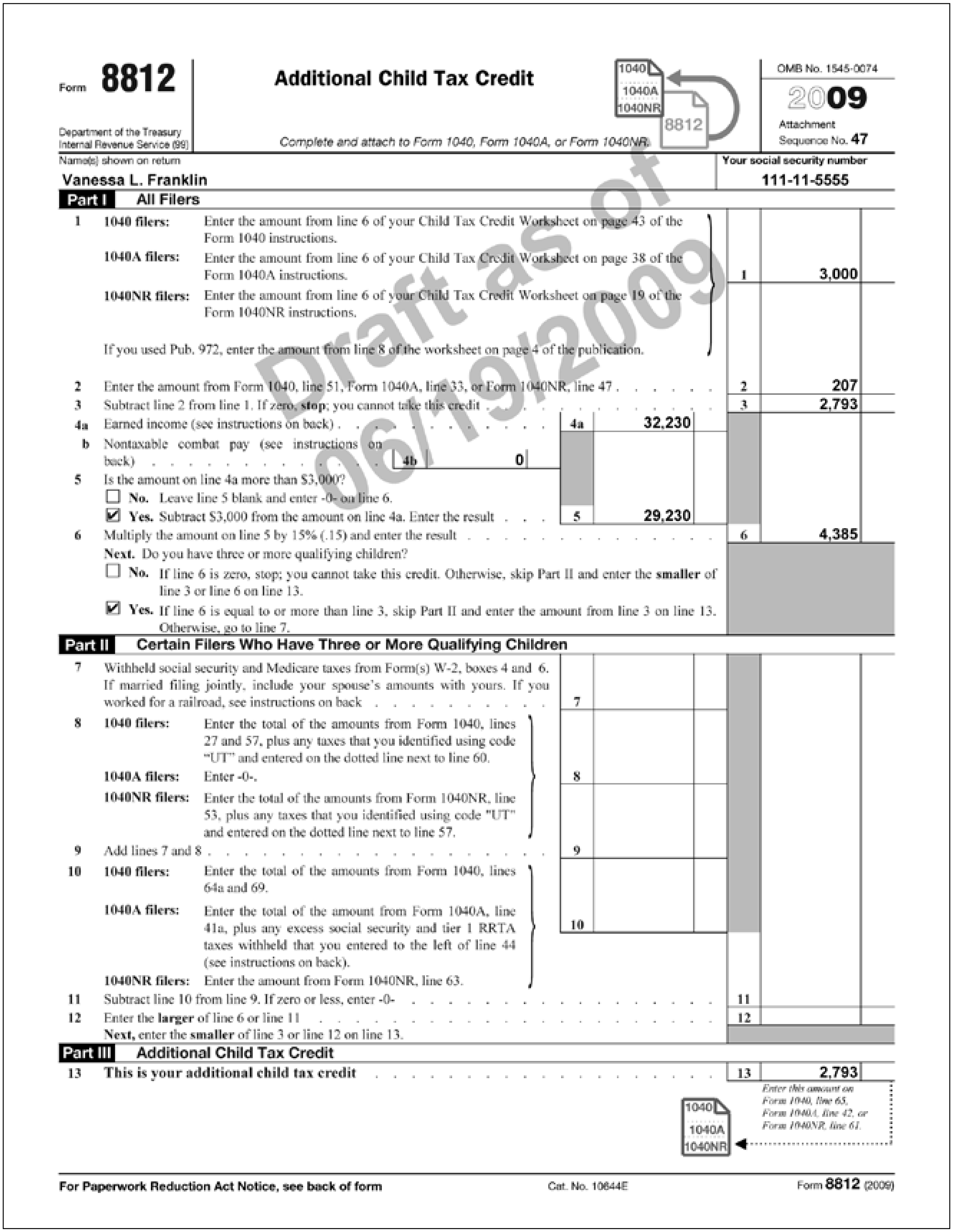
- If you take the EIC even though you are not eligible, you may not be allowed to take the credit for up to 10 years. See back of schedule for details.
- It will take us longer to process your return and issue your refund if you do not fill in all lines that apply for each qualifying child.

Qualifying Child Information	Child 1	Child 2	Child 3
1 Child's name If you have more than three qualifying children, you only have to list three to get the maximum credit.	First name Last name **Bella Franklin**	First name Last name **Zoe Franklin**	First name Last name **Zachary Franklin**
2 Child's SSN The child must have an SSN as defined on page 43 of the Form 1040A instructions or page 50 of the Form 1040 instructions unless the child was born and died in 2009. If your child was born and died in 2009 and did not have an SSN, enter "Died" on this line and attach a copy of the child's birth certificate, death certificate, or hospital medical records.	**111-11-0000**	**111-11-7777**	**111-11-9999**
3 Child's year of birth	Year 2 0 0 9 *If born after 1990, skip lines 4a and 4b; go to line 5.*	Year 2 0 0 6 *If born after 1990, skip lines 4a and 4b; go to line 5.*	Year 2 0 0 0 *If born after 1990, skip lines 4a and 4b; go to line 5.*
4 If the child was born before 1991— **a** Was the child under age 24 at the end of 2009 and a student?	☐ **Yes.** *Go to line 5.* ☐ **No.** *Continue.*	☐ **Yes.** *Go to line 5.* ☐ **No.** *Continue.*	☐ **Yes.** *Go to line 5.* ☐ **No.** *Continue.*
b Was the child permanently and totally disabled during any part of 2009?	☐ **Yes.** *Continue.* ☐ **No.** The child is not a qualifying child.	☐ **Yes.** *Continue.* ☐ **No.** The child is not a qualifying child.	☐ **Yes.** *Continue.* ☐ **No.** The child is not a qualifying child.
5 Child's relationship to you (for example, son, daughter, grandchild, niece, nephew, foster child, etc.)	**daughter**	**daughter**	**son**
6 Number of months child lived with you in the United States during 2009 • If the child lived with you for more than half of 2009 but less than 7 months, enter "7." • If the child was born or died in 2009 and your home was the child's home for the entire time he or she was alive during 2009, enter "12."	12 months *Do not enter more than 12 months.*	12 months *Do not enter more than 12 months.*	12 months *Do not enter more than 12 months.*

For Paperwork Reduction Act Notice, see Form 1040A or 1040 instructions.

Cat. No. 13339M

Schedule EIC (Form 1040A or 1040) 2009



Form **8812**

Department of the Treasury
Internal Revenue Service (99)

Additional Child Tax Credit

Complete and attach to Form 1040, Form 1040A, or Form 1040NR.

1040 / 1040A / 1040NR → 8812

OMB No. 1545-0074

2009

Attachment Sequence No. **47**

Name(s) shown on return: **Vanessa L. Franklin**

Your social security number: **111-11-5555**

Part I All Filers

1	**1040 filers:** Enter the amount from line 6 of your Child Tax Credit Worksheet on page 43 of the Form 1040 instructions. **1040A filers:** Enter the amount from line 6 of your Child Tax Credit Worksheet on page 38 of the Form 1040A instructions. **1040NR filers:** Enter the amount from line 6 of your Child Tax Credit Worksheet on page 19 of the Form 1040NR instructions. If you used Pub. 972, enter the amount from line 8 of the worksheet on page 4 of the publication.		1	3,000
2	Enter the amount from Form 1040, line 51, Form 1040A, line 33, or Form 1040NR, line 47		2	207
3	Subtract line 2 from line 1. If zero, **stop**; you cannot take this credit		3	2,793
4a	Earned income (see instructions on back)	4a 32,230		
b	Nontaxable combat pay (see instructions on back) 4b 0			
5	Is the amount on line 4a more than $3,000? ☐ **No.** Leave line 5 blank and enter -0- on line 6. ☑ **Yes.** Subtract $3,000 from the amount on line 4a. Enter the result	5 29,230		
6	Multiply the amount on line 5 by 15% (.15) and enter the result		6	4,385

Next. Do you have three or more qualifying children?

☐ **No.** If line 6 is zero, stop; you cannot take this credit. Otherwise, skip Part II and enter the **smaller** of line 3 or line 6 on line 13.

☑ **Yes.** If line 6 is equal to or more than line 3, skip Part II and enter the amount from line 3 on line 13. Otherwise, go to line 7.

Part II Certain Filers Who Have Three or More Qualifying Children

7	Withheld social security and Medicare taxes from Form(s) W-2, boxes 4 and 6. If married filing jointly, include your spouse's amounts with yours. If you worked for a railroad, see instructions on back	7		
8	**1040 filers:** Enter the total of the amounts from Form 1040, lines 27 and 57, plus any taxes that you identified using code "UT" and entered on the dotted line next to line 60. **1040A filers:** Enter -0-. **1040NR filers:** Enter the total of the amounts from Form 1040NR, line 53, plus any taxes that you identified using code "UT" and entered on the dotted line next to line 57.	8		
9	Add lines 7 and 8	9		
10	**1040 filers:** Enter the total of the amounts from Form 1040, lines 64a and 69. **1040A filers:** Enter the total of the amount from Form 1040A, line 41a, plus any excess social security and tier 1 RRTA taxes withheld that you entered to the left of line 44 (see instructions on back). **1040NR filers:** Enter the amount from Form 1040NR, line 63.	10		
11	Subtract line 10 from line 9. If zero or less, enter -0-		11	
12	Enter the **larger** of line 6 or line 11		12	

Next, enter the **smaller** of line 3 or line 12 on line 13.

Part III Additional Child Tax Credit

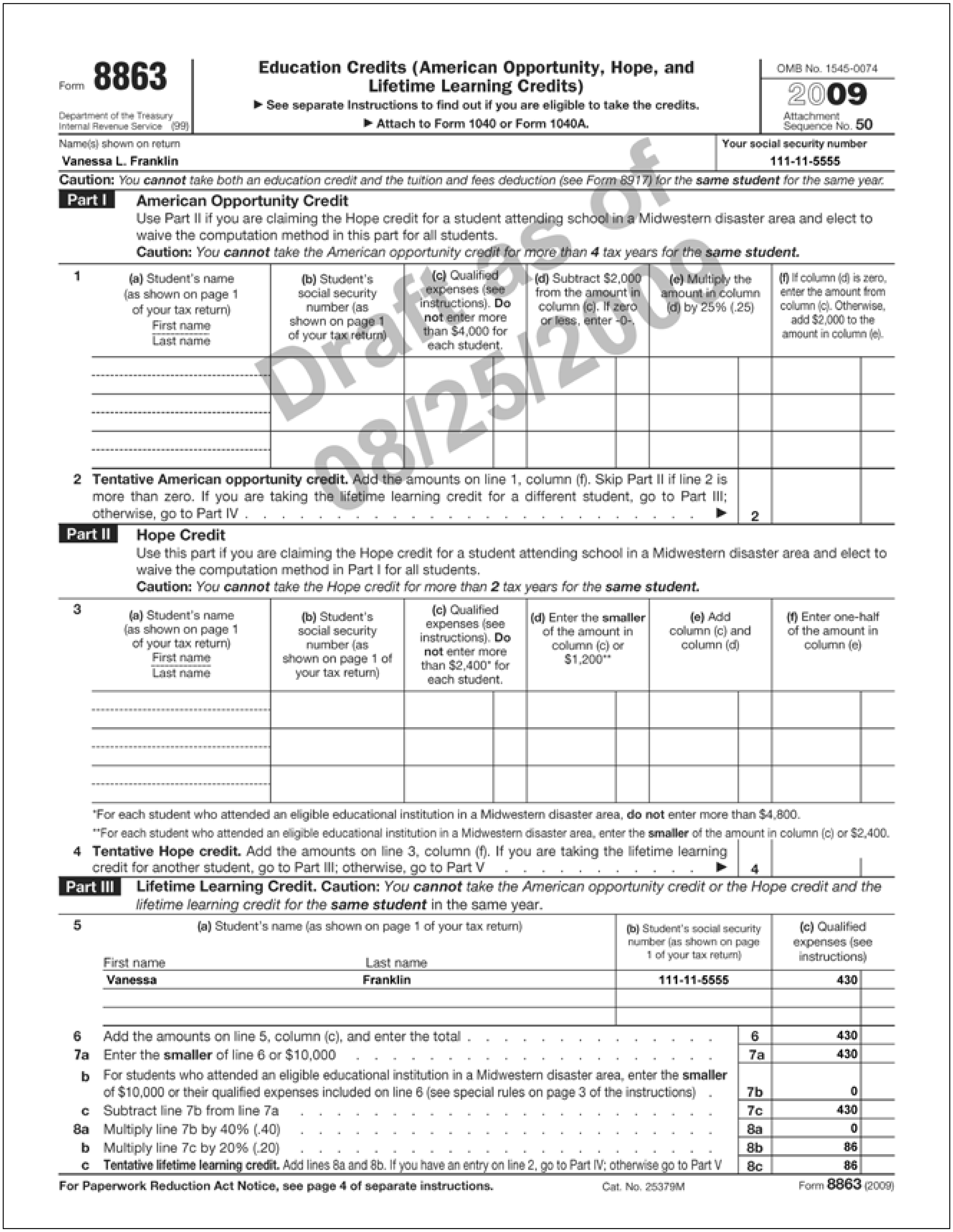
13	**This is your additional child tax credit**	13	2,793

Enter this amount on Form 1040, line 65, Form 1040A, line 42, or Form 1040NR, line 61. → 1040 / 1040A / 1040NR

For Paperwork Reduction Act Notice, see back of form

Cat. No. 10644E

Form **8812** (2009)



Form **8863**

Department of the Treasury
Internal Revenue Service (99)

Education Credits (American Opportunity, Hope, and Lifetime Learning Credits)

▶ See separate Instructions to find out if you are eligible to take the credits.
▶ Attach to Form 1040 or Form 1040A.

OMB No. 1545-0074
2009
Attachment Sequence No. 50

Name(s) shown on return	Your social security number
Vanessa L. Franklin	111-11-5555

Caution: *You **cannot** take both an education credit and the tuition and fees deduction (see Form 8917) for the **same student** for the same year.*

Part I American Opportunity Credit

Use Part II if you are claiming the Hope credit for a student attending school in a Midwestern disaster area and elect to waive the computation method in this part for all students.
Caution: *You **cannot** take the American opportunity credit for more than **4** tax years for the **same student.***

1	**(a)** Student's name (as shown on page 1 of your tax return) First name Last name	**(b)** Student's social security number (as shown on page 1 of your tax return)	**(c)** Qualified expenses (see instructions). **Do not** enter more than $4,000 for each student.	**(d)** Subtract $2,000 from the amount in column (c). If zero or less, enter -0-.	**(e)** Multiply the amount in column (d) by 25% (.25)	**(f)** If column (d) is zero, enter the amount from column (c). Otherwise, add $2,000 to the amount in column (e).

2 **Tentative American opportunity credit.** Add the amounts on line 1, column (f). Skip Part II if line 2 is more than zero. If you are taking the lifetime learning credit for a different student, go to Part III; otherwise, go to Part IV . . . ▶ **2**

Part II Hope Credit

Use this part if you are claiming the Hope credit for a student attending school in a Midwestern disaster area and elect to waive the computation method in Part I for all students.
Caution: *You **cannot** take the Hope credit for more than **2** tax years for the **same student.***

3	**(a)** Student's name (as shown on page 1 of your tax return) First name Last name	**(b)** Student's social security number (as shown on page 1 of your tax return)	**(c)** Qualified expenses (see instructions). **Do not** enter more than $2,400* for each student.	**(d)** Enter the **smaller** of the amount in column (c) or $1,200**	**(e)** Add column (c) and column (d)	**(f)** Enter one-half of the amount in column (e)

*For each student who attended an eligible educational institution in a Midwestern disaster area, **do not** enter more than $4,800.

For each student who attended an eligible educational institution in a Midwestern disaster area, enter the **smaller of the amount in column (c) or $2,400.

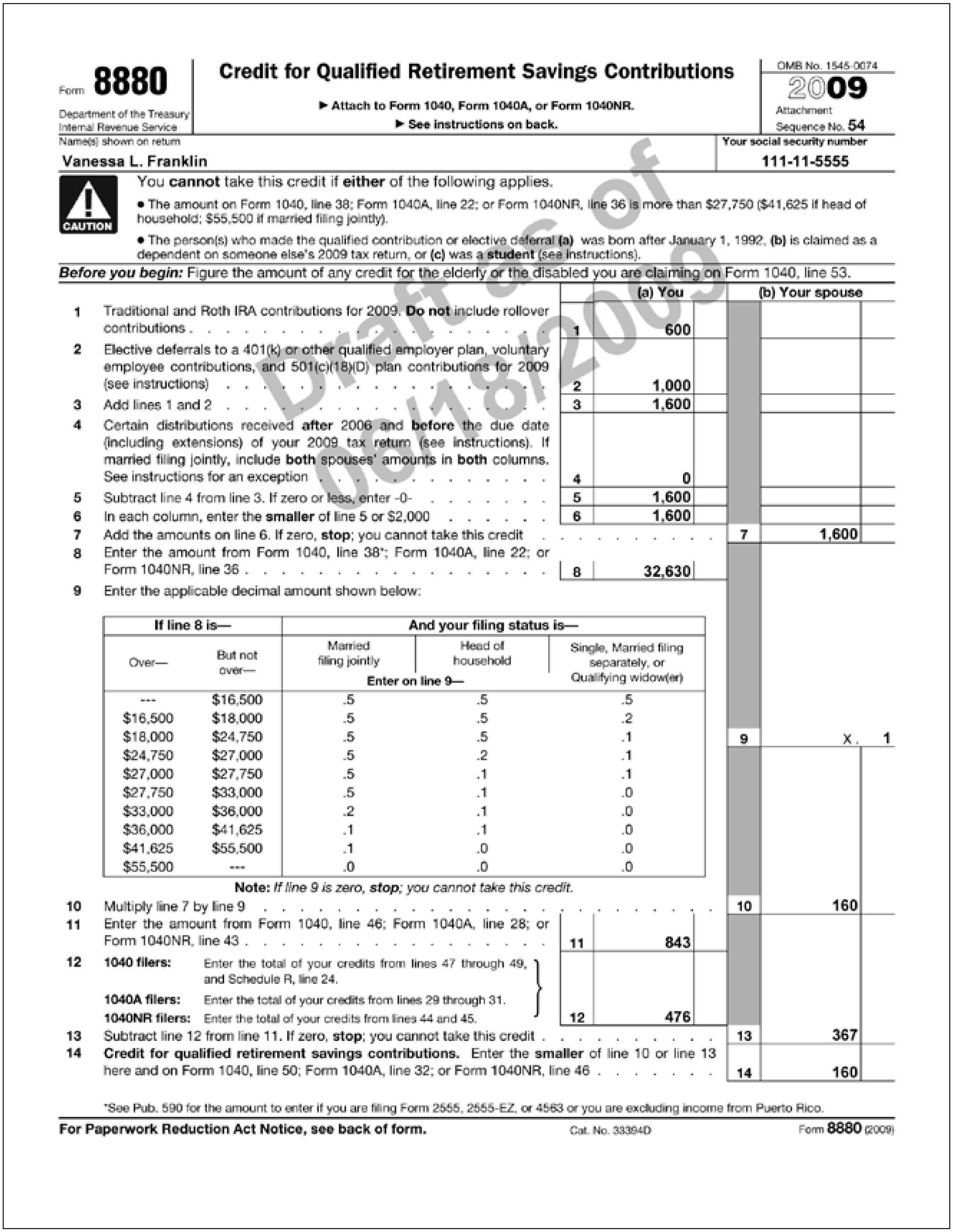
4 **Tentative Hope credit.** Add the amounts on line 3, column (f). If you are taking the lifetime learning credit for another student, go to Part III; otherwise, go to Part V . . . ▶ **4**

Part III Lifetime Learning Credit. Caution: *You cannot take the American opportunity credit or the Hope credit and the lifetime learning credit for the same student in the same year.*

5	**(a)** Student's name (as shown on page 1 of your tax return) First name	Last name	**(b)** Student's social security number (as shown on page 1 of your tax return)	**(c)** Qualified expenses (see instructions)
	Vanessa	Franklin	111-11-5555	430

6	Add the amounts on line 5, column (c), and enter the total . . .	**6**	430
7a	Enter the **smaller** of line 6 or $10,000 . . .	**7a**	430
b	For students who attended an eligible educational institution in a Midwestern disaster area, enter the **smaller** of $10,000 or their qualified expenses included on line 6 (see special rules on page 3 of the instructions) .	**7b**	0
c	Subtract line 7b from line 7a . . .	**7c**	430
8a	Multiply line 7b by 40% (.40) . . .	**8a**	0
b	Multiply line 7c by 20% (.20) . . .	**8b**	86
c	**Tentative lifetime learning credit.** Add lines 8a and 8b. If you have an entry on line 2, go to Part IV; otherwise go to Part V	**8c**	86

For Paperwork Reduction Act Notice, see page 4 of separate instructions. Cat. No. 25379M Form **8863** (2009)



Form **8880**

Department of the Treasury
Internal Revenue Service

Credit for Qualified Retirement Savings Contributions

▶ Attach to Form 1040, Form 1040A, or Form 1040NR.
▶ See instructions on back.

OMB No. 1545-0074
2009
Attachment
Sequence No. **54**

Name(s) shown on return: **Vanessa L. Franklin**

Your social security number: **111-11-5555**

CAUTION

You **cannot** take this credit if **either** of the following applies.

- The amount on Form 1040, line 38; Form 1040A, line 22; or Form 1040NR, line 36 is more than $27,750 ($41,625 if head of household; $55,500 if married filing jointly).
- The person(s) who made the qualified contribution or elective deferral **(a)** was born after January 1, 1992, **(b)** is claimed as a dependent on someone else's 2009 tax return, or **(c)** was a **student** (see instructions).

Before you begin: Figure the amount of any credit for the elderly or the disabled you are claiming on Form 1040, line 53.

			(a) You		(b) Your spouse
1	Traditional and Roth IRA contributions for 2009. **Do not** include rollover contributions	1	600		
2	Elective deferrals to a 401(k) or other qualified employer plan, voluntary employee contributions, and 501(c)(18)(D) plan contributions for 2009 (see instructions)	2	1,000		
3	Add lines 1 and 2	3	1,600		
4	Certain distributions received **after** 2006 and **before** the due date (including extensions) of your 2009 tax return (see instructions). If married filing jointly, include **both** spouses' amounts in **both** columns. See instructions for an exception	4	0		
5	Subtract line 4 from line 3. If zero or less, enter -0-	5	1,600		
6	In each column, enter the **smaller** of line 5 or $2,000	6	1,600		
7	Add the amounts on line 6. If zero, **stop**; you cannot take this credit			7	1,600
8	Enter the amount from Form 1040, line 38*; Form 1040A, line 22; or Form 1040NR, line 36	8	32,630		
9	Enter the applicable decimal amount shown below:			9	X . 1

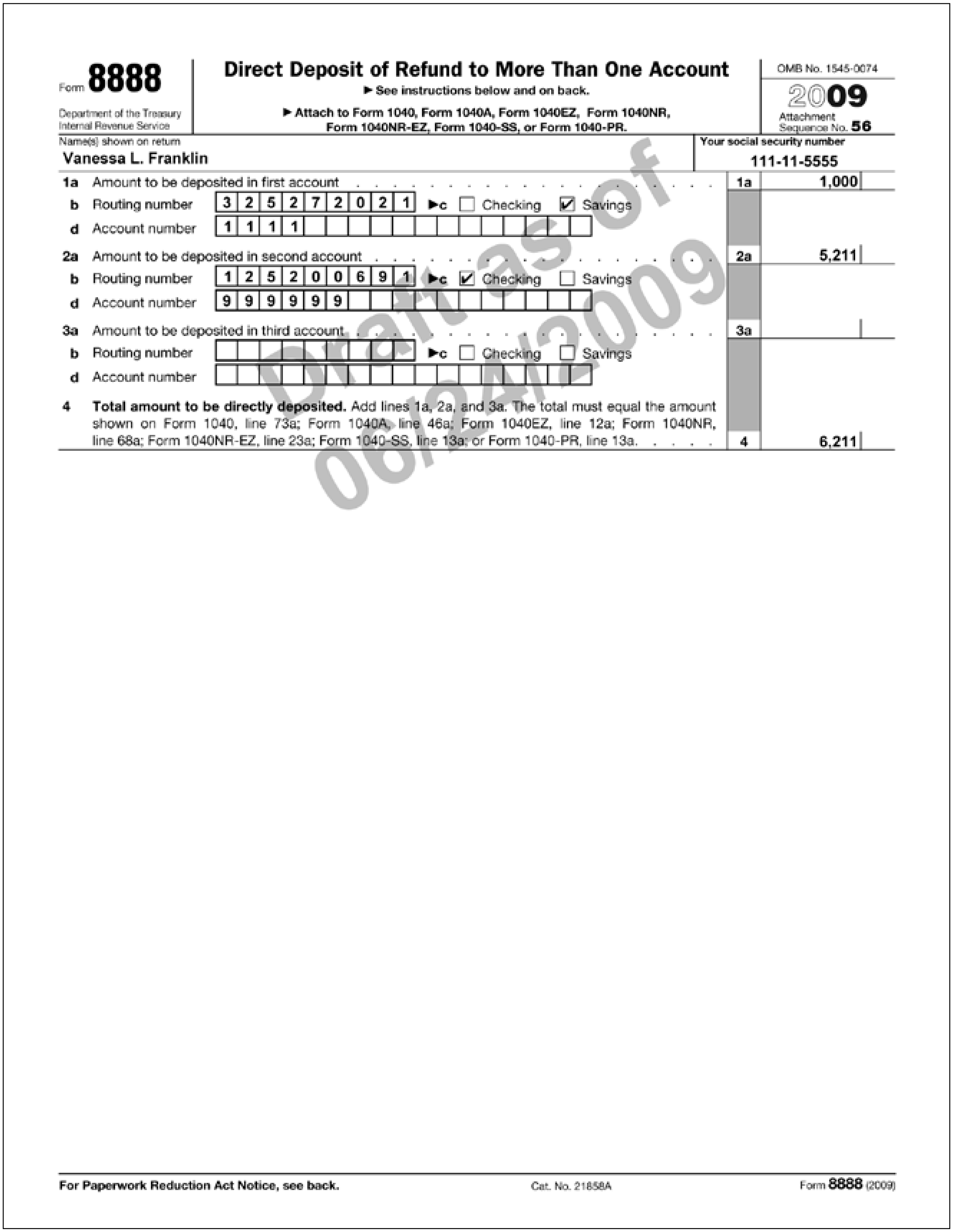
If line 8 is—		And your filing status is—		
Over—	But not over—	Married filing jointly	Head of household	Single, Married filing separately, or Qualifying widow(er)
		Enter on line 9—		
---	$16,500	.5	.5	.5
$16,500	$18,000	.5	.5	.2
$18,000	$24,750	.5	.5	.1
$24,750	$27,000	.5	.2	.1
$27,000	$27,750	.5	.1	.1
$27,750	$33,000	.5	.1	.0
$33,000	$36,000	.2	.1	.0
$36,000	$41,625	.1	.1	.0
$41,625	$55,500	.1	.0	.0
$55,500	---	.0	.0	.0

Note: *If line 9 is zero, **stop**; you cannot take this credit.*

10	Multiply line 7 by line 9			10	160
11	Enter the amount from Form 1040, line 46; Form 1040A, line 28; or Form 1040NR, line 43	11	843		
12	**1040 filers:** Enter the total of your credits from lines 47 through 49, and Schedule R, line 24. **1040A filers:** Enter the total of your credits from lines 29 through 31. **1040NR filers:** Enter the total of your credits from lines 44 and 45.	12	476		
13	Subtract line 12 from line 11. If zero, **stop**; you cannot take this credit			13	367
14	**Credit for qualified retirement savings contributions.** Enter the **smaller** of line 10 or line 13 here and on Form 1040, line 50; Form 1040A, line 32; or Form 1040NR, line 46			14	160

*See Pub. 590 for the amount to enter if you are filing Form 2555, 2555-EZ, or 4563 or you are excluding income from Puerto Rico.

For Paperwork Reduction Act Notice, see back of form. Cat. No. 33394D Form **8880** (2009)



Form **8888**

Department of the Treasury
Internal Revenue Service

Direct Deposit of Refund to More Than One Account

▶ See instructions below and on back.

▶ Attach to Form 1040, Form 1040A, Form 1040EZ, Form 1040NR, Form 1040NR-EZ, Form 1040-SS, or Form 1040-PR.

OMB No. 1545-0074

2009

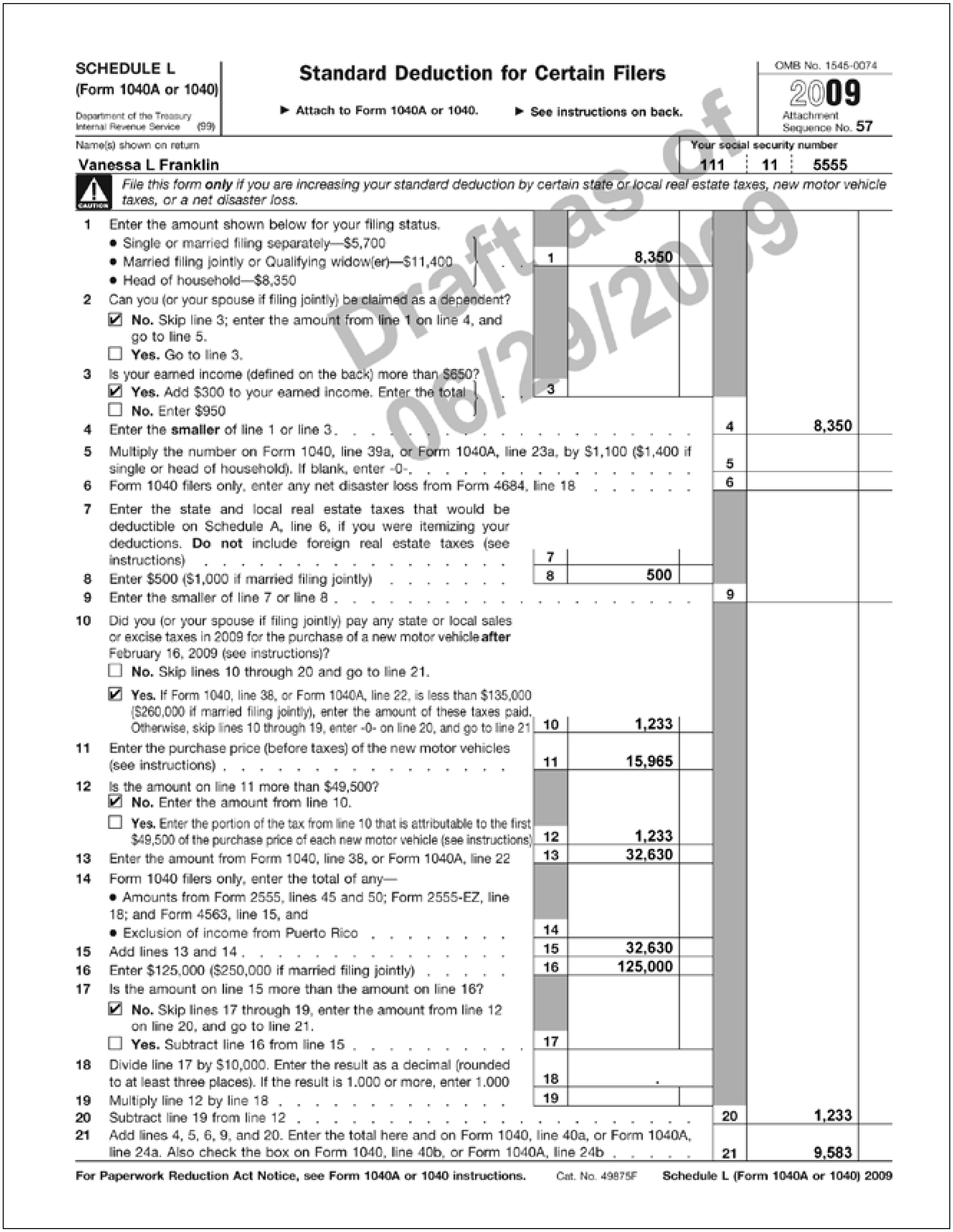
Attachment Sequence No. **56**

Name(s) shown on return: Vanessa L. Franklin

Your social security number: 111-11-5555

1a	Amount to be deposited in first account	**1a**	1,000
b	Routing number 3 2 5 2 7 2 0 2 1 ▶**c** ☐ Checking ☑ Savings		
d	Account number 1 1 1 1		
2a	Amount to be deposited in second account	**2a**	5,211
b	Routing number 1 2 5 2 0 0 6 9 1 ▶**c** ☑ Checking ☐ Savings		
d	Account number 9 9 9 9 9 9		
3a	Amount to be deposited in third account	**3a**	
b	Routing number ▶**c** ☐ Checking ☐ Savings		
d	Account number		
4	**Total amount to be directly deposited.** Add lines 1a, 2a, and 3a. The total must equal the amount shown on Form 1040, line 73a; Form 1040A, line 46a; Form 1040EZ, line 12a; Form 1040NR, line 68a; Form 1040NR-EZ, line 23a; Form 1040-SS, line 13a; or Form 1040-PR, line 13a.	**4**	6,211

For Paperwork Reduction Act Notice, see back. Cat. No. 21858A Form **8888** (2009)



SCHEDULE L
(Form 1040A or 1040)
Department of the Treasury
Internal Revenue Service (99)

Standard Deduction for Certain Filers

► **Attach to Form 1040A or 1040.** ► **See instructions on back.**

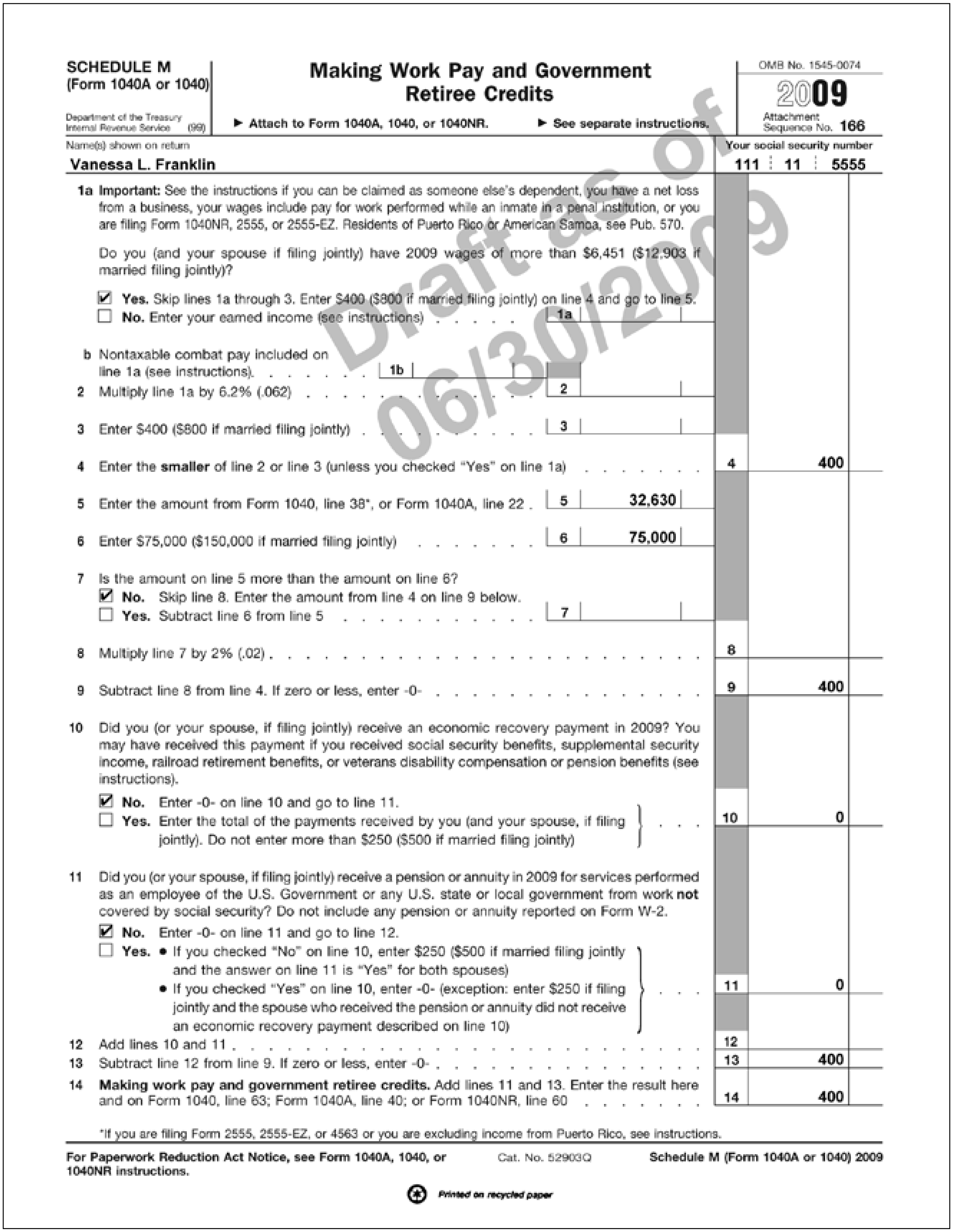
OMB No. 1545-0074
2009
Attachment Sequence No. **57**

Name(s) shown on return: **Vanessa L Franklin**
Your social security number: **111 11 5555**

*File this form **only** if you are increasing your standard deduction by certain state or local real estate taxes, new motor vehicle taxes, or a net disaster loss.*

1	Enter the amount shown below for your filing status. • Single or married filing separately—$5,700 • Married filing jointly or Qualifying widow(er)—$11,400 • Head of household—$8,350	1	8,350		
2	Can you (or your spouse if filing jointly) be claimed as a dependent? ☑ **No.** Skip line 3; enter the amount from line 1 on line 4, and go to line 5. ☐ **Yes.** Go to line 3.				
3	Is your earned income (defined on the back) more than $650? ☑ **Yes.** Add $300 to your earned income. Enter the total ☐ **No.** Enter $950	3			
4	Enter the **smaller** of line 1 or line 3			4	8,350
5	Multiply the number on Form 1040, line 39a, or Form 1040A, line 23a, by $1,100 ($1,400 if single or head of household). If blank, enter -0-			5	
6	Form 1040 filers only, enter any net disaster loss from Form 4684, line 18			6	
7	Enter the state and local real estate taxes that would be deductible on Schedule A, line 6, if you were itemizing your deductions. **Do not** include foreign real estate taxes (see instructions)	7			
8	Enter $500 ($1,000 if married filing jointly)	8	500		
9	Enter the smaller of line 7 or line 8			9	
10	Did you (or your spouse if filing jointly) pay any state or local sales or excise taxes in 2009 for the purchase of a new motor vehicle **after** February 16, 2009 (see instructions)? ☐ **No.** Skip lines 10 through 20 and go to line 21. ☑ **Yes.** If Form 1040, line 38, or Form 1040A, line 22, is less than $135,000 ($260,000 if married filing jointly), enter the amount of these taxes paid. Otherwise, skip lines 10 through 19, enter -0- on line 20, and go to line 21	10	1,233		
11	Enter the purchase price (before taxes) of the new motor vehicles (see instructions)	11	15,965		
12	Is the amount on line 11 more than $49,500? ☑ **No.** Enter the amount from line 10. ☐ **Yes.** Enter the portion of the tax from line 10 that is attributable to the first $49,500 of the purchase price of each new motor vehicle (see instructions)	12	1,233		
13	Enter the amount from Form 1040, line 38, or Form 1040A, line 22	13	32,630		
14	Form 1040 filers only, enter the total of any— • Amounts from Form 2555, lines 45 and 50; Form 2555-EZ, line 18; and Form 4563, line 15, and • Exclusion of income from Puerto Rico	14			
15	Add lines 13 and 14	15	32,630		
16	Enter $125,000 ($250,000 if married filing jointly)	16	125,000		
17	Is the amount on line 15 more than the amount on line 16? ☑ **No.** Skip lines 17 through 19, enter the amount from line 12 on line 20, and go to line 21. ☐ **Yes.** Subtract line 16 from line 15	17			
18	Divide line 17 by $10,000. Enter the result as a decimal (rounded to at least three places). If the result is 1.000 or more, enter 1.000	18	.		
19	Multiply line 12 by line 18	19			
20	Subtract line 19 from line 12			20	1,233
21	Add lines 4, 5, 6, 9, and 20. Enter the total here and on Form 1040, line 40a, or Form 1040A, line 24a. Also check the box on Form 1040, line 40b, or Form 1040A, line 24b			21	9,583

For Paperwork Reduction Act Notice, see Form 1040A or 1040 instructions. Cat. No. 49875F **Schedule L (Form 1040A or 1040) 2009**



SCHEDULE M
(Form 1040A or 1040)
Department of the Treasury
Internal Revenue Service (99)

Making Work Pay and Government Retiree Credits

► Attach to Form 1040A, 1040, or 1040NR. ► See separate instructions.

OMB No. 1545-0074
2009
Attachment Sequence No. **166**

Name(s) shown on return: **Vanessa L. Franklin**
Your social security number: **111 11 5555**

1a **Important:** See the instructions if you can be claimed as someone else's dependent, you have a net loss from a business, your wages include pay for work performed while an inmate in a penal institution, or you are filing Form 1040NR, 2555, or 2555-EZ. Residents of Puerto Rico or American Samoa, see Pub. 570.

Do you (and your spouse if filing jointly) have 2009 wages of more than $6,451 ($12,903 if married filing jointly)?

☑ **Yes.** Skip lines 1a through 3. Enter $400 ($800 if married filing jointly) on line 4 and go to line 5.
☐ **No.** Enter your earned income (see instructions) **1a**

b Nontaxable combat pay included on line 1a (see instructions). **1b**

2 Multiply line 1a by 6.2% (.062) **2**

3 Enter $400 ($800 if married filing jointly) **3**

4 Enter the **smaller** of line 2 or line 3 (unless you checked "Yes" on line 1a) **4** 400

5 Enter the amount from Form 1040, line 38*, or Form 1040A, line 22 . **5** 32,630

6 Enter $75,000 ($150,000 if married filing jointly) **6** 75,000

7 Is the amount on line 5 more than the amount on line 6?
☑ **No.** Skip line 8. Enter the amount from line 4 on line 9 below.
☐ **Yes.** Subtract line 6 from line 5 . . . . **7**

8 Multiply line 7 by 2% (.02) **8**

9 Subtract line 8 from line 4. If zero or less, enter -0- **9** 400

10 Did you (or your spouse, if filing jointly) receive an economic recovery payment in 2009? You may have received this payment if you received social security benefits, supplemental security income, railroad retirement benefits, or veterans disability compensation or pension benefits (see instructions).
☑ **No.** Enter -0- on line 10 and go to line 11.
☐ **Yes.** Enter the total of the payments received by you (and your spouse, if filing jointly). Do not enter more than $250 ($500 if married filing jointly) } **10** 0

11 Did you (or your spouse, if filing jointly) receive a pension or annuity in 2009 for services performed as an employee of the U.S. Government or any U.S. state or local government from work **not** covered by social security? Do not include any pension or annuity reported on Form W-2.
☑ **No.** Enter -0- on line 11 and go to line 12.
☐ **Yes.** • If you checked "No" on line 10, enter $250 ($500 if married filing jointly and the answer on line 11 is "Yes" for both spouses)
• If you checked "Yes" on line 10, enter -0- (exception: enter $250 if filing jointly and the spouse who received the pension or annuity did not receive an economic recovery payment described on line 10) } **11** 0

12 Add lines 10 and 11 . . . . **12**

13 Subtract line 12 from line 9. If zero or less, enter -0- **13** 400

14 **Making work pay and government retiree credits.** Add lines 11 and 13. Enter the result here and on Form 1040, line 63; Form 1040A, line 40; or Form 1040NR, line 60 . . . . **14** 400

*If you are filing Form 2555, 2555-EZ, or 4563 or you are excluding income from Puerto Rico, see instructions.

For Paperwork Reduction Act Notice, see Form 1040A, 1040, or 1040NR instructions. Cat. No. 52903Q **Schedule M (Form 1040A or 1040) 2009**

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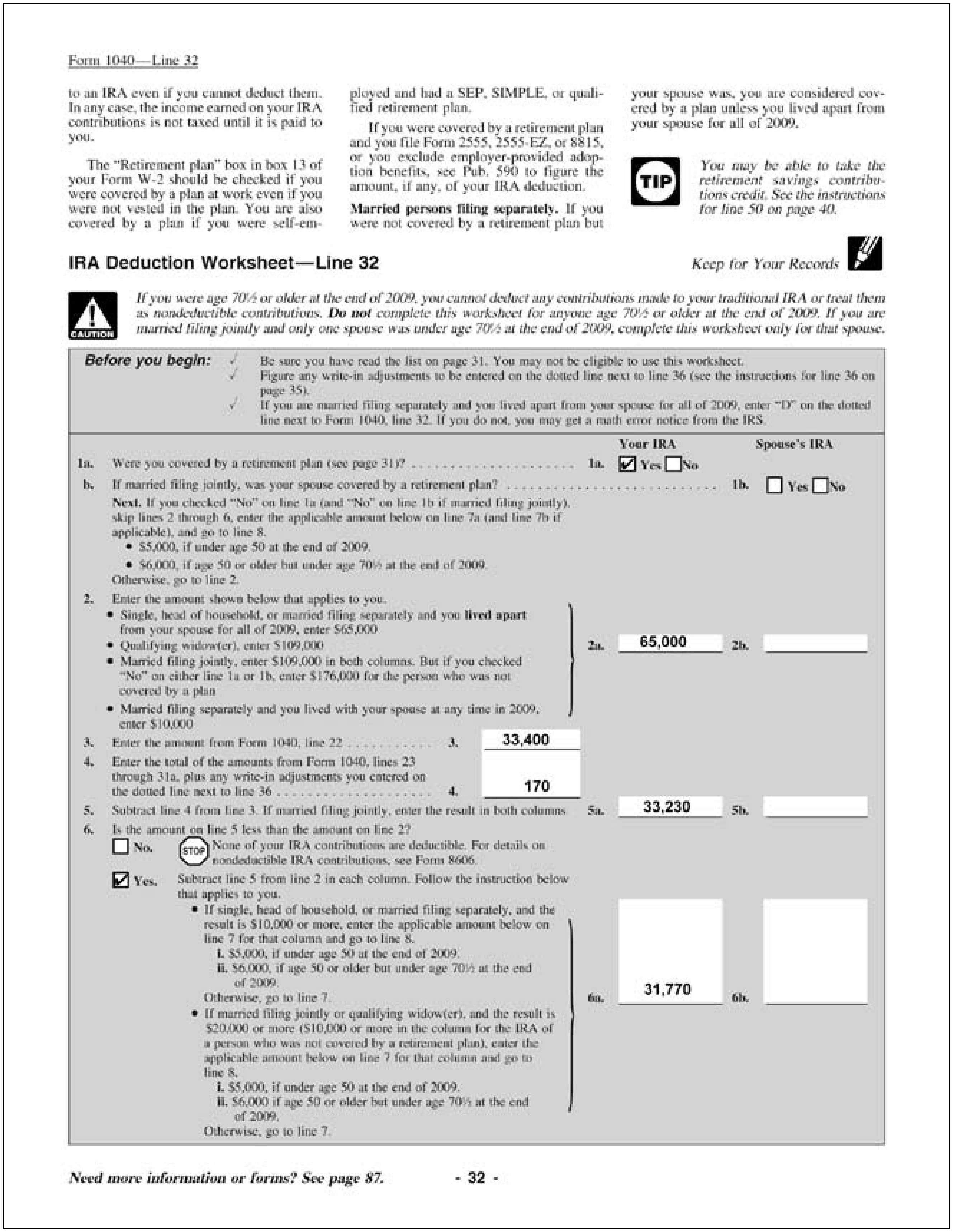


Form 1040—Line 32

to an IRA even if you cannot deduct them. In any case, the income earned on your IRA contributions is not taxed until it is paid to you.

The "Retirement plan" box in box 13 of your Form W-2 should be checked if you were covered by a plan at work even if you were not vested in the plan. You are also covered by a plan if you were self-employed and had a SEP, SIMPLE, or qualified retirement plan.

If you were covered by a retirement plan and you file Form 2555, 2555-EZ, or 8815, or you exclude employer-provided adoption benefits, see Pub. 590 to figure the amount, if any, of your IRA deduction.

Married persons filing separately. If you were not covered by a retirement plan but your spouse was, you are considered covered by a plan unless you lived apart from your spouse for all of 2009.

TIP *You may be able to take the retirement savings contributions credit. See the instructions for line 50 on page 40.*

IRA Deduction Worksheet—Line 32

Keep for Your Records

CAUTION *If you were age 70½ or older at the end of 2009, you cannot deduct any contributions made to your traditional IRA or treat them as nondeductible contributions.* ***Do not*** *complete this worksheet for anyone age 70½ or older at the end of 2009. If you are married filing jointly and only one spouse was under age 70½ at the end of 2009, complete this worksheet only for that spouse.*

Before you begin:

- ✓ Be sure you have read the list on page 31. You may not be eligible to use this worksheet.
- ✓ Figure any write-in adjustments to be entered on the dotted line next to line 36 (see the instructions for line 36 on page 35).
- ✓ If you are married filing separately and you lived apart from your spouse for all of 2009, enter "D" on the dotted line next to Form 1040, line 32. If you do not, you may get a math error notice from the IRS.

			Your IRA		**Spouse's IRA**
1a.	Were you covered by a retirement plan (see page 31)?	**1a.**	☑ Yes ☐ No		
b.	If married filing jointly, was your spouse covered by a retirement plan?			**1b.**	☐ Yes ☐ No

Next. If you checked "No" on line 1a (and "No" on line 1b if married filing jointly), skip lines 2 through 6, enter the applicable amount below on line 7a (and line 7b if applicable), and go to line 8.

- $5,000, if under age 50 at the end of 2009.
- $6,000, if age 50 or older but under age 70½ at the end of 2009.

Otherwise, go to line 2.

2. Enter the amount shown below that applies to you.

- Single, head of household, or married filing separately and you **lived apart** from your spouse for all of 2009, enter $65,000
- Qualifying widow(er), enter $109,000
- Married filing jointly, enter $109,000 in both columns. But if you checked "No" on either line 1a or 1b, enter $176,000 for the person who was not covered by a plan
- Married filing separately and you lived with your spouse at any time in 2009, enter $10,000

2a. 65,000 **2b.**

3. Enter the amount from Form 1040, line 22 . . . . **3.** 33,400

4. Enter the total of the amounts from Form 1040, lines 23 through 31a, plus any write-in adjustments you entered on the dotted line next to line 36 . . . . **4.** 170

5. Subtract line 4 from line 3. If married filing jointly, enter the result in both columns **5a.** 33,230 **5b.**

6. Is the amount on line 5 less than the amount on line 2?

☐ **No.** STOP None of your IRA contributions are deductible. For details on nondeductible IRA contributions, see Form 8606.

☑ **Yes.** Subtract line 5 from line 2 in each column. Follow the instruction below that applies to you.

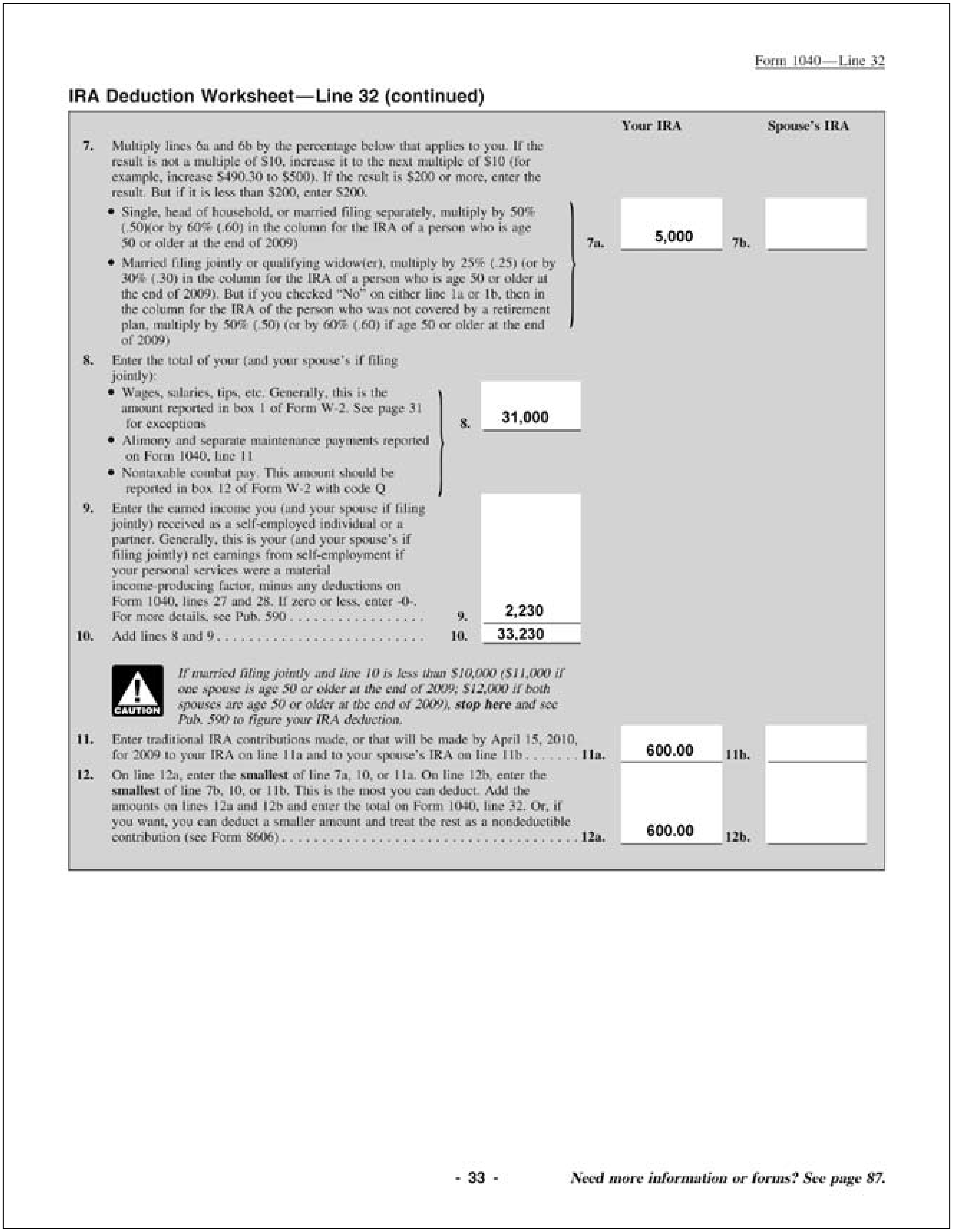
- If single, head of household, or married filing separately, and the result is $10,000 or more, enter the applicable amount below on line 7 for that column and go to line 8.
  - **i.** $5,000, if under age 50 at the end of 2009.
  - **ii.** $6,000, if age 50 or older but under age 70½ at the end of 2009.

  Otherwise, go to line 7.
- If married filing jointly or qualifying widow(er), and the result is $20,000 or more ($10,000 or more in the column for the IRA of a person who was not covered by a retirement plan), enter the applicable amount below on line 7 for that column and go to line 8.
  - **i.** $5,000, if under age 50 at the end of 2009.
  - **ii.** $6,000 if age 50 or older but under age 70½ at the end of 2009.

  Otherwise, go to line 7.

6a. 31,770 **6b.**

Need more information or forms? See page 87. - 32 -



Form 1040—Line 32

IRA Deduction Worksheet—Line 32 (continued)

	Your IRA		Spouse's IRA
7. Multiply lines 6a and 6b by the percentage below that applies to you. If the result is not a multiple of $10, increase it to the next multiple of $10 (for example, increase $490.30 to $500). If the result is $200 or more, enter the result. But if it is less than $200, enter $200. • Single, head of household, or married filing separately, multiply by 50% (.50)(or by 60% (.60) in the column for the IRA of a person who is age 50 or older at the end of 2009) • Married filing jointly or qualifying widow(er), multiply by 25% (.25) (or by 30% (.30) in the column for the IRA of a person who is age 50 or older at the end of 2009). But if you checked "No" on either line 1a or 1b, then in the column for the IRA of the person who was not covered by a retirement plan, multiply by 50% (.50) (or by 60% (.60) if age 50 or older at the end of 2009) **7a.**	5,000	**7b.**	

8. Enter the total of your (and your spouse's if filing jointly):

- Wages, salaries, tips, etc. Generally, this is the amount reported in box 1 of Form W-2. See page 31 for exceptions
- Alimony and separate maintenance payments reported on Form 1040, line 11
- Nontaxable combat pay. This amount should be reported in box 12 of Form W-2 with code Q

8. 31,000

9. Enter the earned income you (and your spouse if filing jointly) received as a self-employed individual or a partner. Generally, this is your (and your spouse's if filing jointly) net earnings from self-employment if your personal services were a material income-producing factor, minus any deductions on Form 1040, lines 27 and 28. If zero or less, enter -0-. For more details, see Pub. 590 . . . . **9.** 2,230

10. Add lines 8 and 9 . . . . **10.** 33,230

CAUTION *If married filing jointly and line 10 is less than $10,000 ($11,000 if one spouse is age 50 or older at the end of 2009; $12,000 if both spouses are age 50 or older at the end of 2009),* ***stop here*** *and see Pub. 590 to figure your IRA deduction.*

	Your IRA		Spouse's IRA
11. Enter traditional IRA contributions made, or that will be made by April 15, 2010, for 2009 to your IRA on line 11a and to your spouse's IRA on line 11b . . . . **11a.**	600.00	**11b.**	
12. On line 12a, enter the **smallest** of line 7a, 10, or 11a. On line 12b, enter the **smallest** of line 7b, 10, or 11b. This is the most you can deduct. Add the amounts on lines 12a and 12b and enter the total on Form 1040, line 32. Or, if you want, you can deduct a smaller amount and treat the rest as a nondeductible contribution (see Form 8606) . . . . **12a.**	600.00	**12b.**	

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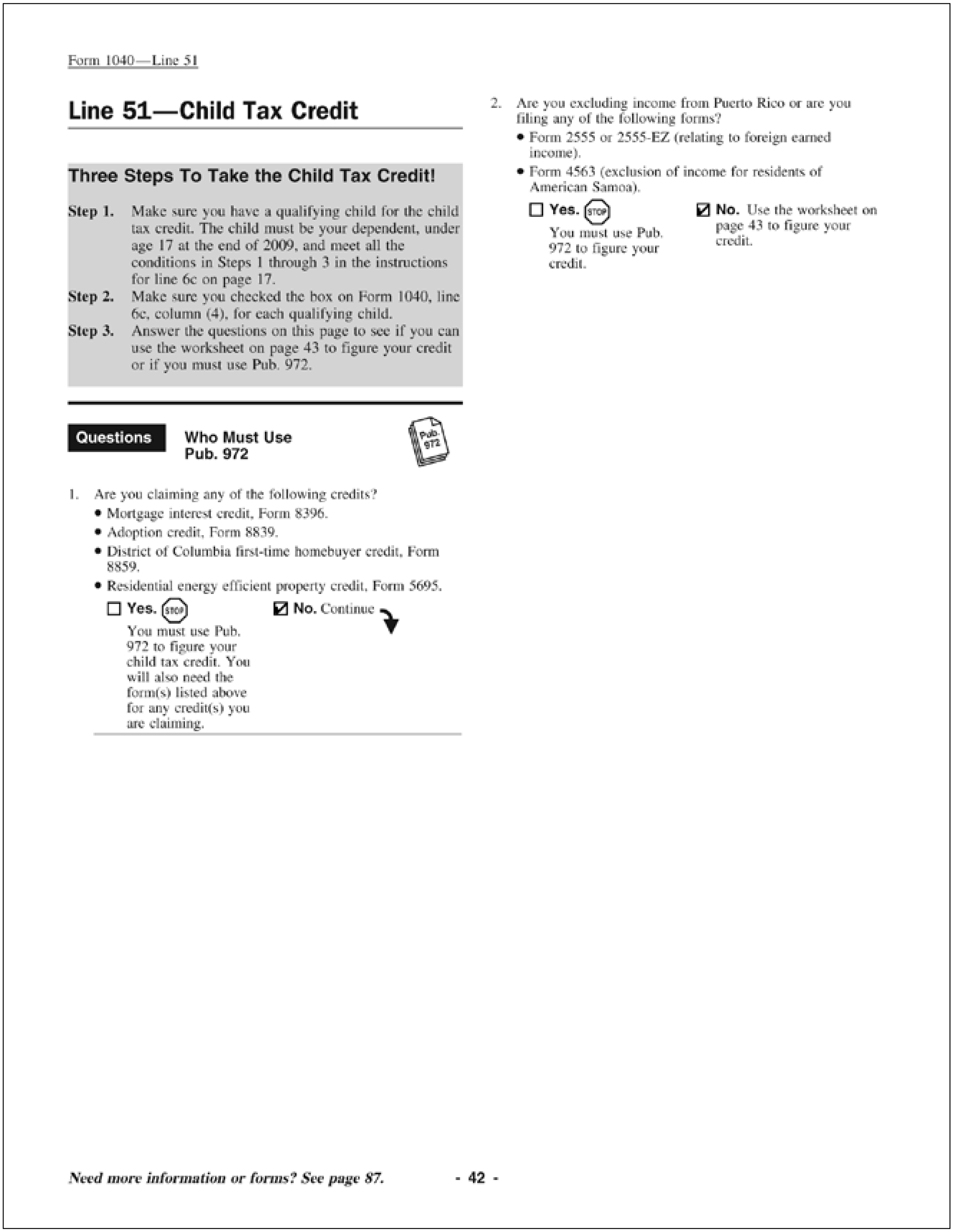
Need more information or forms? See page 87.



Line 51—Child Tax Credit

Three Steps To Take the Child Tax Credit!

Step 1. Make sure you have a qualifying child for the child tax credit. The child must be your dependent, under age 17 at the end of 2009, and meet all the conditions in Steps 1 through 3 in the instructions for line 6c on page 17.

Step 2. Make sure you checked the box on Form 1040, line 6c, column (4), for each qualifying child.

Step 3. Answer the questions on this page to see if you can use the worksheet on page 43 to figure your credit or if you must use Pub. 972.

Questions **Who Must Use Pub. 972**

1. Are you claiming any of the following credits?
   - Mortgage interest credit, Form 8396.
   - Adoption credit, Form 8839.
   - District of Columbia first-time homebuyer credit, Form 8859.
   - Residential energy efficient property credit, Form 5695.

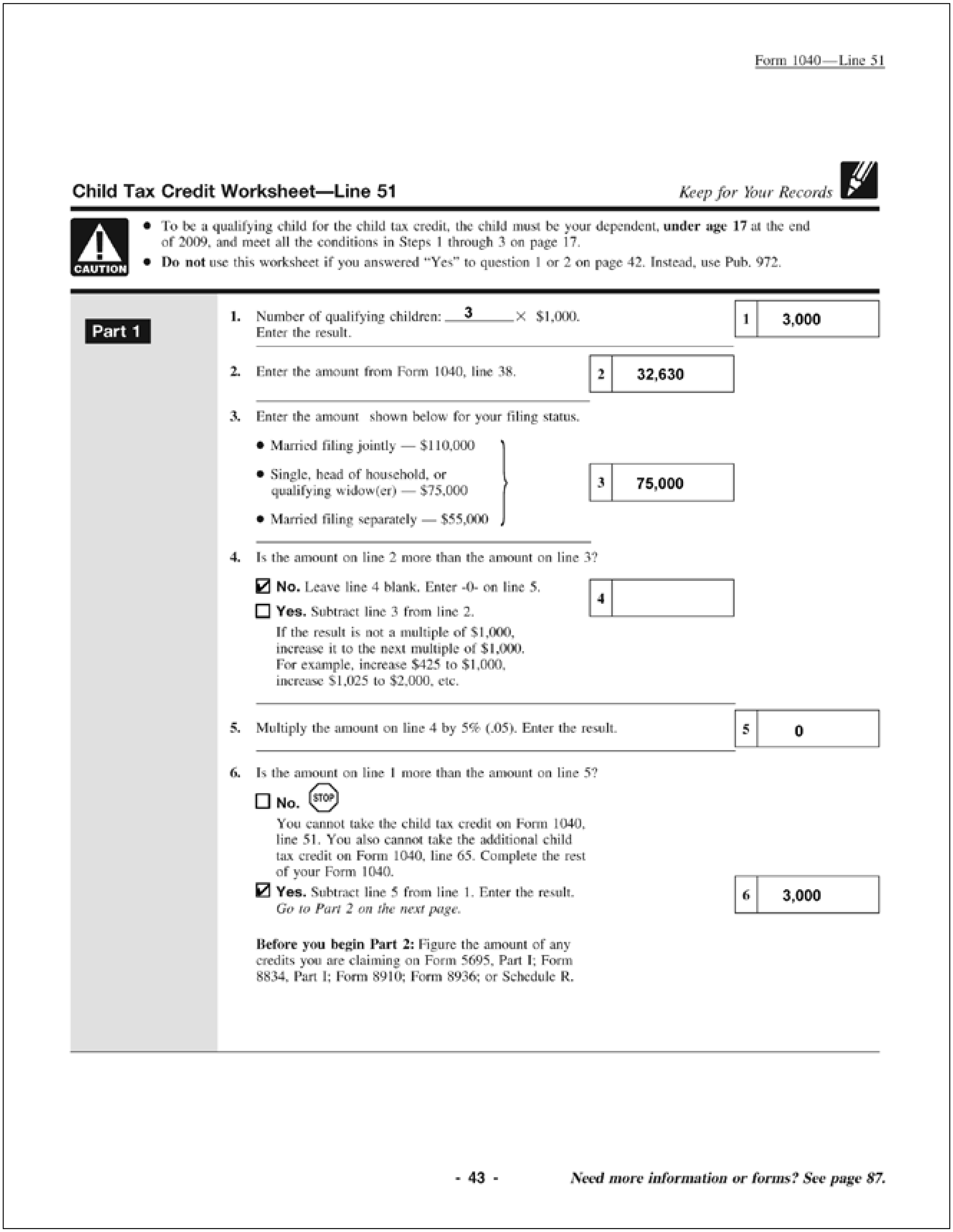
☐ **Yes.** STOP You must use Pub. 972 to figure your child tax credit. You will also need the form(s) listed above for any credit(s) you are claiming.

☑ **No.** Continue ↓

2. Are you excluding income from Puerto Rico or are you filing any of the following forms?
   - Form 2555 or 2555-EZ (relating to foreign earned income).
   - Form 4563 (exclusion of income for residents of American Samoa).

☐ **Yes.** STOP You must use Pub. 972 to figure your credit.

☑ **No.** Use the worksheet on page 43 to figure your credit.



Child Tax Credit Worksheet—Line 51

Keep for Your Records

CAUTION

- To be a qualifying child for the child tax credit, the child must be your dependent, **under age 17** at the end of 2009, and meet all the conditions in Steps 1 through 3 on page 17.
- **Do not** use this worksheet if you answered "Yes" to question 1 or 2 on page 42. Instead, use Pub. 972.

Part 1

1. Number of qualifying children: 3 × $1,000. Enter the result. **1** 3,000

2. Enter the amount from Form 1040, line 38. **2** 32,630

3. Enter the amount shown below for your filing status.

- Married filing jointly — $110,000
- Single, head of household, or qualifying widow(er) — $75,000
- Married filing separately — $55,000

3 75,000

4. Is the amount on line 2 more than the amount on line 3?

☑ **No.** Leave line 4 blank. Enter -0- on line 5.

☐ **Yes.** Subtract line 3 from line 2.
If the result is not a multiple of $1,000, increase it to the next multiple of $1,000. For example, increase $425 to $1,000, increase $1,025 to $2,000, etc.

4

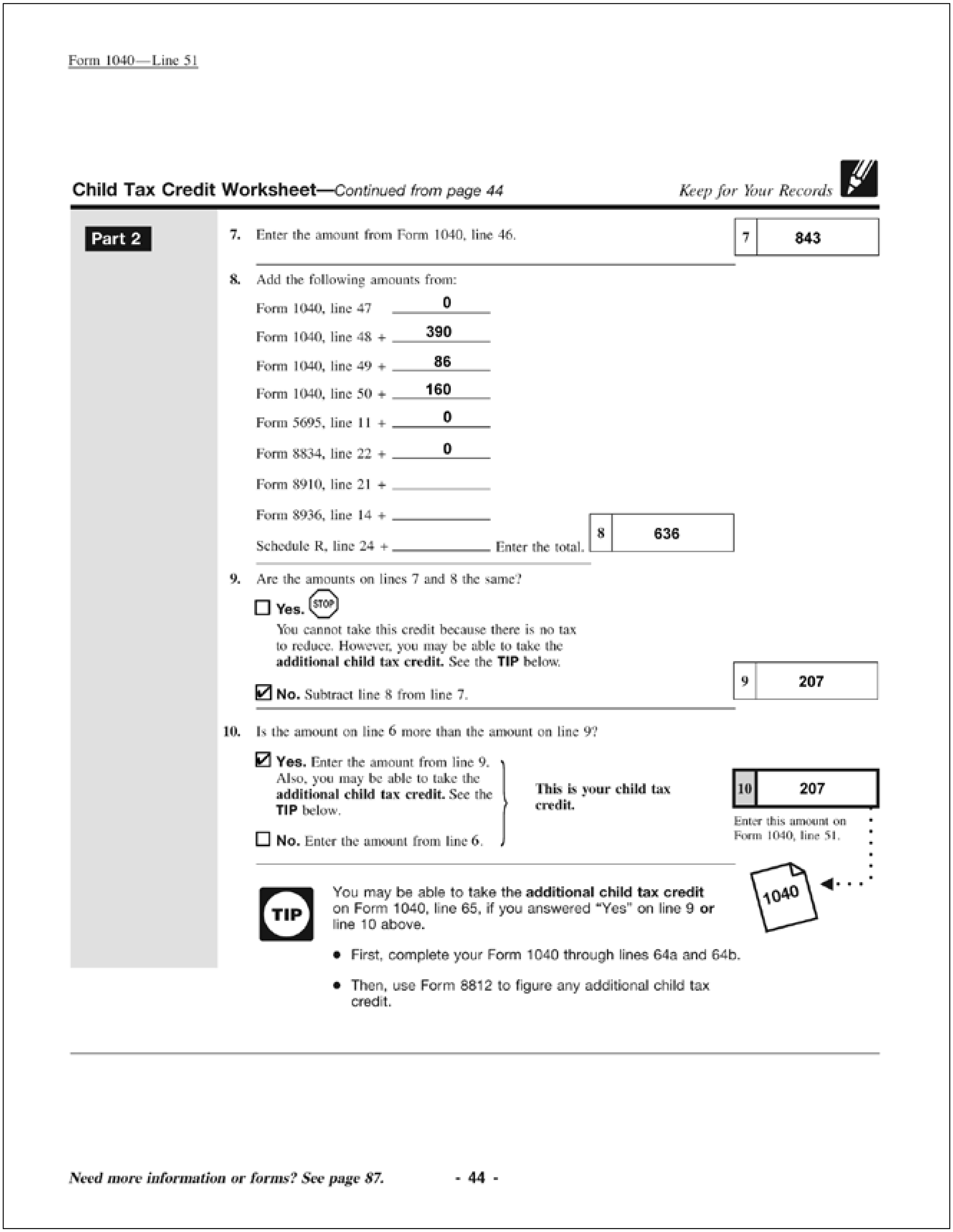
5. Multiply the amount on line 4 by 5% (.05). Enter the result. **5** 0

6. Is the amount on line 1 more than the amount on line 5?

☐ **No.** STOP
You cannot take the child tax credit on Form 1040, line 51. You also cannot take the additional child tax credit on Form 1040, line 65. Complete the rest of your Form 1040.

☑ **Yes.** Subtract line 5 from line 1. Enter the result.
Go to Part 2 on the next page. **6** 3,000

Before you begin Part 2: Figure the amount of any credits you are claiming on Form 5695, Part I; Form 8834, Part I; Form 8910; Form 8936; or Schedule R.



Form 1040—Line 51

Child Tax Credit Worksheet—*Continued from page 44*

Keep for Your Records

Part 2

7. Enter the amount from Form 1040, line 46. **7** 843

8. Add the following amounts from:

Form 1040, line 47 0

Form 1040, line 48 + 390

Form 1040, line 49 + 86

Form 1040, line 50 + 160

Form 5695, line 11 + 0

Form 8834, line 22 + 0

Form 8910, line 21 + ______

Form 8936, line 14 + ______

Schedule R, line 24 + ______ Enter the total. **8** 636

9. Are the amounts on lines 7 and 8 the same?

☐ **Yes.** STOP
You cannot take this credit because there is no tax to reduce. However, you may be able to take the **additional child tax credit.** See the **TIP** below.

☑ **No.** Subtract line 8 from line 7. **9** 207

10. Is the amount on line 6 more than the amount on line 9?

☑ **Yes.** Enter the amount from line 9. Also, you may be able to take the **additional child tax credit.** See the **TIP** below.

☐ **No.** Enter the amount from line 6.

This is your child tax credit. **10** 207

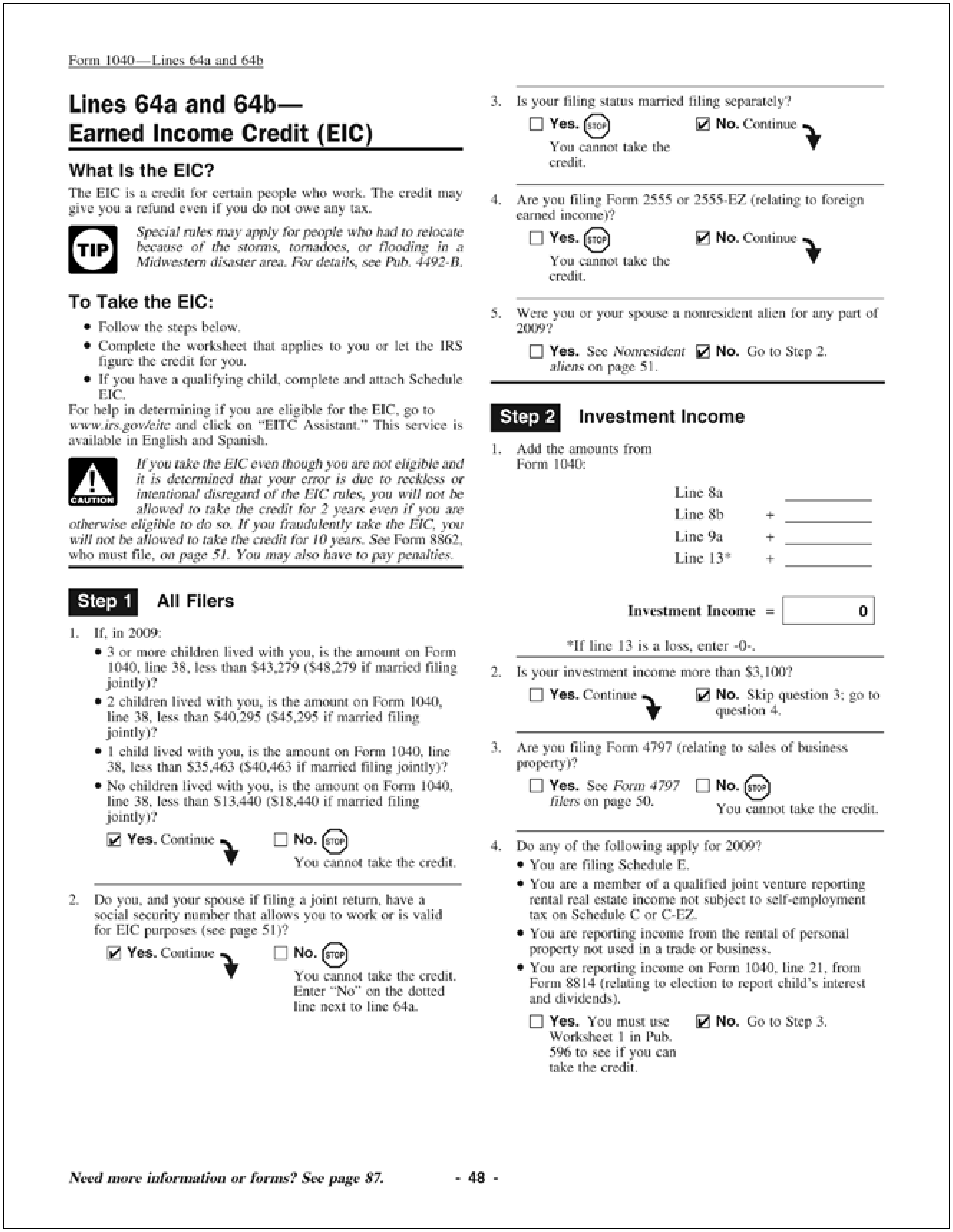
Enter this amount on Form 1040, line 51.

1040

TIP You may be able to take the **additional child tax credit** on Form 1040, line 65, if you answered "Yes" on line 9 **or** line 10 above.

- First, complete your Form 1040 through lines 64a and 64b.
- Then, use Form 8812 to figure any additional child tax credit.

Need more information or forms? See page 87. - 44 -



Lines 64a and 64b— Earned Income Credit (EIC)

What Is the EIC?

The EIC is a credit for certain people who work. The credit may give you a refund even if you do not owe any tax.

TIP *Special rules may apply for people who had to relocate because of the storms, tornadoes, or flooding in a Midwestern disaster area. For details, see Pub. 4492-B.*

To Take the EIC:

- Follow the steps below.
- Complete the worksheet that applies to you or let the IRS figure the credit for you.
- If you have a qualifying child, complete and attach Schedule EIC.

For help in determining if you are eligible for the EIC, go to *www.irs.gov/eitc* and click on "EITC Assistant." This service is available in English and Spanish.

CAUTION *If you take the EIC even though you are not eligible and it is determined that your error is due to reckless or intentional disregard of the EIC rules, you will not be allowed to take the credit for 2 years even if you are otherwise eligible to do so. If you fraudulently take the EIC, you will not be allowed to take the credit for 10 years. See* Form 8862, who must file, *on page 51. You may also have to pay penalties.*

Step 1 All Filers

1. If, in 2009:
   - 3 or more children lived with you, is the amount on Form 1040, line 38, less than $43,279 ($48,279 if married filing jointly)?
   - 2 children lived with you, is the amount on Form 1040, line 38, less than $40,295 ($45,295 if married filing jointly)?
   - 1 child lived with you, is the amount on Form 1040, line 38, less than $35,463 ($40,463 if married filing jointly)?
   - No children lived with you, is the amount on Form 1040, line 38, less than $13,440 ($18,440 if married filing jointly)?

   ☑ **Yes.** Continue ↓ ☐ **No.** STOP You cannot take the credit.

2. Do you, and your spouse if filing a joint return, have a social security number that allows you to work or is valid for EIC purposes (see page 51)?

   ☑ **Yes.** Continue ↓ ☐ **No.** STOP You cannot take the credit. Enter "No" on the dotted line next to line 64a.

3. Is your filing status married filing separately?

   ☐ **Yes.** STOP You cannot take the credit. ☑ **No.** Continue ↓

4. Are you filing Form 2555 or 2555-EZ (relating to foreign earned income)?

   ☐ **Yes.** STOP You cannot take the credit. ☑ **No.** Continue ↓

5. Were you or your spouse a nonresident alien for any part of 2009?

   ☐ **Yes.** See *Nonresident aliens* on page 51. ☑ **No.** Go to Step 2.

Step 2 Investment Income

1. Add the amounts from Form 1040:

Line 8a		
Line 8b	+	
Line 9a	+	
Line 13*	+	
Investment Income	=	**0**

*If line 13 is a loss, enter -0-.

2. Is your investment income more than $3,100?

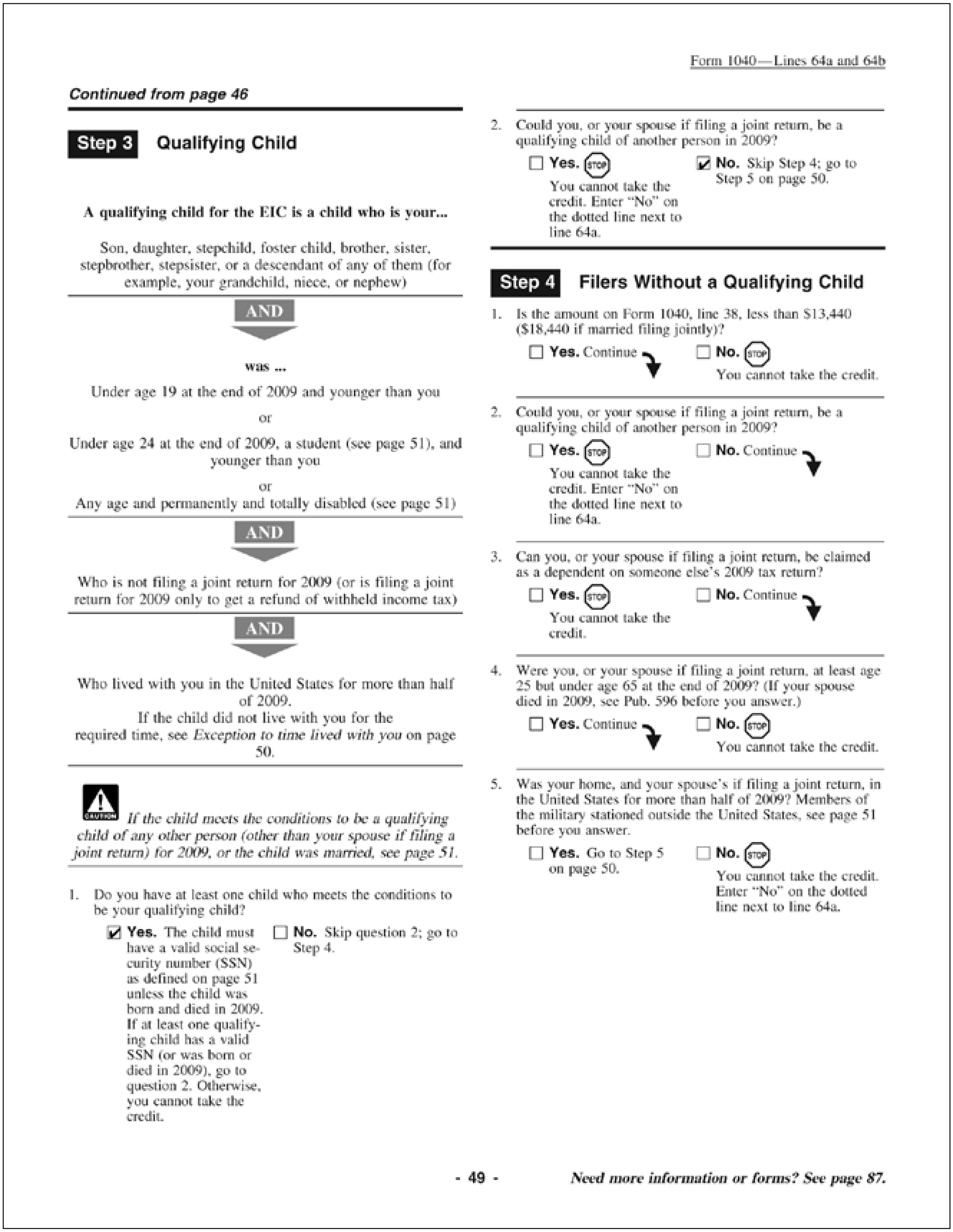
   ☐ **Yes.** Continue ↓ ☑ **No.** Skip question 3; go to question 4.

3. Are you filing Form 4797 (relating to sales of business property)?

   ☐ **Yes.** See *Form 4797 filers* on page 50. ☐ **No.** STOP You cannot take the credit.

4. Do any of the following apply for 2009?
   - You are filing Schedule E.
   - You are a member of a qualified joint venture reporting rental real estate income not subject to self-employment tax on Schedule C or C-EZ.
   - You are reporting income from the rental of personal property not used in a trade or business.
   - You are reporting income on Form 1040, line 21, from Form 8814 (relating to election to report child's interest and dividends).

   ☐ **Yes.** You must use Worksheet 1 in Pub. 596 to see if you can take the credit. ☑ **No.** Go to Step 3.



Continued from page 46

Step 3 Qualifying Child

A qualifying child for the EIC is a child who is your...

Son, daughter, stepchild, foster child, brother, sister, stepbrother, stepsister, or a descendant of any of them (for example, your grandchild, niece, or nephew)

AND

was ...

Under age 19 at the end of 2009 and younger than you

or

Under age 24 at the end of 2009, a student (see page 51), and younger than you

or

Any age and permanently and totally disabled (see page 51)

AND

Who is not filing a joint return for 2009 (or is filing a joint return for 2009 only to get a refund of withheld income tax)

AND

Who lived with you in the United States for more than half of 2009.
If the child did not live with you for the required time, see *Exception to time lived with you* on page 50.

CAUTION *If the child meets the conditions to be a qualifying child of any other person (other than your spouse if filing a joint return) for 2009, or the child was married, see page 51.*

1. Do you have at least one child who meets the conditions to be your qualifying child?

   ☑ **Yes.** The child must have a valid social security number (SSN) as defined on page 51 unless the child was born and died in 2009. If at least one qualifying child has a valid SSN (or was born or died in 2009), go to question 2. Otherwise, you cannot take the credit.

   ☐ **No.** Skip question 2; go to Step 4.

2. Could you, or your spouse if filing a joint return, be a qualifying child of another person in 2009?

   ☐ **Yes.** STOP You cannot take the credit. Enter "No" on the dotted line next to line 64a.

   ☑ **No.** Skip Step 4; go to Step 5 on page 50.

Step 4 Filers Without a Qualifying Child

1. Is the amount on Form 1040, line 38, less than $13,440 ($18,440 if married filing jointly)?

   ☐ **Yes.** Continue ↓

   ☐ **No.** STOP You cannot take the credit.

2. Could you, or your spouse if filing a joint return, be a qualifying child of another person in 2009?

   ☐ **Yes.** STOP You cannot take the credit. Enter "No" on the dotted line next to line 64a.

   ☐ **No.** Continue ↓

3. Can you, or your spouse if filing a joint return, be claimed as a dependent on someone else's 2009 tax return?

   ☐ **Yes.** STOP You cannot take the credit.

   ☐ **No.** Continue ↓

4. Were you, or your spouse if filing a joint return, at least age 25 but under age 65 at the end of 2009? (If your spouse died in 2009, see Pub. 596 before you answer.)

   ☐ **Yes.** Continue ↓

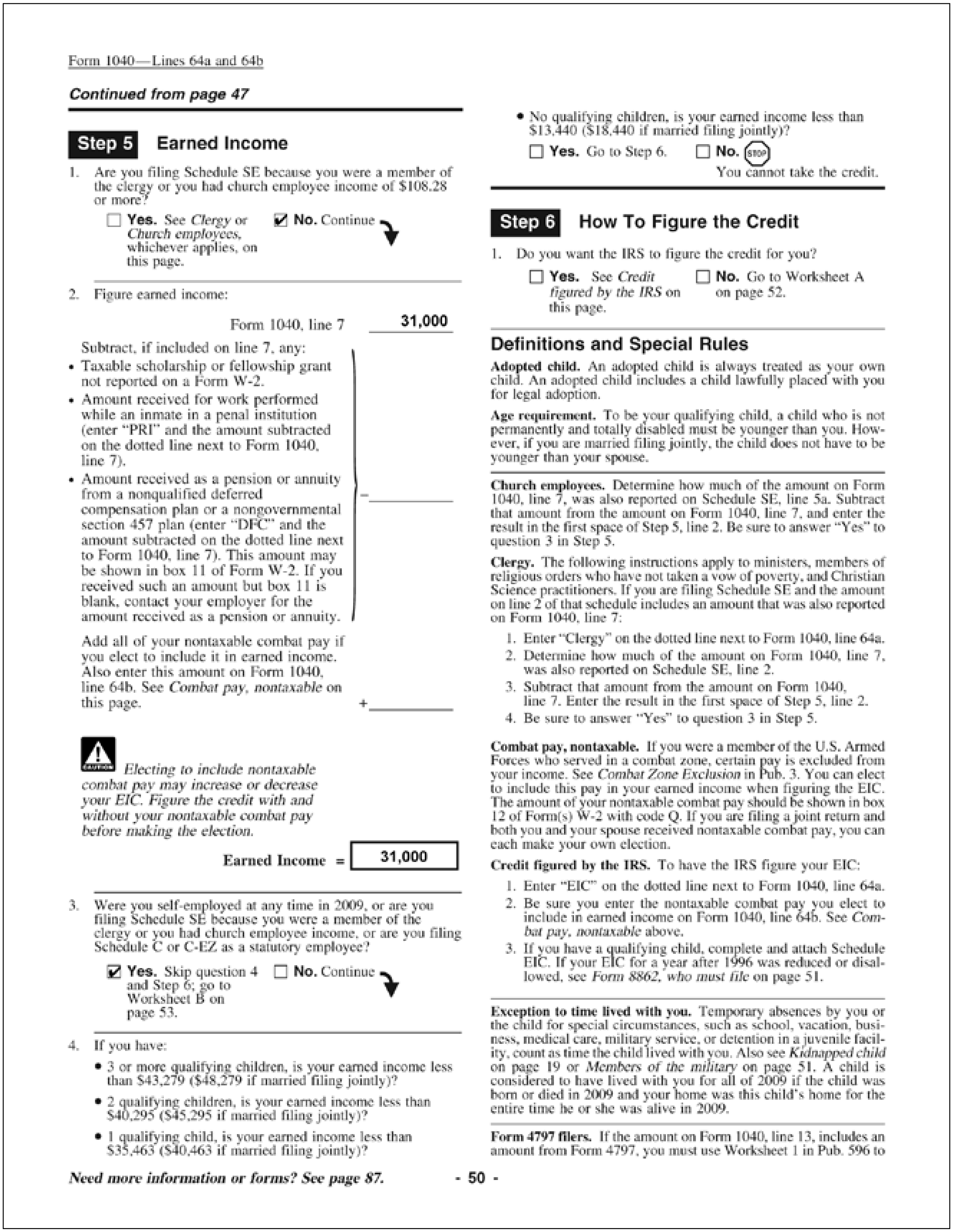
   ☐ **No.** STOP You cannot take the credit.

5. Was your home, and your spouse's if filing a joint return, in the United States for more than half of 2009? Members of the military stationed outside the United States, see page 51 before you answer.

   ☐ **Yes.** Go to Step 5 on page 50.

   ☐ **No.** STOP You cannot take the credit. Enter "No" on the dotted line next to line 64a.

Need more information or forms? See page 87.



Continued from page 47

Step 5 Earned Income

1. Are you filing Schedule SE because you were a member of the clergy or you had church employee income of $108.28 or more?

   ☐ **Yes.** See *Clergy* or *Church employees,* whichever applies, on this page.   ☑ **No.** Continue

2. Figure earned income:

Form 1040, line 7 31,000

Subtract, if included on line 7, any:

- Taxable scholarship or fellowship grant not reported on a Form W-2.
- Amount received for work performed while an inmate in a penal institution (enter "PRI" and the amount subtracted on the dotted line next to Form 1040, line 7).
- Amount received as a pension or annuity from a nonqualified deferred compensation plan or a nongovernmental section 457 plan (enter "DFC" and the amount subtracted on the dotted line next to Form 1040, line 7). This amount may be shown in box 11 of Form W-2. If you received such an amount but box 11 is blank, contact your employer for the amount received as a pension or annuity.

–________

Add all of your nontaxable combat pay if you elect to include it in earned income. Also enter this amount on Form 1040, line 64b. See *Combat pay, nontaxable* on this page. +________

Electing to include nontaxable combat pay may increase or decrease your EIC. Figure the credit with and without your nontaxable combat pay before making the election.

Earned Income = 31,000

3. Were you self-employed at any time in 2009, or are you filing Schedule SE because you were a member of the clergy or you had church employee income, or are you filing Schedule C or C-EZ as a statutory employee?

   ☑ **Yes.** Skip question 4 and Step 6; go to Worksheet B on page 53.   ☐ **No.** Continue

4. If you have:
   - 3 or more qualifying children, is your earned income less than $43,279 ($48,279 if married filing jointly)?
   - 2 qualifying children, is your earned income less than $40,295 ($45,295 if married filing jointly)?
   - 1 qualifying child, is your earned income less than $35,463 ($40,463 if married filing jointly)?
   - No qualifying children, is your earned income less than $13,440 ($18,440 if married filing jointly)?

   ☐ **Yes.** Go to Step 6.   ☐ **No.** STOP You cannot take the credit.

Step 6 How To Figure the Credit

1. Do you want the IRS to figure the credit for you?

   ☐ **Yes.** See *Credit figured by the IRS* on this page.   ☐ **No.** Go to Worksheet A on page 52.

Definitions and Special Rules

Adopted child. An adopted child is always treated as your own child. An adopted child includes a child lawfully placed with you for legal adoption.

Age requirement. To be your qualifying child, a child who is not permanently and totally disabled must be younger than you. However, if you are married filing jointly, the child does not have to be younger than your spouse.

Church employees. Determine how much of the amount on Form 1040, line 7, was also reported on Schedule SE, line 5a. Subtract that amount from the amount on Form 1040, line 7, and enter the result in the first space of Step 5, line 2. Be sure to answer "Yes" to question 3 in Step 5.

Clergy. The following instructions apply to ministers, members of religious orders who have not taken a vow of poverty, and Christian Science practitioners. If you are filing Schedule SE and the amount on line 2 of that schedule includes an amount that was also reported on Form 1040, line 7:

1. Enter "Clergy" on the dotted line next to Form 1040, line 64a.
2. Determine how much of the amount on Form 1040, line 7, was also reported on Schedule SE, line 2.
3. Subtract that amount from the amount on Form 1040, line 7. Enter the result in the first space of Step 5, line 2.
4. Be sure to answer "Yes" to question 3 in Step 5.

Combat pay, nontaxable. If you were a member of the U.S. Armed Forces who served in a combat zone, certain pay is excluded from your income. See *Combat Zone Exclusion* in Pub. 3. You can elect to include this pay in your earned income when figuring the EIC. The amount of your nontaxable combat pay should be shown in box 12 of Form(s) W-2 with code Q. If you are filing a joint return and both you and your spouse received nontaxable combat pay, you can each make your own election.

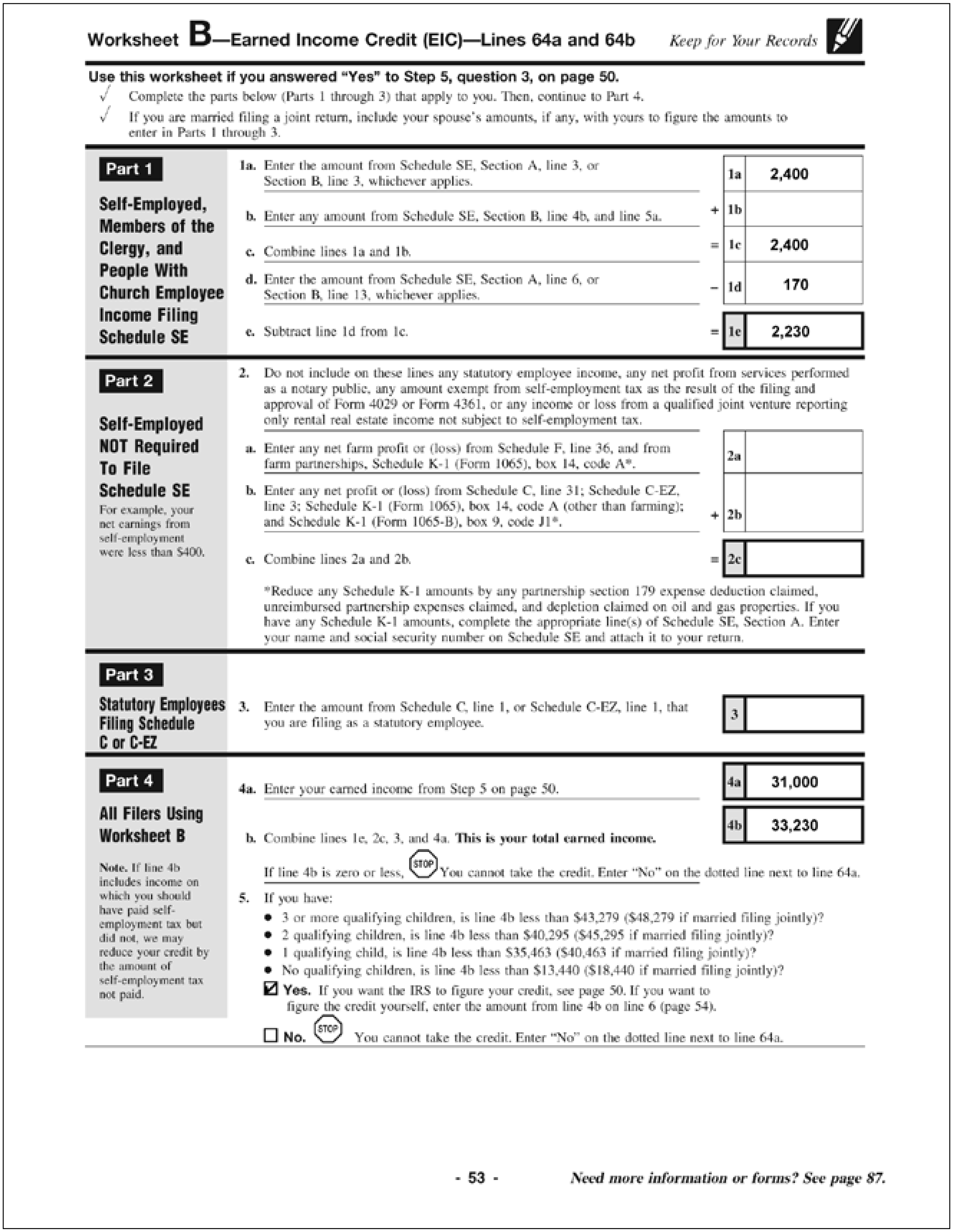
Credit figured by the IRS. To have the IRS figure your EIC:

1. Enter "EIC" on the dotted line next to Form 1040, line 64a.
2. Be sure you enter the nontaxable combat pay you elect to include in earned income on Form 1040, line 64b. See *Combat pay, nontaxable* above.
3. If you have a qualifying child, complete and attach Schedule EIC. If your EIC for a year after 1996 was reduced or disallowed, see *Form 8862, who must file* on page 51.

Exception to time lived with you. Temporary absences by you or the child for special circumstances, such as school, vacation, business, medical care, military service, or detention in a juvenile facility, count as time the child lived with you. Also see *Kidnapped child* on page 19 or *Members of the military* on page 51. A child is considered to have lived with you for all of 2009 if the child was born or died in 2009 and your home was this child's home for the entire time he or she was alive in 2009.

Form 4797 filers. If the amount on Form 1040, line 13, includes an amount from Form 4797, you must use Worksheet 1 in Pub. 596 to

Need more information or forms? See page 87.



Worksheet B—Earned Income Credit (EIC)—Lines 64a and 64b

Keep for Your Records

Use this worksheet if you answered "Yes" to Step 5, question 3, on page 50.

- √ Complete the parts below (Parts 1 through 3) that apply to you. Then, continue to Part 4.
- √ If you are married filing a joint return, include your spouse's amounts, if any, with yours to figure the amounts to enter in Parts 1 through 3.

Part 1

Self-Employed, Members of the Clergy, and People With Church Employee Income Filing Schedule SE

1a. Enter the amount from Schedule SE, Section A, line 3, or Section B, line 3, whichever applies.		1a	2,400
b. Enter any amount from Schedule SE, Section B, line 4b, and line 5a.	+	1b	
c. Combine lines 1a and 1b.	=	1c	2,400
d. Enter the amount from Schedule SE, Section A, line 6, or Section B, line 13, whichever applies.	–	1d	170
e. Subtract line 1d from 1c.	=	1e	2,230

Part 2

Self-Employed NOT Required To File Schedule SE

For example, your net earnings from self-employment were less than $400.

2. Do not include on these lines any statutory employee income, any net profit from services performed as a notary public, any amount exempt from self-employment tax as the result of the filing and approval of Form 4029 or Form 4361, or any income or loss from a qualified joint venture reporting only rental real estate income not subject to self-employment tax.

a. Enter any net farm profit or (loss) from Schedule F, line 36, and from farm partnerships, Schedule K-1 (Form 1065), box 14, code A*.		2a	
b. Enter any net profit or (loss) from Schedule C, line 31; Schedule C-EZ, line 3; Schedule K-1 (Form 1065), box 14, code A (other than farming); and Schedule K-1 (Form 1065-B), box 9, code J1*.	+	2b	
c. Combine lines 2a and 2b.	=	2c	

*Reduce any Schedule K-1 amounts by any partnership section 179 expense deduction claimed, unreimbursed partnership expenses claimed, and depletion claimed on oil and gas properties. If you have any Schedule K-1 amounts, complete the appropriate line(s) of Schedule SE, Section A. Enter your name and social security number on Schedule SE and attach it to your return.

Part 3

Statutory Employees Filing Schedule C or C-EZ

3. Enter the amount from Schedule C, line 1, or Schedule C-EZ, line 1, that you are filing as a statutory employee.	3	

Part 4

All Filers Using Worksheet B

Note. If line 4b includes income on which you should have paid self-employment tax but did not, we may reduce your credit by the amount of self-employment tax not paid.

4a. Enter your earned income from Step 5 on page 50.	4a	31,000
b. Combine lines 1e, 2c, 3, and 4a. **This is your total earned income.**	4b	33,230

If line 4b is zero or less, STOP You cannot take the credit. Enter "No" on the dotted line next to line 64a.

5. If you have:

- 3 or more qualifying children, is line 4b less than $43,279 ($48,279 if married filing jointly)?
- 2 qualifying children, is line 4b less than $40,295 ($45,295 if married filing jointly)?
- 1 qualifying child, is line 4b less than $35,463 ($40,463 if married filing jointly)?
- No qualifying children, is line 4b less than $13,440 ($18,440 if married filing jointly)?

☒ **Yes.** If you want the IRS to figure your credit, see page 50. If you want to figure the credit yourself, enter the amount from line 4b on line 6 (page 54).

☐ **No.** STOP You cannot take the credit. Enter "No" on the dotted line next to line 64a.

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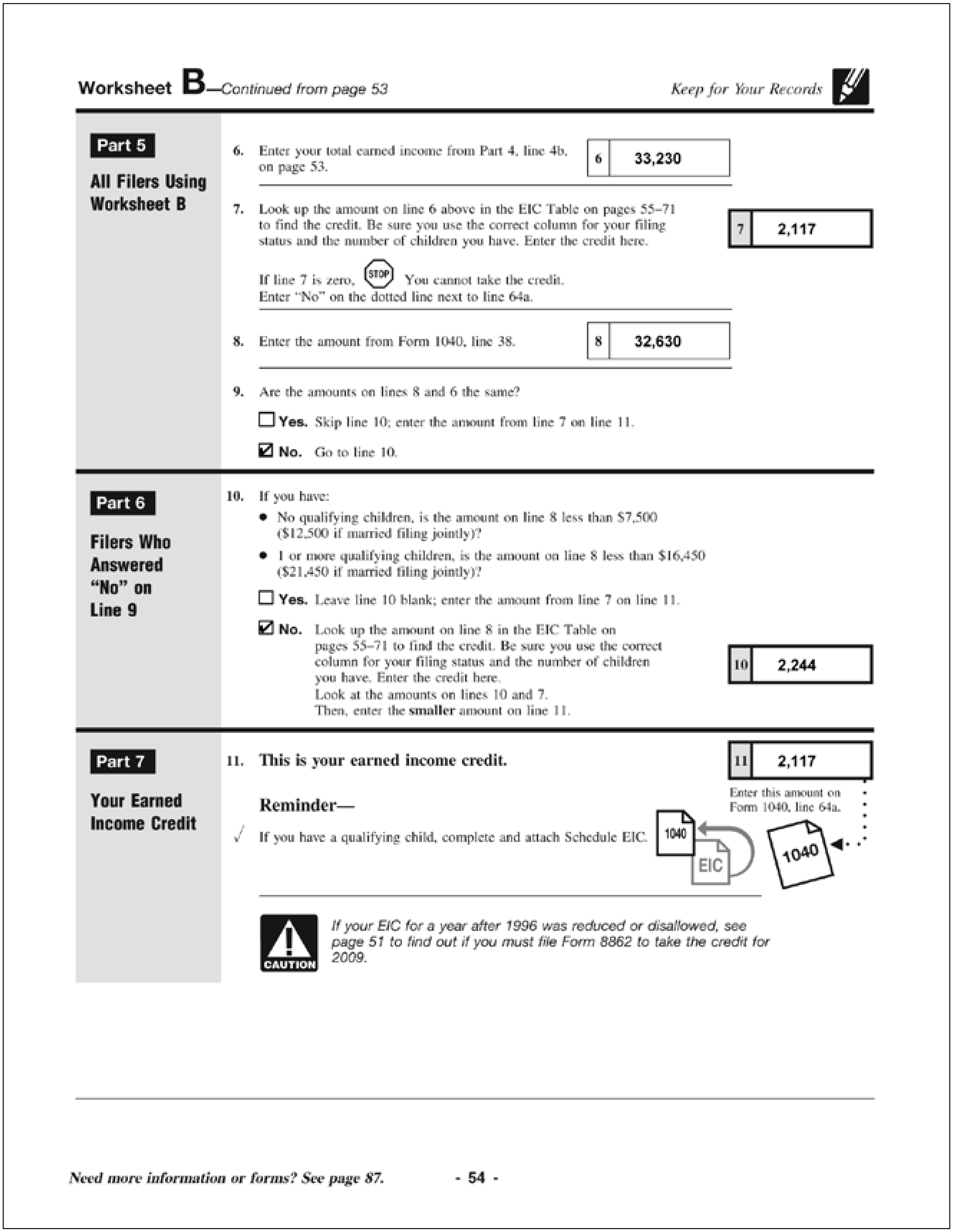
Need more information or forms? See page 87.



Worksheet B—*Continued from page 53*

Keep for Your Records

Part 5

All Filers Using Worksheet B

6. Enter your total earned income from Part 4, line 4b, on page 53. **6** 33,230

7. Look up the amount on line 6 above in the EIC Table on pages 55–71 to find the credit. Be sure you use the correct column for your filing status and the number of children you have. Enter the credit here. **7** 2,117

If line 7 is zero, STOP You cannot take the credit. Enter "No" on the dotted line next to line 64a.

8. Enter the amount from Form 1040, line 38. **8** 32,630

9. Are the amounts on lines 8 and 6 the same?

☐ **Yes.** Skip line 10; enter the amount from line 7 on line 11.

☑ **No.** Go to line 10.

Part 6

Filers Who Answered "No" on Line 9

10. If you have:

- No qualifying children, is the amount on line 8 less than $7,500 ($12,500 if married filing jointly)?
- 1 or more qualifying children, is the amount on line 8 less than $16,450 ($21,450 if married filing jointly)?

☐ **Yes.** Leave line 10 blank; enter the amount from line 7 on line 11.

☑ **No.** Look up the amount on line 8 in the EIC Table on pages 55–71 to find the credit. Be sure you use the correct column for your filing status and the number of children you have. Enter the credit here. **10** 2,244
Look at the amounts on lines 10 and 7.
Then, enter the **smaller** amount on line 11.

Part 7

Your Earned Income Credit

11. This is your earned income credit. **11** 2,117

Enter this amount on Form 1040, line 64a.

Reminder—

√ If you have a qualifying child, complete and attach Schedule EIC.

CAUTION *If your EIC for a year after 1996 was reduced or disallowed, see page 51 to find out if you must file Form 8862 to take the credit for 2009.*

Need more information or forms? See page 87. - 54 -

Index

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- Prepare the exercises and problems online
- Prepare tax returns based on the test scenarios online

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- Stand alone online test and certification
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  - Glossary

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The Volunteer Resource Center

(Keyword: Community Network)

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- Site Coordinator's Corner
- Volunteer Tax Alerts
- Volunteer Training Resources
- EITC Information for Partners
- e-file Materials and Outreach Products

Tax Information for Individuals

(Keyword: Individuals)

- 1040 Central (What's new this filing season)
- Where's My Refund
- EITC Assistant - Available in English and Spanish
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- Tax Trails for Answers to common tax questions
- Alternative Minimum Tax (AMT) Assistant

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