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Presents

Tax Preparation 101

Training Manual

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1 Filing Status, Filing Requirements, Dependents

Learning Objectives

NOTES

Successful completion of this course will enable the participant to:
1-A Recognize the filing status rules.
1-B Recognize the limitations for filing as Head of Household.
1-C Identify filing requirements based on filing status and income.
1-D Identify the tests for claiming someone as a dependent.
1-E Recognize the special dependency rules for divorced or separated parents.

Glossary Terms

Considered unmarried. Considered unmarried is a term used for certain married taxpayers for purposes of qualifying for the Head of Household filing status.
Permanently and totally disabled. An individual is permanently and totally disabled if he or she cannot engage in any substantial gainful activity due to a physical or mental condition, and a doctor determines the condition has lasted, or can be expected to last, continuously for at least a year or can lead to death.

Learning Objective 1-A

Recognize the filing status rules.

There are five different statuses to choose from.

[1] Filing Statuses

One of the first decisions that needs to be made when preparing a tax return is which filing status to use. There are five different statuses to choose from. The 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.

KEY FACT: **Many taxpayers qualify to use more than one filing status.**

Single

The Single filing status is for unmarried individuals only. A taxpayer is unmarried if:

- The taxpayer has never married.
- The taxpayer was legally separated, according to state law, under a decree of divorce or separate maintenance.
- The taxpayer's spouse died before January 1, 2019, and the taxpayer did not remarry in 2019.

If the taxpayer meets the definition of unmarried, file as Single unless the requirements for the Head of Household or Qualifying Widow(er) status is met.

Registered domestic partnerships and civil unions. For federal tax purposes, individuals who have entered into a registered domestic partnership, civil union, or other similar relationship that is not considered a marriage under state law, are not considered married.

If a taxpayer is married as of the last day of the year, the filing status of Married Filing Jointly, Married Filing Separately, or Head of Household must be used.

Married Filing Jointly (MFJ)

If a taxpayer is married as of the last day of the year, the filing status of Married Filing Jointly, Married Filing Separately, or Head of Household must be used. A married taxpayer may not use the Single filing status.
Generally, a married couple will benefit from lower combined taxes when they file a joint tax return.

A taxpayer can file a joint return for the tax year with a spouse if:

- The taxpayer was married at the end of the year, even if the taxpayer did not live with the spouse at the end of the year.

- The taxpayer's spouse died in the year, and the taxpayer did not remarry in the year.
- The taxpayer was married at the end of the year, and the spouse died in a following year before filing the return.
- The taxpayer lived with a person in a common-law marriage recognized in the state where they live or in the state where the common-law marriage began.

NOTES

A taxpayer can file MFJ if both spouses agree, otherwise a married taxpayer may file:
- Married Filing Separately (MFS), or
- Head of Household (HOH) if the taxpayer meets the requirements to be considered unmarried. See Head of Household, Learning Objective 1-B.

Married Filing Separately (MFS)

Any taxpayer that was married at the end of the tax year can file as MFS. Generally, a taxpayer will pay more tax by filing MFS. In addition, certain credits are disallowed for MFS taxpayers.

Married Filing Separately		
50% of MFJ	• Standard deduction • Tax brackets • AMT exemptions	• Net capital loss deduction ($1,500). • Exclusion of gain on home sale. • Home mortgage interest limits.
Income limits 50% of MFJ	• Child Tax Credit. • Credit for Other Dependents. • Retirement Savings Credit.	
Credits disallowed	• Earned Income Credit. • Elderly or Disabled Credit unless spouses lived apart all year. • Child and Dependent Care Credit in most cases. • Adoption Expense Credit or exclusion in most cases.	
Education benefits disallowed	• Education credits. • Students loan interest deduction. • Exclusion for U.S. bond interest.	
IRAs	If the taxpayer or spouse is covered by an employer retirement plan, contributions are phased out at AGI of $10,000 unless the spouse lived apart all year.	
Social Security	For MFJ, benefits are not taxable if income is under $32,000. That amount is reduced to zero for MFS, unless spouses did not live together at any time during the year	
Rental real estate losses	Special loss allowance is $12,500 reduced at modified AGI over $50,000. No deduction if spouses lived together at any time during the year.	

However, the following are reasons why a taxpayer might choose to file separately.

- **Limit liability.** Spouses filing jointly have joint and several liabilities. Each spouse is responsible for the accuracy of the return and for the payment of the entire tax due. Spouses who file separately are not responsible for the other spouse's reporting or tax. A spouse who has filed a joint return may seek relief from joint liability under the innocent spouse rules. [2]
- **Lower tax.** Some couples may pay less filing separately. For example, if one spouse has high medical expenses and both spouses have income, deductions may be higher on separate returns.
- **Avoid offsets.** Another common reason a taxpayer may file MFS is to avoid an offset of his or her refund against his or her spouse's outstanding debts.

If a taxpayer has outstanding debts, including past due child support, past due student loans, or a tax liability, any refunds can be used to offset these amounts owed. [3]

Standard deduction.

If a taxpayer files MFS and his or her spouse itemizes deductions, the taxpayer cannot claim the standard deduction. In this case the MFS taxpayer must use itemized deductions. A taxpayer filing HOH can claim a standard deduction if his or her spouse itemizes deductions.

Community property states.

The income of taxpayers living in Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, or Wisconsin during the tax year and who choose to file separate returns may be considered separate income or community income for tax purposes. Each spouse must report half of combined community income, in addition to his or her separate income. Each state has its own community property laws, which may affect the amount of tax owed by taxpayers.

Income and deductions in non community property states.

Each spouse claims his or her earned income and income on his or her assets. Each spouse must meet the criteria for any particular deduction in order to claim it and can deduct amounts that he or she paid. If one spouse meets the criteria for a deduction the other spouse paid, no deduction is allowed on separate returns. Expenses paid from a joint account that holds earnings from both spouses are presumed to have been paid equally by the spouses unless one spouse can show otherwise.

Medical expenses of spouse. Expenses are deductible by the spouse who paid if the spouses were married when service was provided or when the expense was paid.

Medical expenses of children. Expenses are deductible if the child was a dependent when service was provided or when the expense was paid. For children of divorced or separated parents, each parent can deduct medical expenses for the child even if the other parent claims the child as a dependent.

State and local taxes. If separate state returns are filed, each spouse deducts his or her own tax. If a joint state return is filed, and the state has a joint and several liability law, each spouse deducts the amount he or she paid. If the state has no such law, each spouse deducts a proportionate share of the tax (taxpayer's gross income divided by combined gross income).

Mortgage interest. If spouses own more than one home jointly, each spouse can deduct interest from only one home unless both spouses consent in writing, then one spouse can deduct interest from both homes.

Amending joint/separate returns.

Spouses can amend separate returns to file jointly. Once a joint return is filed, taxpayers cannot choose to file separate returns after the due date of the return.

Exception: A personal representative can choose to file a separate return for a deceased spouse up to one year from the due date of the return.

Qualifying Widow(er)

If the taxpayer's spouse died during the year, he or she can use the Married Filing Jointly filing status for that year if otherwise qualified. The year of death is the last year for which a taxpayer can file jointly with his or her deceased spouse. For two years following the year his or her spouse died, a taxpayer may be eligible to use the Qualifying Widow(er) filing status. For example, if the spouse died in 2017, and the taxpayer has not remarried, he or she may be able to use this filing status in 2018 and 2019. This filing status entitles the taxpayer to use joint return tax rates and the highest standard deduction amount (if not itemizing deductions).

Eligibility.

A taxpayer is eligible to file as a Qualifying Widow(er) if all of the following tests are met.

- The taxpayer was entitled to file a joint return with his or her spouse for the year in which the spouse died. It does not matter whether a joint return was actually filed.
- The spouse died in one of the previous two years and the taxpayer has not remarried.
- The taxpayer has a child or stepchild who he or she may claim as a dependent. This does not include a foster child.
- This child lived in the taxpayer's home all year, except for temporary absences. There are exceptions for a child who was born or died during the year.
- The taxpayer paid more than half the cost of keeping up a home for the year.

NOTES

If a taxpayer files MFS and his or her spouse itemizes deductions, the taxpayer cannot claim the standard deduction.

Once a joint return is filed, taxpayers cannot choose to file separate returns after the due date of the return.

EXAMPLE: Will's wife died in 2017. Will has not remarried. During 2018 and 2019, he continued to keep up a home for himself and his daughter, who lives with him and who he can claim as a dependent. For 2017, he was entitled to file a joint return for himself and his deceased wife and claim his daughter as a dependent. For 2018 and 2019, he can file as Qualifying Widower With Dependent Child. After 2019, he can file as Head of Household if he otherwise qualifies.

Child who was born or died.

If the taxpayer's child is born or died during the year, the taxpayer may still be eligible to use the Qualifying Widow(er) filing status. The taxpayer must have provided more than half the cost of keeping up a home that was the child's main home during the entire part of the year the child was alive.

Learning Objective 1-A Self-Quiz

For answer, see Chapter 1 Self-Quiz Answers.

Test your knowledge and comprehension of information presented in Learning Objective 1-A.

Learning Objective 1-A.

Which of the following statements about the Married Filing Separately filing status is true?

a) Both spouses can claim a net capital loss deduction of $3,000.

b) Only one spouse can claim the Earned Income Credit.

c) The spouses cannot claim education credits.

d) One spouse can claim the $25,000 rental real estate loss if his or her modified AGI is under $100,000.

Learning Objective 1-B

Recognize the limitations for filing as Head of Household.

Head of Household

The Head of Household filing status is for unmarried individuals who provide a home for certain qualifying persons. Filing as Head of Household will usually result in a lower tax rate than the Single or Married Filing Separately filing status. The Head of Household filing status also receives a higher standard deduction than Single or Married Filing Separately.

A taxpayer may file as Head of Household if all of the following requirements are met.

- The taxpayer must be unmarried or considered unmarried on the last day of the year,
- The taxpayer must pay more than half the cost of keeping up a home for the year, and
- A qualifying person must have lived with the taxpayer in the home for more than half the year except for temporary absences, such as school. However, if the qualifying person is a dependent parent, he or she does not have to live with the taxpayer.

KEY FACT: If the taxpayer is married but lives apart from his or her spouse and meets certain tests to be considered unmarried, he or she may file as Head of Household even though not divorced or legally separated.

[1] Due diligence requirements.

If a taxpayer is filing as Head of Household, the return preparer must complete Form 8867, Paid Preparer's Due Diligence Checklist, to ensure the taxpayer is eligible to claim that filing status. Failure to comply with due diligence requirements may result in a $530 (2019) penalty for each failure.

Considered Unmarried

To be considered unmarried on the last day of the tax year, the taxpayer must meet all of the following tests.

NOTES

If the taxpayer's child is born or died during the year, the taxpayer may still be eligible to use the Qualifying Widow(er) filing status.

Filing as Head of Household will usually result in a lower tax rate than the Single or Married Filing Separately filing status.

Failure to comply with due diligence requirements may result in a $530 (2019) penalty for each failure.

- The taxpayer must file a separate return for his or her spouse,
- The taxpayer must pay more than half the cost of keeping up his or her home for the tax year,
- The taxpayer's spouse must not have lived in the home during the last six months of the tax year. The spouse is considered to live in the home even if he or she is temporarily absent due to special circumstances,
- The taxpayer's home must have been the main home of his or her child, stepchild, or foster child for more than half the year, and
- The taxpayer must be able to claim the child as a dependent. The taxpayer will meet this test if the only reason the taxpayer cannot claim the child is because he or she signed over the exemption to the noncustodial parent.

NOTES

Nonresident alien spouse. A taxpayer will be considered unmarried for Head of Household purposes if his or her spouse was a nonresident alien at any time during the year, and the taxpayer does not choose to treat the nonresident spouse as a resident alien. However, the spouse is not a qualifying person for Head of Household purposes. The taxpayer must have another qualifying person and meet the other tests to be eligible to file as Head of Household. The taxpayer will be considered married if he or she chooses to treat the nonresident spouse as a resident alien.

Keeping Up a Home

To qualify for Head of Household status, the taxpayer must pay more than half of the cost of keeping up a home for the year. The taxpayer can determine whether or not he or she paid more than half the cost of keeping up a home by using the following worksheet.

To qualify for Head of Household status, the taxpayer must pay more than half of the cost of keeping up a home for the year.

Cost of Keeping Up a Home

	Amount Taxpayer Paid	Total Cost
Property taxes	$	$
Mortgage interest expense		
Rent		
Utility charges		
Repairs/Maintenance		
Property insurance		
Food consumed on the premises		
Other household expenses		
Totals	$	$
Minus total amount the taxpayer paid		( )
Amount others paid		$

If the total amount the taxpayer paid is more than the amount others paid, the requirement of paying more than half the cost of keeping up the home is met.

Costs included. Include in the costs of upkeep expenses such as rent, mortgage interest, real estate taxes, insurance on the home, repairs, utilities, and food eaten in the home. If the taxpayer used payments received under Temporary Assistance for Needy Families (TANF) or other public assistance programs to pay part of the cost of keeping up the home, those payments cannot be counted as money paid by the taxpayer.

Costs not included. Do not include in the cost of upkeep expenses such as clothing, education, medical treatment, vacations, life insurance, or transportation. Also, do not include the rental value of the home owned by the taxpayer or the value of the taxpayer's services or those of a member or his or her household. Note that while some of these costs are included for purposes of determining total support for dependency, they are not included as a cost of keeping up a home for Head of Household filing status.

Qualifying Person

Only a person described in the following table is a qualifying person for purposes of Head of Household. A qualifying person cannot qualify more than one taxpayer to use the Head of Household status for the year.

NOTES

A qualifying person cannot qualify more than one taxpayer to use the Head of Household status for the year.

Who is a Qualifying Person Qualifying the Taxpayer to File as Head of Household?

If the person is the taxpayer's:	And:	Then that person is:
Qualifying child [1] (such as a son, daughter, or grandchild who lived with the taxpayer more than half the year and meets certain other tests)	He or she is single	A qualifying person whether or not the taxpayer can claim the person as a dependent.
	He or she is married and the taxpayer can claim the person as a dependent	A qualifying person.
	He or she is married and the taxpayer cannot claim the person as a dependent	Not a qualifying person.[2]
Qualifying relative [3] who is the taxpayer's father or mother	The taxpayer can claim the person as a dependent [4]	A qualifying person.[5]
	The taxpayer cannot claim the person as a dependent	Not a qualifying person.
Qualifying relative [3] other than the taxpayer's father or mother (such as a grandparent, brother, or sister who meets certain tests)	He or she lived with the taxpayer more than half the year and is related to the taxpayer in one of the ways listed under Qualifying relative, and the taxpayer can claim the person as a dependent [4]	A qualifying person.
	He or she did not live with the taxpayer more than half the year	Not a qualifying person.
	He or she is not related to the taxpayer in one of the ways listed under *Qualifying relative,* and is a qualifying relative only because he or she lived with the taxpayer all year as a member of the taxpayer's household	Not a qualifying person.
	The taxpayer cannot claim the person as a dependent	Not a qualifying person.

[1] The term qualifying child is defined under Dependency Chart, Learning Objective 1-D. See also Child of divorced or separated parents, for more information for custodial and noncustodial parents.
[2] This person is a qualifying person if the only reason the taxpayer cannot claim the person as a dependent is that the taxpayer can be claimed as a dependent on someone else's return.
[3] See Dependency Chart, Learning Objective 1-D.
[4] If the taxpayer can claim the person as a dependent only because of a multiple support agreement, that person is not a qualifying person.
[5] See Special rule for parent.

Qualifying child.

If a child meets the tests for a qualifying child dependent, the child is a qualifying person for purposes of Head of Household filing status under the following circumstances.

Single child. If the taxpayer's child is single, and the child meets the tests as a qualifying dependent, the child is a qualifying person for Head of Household filing status whether or not the taxpayer can claim the child as a dependent.

NOTES

EXAMPLE: **Rebecca is single. Her unmarried son, Eric, lived with her all year and was age 18 at the end of the year. Eric did not provide more than half of his own support and does not meet the tests to be a qualifying child of anyone else. As a result, Eric is Rebecca's qualifying child. Because Eric is single, he is a qualifying person for purposes of Rebecca's Head of Household filing status.**

EXAMPLE: **Keith's unmarried son, John, who was age 25 at the end of the year, lived with Keith all year. John's gross income was $5,000. Because he does not meet the age test, he is not a qualifying child. Because he does not meet the gross income test, he is not a qualifying relative. As a result, John is not a qualifying person for Keith to file as Head of Household.**

Married child. If the taxpayer's child is married, the child is a qualifying person for purposes of Head of Household filing status only if the taxpayer is allowed to claim the child as a dependent. If the child is married, and the taxpayer cannot claim the child as a dependent, the child is not a qualifying person for purposes of Head of Household filing status.

Note: This person can be a qualifying child if the only reason the taxpayer cannot claim the child as a dependent is that the taxpayer can be claimed as a dependent on someone else's return.

Child of divorced or separated parents. If a child is a qualifying child of a noncustodial parent under the rules for divorced or separated parents, the child does not qualify the noncustodial parent for Head of Household filing status. In this case, the custodial parent can generally claim the child as a qualifying person for Head of Household filing status even though the custodial parent signed over the exemption to the noncustodial parent.

If a child is a qualifying child of a noncustodial parent under the rules for divorced or separated parents, the child does not qualify the noncustodial parent for Head of Household filing status.

Qualifying relative.

A qualifying relative can be a qualifying person for purposes of the Head of Household filing status if the taxpayer paid more than half of the cost of keeping up a home where the qualifying relative lived for more than half the year. The taxpayer must be eligible to claim the qualifying relative as a dependent, and the qualifying relative must meet one of the following relationship tests.

- Son, daughter, stepchild, foster child, or a descendant of any of these (such as a grandchild),
- Brother, sister, or a son or daughter of either (such as a niece or nephew),
- Father, mother, or ancestor or sibling of either, (such as grandmother, grandfather, aunt, or uncle), or
- Stepbrother, stepsister, stepfather, stepmother, son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law.

Note: A person other than the relationships listed above who lived with the taxpayer all year as a member of the taxpayer's household could be claimed as a dependent by the taxpayer, but such person who is a dependent only because they lived with the taxpayer all year does not qualify the taxpayer for Head of Household filing status.

EXAMPLE: **Keith's girlfriend lived with him all year. Even though she may be his qualifying relative if the gross income and support tests are met, she is not his qualifying person for Head of Household purposes because she is not related to him in one of the ways listed.**

Home of qualifying person.

Generally, the qualifying person must live with the taxpayer for more than half the year.

Special rule for parent. If the qualifying person is the taxpayer's father or mother, the taxpayer may be eligible to file as Head of Household even if the parent does not live with the taxpayer. However, the taxpayer must be able to claim the parent as a dependent.

If the qualifying person is the taxpayer's father or mother, the taxpayer may be eligible to file as Head of Household even if the parent does not live with the taxpayer.

Also, the taxpayer must pay more than half the cost of keeping up a home that was the main home for the entire year of that parent. The taxpayer is keeping up a main home for the parent if he or she is paying more than half the cost of keeping that parent in a rest home or home for the elderly.

Temporary absences. The taxpayer and his or her qualifying relative are considered to live together even if one or both are temporarily absent from the home due to special circumstances such as illness, education, business, vacation, or military service. It must be reasonable to assume that the absent person will return to the home after the temporary absence. The taxpayer must continue to keep up the home during the absence.

Death or birth. The taxpayer may be eligible to file as Head of Household if the individual who qualifies him or her for this status is born or dies during the year. The taxpayer must have provided more than half of the cost of keeping up the home that was the individual's main home for more than half the year or, if less, the period during which the individual lived.

EXAMPLE: Linda is unmarried. Her mother, whom Linda can claim as a dependent, lived in an apartment by herself. Her mother died on October 3. The cost of the upkeep of the mother's apartment for the year until she died was $8,000. Linda paid $5,000 and her brother paid $3,000. The mother had no income. Because Linda paid more than half the cost of keeping up her mother's apartment from January 1 until the date of death, and she can claim her mother as a qualifying relative dependent, she can file as Head of Household.

Learning Objective 1-B Self-Quiz

For answer, see Chapter 1 Self-Quiz Answers.

Test your knowledge and comprehension of information presented in Learning Objective 1-B.

Learning Objective 1-B. In which one of the following scenarios can a taxpayer properly claim the Head of Household filing status?

a) The taxpayer's married child has lived in the taxpayer's home for the entire year. The taxpayer cannot claim the child as a dependent.
b) The taxpayer pays more than half the cost of keeping her father in a home for the elderly. The father qualifies as the taxpayer's dependent.
c) The taxpayer is the noncustodial parent of a child who the taxpayer is allowed to claim as a dependent because the custodial parent has signed a written release of the exemption.
d) The taxpayer is married with a dependent child. However, her spouse did not live in the home during the last four months of the year.

Learning Objective 1-C

Identify filing requirements based on filing status and income.

Whether a taxpayer is required to file a tax return depends on his or her filing status and income for the year.

KEY FACT: Even if a return is not required, a taxpayer must file a return to get a refund of any federal income tax withheld.

A return should also be filed if the taxpayer qualifies for the Earned Income Credit, the Additional Child Tax Credit, the refundable American Opportunity Credit, or the Premium Tax Credit.

2019 Filing Requirements

Use Chart A, B, or C to see if a return must be filed in 2019.

NOTES

A return should also be filed if the taxpayer qualifies for the Earned Income Credit, the Additional Child Tax Credit, the refundable American Opportunity Credit, or the Premium Tax Credit.

Chart A - For Most Taxpayers

if filing status is:	*And at the end of 2019, the taxpayer was:*	*Then file a return if gross income was at least:*
single	Under age 65	$12,200
	Age 65 or older	$13,850
MFJ	Under age 65 (both spouses)	$24,400
	Age 65 or older (one spouse)	$25,700
	Age 65 or older (both spouse)	$27,000
MFS	Ange age	$5
HOH	Under age 65	$18,350
	Age 65 or older	$20,000
QW	Under age 65	$24,400
	Age 65 or older	$25,700

Chart A Notes:

- A person born on January 1, 1955, is considered to be age 65 at the end of 2019.
- Gross income means all income received in the form of money, goods, property, and services that is not exempt from tax, including any income from sources outside the United States, even if part of it can be excluded. Social Security benefits are included in gross income only to the extent they are taxable.

Chart B - For Children and Other Dependents

Use this chart if someone else, such as a parent, can claim the taxpayer as a dependent.

Single dependents: Was the taxpayer either age 65 or older or blind?	
No	File a return if any of the following apply: • Unearned income was over $1,100. • Earned income was over $12,200. • Gross income was more than the larger of $1,100, or earned income (up to $11,850) plus $350.
Yes	File a return if any of the following apply: • Unearned income was over $2,750 ($4,400 if age 65 or older and blind). • Earned income was over $13,850 ($15,500 if age 65 or older and blind). • Gross income was more than the larger of $2,750 ($4,400 if 65 or older and blind), or earned income (up to $11,850) plus $2,000 ($3,650 if age 65 or older and blind).
Married dependents: Was the taxpayer either age 65 or older or blind?	
No	File a return if any of the following apply: • Unearned income was over $1,100. • Earned income was over $12,200. • Gross income was at least $5 and spouse files a separate return and itemizes deductions. • Gross income was more than the larger of $1,100, or earned income (up to $11,850) plus $350.
Yes	File a return if any of the following apply: • Unearned income was over $2,400 ($3,700 if age 65 or older and blind). • Earned income was over $13,500 ($14,800 if age 65 or older and blind). • Gross income was at least $5 and spouse files a separate return and itemizes deductions. • Gross income was more than the larger of $2,400 ($3,700 if 65 or older and blind), or earned income (up to $11,850) plus $1,650 ($2,950 if age 65 or older and blind).

Chart B Notes:

- Unearned income includes taxable interest, ordinary dividends, capital gain distributions, unemployment compensation, taxable Social Security benefits, pensions, annuities, and distributions of unearned income from a trust.
- Earned income includes salaries, wages, tips, professional fees, and taxable scholarship and fellowship grants.
- Gross income is the total of unearned and earned income.

NOTES

Earned income includes salaries, wages, tips, professional fees, and taxable scholarship and fellowship grants.

Chart C – Other Situations Where A Return Must Be Filed

NOTES

A taxpayer must file a return if any of the seven conditions, below, apply for 2019.

1. The taxpayer owes any special taxes, including any of the following:
   - Alternative minimum tax.
   - Additional tax on a qualified plan, including an IRA, or other tax-favored account. However, if a return is filed only because of this tax, Form 5329 can be filed by itself.
   - Household employment taxes. However, if a return is filed only because of this tax, Schedule H (Form 1040) can be filed by itself.
   - Social Security and Medicare tax on tips that were not reported to the employer, or on wages received from an employer who did not withhold these taxes.
   - Repayment of First-Time Homebuyer Credit.
   - Write-in taxes, including uncollected Social Security and Medicare or RRTA tax on tips reported to the employer or on group-term life insurance and additional tax on health savings account distributions.
   - Recapture taxes.
2. The taxpayer (or spouse if filing jointly), received HSA, Archer MSA or Medicare Advantage MSA distributions.
3. The taxpayer had net earnings from self-employment of at least $400.
4. The taxpayer had wages of $108.28 or more from a church or qualified church-controlled organization that is exempt from employer Social Security and Medicare taxes.
5. Advance payments of the Premium Tax Credit were made for the taxpayer, spouse, or a dependent who enrolled in coverage through the Marketplace.
6. Advance payments of the Health Coverage Tax Credit were made for the taxpayer, spouse, or dependent. Advance payments are shown on Form 1099-H, *Health Coverage Tax Credit (HCTC) Advance Payments*.
7. The taxpayer has a net tax liability that he or she deferred by making an election under IRC section 965(i).

Learning Objective 1-C Self-Quiz

For answer, see Chapter 1 Self-Quiz Answers.
Test your knowledge and comprehension of information presented in Learning Objective 1-C.

Learning Objective 1-C.

Which of the following situations requires a taxpayer to file a Form 1040 tax return?

a) Additional tax on an IRA distribution is due and the only tax due is this additional tax from the distribution.
b) Household employment taxes are due and the only tax due is this tax on household employment.
c) Repayment of the First-Time Homebuyer Credit is due and the only tax due is this repayment.
d) The taxpayer had net earnings from self-employment of at least $108.28 and the only tax due is on this self-employment income.

Learning Objective 1-D

Identify the tests for claiming someone as a dependent.

Dependents

For a taxpayer to claim another person as a dependent, the individual must be either a qualifying child or a qualifying relative of the taxpayer.
All of the following tests must be met for a taxpayer to claim an individual as a dependent. Tests in the *Dependency Chart*, below, vary depending on whether the person is a qualifying child or a qualifying relative of the taxpayer.

Taxpayer ineligible if a dependent test. To claim another person as a dependent, the taxpayer, or spouse of the taxpayer if filing jointly, cannot be claimed as a dependent on someone else's tax return.

Married Filing Jointly test. A person cannot be treated as a dependent if he or she files a joint return with a spouse. This rule does not apply if the joint return was filed only as a claim for refund and no tax liability would exist for either spouse if they had filed separate returns.

NOTES

To claim another person as a dependent, the taxpayer, or spouse of the taxpayer if filing jointly, cannot be claimed as a dependent on someone else's tax return.

KEY FACT: Citizen or resident test. The person claimed as a dependent must be either a U.S. citizen, U.S. resident alien, U.S. national, or a resident of the United States, Canada, or Mexico. An adopted child that lived with the taxpayer all year passes this test if the taxpayer is a U.S. citizen or U.S. national.

Dependency Chart

Qualifying Child	*Qualifying Relative*
Relationship test. The child must be the taxpayer's son, daughter, stepchild, foster child, brother, sister, stepbrother, stepsister, or a descendant of any of these, such as the taxpayer's grandchild, niece, or nephew.	**Relationship test.** A relative of the taxpayer must be: • A son, daughter, stepchild, foster child, or a descendant of any of these (such as a grandchild), or • A brother, sister, or a son or daughter of either of these (such as a niece or nephew), or • A father, mother, or an ancestor or sibling of either of them (such as a grandmother, grandfather, aunt, or uncle), or • A stepbrother, stepsister, stepfather, stepmother, son-in-law, daughter-in law, father-in-law, mother-in-law, brother-in-law, or sister-in-law, or • Any other person (other than the taxpayer's spouse) who lived with the taxpayer all year as a member of the taxpayer's household if the relationship does not violate local law.
Member of household test. The child must have lived with the taxpayer for more than half of the tax year. See *Special Rules for Children of Divorced or Separated Parents*, Learning Objective 1-E.	**Not a qualifying child test.** The relative must not be a qualifying child of any taxpayer for the tax year. For this purpose, a person is not a taxpayer if he or she is not required to file a tax return and either does not file a return or only files a return to get a refund of withheld income taxes.
Age test. The child must be: • Under age 19 at the end of the tax year and younger than the taxpayer (or spouse if MFJ), or • Under age 24 at the end of the tax year, a full-time student for any part of five calendar months during the tax year, and younger than the taxpayer (or spouse if MFJ), or • Any age and permanently and totally disabled.	**Gross income test.** The relative must have gross income of less than the qualifying relative income limit ($4,200 for 2019). ***Gross income defined.*** Gross income is all income that is not exempt from tax. Gross income includes all taxable unemployment compensation and certain scholarship and fellowship grants. Scholarships received by degree candidates that are used for tuition, fees, supplies, books, and equipment required for particular courses are generally not included in gross income.
Support test. The child cannot have provided over half of his or her own support during the tax year. ***Note:*** Third-party payments (welfare, AFOC, etc.) and scholarships received by the student are not considered support provided by the child.	**Support test.** The taxpayer must have provided over half of the relative's support in the tax year. This test does not apply for persons who qualify as dependents under the children of divorced or separated parents rule, the multiple support agreements rules, and the rule for kidnapped children.

Note: If a taxpayer's child is not a dependent under the qualifying child rules, the child may still qualify as a dependent under the qualifying relative rules.

If a taxpayer's child is not a dependent under the qualifying child rules, the child may still qualify as a dependent under the qualifying relative rules.

Learning Objective 1-D Self-Quiz

For answer, see Chapter 1 Self-Quiz Answers.

Test your knowledge and comprehension of information presented in Learning Objective 1-D.

NOTES

Learning Objective 1-D.

Some of the tests to determine whether the dependent is a qualify child are similar to the tests for a qualifying relative. Which of the following tests is used solely for determining the qualifying relative status?

a. Gross income test.
b. Relationship test.
c. Citizen or resident test.
d. Support test.

Learning Objective 1-E

Recognize the special dependency rules for divorced or separated parents.

Special Rules for Children of Divorced or Separated Parents

In most cases, because of the residency test, a child of divorced or separated parents is the qualifying child of the custodial parent.

Exception for noncustodial parent. Although a child is generally the qualifying child of the custodial parent, the child will be treated as the qualifying child of the noncustodial parent if all four of the following statements are true.

1) The parents:
a) Are divorced or legally separated under a decree of divorce or separate maintenance,
b) Are separated under a written separation agreement, or
c) Lived apart at all times during the last six months of the year, whether or not they are or were married.
2) The child received over half of his or her support for the year from the parents.
3) The child is in the custody of one or both parents for more than half of the year.
4) Either of the following statements is true.
a) The custodial parent signs a written declaration, discussed later, that he or she will not claim the child as a dependent for the year, and the noncustodial parent attaches this written declaration to his or her return. (If the decree or agreement went into effect after 1984 and before 2009, see *Post-1984 and pre-2009 divorce decree or separation agreement*. If the decree or agreement went into effect after 2008, see *Post-2008 divorce decree or separation agreement*.
b) A pre-1985 decree of divorce or separate maintenance, or written separation agreement that applies to the tax year, states that the noncustodial parent can claim the child as a dependent, the decree or agreement was not changed after 1984 to say the noncustodial parent cannot claim the child as a dependent, and the noncustodial parent provides at least $600 for the child's support during the year.

Custodial parent and noncustodial parent. The custodial parent is the parent with whom the child lived for the greater number of nights during the year. The other parent is the noncustodial parent.

The custodial parent is the parent with whom the child lived for the greater number of nights during the year.

KEY FACT: **If the parents divorced or separated during the year, and the child lived with both parents before the separation, the custodial parent is the one with whom the child lived for the greater number of nights during the rest of the year.**

A child is treated as living with a parent for a night if the child sleeps:

- At that parent's home, whether or not the parent is present, or
- In the company of the parent, when the child does not sleep at a parent's home (for example, the parent and child are on vacation together).

Equal number of nights. If the child lived with each parent for an equal number of nights during the year, the custodial parent is the parent with the higher adjusted gross income (AGI).

Emancipated child. If a child is emancipated under state law, the child is treated as not living with either parent.

Absences. If a child was not with either parent on a particular night (because, for example, the child was staying at a friend's house), the child is treated as living with the parent with whom the child normally would have lived for that night, except for the absence. But if it cannot be determined with which parent the child normally would have lived, or if the child would not have lived with either parent that night, the child is treated as not living with either parent that night.

Form 8332, Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent. The custodial parent may use either Form 8332 or a similar statement (containing the same information required by the form) to make the written declaration to release a claim to exemption for the child so the noncustodial parent can claim the child as a dependent and claim the Child Tax Credit, the Additional Child Tax Credit, and the Credit for Other Dependents (if applicable). The noncustodial parent must attach a copy of the form or statement to his or her tax return.

The exemption can be released for one year, for a number of specified years (for example, alternate years), or for all future years, as specified in the declaration. [1] For tax years 2018 through 2025, the deduction for personal and dependent exemptions is suspended. Although the deduction amount is zero, eligibility to claim an exemption may make a taxpayer eligible for claiming certain tax benefits.

Post-1984 and pre-2009 divorce decree or separation agreement. If the divorce decree or separation agreement went into effect after 1984 and before 2009, the noncustodial parent may be able to attach certain pages from the decree or agreement instead of Form 8332. The decree or agreement must state all three of the following.

1) The noncustodial parent can claim the child as a dependent without regard to any condition, such as payment of support,
2) The custodial parent will not claim the child as a dependent for the year, and
3) The years for which the noncustodial parent, rather than the custodial parent, can claim the child as a dependent.

The noncustodial parent must attach all of the following pages of the decree or agreement to his or her tax return.

- The cover page (write the other parent's Social Security number on this page).
- The pages that include all the information identified in items (1) through (3), above.
- The signature page with the other parent's signature and the date of the agreement.

Post-2008 divorce decree or separation agreement. The noncustodial parent cannot attach pages from the decree or agreement instead of Form 8332 if the decree or agreement went into effect after 2008. The custodial parent must sign either Form 8332 or a similar statement whose only purpose is to release the custodial parent's claim to an exemption for a child, and the noncustodial parent must attach a copy to his or her return. The form or statement must release the custodial parent's claim to the child without any conditions. For example, the release must not depend on the noncustodial parent paying support.

Revocation of release of claim to an exemption. The custodial parent can revoke a release of claim to an exemption that he or she previously released to the noncustodial parent on Form 8332 or a similar statement. In order for the revocation to be effective for the tax year, the custodial parent must have given (or made reasonable efforts to give) written notice of the revocation to the noncustodial parent in the previous tax year or earlier. The custodial parent can use Part III, Form 8332 for this purpose and must attach a copy of the revocation to his or her return for each tax year he or she claims the child as a dependent as a result of the revocation.

NOTES

If a child is emancipated under state law, the child is treated as not living with either parent.

Remarried parent. If the taxpayer remarries, the support provided by the taxpayer's new spouse is treated as provided by the taxpayer.

Parents who never married. This special rule for divorced or separated parents also applies to parents who never married and lived apart at all times during the last six months of the year.

Learning Objective 1-E Self-Quiz

For answer, see Chapter 1 Self-Quiz Answers.
Test your knowledge and comprehension of information presented in Learning Objective 1-D.

Learning Objective 1-E.

Which of the following statements is true regarding Form 8332, Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent?

a. The exemption can only be released for one year.
b. The exemption can be released by attaching a similar statement (containing the same information required by the form).
c. The noncustodial parent must retain the form but does not have to attach the form to his or her tax return.
d. The noncustodial parent may attach certain pages from the divorce decree instead of Form 8332 for a divorce decree going into effect after 2009.

Chapter 1 Self-Quiz Answers

Learning Objective 1-A.

Which of the following statements about the Married Filing Separately filing status is true?

a) Both spouses can claim a net capital loss deduction of $3,000.
Incorrect. Both spouses can claim a net capital loss deduction of $1,500.
b) Only one spouse can claim the Earned Income Credit.
Incorrect. Neither spouse can claim the Earned Income Credit.
c) The spouses cannot claim education credits.
Correct. Neither spouse can claim education credits.
d) One spouse can claim the $25,000 rental real estate loss if his or her modified AGI is under $100,000.
Incorrect. The deduction is $12,500 and reduced at modified AGI over $50,000. There is no deduction if the spouses lived together at any time during the year.

Learning Objective 1-B.

In which of the following scenarios can a taxpayer properly claim the Head of Household filing status?

a) The taxpayer's married child has lived in the taxpayer's home for the entire year. The taxpayer cannot claim the child as a dependent.
Incorrect. A married child generally cannot be a qualifying person for purposes of Head of Household filing status.
b) The taxpayer pays more than half the cost of keeping her father in a home for the elderly. The father qualifies as the taxpayer's dependent.
Correct. If a taxpayer paid over half the cost of keeping up a home that was the main home for the year of his or her parent who can be claimed as a dependent of the taxpayer, the parent is a qualifying person for purposes of Head of Household filing status.
c) The taxpayer is the noncustodial parent of a child who the taxpayer is allowed to claim as a dependent because the custodial parent has signed a written release of the exemption.
Incorrect. A child must have lived in the taxpayer's home for over half the year in order to be a qualifying person for purposes of Head of Household filing status.
d) The taxpayer is married with a dependent child. However, her spouse did not live in the home during the last four months of the year.

NOTES

If the taxpayer remarries, the support provided by the taxpayer's new spouse is treated as provided by the taxpayer.

Incorrect. For a married taxpayer to be considered unmarried for purposes of Head of Household filing status, the spouses cannot have lived in the same household for the last six months of the tax year.

NOTES

Learning Objective 1-C.

Which of the following situations requires a taxpayer to file a Form 1040 tax return?

a) Additional tax on an IRA distribution is due and the only tax due is this additional tax from the distribution.
Incorrect. If tax is due only because of the additional tax on an IRA distribution, Form 5329 can be filed by itself.

b) Household employment taxes are due and the only tax due is this tax on household employment.
Incorrect. If tax is due only because of the household employment taxes, Schedule H (Form 1040) can be filed by itself.

c) Repayment of the First-Time Homebuyer Credit is due and the only tax due is this repayment.
Correct. A taxpayer must file a tax return to repay of the First-Time Homebuyer Credit.

d) The taxpayer had net earnings from self-employment of at least $108.28 and the only tax due is on this self-employment income.
Incorrect. A taxpayer with net earnings from self-employment of at least $400 is required to file a tax return. If a taxpayer has wages of $108.28 or more from qualified church employment, he or she is required to file a tax return.

Learning Objective 1-D.

Some of the tests to determine whether the dependent is a qualify child are similar to the tests for a qualifying relative. Which of the following tests is used solely for determining the qualifying relative status?

a) Gross income test.
Correct. To be a qualifying relative, the dependent must have gross income of less than $4,200 in 2019. There is no gross income test for a qualifying child.

b) Relationship test.
Incorrect. There is a relationship test for both the qualifying child and qualifying relative status.

c) Citizen or resident test.
Incorrect. The person claimed as a dependent as a qualifying child or as a qualifying relative must be either a U.S. citizen, U.S. resident alien, U.S. national, or a resident of the United States, Canada, or Mexico.

d) Support test.
Incorrect. A qualifying child cannot have provided over half of his or her own support during the current tax year. The qualifying relative status has some exceptions to providing support by the taxpayer, but in general the taxpayer must have provided over half of the support for the dependent to be considered a qualifying relative.

Learning Objective 1-E.

Which of the following statements is true regarding Form 8332, *Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent?*

a) The exemption can only be released for one year.
Incorrect. The exemption can be released for one year, for a number of specified years, or all future years, as specified in the declaration.

b) The exemption can be released by attaching a similar statement (containing the same information required by the form).
Correct. Either Form 8332 or a similar statement (containing the same information required by Form 8332) can be used to release the exemption.

NOTES

c) The noncustodial parent must retain the form but does not have to attach the form to his or her tax return.
Incorrect. Form 8332 must be attached to the taxpayer's return.

d) The noncustodial parent may attach certain pages from the divorce decree instead of Form 8332 for a divorce decree going into effect after 2009.
Incorrect. Certain pages from a divorce decree can only be used in place of Form 8332 for a divorce decree that went into effect after 1984 and before 2009.

2 Income

Learning Objectives

NOTES

Successful completion of this course will enable the participant to:
2-A Identify taxable and nontaxable income.
2-B Differentiate between total income, adjusted gross income, and taxable income on Form 1040.
2-C Identify what is reported in the various boxes on Form W-2.
2-D Identify when a taxpayer is required to use Schedule B.
2-E Recognize the various Forms 1099 received for retirement.

Glossary Terms

Certificate of deposit. A certificate of deposit (CD) is a savings certificate with a fixed maturity date and specified fixed interest rate.
Earned income. Earned income generally means taxable employee pay and net earnings from self-employment.
U.S. savings bonds. U.S. savings bonds are debt securities issued by the U.S. Department of the Treasury to help pay for the U.S. government's borrowing needs.

Learning Objective 2-A

Identify taxable and nontaxable income.

[1] Gross Income

Gross income includes income from whatever source derived unless it is specifically excluded under the Internal Revenue Code. The following list illustrates common types of taxable and nontaxable income.

Gross income includes income from whatever source derived unless it is specifically excluded under the Internal Revenue Code.

Taxable Income	Nontaxable Income
Compensation for services, including fees, commissions, fringe benefits, and similar items. Gross income derived from business. Gains derived from dealings in property. Interest, rents, royalties, and dividends from investments. Alimony and separate maintenance payments (for decrees executed before 2019). Annuities and income from life insurance and endowment contracts. Distributions from pensions and IRAs. Certain income from discharge of indebtedness. Distributive share of partnership gross income. Prizes and awards. Cost of more than $50,000 of group term life insurance purchased for employees. Reimbursement of certain moving expenses. Property transferred in connection with performance of services. Unemployment compensation. Certain Social Security and Tier 1 Railroad Retirement benefits. Sick pay. Certain disability payments.	Certain Social Security and Tier 1 Railroad Retirement benefits. Certain death benefits. Gifts and inheritances. Interest on state and local bonds. Compensation for injuries or sickness. Amounts received under accident and health plans. Contributions by employer to accident and health plans. Rental value of parsonages. Certain income from discharge of indebtedness. Certain combat zone compensation of members of the Armed Forces. Qualified scholarships. Contributions to the capital of a corporation. Meals or lodging furnished for the convenience of the employer. Exclusion of gain from sale of principal residence. Cafeteria plans. Educational assistance program. Dependent care assistance programs. Certain foster care payments. Certain fringe benefits. Certain military benefits. Income from U.S. savings bonds used to pay higher education tuition and fees. Adoption assistance program. Disaster relief payments.

Income is generally divided into either earned income or unearned income. Both types of income may be taxable, but the differentiation is important in determining certain credits, like the Earned Income Credit.

NOTES

Earned Income

Earned income generally means taxable employee pay and net earnings from self-employment. In addition to wages, salaries, commissions, fees, and tips, earned income includes other forms of compensation such as fringe benefits and stock options.

Employees receive Form W-2 from their employer showing the pay received for services over the previous tax year.

In most cases, a taxpayer must include in gross income everything received in payment for personal services. Therefore, earned income includes net earnings from self-employment from a business in which the services of the self-employed individual materially helped to produce the income.

In most cases, a taxpayer must include in gross income everything received in payment for personal services.

Earned income can also come from property created by an individual's personal efforts, such as royalties from books or inventions. Earned income includes net earnings from selling or disposing of the property but does not include capital gains.

KEY FACT: Earned income also includes distributions from a qualified disability trust.

Unearned Income

Unearned income is generally referred to as net investment income. Net investment income is gross income from interest, dividends, annuities, royalties, and rents. Additionally, net gain attributable to the disposition of property, other than property held in a trade or business, is considered unearned income.

Learning Objective 2-A Self-Quiz

For answer, see *Chapter 2 Self-Quiz Answers*.

Test your knowledge and comprehension of information presented in Learning Objective 2-A.

Learning Objective 2-A.

Which of the following is an example of nontaxable income?

a) $1,500 won on a game show.
b) $1,500 unemployment compensation.
c) $1,500 gift from a parent.
d) $1,500 of ordinary dividends.

Learning Objective 2-B

Differentiate between total income, adjusted gross income, and taxable income on Form 1040.

A taxpayer will often ask what his or her income for the year was. There is not a straightforward answer to this question as each taxpayer, the government, and other third parties may be looking for different information.

Total Income

Total income is all income received in the form of money, goods, property, and services that is not exempt from tax. It includes income from sources outside the U.S. or from the sale of a primary residence, even if part or all of that income can be excluded. Total income may include part of Social Security benefits received and certain scholarship and fellowship grants.

Total income is all income received in the form of money, goods, property, and services that is not exempt from tax.

- Income that is taxable must be reported on a taxpayer's return and is subject to tax.
- Income that is nontaxable may have to be shown on a taxpayer's return but is exempt from tax.

Reportable income. Form 1040 and its associated schedules are used to report earned and unearned taxable income.

- Earned income is any income received for work, such as wages or business/self-employment income.
- Unearned income is any income not earned from work, such as unemployment income or income produced by investments, such as interest on savings, dividends on stocks, or rental income.

NOTES

Nontaxable or exempt income. Some nontaxable income such as gifts and inheritances are excludable and not shown on the tax return.

Exempt income includes such things as interest income produced from certain types of investments. There are instances when exempt income is shown on the return but not included in the income tax computation, for example, tax-exempt municipal bond interest income.

Total income, line 7b, Form 1040. Line 7b of Form 1040 is labeled "total income." This is the taxpayer's gross income less any nontaxable and exempt income he or she has.

Adjusted Gross Income (AGI)

Taxpayers can include certain expenses, payments, contributions, fees, etc. on lines 10 through 22 of Schedule 1, *Additional Income and Adjustments to Income*. These adjustments to income are then subtracted from the total income on line 7b of Form 1040 to establish the taxpayer's adjusted gross income (AGI).

Certain items on the tax return are affected by the taxpayer's AGI. For example, medical expenses on Schedule A need to exceed 10% of the taxpayer's AGI.

Certain items on the tax return are affected by the taxpayer's AGI.

Modified AGI. Even though some items are affected by the taxpayer's AGI, most are affected by a modified AGI. The definition of modified AGI varies based on the tax attribute. For example, for the Child Tax Credit and Credit for Other dependents, modified AGI is the taxpayer's AGI plus any excluded income from Puerto Rico, American Samoa, or other excluded foreign income. However, the modified AGI for purposes of the IRA deduction phase-out is the taxpayer's AGI without taking into account any IRA deduction plus the sum of the student loan interest deduction, foreign earned income exclusion, foreign housing exclusion or deduction, excluded qualified savings bond interest, and the exclusion of employer-provided adoption benefits.

Taxable Income

Line 11b of Form 1040 is taxable income. This is the taxpayer's AGI less deductions. There are two different deductions that a taxpayer may take. All taxpayers can take either the standard deduction based on their filing status or itemized deductions. Also, a taxpayer with qualified business income may be allowed an additional deduction of up to 20% of his or her business income.[1]

The taxable income on line 11b of Form 1040 is used to calculate how much income tax is owed. For more information, see Learning Objective 3-D.

Learning Objective 2-B Self-Quiz

For answer, see Chapter 2 Self-Quiz Answers.

Test your knowledge and comprehension of information presented in Learning Objective 2-B.

Learning Objective 2-B.

"All income received in the form of money, goods, property, and services that is not exempt from tax" is the definition of what?

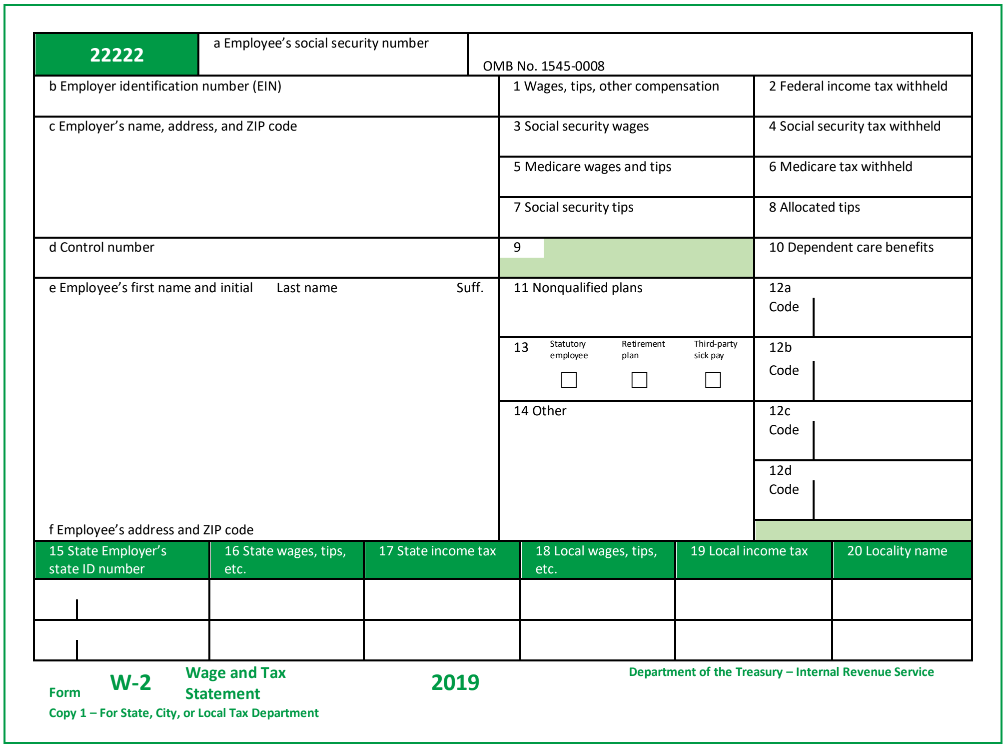
a) Total income.
b) Adjusted gross income.
c) Modified adjusted gross income.
d) Taxable income.

Learning Objective 2-C

Identify what is reported in the various boxes on Form W-2.

First Tax Form

For most taxpayers, Form W-2, Wage and Tax Statement, is the first tax form they ever receive. Anyone who works as an employee should receive a Form W-2 from his or her employer reporting the amount of wages and other employee compensation the employee received. Form W-2 also reports any federal, state, and local income taxes that were withheld.


22222
a Employee's social security number
OMB No. 1545-0008
b Employer identification number (EIN)
1 Wages, tips, other compensation
2 Federal income tax withheld
c Employer's name, address, and ZIP code
3 Social security wages
4 Social security tax withheld
5 Medicare wages and tips
6 Medicare tax withheld
7 Social security tips
8 Allocated tips
d Control number
9
10 Dependent care benefits
e Employee's first name and initial Last name Suff.
11 Nonqualified plans
12a Code
13 Statutory employee Retirement plan Third-party sick pay
12b Code
14 Other
12c Code
12d Code
f Employee's address and ZIP 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
Form W-2 Wage and Tax Statement 2019
Department of the Treasury – Internal Revenue Service
Copy 1 – For State, City, or Local Tax Department

Availability. Employers are not required to mail Form W-2, but they must make it available to employees by January 31 of the following year. A taxpayer may need to pick up Form W-2 from his or her employer or may be able to obtain it electronically.

If a taxpayer has not received his or her Form W-2 by January 31, he or she should first contact the employer and find out if, or when, the form was mailed, or if it can be picked up or accessed online. If Form W-2 is still not received after allowing a reasonable amount of time for the employer to issue or reissue it, then the taxpayer should contact the IRS for assistance after February 15.

If these efforts fail, a taxpayer may file his or her tax return using 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.*

KEY FACT: **If the taxpayer eventually receives the employer's Form W-2, and the numbers differ from those on Form 4852, the taxpayer will need to amend his or her return to report the correct amounts.**

Information reported on Form W-2. Not all information on Form W-2 is reported on Form 1040.

NOTES

Employers are not required to mail Form W-2, but they must make it available to employees by January 31 of the following year.

[1] ***Box 1, Wages, tips, other compensation.*** For most taxpayers, the total of box 1 for all Forms W-2 received is reported on line 1, Form 1040.

[2] ***Box 2, Federal income tax withheld.*** This is the amount of federal income tax the employer withheld on the taxpayer's behalf. This amount, along with any other federal withholding amounts reported on other forms the taxpayer received is reported on line 17, Form 1040. If a taxpayer needs to adjust his or her withholdings, he or she should fill out a new Form W-4, *Employee's Withholding Allowance Certificate, and give it to his or her employer.*

[3] ***Box 3, Social Security wages and Box 4, Social Security tax withheld.*** These amounts are not reported anywhere on Form 1040. However, for 2019, a taxpayer should not have more than $132,900 reported in box 3 and $8,239.80 reported in box 4. *See Learning Objective 4-E*.

[4] ***Box 5, Medicare wages and tips and Box 6, Medicare tax withheld.*** If the amount in box 5 is greater than $200,000 or the total of box 5 for all Forms W-2 is greater than $200,000 ($250,000 if the filing status of the return is married filing joint or $125,000 the filing status is married filing separate) Form 8959, *Additional Medicare Tax*, must be included with the Form 1040.

[5] ***Box 7, Social Security tips and Box 8, Allocated tips.*** If a taxpayer receives more than $20 per month in tips at one job and reports his or her tip income to his or her employer, the tips will be included as wages in box 1.

[6] ***Box 10, Dependent care benefits.*** If the taxpayer has elected to exclude a portion of his or her wages from taxable income to be used to provide dependent care to a qualified dependent, the amount elected will be reported in box 10, Form W-2. Part III, Form 2441, Child and Dependent Care Expenses, is used to compute any taxable and nontaxable amounts. *See Learning Objective 4-C*.

Box 11, Nonqualified plans. Nonqualified plans are generally those plans that do not meet certain requirements under the Internal Revenue Code. Nonqualified plans are beyond the scope of this course.

Box 12. Box 12 of Form W-2 may include a letter code along with a dollar amount. Common letter codes are D and AA, which report contributions to 401(k) retirement plans and W, which reports contributions to a Health Savings Account (HSA). *See Box 12 codes*, for a list of all codes.

[7,8] ***Box 13. Box 13 includes three separate checkboxes.*** They are:

- Statutory employee. Income is reported on Schedule C as opposed to line 1, Form 1040.
- Retirement plan. Special limits may apply to the amount of traditional IRA contributions a taxpayer may deduct.
- Third-party sick pay. Indicates that the taxpayer received sick pay from a third party who is not acting as a agent of his or her employer.

Box 14, Other. Employers may use this box to report information such as state disability insurance taxes withheld, union dues, uniform payments, health insurance premiums deducted, nontaxable income, educational assistance payments, or a member of the clergy's parsonage allowance and utilities.

Boxes 15 - 20. Boxes 15-20 are used to report state and local wages and withholdings.

Box 12 codes. As mentioned above, some of the more common letter codes for Box 12 of Form W-2 are D, AA, and W. The following is a list of all codes.

NOTES

Statutory employee. Income is reported on Schedule C as opposed to line 1, Form 1040.

Note: If a year follows code D through H, S, Y, AA, BB, or EE, a make-up pension contribution was made for a prior year(s) when in military service. To calculate whether excess deferrals were made, consider these amounts for the year shown, not the current year. If no year is shown, the contributions are for the current year.

NOTES

To calculate whether excess deferrals were made, consider these amounts for the year shown, not the current year.

A – Uncollected Social Security or RRTA tax on tips.
B – Uncollected Medicare tax on tips.
C – Taxable cost of group-term life insurance over $50,000—included in boxes 1, 3 (up to Social Security wage base), and 5.
D – Elective deferrals to a section 401(k) cash or deferred arrangement. Also includes deferrals under a SIMPLE section 401(k) arrangement.
E – Elective deferrals under a section 403(b) salary reduction agreement.
F – Elective deferrals under a section 408(k)(6) salary reduction SEP.
G – Elective deferrals and employer contributions (including nonelective deferrals) to a section 457(b) deferred compensation plan.
H – Elective deferrals to a section 501(c)(18)(D) tax-exempt organization plan.
J – Nontaxable sick pay (information only, not included in boxes 1, 3, or 5).
K – 20% excise tax on excess golden parachute payments.
L – Substantiated employee business expense reimbursements (nontaxable).
M – Uncollected Social Security or RRTA tax on taxable cost of group-term life insurance over $50,000 (former employees only).
N – Uncollected Medicare tax on taxable cost of group-term life insurance over $50,000 (former employees only).
P – Excludable moving expense reimbursements paid directly to a member of the U.S. Armed Forces (not included in boxes 1, 3, or 5).
Q – Nontaxable combat pay.
R – Employer contributions to an Archer MSA. Report on Form 8853, *Archer MSAs and Long-Term Care Insurance Contracts*.
S – Employee salary reduction contributions under a section 408(p) SIMPLE plan (not included in box 1).
T – Adoption benefits (not included in box 1). Complete Form 8839, *Qualified Adoption Expenses*.
V – Income from exercise of nonstatutory stock option(s)—included in boxes 1, 3 (up to Social Security wage base), and 5.
W – Employer contributions-including amounts the employee elected to contribute using a section 125 (cafeteria) plan-to health savings account. Report on Form 8889, *Health Savings Accounts (HSAs)*.
Y – Deferrals under a section 409A nonqualified deferred compensation plan.
Z – Income under a nonqualified deferred compensation plan that fails to satisfy section 409A. This amount is also included in box 1. It is subject to an additional 20% tax plus interest.
AA – Designated Roth contributions under a section 401(k) plan.
BB – Designated Roth contributions under a section 403(b) plan.
DD – Cost of employer-sponsored health coverage. The amount reported with Code DD is not taxable.
EE – Designated Roth contributions under a governmental section 457(b) plan. This amount does not apply to contributions under a tax-exempt organization section 457(b) plan.
FF – Permitted benefits under a qualified small employer health reimbursement arrangement.
GG – Income from qualified equity grants under section 83(i).
HH – Aggregate deferrals under section 83(i) elections as of the close of the calendar year.

9 Form W-2G

Form W-2G, *Certain Gambling Winnings*, is another form many taxpayers receive for winnings at casinos, racetracks, or from the lottery. The amounts reported on Form W-2G are not included in line 1, Form 1040. Instead, they are usually reported on line 8, Schedule 1 (Form 1040).

The amounts reported on Form W-2G are not included in line 1, Form 1040.

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PAYER'S name, street address, city or town, province or state, country, and ZIP or foreign postal code		1 Reportable winnings $	2 Date won	OMB No. 1545-0238 **2019** **Form W-2G** **Certain Gambling Winnings**
		3 Type of wager	4 Federal income tax withheld $	
		5 Transaction	6 Race	
		7 Winnings from identical wagers $	8 Cashier	
PAYER'S federal identification no.	PAYER'S telephone no.	9 Winner's taxpayer identification no.	10 Window	**Copy 1** **For State, City, or Local Tax Department**
WINNER'S name		11 First I.D.	12 Second I.D.	
Street address (including apt. no.)		13 State Payer's state identification no.	14 State winnings $	
City or town, province or state, country, and ZIP or foreign postal code		15 State income tax withheld $	16 Local winnings $	
		17 Local income tax withheld $	18 Name of Locality	

Under penalties of perjury, I declare that, to the best of my knowledge and belief, the name, address and taxpayer identification number that I have furnished correctly identify me as the recipient of this payment and any payments from identical wagers, and that no other person is entitled to any part of these payments.

Signature ► **Date ►**

Form W-2G www.irs.gov/FormW2G Department of the Treasury – Internal Revenue Service

Form 1099-G

Form 1099-G, *Certain Government Payments*, is issued by government agencies for certain types of payments.

☐ VOID ☐ CORRECTED

PAYER'S name, street address, city or town, province or state, country, and ZIP or foreign postal code		1 Unemployment compensation $		OMB No. 1545-0120 **2019** **Form 1099-G**	**Certain Government Payments**
		2 State or local income tax refunds, credits, or offsets $			
PAYER'S TIN	RECIPIENT'S TIN	3 Box 2 amount is for tax year		4 Federal income tax withheld $	**Copy 1** **For State Tax Department**
RECIPIENT'S name		5 RTAA payments $		6 Taxable grants $	
		7 Agriculture payments $		8 Check if box 2 is trade or business income ► ☐	
Street address (including apt. no.)					
City or town, province or state, country, and ZIP or foreign postal code		9 Market gain $			
		10a State	10b State identification no.	11 State income tax withheld	
Account number (see instructions)				$	
				$	

Form 1099-G www.irs.gov/Form1099G Department of the Treasury – Internal Revenue Service

Information reported on Form 1099-G. The three most commonly used boxes on Form 1099-G are 1, 2, and 4.

[10] ***Box 1.*** Box 1 of Form 1099-G shows the total amount of unemployment compensation v the taxpayer received during the year. This amount is reported on line 7 of Schedule 1 (Form 1040).

[11] ***Box 2.*** Box 2 of Form 1099-G includes refunds, credits, or offsets of state or local income taxes the taxpayer received. If any of the amount reported in box 2 is taxable, then it is reported on line 1 of Schedule 1 (Form 1040).

Box 4. Box 4 of Form 1099-G includes the amount of federal income tax withheld on the taxpayer's behalf. This amount, along with any other federal withholdings reported on other forms the taxpayer received is reported on line 17, Form 1040.

NOTES

Box 2 of Form 1099-G includes refunds, credits, or offsets of state or local income taxes the taxpayer received.

Learning Objective 2-C Self-Quiz

NOTES

For answer, see *Chapter 2 Self-Quiz Answers,* page 41.
Test your knowledge and comprehension of information presented in Learning Objective 2-C.

Learning Objective 2-C.

What amount is reported in box 2 of Form W-2?

a) Wages, tips, and other compensation paid to a taxpayer.
b) Federal income tax withheld.
c) Social Security tax withheld.
d) Dependent care benefits.

Learning Objective 2-D

Identify when a taxpayer is required to use Schedule B.

Investments

When a taxpayer has money in investments, outside of his or her retirement accounts, the ultimate goal is for that money to grow. The investment can be as simple as money in a savings account at the local bank or money invested in mutual funds or individual stocks.

Due to the complexity of many investments, a taxpayer might receive a corrected 1099 after he or she files his or her tax return. Depending on what is being corrected, and the amount, the taxpayer might need to amend his or her original return.

There are three common 1099 forms that might be generated when a taxpayer has investments. Form 1099-INT, *Interest Income,* and Form 1099-DIV, *Dividends and Distributions,* are discussed here. Form 1099-B, *Proceeds From Broker and Barter Exchange Transactions,* is discussed in the *Individual Tax Prep 202* course.

Interest and Dividends

Taxable interest includes interest received from bank accounts, loans made by a taxpayer to another person, and other sources.

Taxable interest. Taxable interest includes interest received from bank accounts, loans made by a taxpayer to another person, and other sources.

Original issue discount (OID). Original issue discount is a form of interest. It is the excess of a debt instrument's stated redemption price at maturity over its issue price. OID is included in income as it accrues, whether or not any interest payments have been received from the issuer.

Tax-exempt interest. Interest on a municipal bond used to finance government operations is generally not subject to federal tax if the bond is issued by a state, the District of Columbia, a U.S. possession, or any of their political subdivisions (such as port authorities, toll road commissions, utility services authorities, community redevelopment agencies, or qualified volunteer fire departments). Most states tax interest on municipal bonds issued by other states but exempt interest on municipal bonds issued by their own state.

U.S. savings bonds. Interest on Series EE and Series I bonds is payable when the taxpayer redeems the bonds. The difference between the purchase price and redemption value is taxable interest.

Reporting options for cash method taxpayers. Cash method taxpayers can report the interest on Series EE, Series E, and Series I bonds in either of the following ways.

- Postpone reporting the interest until the earlier of the year in which the bonds are cashed or disposed of or the year in which they mature.
- Choose to report the increase in redemption value as interest each year.

Taxpayers must use the same method for all Series EE, Series E, and Series I bonds owned.

U.S. Treasury bills, notes, and bonds. Treasury bills, notes, and bonds are direct debts (obligations) of the U.S. government. Interest from Treasury bills, notes and bonds is subject to federal income tax, but is exempt from all state and local income taxes.

Taxable dividends. Dividends are distributions of money, stock, or other property made by a corporation to a shareholder. Ordinary dividends are taxed as ordinary income unless the dividends are qualified dividends. Qualified dividends are qualified for the same 0%, 15%, or 20% maximum tax rate that applies to net capital gains.
Non dividend distributions. Some distributions are a return of cost (or other basis). They will not be taxed until cost (or other basis) is completely recovered.
Exempt-interest dividends. Exempt-interest dividends received from a mutual fund or other regulated investment company are not included in taxable income, but must be reported as tax-exempt interest.
Stock dividends. Stock dividends are distributions made by a corporation of its own stock. Generally, stock dividends are not taxable.
[1] **Nominee income.** If a taxpayer receives Form 1099-INT, 1099-DIV, or 1099-OID showing amounts belonging to another person(s), the taxpayer is considered a nominee recipient.

NOTES

Dividends are distributions of money, stock, or other property made by a corporation to a shareholder.

Form 1099-INT

Form 1099-INT, Interest Income, reports interest earned by the taxpayer for the year. This interest might be from a savings account, certificate of deposit (CD), U.S. Savings Bond, or municipal bond.

☐ VOID ☐ CORRECTED

PAYER'S name, street address, city or town, province or state, country, ZIP or foreign postal code, and telephone no.	Payer's RTN (optional) 1 Interest Income $	OMB No. 1545-0112 **2019** **Form 1099-INT**	**Interest Income**
PAYER'S TIN / RECIPIENT'S TIN	2 Early withdrawal penalty $ 3 Interest on U.S. Savings Bonds and Treas. Obligations $		**Copy 1** **For State Tax Department**
RECIPIENT'S name	4 Federal income tax withheld $	5 Investment expenses $	
Street address (including apt. no.)	6 Foreign tax paid $	7 Foreign country or U.S. Possession $	
City or town, province or state, country, and ZIP or foreign postal code	8 Tax-exempt interest $	9 Specified private activity bond interest $	
	10 Market discount $	11 Bond premium $	
FATCA filing requirement ☐	12 Bond premium on Treasury obligations $	13 Bond premium on tax-exempt bond $	
Account number (see instructions)	14 Tax-exempt and tax credit bond CUSIP no.	15 State / 16 State identification no.	17 State tax withheld $ $

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

KEY FACT: Even if the taxpayer did not receive Form 1099-INT, he or she must still report all taxable interest received.

Information reported on Form 1099-INT. The most commonly used boxes on Form 1099-INT are 1, 2, 3, 4, and 8.

[2] ***Box 1, Interest income.*** Box 1 of Form 1099-INT reports any taxable interest received during the year that is not from U.S. Savings Bonds and Treasury obligations. This might include interest from a savings account or certificate of deposit (CD). All taxable interest that a taxpayer received is reported on line 2b, Form 1040.

[3] ***Box 2, Early withdrawal penalty.*** If the taxpayer took money out of a CD or other timed savings account early, and had to forfeit any interest or principal because of the early withdrawal, the amount forfeited will be reported in box 2. The taxpayer can use the amount in this box to reduce his or her income by reporting it on line 17 of Schedule 1 (Form 1040).

[4,5] ***Box 3, Interest on U.S. Savings Bonds and Treas.*** obligations. Interest on U.S. Savings Bonds, Treasury bills, Treasury bonds, and Treasury notes may or may not be taxable. Any taxable interest is exempt from state and local income taxes. All taxable interest that a taxpayer received is included on line 2b, Form 1040.

Box 4, Federal income tax withheld. Generally, a payer must withhold income tax if the taxpayer did not furnish his or her taxpayer identification number (TIN) or he or she did not furnish the correct TIN to the payer. Any amount withheld is included on line 17, Form 1040.

[6] ***Box 8, Tax-exempt interest.*** Interest on a municipal bond used to finance government operations is generally not subject to federal tax but may be taxable to the state. Although tax-exempt interest is not taxable, it must be reported on line 2a, Form 1040 as it is used in calculating the taxability of some income items, such as Social Security benefits.

NOTES

Interest on a municipal bond used to finance government operations is generally not subject to federal tax but may be taxable to the state.

Form 1099-DIV

Dividends are distributions of money, stock, or other property made by a corporation to a shareholder and are reported on Form 1099-DIV, *Dividends and Distributions*.

☐ VOID ☐ CORRECTED

PAYER'S name, street address, city or town, province or state, country, ZIP or foreign postal code, and telephone no.	1a Total ordinary dividends $ 1b Qualified dividends $	OMB No. 1545-0110 **2019** **Form 1099-DIV**	**Dividends and Distributors**
PAYER'S TIN / RECIPIENT'S TIN	2a Total capital gain distr. $	2b Unrecap. Sec. 1250 gain $	
	2c Section 1202 gain $	2d Collection (28%) gain $	
RECIPIENT'S name	3 Nondividend distributions $	4 Federal income tax withheld $	
Street address (including apt. no.)	5 Section 199A dividends $	6 Investment expenses $	**Copy 1**
City or town, province or state, country, and ZIP or foreign postal code	7 Foreign tax paid $	8 Foreign country or U.S. possession	**For State Tax Department**
	9 Cash liquidation distributions $	10 Noncash liquidation distributions $	
FATCA filing requirement ☐	11 Exempt-interest dividends $	12 Specified private activity bond interest dividends $	
Account number (see instructions)	13 State / 14 State identification no.	15 State tax withheld $ $	

Form 1099-DIV www.irs.gov/Form1099DIV Department of the Treasury – Internal Revenue Service

Information reported on Form 1099-DIV. The information reported on Form 1099-DIV is reported in various boxes. The most commonly used boxes of Form 1099-DIV are 1a, 1b, and 2a.

[7] ***Box 1a, Total ordinary dividends.*** Box 1a of Form 1099-DIV reports the total ordinary dividends that are taxable. All ordinary dividends that a taxpayer received are included on line 3b of Form 1040.

[8] ***Box 1b, Qualified dividends.*** Box 1b of Form 1099-DIV shows the portion of dividends reported in box 1a that may be eligible for reduced capital gains rates. These are called "qualified dividends." All qualified dividends are included on line 3a of Form 1040.

Box 1b of Form 1099-DIV shows the portion of dividends reported in box 1a that may be eligible for reduced capital gains rates.

[9] ***Box 2a, Total capital gain distr.*** Any capital gain distributions are reported in box 2a of Form 1099-DIV. Capital gain distributions are included in the total on line 6, Form 1040.

[10] Schedule B

NOTES

If a taxpayer receives interest or dividends, he or she might have to include Schedule B, *Interest and Ordinary Dividends,* with his or her return. The taxpayer should complete Schedule B if any of the following apply. The taxpayer:

- Has over $1,500 of taxable interest or ordinary dividends.
- Receives interest from a seller-financed mortgage and the buyer used the property as a personal residence.
- Has accrued interest from a bond.
- Is reporting original issue discount (OID) in an amount less than the amount shown on Form 1099-OID.
- Is reducing interest income on a bond by the amount of amortizable bond premium.
- Claims the exclusion of interest from Series EE or I U.S. Savings Bonds issued after 1989.
- Receives interest or ordinary dividends as a nominee.
- Has a financial interest in, or signature authority over, a financial account in a foreign country or receives a distribution from, or was a grantor of, or transferor to, a foreign trust.

Learning Objective 2-D Self-Quiz

For answer, see *Chapter 2 Self-Quiz Answers*.

Test your knowledge and comprehension of information presented in Learning Objective 2-D.

Learning Objective 2-D.

Which of the following taxpayers should complete Schedule B?

a) Ray has $2,000 of capital gain distributions reported in box 2a of Form 1099-DIV.
b) Egon has $100 of interest income reported in box 1 and a $25 early withdrawal penalty reported in box 2 of Form 1099-INT.
c) Peter has $1,600 of interest income reported in box 1 and a $250 early withdrawal penalty reported in box 2 of Form 1099-INT.
d) Winston has $800 of taxable interest reported in box 1 of Form 1099-INT and $800 of ordinary dividends reported in box 1a of Form 1099-DIV.

Learning Objective 2-E

Recognize the various Forms 1099 received for retirement.

Retirement Income

When a taxpayer receives Social Security benefits, railroad retirement benefits, or takes money out of any of the various types of retirement accounts, the distributions are reported on various Forms 1099.

[1] Form SSA-1099

The taxability of Social Security benefits is based on the taxpayer's total income for the year. The maximum amount of benefits that are taxable for any individual is 85%. Social Security benefits, whether they are received for retirement, disability, or as a survivor, are reported on Form SSA-1099, *Social Security Benefit Statement.*

The maximum amount of benefits that are taxable for any individual is 85%.

FORM SSA-1099 – SOCIAL SECURITY BENEFIT STATEMENT

2019	PART OF YOUR SOCIAL SECURITY BENEFITS SHOWN IN BOX 5 MAY BE TAXABLE INCOME SEE THE REVERSE FOR MORE INFORMATION	
Box 1. Name		Box 2. Beneficiary's Social Security Number
Box 3. Benefits Paid in 2019	Box 4. Benefits Repaid to SSA in 2019	Box 5. Net Benefits for 2019 (Box 3 minus Box 4)
DESCRIPTION OF AMOUNT IN BOX 3		DESCRIPTION OF AMOUNT IN BOX 4
		Box 6. Voluntary Federal Income Tax Withheld
		Box 7. Address
		Box 8. Claim Number (Use this number if you need to contact SSA.)

Form SSA-1099-SM (1-2019) DO NOT RETURN THIS FORM TO SSA OR IRS

NOTES

Information reported on Form SSA-1099. Not all information on Form SSA-1099 is reported on Form 1040. The following are the most commonly used boxes on Form SSA-1099.

Box 5, Net Benefits for 2019. Box 5 reports the net benefits the taxpayer received. This amount is reported on line 5a, Form 1040.

Box 6, Voluntary Federal Income Tax Withheld. Box 6 shows any federal income tax that was withheld from the taxpayer's benefits. This amount, along with any other federal withholding reported on other forms the taxpayer received is reported on line 17, Form 1040.

[2] ***Other helpful information.*** Besides boxes 5 and 6, the other important box to look at is the one labeled "description of amount in box 3." This box will include any Medicare premiums that were paid out of the benefits. Also, if the taxpayer was paid benefits for a prior year, a breakdown will be shown here listing how much was received for each of the prior years.

[3] Form 1099-R

There are many different types of retirement accounts. The most common are Individual Retirement Accounts (IRAs), qualified retirement accounts (e.g. 401(k) plans), and pensions. If the taxpayer receives money from any retirement account, with the exception of a loan that is being repaid, the amount of the distribution is reported on Form 1099-R.

If the taxpayer receives money from any retirement account, with the exception of a loan that is being repaid, the amount of the distribution is reported on Form 1099-R.

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PAYER'S name, street address, city or town, province or state, country, ZIP or foreign postal code, and telephone no.	1 Gross distribution $ 2a Taxable amount $	OMB No. 1545-0119 **2019** **Form 1099-R**	**Distributions Form Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.**
	2b Taxable amount not determined ☐	Total distribution ☐	**Copy 1 For State, City, or Local Tax Department**
PAYER'S TIN / RECIPIENT'S TIN	3. Capital gain (included in box 2a) $	4 Federal income tax withheld $	
RECIPIENT'S name	5 Employee contributions / Designated Roth contributions or insurance premiums $	6 Net unrealized appreciation in employer's securities $	
Street address (including apt. no.)	7 Distribution code(s) / IRA/SEP/ SIMPLE ☐	8 Other $ %	
City or town, state or province, country, and ZIP or foreign postal code	9a Your percentage of total distribution %	9b Total employee contributions $	
10 Amount allocable to IRR within 5 years $ / 11 1st year of desig. Roth contrib. / FATCA filing requirement ☐	12 State tax withheld $	13 State/Payer's state no.	14 State distribution $
Account number (see instructions) / Date of payment	15 Local tax withheld $ $	16 Name of locality	17 Local distribution $ $

Form 1099-R www.irs.gov/Form1099R Department of the Treasury – Internal Revenue Service

NOTES

Information reported on Form 1099-R. The following are the most common boxes used on Form 1099-R.

Box 1, Gross distribution. Box 1 of Form 1099-R shows the total amount that the taxpayer received from the retirement account. The amount is usually reported on line 4a, Form 1040 if the distribution is from an IRA and line 4c, Form 1040 if the distribution is from a pension or annuity.

Box 2a, Taxable amount. Box 2a reports the amount from box 1 that is taxable. The taxable amount of all IRAs is reported on line 4b, Form 1040. The taxable amount of all pensions and annuities is reported on line 4d, Form 1040. If the taxable amount is the same as the total distribution, then nothing is reported on line 4a or 4c, Form 1040.

Box 2b. Box 2b includes two checkboxes labeled "taxable amount not determined" and "total distribution." If the first checkbox in box 2b is checked, the payer is unable to determine the taxable amount.

KEY FACT: For a traditional IRA, the first checkbox in box 2b will always be checked because it is the taxpayer's responsibility to determine the taxable amount.

[4] ***Box 4, Federal income tax withheld.*** Box 4 of Form 1099-R reports the amount of federal income tax withheld on the taxpayer's behalf. This amount, along with any other federal withholdings reported on other forms the taxpayer received is reported on line 17 of Form 1040.

Box 7, Distribution code(s). Box 7 of Form 1099-R includes codes used to identify the type of distribution received. See Box 7 codes, below for a list of all codes. If the IRA/SEP/ SIMPLE box next to box 7 is checked, a traditional IRA, SEP, or SIMPLE distribution was received.

If the IRA/SEP/ SIMPLE box next to box 7 is checked, a traditional IRA, SEP, or SIMPLE distribution was received.

Boxes 12-17. Boxes 12-17 are used to report state and local distributions and withholdings.

Box 7 codes. The following is a list of all codes for box 7 of Form 1099-R.

1. Early distribution, no known exception (in most cases, under age 59½).
2. Early distribution, exception applies (under age 59½).
3. Disability.
4. Death.

5. Prohibited transaction.
6. Section 1035 exchange (a tax-free exchange of life insurance, annuity, qualified long-term care insurance, or endowment contracts).
7. Normal distribution.
8. Excess contributions plus earnings/excess deferrals (and/or earnings) taxable in the current year.
9. Cost of current life insurance protection.
A. May be eligible for 10-year tax option (see Form 4972, Tax on Lump-Sum Distributions).
B. Designated Roth account distribution.

Note: If Code B is in box 7 and an amount is reported in box 10, see the instructions for Form 5329, Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts.

C. Reportable death benefits under section 6050Y.
D. Annuity payments from nonqualified annuities that may be subject to tax under section 1411.
E. Distributions under Employee Plans Compliance Resolution System (EPCRS).
F. Charitable gift annuity.
G. Direct rollover of a distribution to a qualified plan, a section 403(b) plan, a governmental section 457(b) plan, or an IRA.
H. Direct rollover of a designated Roth account distribution to a Roth IRA.
J. Early distribution from a Roth IRA, no known exception (in most cases, under age 59½).
K. Distribution of traditional IRA assets not having a readily available fair market value.
L. Loans treated as distributions.
M. Qualified plan loan offset.
N. Recharacterized IRA contribution made for the current year and recharacterized in the current year.
P. Excess contributions plus earnings/excess deferrals (and/or earnings) taxable in the immediately preceding year.
Q. Qualified distribution from a Roth IRA.
R. Recharacterized IRA contribution made for the preceding year and recharacterized in the current year.
S. Early distribution from a SIMPLE IRA in first two years, no known exception (under age 59½).
T. Roth IRA distribution, exception applies.
U. Dividends distributed from an ESOP under section 404(k).

Note: This distribution is not eligible for rollover.

W. Charges or payments for purchasing qualified long-term care insurance contracts under combined arrangements.

Form 5498

Form 5498, IRA Contribution Information, provides the IRS and recipients information on contributions, rollovers, conversions, recharacterizations, and the fair market value (FMV) of the account at the end of the year. The FMV information is needed for purposes of the required minimum distribution (RMD) rules and in computing the taxable and nontaxable portion of an IRA distribution.

Note: Because a taxpayer has until April 15 of the following year to make a contribution to his or her IRA, Form 5498 is not required to be issued until May 31.

[5] Railroad Retirement

Benefits paid to retirees under the Railroad Retirement Act fall into two tiers.

- **Tier 1.** Tier 1 benefits are equivalent to Social Security benefits that a railroad employee or beneficiary would have been entitled to receive under the Social Security system. These benefits are reported on Form RRB-1099, Payments by the Railroad Retirement Board.

NOTES

The FMV information is needed for purposes of the required minimum distribution (RMD) rules and in computing the taxable and nontaxable portion of an IRA distribution.

UNFOLD TO SEE ALL TAX STATEMENT FORMS – SEE REVERSE SIDE FOR GENERAL INFORMATION

PAYER'S NAME, STREET ADDRESS, CITY, STATE, AND ZIP CODE **UNITED STATES RAILROAD RETIREMENT BOARD** 844 N RUSH ST CHICAGO IL 60611-1275	**2019**		**PAYMENTS BY THE RAILROAD RETIREMENT BOARD**
PAYER'S FEDERAL IDENTIFYING NO.	3. Gross Social Security Equivalent Benefit Portion of Tier 1 Paid in 2019		**COPY C -** **FOR RECIPIENT'S RECORDS.** THIS INFORMATION IS BEING FURNISHED TO THE INTERNAL REVENUE SERVICE.
1. Claim Number and Payee Code	4. Social Security Equivalent Benefit Portion of Tier Repaid to RRB in 2019		
2. Recipient's Identification Number	5. Net Social Security Equivalent Benefit Portion Tier 1 Paid in 2019		
Recipient's Name, Street Address, City, State, and ZIP Code	6. Workers' Compensation Offset in 2019		
	7. Social Security Equivalent Benefit Portion of Tier 1 Paid for 2018		
	8. Social Security Equivalent Benefit Portion of Tier 1 Paid for 2017		
	9. Social Security Equivalent Benefit Portion of Tier 1 Paid for Years Prior to 2017		
	10. Federal Income Tax Withheld		
	11. Medicare Premium Total		

Form RRB-1099 **DO NOT ATTACH TO YOUR INCOME TAX RETURN**

NOTES

- **Tier 2.** Tier 2 benefits are treated the same as if received from a qualified employee plan. These benefits are reported on Form RRB-1099-R, *Annuities or Pensions by the Railroad Retirement Board.*

Tier 2 benefits are treated the same as if received from a qualified employee plan.

PAYER'S NAME, STREET ADDRESS, CITY, STATE, AND ZIP CODE **UNITED STATES RAILROAD RETIREMENT BOARD** 844 N RUSH ST CHICAGO IL 60611-2092	**2019**		**ANNUITIES OR PENSIONS BY THE RAILROAD RETIREMENT BOARD**
PAYER'S FEDERAL IDENTIFYING NO.	3. Employee Contributions		**COPY B -** **REPORT THIS INCOME ON YOUR FEDERAL TAX RETURN. IF THIS FORM SHOWS FEDERAL INCOME TAX WITHHELD IN BOX 9 ATTACH THIS COPY TO YOUR RETURN.** THIS INFORMATION IS BEING FURNISHED TO THE INTERNAL REVENUE SERVICE.
1. Claim Number and Payee Code	4. Contributory Amount Paid		
2. Recipient's Identification Number	5. Vested Dual Benefit		
Recipient's Name, Street Address, City, State, and ZIP Code	6. supplemental Annuity		
	7. Total Gross Paid (Sum of boxes 4,5, and 6)		
	8. Repayments		
	9. Federal Income Tax Withheld		
	10. Rate of Tax		
	11. Country		
	12. Medicare Premium Total		

Form RRB-1099-R

Learning Objective 2-E Self-Quiz

NOTES

For answer, see *Chapter 2 Self-Quiz Answers,* below.
Test your knowledge and comprehension of information presented in Learning Objective 2-E.

Learning Objective 2-E.

Which of the following types of income is not reported on Form 1099-R?

a) Social Security benefits received.
b) IRA distributions.
c) Distributions received from a 401(k).
d) Pension distributions.

Chapter 2 Self-Quiz Answers

Learning Objective 2-A.

Which of the following is an example of nontaxable income?

a) $1,500 won on a game show.
Incorrect. Prizes and awards are considered taxable income.
b) $1,500 unemployment compensation.
Incorrect. Unemployment compensation is considered taxable income.
c) $1,500 gift from a parent.
Correct. Gifts and inheritances are not taxable income for the recipient.
d) $1,500 of ordinary dividends.
Incorrect. Dividends earned are subject to federal income tax even if the earnings are reinvested and not distributed to the taxpayer.

Learning Objective 2-B.

"All income received in the form of money, goods, property, and services that is not exempt from tax" is the definition of what?

a) Total income.
Correct. Total income is all income received in the form of money, goods, property, and services that is not exempt from tax.
b) Adjusted gross income.
Incorrect. Adjusted gross income is a taxpayer's total income less any adjustments reported on Schedule 1.
c) Modified adjusted gross income.
Incorrect. The definition of modified AGI varies based on the tax attribute.
d) Taxable income.
Incorrect. Taxable income is the taxpayer's AGI less deductions.

Learning Objective 2-C.

What amount is reported in box 2 of Form W-2?

a) Wages, tips, and other compensation paid to a taxpayer.
Incorrect. Box 1 of Form W-2 reports wages, tips, and other compensation. Federal income tax withheld is reported in box 2.
b) Federal income tax withheld.
Correct. Box 2 of Form W-2 reports the amount of federal income tax the employer withheld on the taxpayer's behalf.
c) Social Security tax withheld.
Incorrect. Box 4 of Form W-2 reports the amount of Social Security tax withheld. Federal income tax withheld is reported in box 2.
d) Dependent care benefits.
Incorrect. Any amount the taxpayer elects to exclude from his or her taxable income for dependent care benefits is reported in box 10 of Form W-2. Federal income tax withheld is reported in box 2.

Learning Objective 2-D.

NOTES

Which of the following taxpayers should complete Schedule B?

a) Ray has $2,000 of capital gain distributions reported in box 2a of Form 1099-DIV.
   Incorrect. Capital gain distributions are included in the total on line 6, Form 1040.

b) Egon has $100 of interest income reported in box 1 and a $25 early withdrawal penalty reported in box 2 of Form 1099-INT.
   Incorrect. If this is Egon's only interest income, it would be reported directly on line 2b, Form 1040. The $25 early withdrawal penalty would be reported on line 17, Schedule 1.

c) Peter has $1,600 of interest income reported in box 1 and a $250 early withdrawal penalty reported in box 2 of Form 1099-INT.
   Correct. Schedule B is required if the taxpayer has over $1,500 of taxable interest or ordinary dividends.

d) d) Winston has $800 of taxable interest reported in box 1 of Form 1099-INT and $800 of ordinary dividends reported in box 1a of Form 1099-DIV.
   Incorrect. Schedule B is required if the taxpayer has over $1,500 of taxable interest or ordinary dividends. Even though Winston's total interest and dividends is $1,600, he does not have more than $1,500 of either one.

Learning Objective 2-E.

Which of the following types of income is not reported on Form 1099-R?

a) Social Security benefits received.
   Correct. Social Security benefits are reported on Form SSA-1099.

b) IRA distributions.
   Incorrect. IRA distributions are reported on Form 1099-R.

c) Distributions received from a 401(k).
   Incorrect. Distributions received from a 401(k) are reported on Form 1099-R.

d) Pension distributions.
   Incorrect. Pension distributions are reported on Form 1099-R.

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3 Adjustments and Deductions

Learning Objectives

Successful completion of this course will enable the participant to:

3-A Recognize the impact adjustments and deductions have on income.
3-B Apply the rules for the student loan interest deduction.
3-C Compute the deduction for contributions to a health savings account.
3-D Identify when a taxpayer is eligible for an increased standard deduction.
3-E Recognize which taxpayers are allowed to use the tax tables.

Glossary Terms

Effective rate. The effective rate is the actual percentage of taxes a taxpayer pays compared to his or her taxable income.

Eligible educator. An eligible educator, for the educator expense deduction, is a kindergarten through grade 12 teacher, instructor, counselor, principal, or aide who worked in a school for at least 900 hours during a school year.

Standard deduction. The standard deduction is a benefit that eliminates the need for many taxpayers to itemize actual deductions such as medical expenses, charitable contributions, and taxes.

Learning Objective 3-A

Recognize the impact adjustments and deductions have on income.

Adjustments to Income

Adjustments to income are shown on lines 10 through 21 of Schedule 1, *Additional Income and Adjustments to Income*, and reduce the taxpayer's total income. These adjustments, also known as above the line adjustments because of where they were located on the previous version of Form 1040, include the following.

[1] **Educator expenses.** Eligible educators can deduct up to $250 of qualified out-of-pocket expenses paid during the year. *See Educator Expense Deduction, Learning Objective 3-B*.

[2] **Certain business expenses of reservists, performing artists, and fee-basis government officials.** The taxpayer must include Form 2106, *Employee Business Expenses*, with his or her return.

[3] **Health savings account deduction.** If a taxpayer makes a contribution to a health savings account (HSA) directly out of his or her pocket, he or she may be able to deduct that amount.

[4] **Moving expenses for members of the Armed Forces.** The taxpayer must include Form 3903, *Moving Expenses*, with his or her return.

[5] **Deductible part of self-employment tax.** Self-employed taxpayers can deduct one-half of the total self-employment tax.

Self-employed SEP, SIMPLE, and qualified plans. If the taxpayer is self-employed and makes contributions to certain retirement plans, he or she might be able to take a deduction for the contribution.

[6] **Self-employed health insurance deduction.** Health insurance paid on behalf of the sole proprietor as a self-employed taxpayer is deductible if certain conditions apply.

[7] **Penalty on early withdrawal of savings.** If a taxpayer withdraws funds from a certificate of deposit or other deferred interest account before maturity, he or she may be charged a penalty. *See Penalty on Early Withdrawal of Savings, Learning Objective 3-B*.

[8] **Alimony paid.** If the divorce or separate maintenance instrument was executed before January 1, 2019, and has not been modified after December 31, 2018, alimony is deductible by the payer and must be included in the recipient's income.

[9] **IRA deduction.** A taxpayer who makes contributions to a traditional IRA may be able to deduct up to $6,000 ($7,000 if the taxpayer is at least age 50) for 2019, subject to limitations.

NOTES

These adjustments, also known as above the line adjustments because of where they were located on the previous version of Form 1040.

[10] **Student loan interest deduction.** A taxpayer may be able to deduct up to $2,500 of student loan interest paid. *See Student Loan Interest Deduction, Learning Objective 3-B*.

[11] **Tuition and fees deduction.** A taxpayer may be able to deduct up to $4,000 of qualified education expenses paid to a qualified educational institution. A taxpayer may claim only one of the following education benefits: tuition and fees deduction, American Opportunity Credit, or Lifetime Learning Credit. The deduction phases out when modified AGI is between $65,000–$80,000 ($130,000–$160,000 MFJ).

NOTES

Taxpayers can either claim a standard deduction or itemized deductions.

Deductions

Deductions are used to reduce a taxpayer's AGI in order to come up with the taxpayer's taxable income. Taxpayers can either claim a standard deduction or itemized deductions. Taxpayers with qualified business income may be able to claim the qualified business income deduction. See Qualified business income (QBI) deduction.

Standard deduction or itemized deductions. Most taxpayers have a choice of either taking a standard deduction or itemizing their deductions. If a taxpayer has a choice, he or she can use the method that gives him or her the lowest tax.

[12] **Standard deduction.** For 2019, most single taxpayers and married taxpayers filing separately (if the taxpayer's spouse does not itemize) have a standard deduction of $12,200. Married taxpayers filing a joint return and a taxpayer who qualifies as a Qualifying Widow(er) have a standard deduction of $24,400. Taxpayers with a filing status of Head of Household have a standard deduction of $18,350. For taxpayers age 65 or older and/or blind, the standard deduction is higher.

For a taxpayer who may be claimed as a dependent by another taxpayer, the standard deduction is based on his or her earned income. *See Learning Objective 3-D*.

[13] **Itemized deductions.** If a taxpayer's itemized deductions are greater than his or her standard deduction, he or she can deduct that amount instead. Itemized deductions are discussed in the Individual Tax Prep 202 course.

[14] **Qualified business income (QBI) deduction.** Eligible taxpayers may be able to deduct up to 20% of qualified business income from a domestic business operated as a sole proprietorship, or through a partnership, S corporation, trust or estate, plus up to 20% of combined qualified real estate investment trust (REIT) dividends and qualified publicly traded partnership (PTP) income.

KEY FACT: **The QBI deduction can be taken in addition to the standard deduction or itemized deductions.**

The QBI deduction is discussed in the Individual Tax Prep 202 course.

Learning Objective 3-A Self-Quiz

For answer, see Chapter 3 Self-Quiz Answers.
Test your knowledge and comprehension of information presented in Learning Objective 3-A.

Learning Objective 3-A.

What is the maximum amount an eligible educator can deduct for qualified out-of-pocket expenses paid during the year?

a) $0
b) $250
c) $500
d) No limit.

Learning Objective 3-B

Apply the rules for the student loan interest deduction.

[1] Educator Expense Deduction

NOTES

Eligible educators can deduct up to $250 of qualified out-of-pocket expenses paid in the year. If a taxpayer and spouse are filing jointly and both are eligible educators, the maximum deduction is $500. Neither spouse can deduct more than $250 of his or her own qualified expenses. The deduction is included on line 10, Schedule 1, *Additional Income and Adjustments to Income.*

Eligible educator. An eligible educator is a kindergarten through grade 12 teacher, instructor, counselor, principal, or aide who worked in a school for at least 900 hours during a school year.

Qualified expenses. Qualified expenses include ordinary and necessary expenses paid in connection with books, supplies, equipment (including computer equipment, software, and services), and other materials used in the classroom.

Penalty on Early Withdrawal of Savings

If a taxpayer withdraws funds from a certificate of deposit or other deferred interest account before maturity, he or she may be charged a penalty. The Form 1099-INT, *Interest Income,* or similar statement given to the taxpayer by the financial institution will show the total amount of interest in box 1 and will show the penalty separately in box 2. The taxpayer must include in income all interest shown in box 1 on line 2b, Form 1040. He or she can deduct the penalty on line 17, Schedule 1, *Additional Income and Adjustments to Income.* See *Form 1099-INT,* Learning Objective 2-D.

If a taxpayer withdraws funds from a certificate of deposit or other deferred interest account before maturity, he or she may be charged a penalty.

KEY FACT: **The entire penalty is deductible even if it is more than the taxpayer's interest income.**

2 Student Loan Interest Deduction

A taxpayer who makes payments to qualified student loans may deduct the interest portion of those payments if all of the following apply.

- The taxpayer paid interest in the year on a qualified student loan (see below).
- The taxpayer's filing status is any status except Married Filing Separately.
- Modified adjusted gross income (AGI) is less than $85,000 if Single, Head of Household, or Qualifying Widow(er); $170,000 if Married Filing Jointly.
- The taxpayer cannot be claimed as a dependent on someone else's (such as a parent's) tax return.

Qualified student loan. A qualified student loan is any loan a taxpayer took out to pay the qualified higher education expenses for the taxpayer or spouse, a person who was a dependent when the loan was taken out, or any person who could have been claimed as a dependent when the loan was taken out except that:

- The person filed a joint return,
- The person had gross income that was equal to or more than $4,200 for 2019, or
- The taxpayer, or spouse if filing jointly, could be claimed as a dependent on someone else's return.

Qualified higher education expenses. Qualified higher education expenses generally include tuition, fees, room and board, and related expenses such as books and supplies.

Eligible student. An eligible student is a person who was enrolled in a degree, certificate, or other program leading to a recognized educational credential at an eligible education institution, and who is enrolled at least half-time.

A deduction of up to $2,500 is allowed for interest paid by the taxpayer during the year on qualified student loan interest.

Maximum deduction. A deduction of up to $2,500 is allowed for interest paid by the taxpayer during the year on qualified student loan interest. The deduction is subject to phaseout.

Filing Status	2019 Phaseout Amount (of modified AGI)
MFJ	$140,000 - $170,000
MFS	No deduction is allowed
ALL Others	$70,000 - $85,000

NOTES

Any deductible amount is included on line 20, Schedule 1, *Additional Income and Adjustments to Income*.

Form 1098-E

Form 1098-E, Student Loan Interest Internet Statement, is issued to a tax-payer to report the amount of student loan interest that was paid.

☐ CORRECTED (if checked)

RECIPIENT'S/LENDER'S name, street address, city or town, province or state, country, ZIP or foreign postal code, and telephone no.		OMB No. 1545-1576 **2019** **Form 1098-E**	**Student Loan Interest Statement**
RECIPIENT'S TIN	BORROWER'S TIN	1 Student loan interest received by lender $	**Copy B** **For Borrower** **This is important tax information and is being furnished to the IRS. 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 student loan interest.**
BORROWER'S name			
Street address (including apt. no.)			
City or town, state or province, country, and ZIP or foreign postal code			
Account number (see instructions)		2 If checked, box 1 does not include loan origination fees and/or capitalized interest for loans made before September 1, 2004 ☐	

Form 1098-E (Keep for your records) www.irs.gov/Form1099R Department of the Treasury – Internal Revenue Service

Learning Objective 3-B Self-Quiz

For answer, see Chapter 3 Self-Quiz Answers.

Test your knowledge and comprehension of information presented in Learning Objective 3-B.

Learning Objective 3-B.

Rhonda and Ron file a joint return. Their AGI is $130,000. Rhonda pays $3,000 in student loan interest during the year. What is the maximum amount Rhonda and Ron can claim as a deduction on their 2019 return?

a) $0
b) $1,500
c) $2,500
d) $3,000

Learning Objective 3-C

Compute the deduction for contributions to a health savings account.

[1] Health Savings Accounts (HSAs)

A health savings account (HSA) is a tax-exempt custodial account set up with a qualified HAS trustee to pay or reimburse certain medical expenses incurred by an individual, his or her spouse, and qualified dependents. The medical expenses must not be reimbursable by insurance or other sources, and distributions from HSA funds will not give rise to a medical expense deduction on the individual's tax return.

KEY FACT: **HSAs allow eligible individuals to save for, and pay for, health care expenses on a tax-free basis.**

The taxpayer can either make tax deductible contributions to the HSA, or an employer can make contributions to the HSA of an employee and exclude the benefit from taxable wages. Once the pre-tax dollars are in the account, they can be withdrawn tax free to pay for the qualified medical expenses that are not covered by insurance. The funds in the account can be withdrawn to pay for medical expenses, or they can be allowed to accumulate from year to year. Interest or other earnings on the account accumulate tax free.

Like an IRA, the HAS is owned by the individual participant and stays with the participant even after a job change or retirement. The participant does not need to have W-2 earnings or self-employment earnings to make deductible contributions to an HSA.

HSA Limitations

Annual contribution is limited to: 2019

Self-only coverage, under age 55.......... $3,500
Self-only coverage, age 55 and older.......... $4,500
Family coverage, under age 55.......... $7,000
Family coverage, age 55 and older*.......... $8,000

Minimum annual deductibles:

Self-only coverage.......... $1,350
Family coverage.......... $2,700

Maximum annual deductible and out-of-pocket expense limit:

Self-only coverage.......... $6,750
Family coverage.......... $13,500

*Assumes only one spouse has an HSA.

Qualifying for an HSA. To be eligible, a participant must meet the following requirements.

- Must be covered under a high deductible health plan (HDHP).
- Cannot have any other health coverage. ***Exception:*** Coverage for specific things such as disability, dental care, vision care, and long-term care can be purchased in addition to the HDHP without disqualifying the HSA.
- Cannot be enrolled in Medicare.
- Cannot be eligible to be claimed as a dependent on someone else's tax return.

Adult child. The Affordable Care Act allows an adult child, under the age of 26, to be covered under his or her parent's health plan. However, HSA distributions for the adult child might not qualify if he or she does not meet the qualifications listed above.

Last-month rule. If an individual is an eligible individual on the first day of the last month of his or her tax year (December 1 for most taxpayers), that individual is considered an eligible individual for the entire year. Special rules apply if the individual does not remain an eligible individual during a full 12-month period. Exceptions apply in case of death or disability.

Spousal HSAs. The HSAs cannot be joint accounts. Each spouse must open a separate account. However, if only one has an account, the funds in that account can be used to pay for expenses incurred by the other spouse, as well as the participant's other family members.

High deductible health plan (HDHP). See *HSA Limitations,* for minimum and maximum annual deductible and out-of-pocket expense limits. An HDHP can provide for preventive care benefits without a deductible or with a deductible below the minimum limit. Family HDHP coverage covers an eligible individual and at least one other person.

Prescription drug plans. An HDHP can include a prescription plan as long as it does not provide benefits until the minimum annual deductible has been met.

Family plans with deductibles for both family and individuals. Some family plans have deductibles for both the family as a whole and for individual family members. If either the deductible for the family as a whole, or the deductible for an individual family member, is below the minimum annual deductible for family coverage, the plan does not qualify as an HDHP.

NOTES

Like an IRA, the HSA is owned by the individual participant and stays with the participant even after a job change or retirement.

If only one has an account, the funds in that account can be used to pay for expenses incurred by the other spouse, as well as the participant's other family members.

EXAMPLE: Joe has family health insurance coverage in 2019. The annual deductible for the family plan is $4,500. His plan also has an individual deductible of $2,000 for each family member. His plan does not qualify as an HDHP because the deductible for an individual family member is below the minimum annual deductible ($2,700) for family coverage.

Other health coverage. The individual (and spouse if holding family coverage) generally cannot have any other health coverage that is not an HDHP. An individual can still be eligible even if the spouse has non-HDHP coverage, provided the taxpayer is not covered by that plan.

Contributions. See *HSA Limitations*. Contributions for a tax year must be made by the return due date (no extensions).

Rules for married people. If both spouses are eligible individuals, and either spouse has family HDHP coverage, both spouses are treated as having family

HDHP coverage. The total contribution limit for 2019 is $7,000 (if both spouses are under age 55), split equally unless they agree on a different allocation. Special rules apply if either spouse is over 55 or enrolled in Medicare.

Form 8889, *Health Savings Accounts.* Use Form 8889 to report all contributions to an HSA, including employer contributions. This form is also used to report the taxable and nontaxable amount of an HSA distribution.

Rollovers. Amounts from Archer MSAs and other HSAs can be rolled over into another HSA. Rollovers are not subject to the annual contribution limits. The same 60-day and 1-year rules for IRA rollovers apply to HSA rollovers.

One time rollovers from IRAs to HSAs. A one-time tax free rollover from a traditional IRA or Roth IRA into an HSA is allowed.

- The rollover must be a direct trustee-to-trustee transfer.
- Amounts rolled over are not included in income and not subject to the 10% early withdrawal penalty.
- For purposes of determining the basis of any amount remaining in an IRA following a rollover to an HSA, the pro-rata recovery rules do not apply. The rollover is treated as included in gross income to the extent that such amount does not exceed the aggregate amount that would have been included if there had been a total distribution of the owner's IRA account.
- The amount that can be rolled over is limited to the maximum deductible contribution otherwise allowed to the HSA, which is dependent on whether the individual has self-only or family HDHP coverage.
- The limitations on other contributions to the HSA during the year are reduced by the amount rolled over from the IRA.
- The provision allows for only one rollover during the lifetime of the individual, except in the case where an individual with self-only coverage switches to family coverage in a subsequent month within the taxable year.
- The individual must remain an eligible individual after the rollover for 12 months, except in the case of death or disability.
- This provision does not apply to ongoing SEP IRAs or SIMPLE IRAs.

Excess contributions. Excess contributions are treated the same as excess contributions to IRAs.

Distributions. The following rules apply to distributions from HSAs.

- Distributions used to pay for, or be reimbursed for, qualified medical expenses not covered by insurance are tax free. Distributions for any other purpose are taxable and subject to an additional 20% penalty. ***Exception:*** The 20% penalty does not apply to distributions after reaching age 65, or death.
- Distributions used to pay for medical expenses that were incurred prior to establishing the HSA are taxable.

NOTES

A one-time tax-free rollover from a traditional IRA or Roth IRA into an HAS is allowed.

- Qualified medical expenses are those that would otherwise be deductible as itemized deductions.
- Qualified medical expenses do not include the insurance premiums for the high deductible health plan. However, insurance premiums for long-term care (subject to limits) and health coverage while unemployed qualify. Also, if over age 65, health insurance premiums (other than Medigap premiums) are qualified medical expenses for HSA purposes.

Failure to maintain HDHP coverage. An individual can receive distributions from an HSA even if not currently eligible to contribute to an HSA. However, any part of a distribution not used to pay qualified medical expenses is includible in gross income and subject to an additional 20% tax unless an exception applies.

Death of HSA participant. If a spouse is the beneficiary, the spouse is treated as the participant of the HSA after the death of the original participant. If someone other than a spouse inherits an HSA, it stops being an HSA and the FMV becomes taxable to the beneficiary in the year of the HSA participant's death. If the estate is the beneficiary, the FMV is taxable on the decedent's final Form 1040. Any taxable amount is reduced by qualified medical expenses of the decedent paid within one year after the date of death.

Employer participation. Employers can provide employees with high deductible health plan coverage and contribute to an HSA on behalf of an employee and exclude the value of the benefits from taxable wages. If an employer contributes to an HSA for one employee, the employer must make comparable contributions to all comparable participating employees who have the same category of high deductible health coverage. If the HSA is offered through a cafeteria plan, the IRC section 125 cafeteria plan participation rules apply rather than the comparable contribution rules.

Comparable contribution exception. An exception applies to the comparable contribution rules which allows larger HSA contributions for non highly-compensated employees than for highly-compensated employees. For example, an employer is permitted to make a contribution to the HSA of each non highly-compensated employee for a year without making any contributions to the HSA of each highly-compensated employee.

Employment taxes. Amounts contributed to an employee's HSA are exempt from income tax and generally not subject to employment taxes. Report the contributions in box 12, Form W 2, and using code "W."

Form 1099-SA.

Form 1099-SA, Distributions From an HSA, Archer MSA, or Medicare Advantage MSA, is used to report amounts taken out of a health savings account (HSA) and other similar type accounts.

☐ CORRECTED (if checked)

TRUSTEE'S/PAYER'S name, street address, city or town, province or state, country, ZIP or foreign postal code, and telephone no.			OMB No. 1545-1517 **2019** **Form 1099-SA**	**Distributions From an HAS, Archer MSA, or Medicare Advantage MSA**
PAYER'S TIN	RECIPIENT'S TIN	1 Gross distribution $	2 Earnings on excess cont. $	**Copy B For Recipient** This information is being furnished to the IRS.
RECIPIENT'S name Street address (including apt. no.) City or town, state or province, country, and ZIP or foreign postal code		3 Distribution code 5 HSA ☐ Archer MSA ☐ MA MSA ☐	4 FMV on date of death $	
Account number (see instructions)				

Form 1099-SA (Keep for your records) www.irs.gov/Form1099SA Department of the Treasury – Internal Revenue Service

NOTES

Amounts contributed to an employee's HSA are exempt from income tax and generally not subject to employment taxes.

Learning Objective 3-C Self-Quiz

NOTES

For answer, see Chapter 3 Self-Quiz Answers.

Test your knowledge and comprehension of information presented in Learning Objective 3-C.

Learning Objective 3-C.

Which of the following statements about an HSA is true?

a) To claim an HSA deduction, the participant must be covered by a high deductible health plan.
b) Participants with self-only coverage must contribute a minimum of $1,350 to the HSA.
c) An HDHP must contain a prescription drug plan.
d) Contributions to an HSA must be made by December 31 of the year of the contribution.

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Learning Objective 3-D

NOTES

Identify when a taxpayer is eligible for an increased standard deduction.

Standard Deduction

Most taxpayers have a choice of either taking a standard deduction or itemizing their deductions. If a taxpayer has a choice, he or she can use the method that gives him or her the lower tax.

The standard deduction is a dollar amount that reduces a taxpayer's taxable income. It is a benefit that eliminates the need for many taxpayers to itemize actual deductions, such as medical expenses, charitable contributions, and taxes, on Schedule A (Form 1040). The standard deduction is higher for taxpayers who:

- Are age 65 or older, or
- Are blind.

Standard deduction amounts. For 2019, single taxpayers and married taxpayers filing separately (if the taxpayer's spouse does not itemize) have a standard deduction of $12,200. Married taxpayers filing a joint return and taxpayers who qualify as a Qualifying Widow(er) have a standard deduction of $24,400. Taxpayers with a filing status of Head of Household have a standard deduction of $18,350.

Age 65 and/or blind. Single and Head of Household taxpayers who are 65 or older or blind in 2019 get an additional amount of $1,650 added to their standard deduction ($3,300 if both age 65 or older and blind). All other taxpayers get an additional amount of $1,300 (married taxpayers where both spouses are age 65 or older and blind qualify for an additional amount of $5,200).

Dependents. For taxpayers who may be claimed as a dependent by another taxpayer, whether or not the other taxpayer actually claims the dependent, the standard deduction is generally limited to the greater of $1,100 or earned income plus $350 (but not more than the regular standard deduction amount).

Dependent's earned income. Earned income includes salaries, wages, tips, professional fees, and other amounts received as pay for work the taxpayer actually performed.

For purposes of the standard deduction, earned income also includes any part of a taxable scholarship or fellowship grant.

EXAMPLE: Michael is 16 years old and single. His parents can claim him as a dependent on their 2019 tax return. He has interest income of $780 and wages of $1,200. His standard deduction is $1,550 (his earned income plus $350).

Increased standard deduction for net qualified disaster loss. If a taxpayer has a net qualified disaster loss, he or she may elect to increase his or her standard deduction by the amount of his or her net qualified disaster loss.

For purposes of the standard deduction, earned income also includes any part of a taxable scholarship or fellowship grant.

Death of taxpayer or spouse. The standard deduction for a decedent's final tax return is the same as it would have been had the decedent been alive the entire year. However, if the taxpayer or spouse was born before January 2, 1955, but died in 2019 before reaching age 65, he or she is not considered 65 or older at the end of 2019.

KEY FACT: A person is considered to reach age 65 on the day before his or her 65th birthday.

EXAMPLE: Hannah's husband David was born on February 14, 1954 and died on February 13, 2019. David is considered age 65 at the time of death. However, if David had died on February 12, 2019, he would not be considered age 65.

Blindness. If a taxpayer is not totally blind as of the end of the tax year, he or she must get a statement certified by his or her eye doctor (ophthalmologist or optometrist) that:

- The taxpayer cannot see better than 20/200 in his or her better eye with glasses or contact lenses, or
- The taxpayer's field of vision is 20 degrees or less.

If the taxpayer's eye condition is not likely to improve beyond the conditions listed above, he or she can get a statement certified by his or her eye doctor to this effect instead.

The taxpayer must keep the statement for his or her records.

If a taxpayer's vision can be corrected beyond the limits listed above only by contact lenses that he or she can wear only briefly because of pain, infection, or ulcers, he or she can take the higher standard deduction for blindness if he or she otherwise qualifies.

Taxpayers not eligible for the standard deduction. A taxpayer's standard deduction is zero if:

- His or her filing status is Married Filing Separately (MFS) and his or her spouse itemizes deductions on his or her return,
- The taxpayer is filing a tax return for a short tax year because of a change in his or her annual accounting period, or
- The taxpayer is a nonresident or dual-status alien during the year.

A nonresident alien taxpayer who is married to a U.S. citizen or resident alien at the end of the year can choose to be treated as a U.S. resident. If this choice is made, then the taxpayer can take the standard deduction.

Learning Objective 3-D Self-Quiz

For answer, see *Chapter 3 Self-Quiz Answers*.

Test your knowledge and comprehension of information presented in Learning Objective 3-D.

Learning Objective 3-D.

John is 30 years old and single. He is also deaf. How much is his standard deduction for 2019?

a) $6,400
b) $12,200
c) $13,500
d) $13,850

Learning Objective 3-E

Recognize which taxpayers are allowed to use the tax tables.

The tax tables and tax rate schedules are the easiest ways of calculating the amount of income taxes owed.

If taxable income is less than $100,000 the tax table method must be used. If taxable income is $100,000 or more, then the tax rate schedules should be used. If one of the following apply, neither the tax tables nor tax rate schedules should be used.

- The taxpayer is subject to the Kiddie Tax1.
- The taxpayer has to file Schedule D (Form 1040) and line 18 or 19 is greater than zero. Line 18 is used for gains taxed at a maximum 28% rate and line 19 is used for unrecaptured section 1250 gains.
- The taxpayer has qualified dividends or long-term capital gains.
- The taxpayer qualifies for income averaging[2].
- The taxpayer claimed the foreign earned income exclusion, housing exclusion, or housing deduction[3].

[4] Tax Tables

To use the tax tables, simply locate the row for taxpayer's taxable income as shown on line 11b of Form 1040 and the column for the taxpayer's filing status. Whatever amount is listed is the amount of income tax that is owed.

Tax Rates

The United States tax system is a progressive system. Meaning that, as a taxpayer's income increases, the percentage of tax owed on the income also increases. Fortunately, when a taxpayer moves from one tax rate to the next, only those dollars within the new range are taxed at the higher rate. Because of this, taxpayers are said to have two different tax rates. A marginal rate and an effective rate.

Marginal rate. The marginal rate that a taxpayer is subject to is often referred to as his or her tax bracket. There is a total of seven different tax rates. They are 10%, 12%, 22%, 24%, 32%, 35%, and 37%.

NOTES

The taxpayer must keep the statement for his or her records.

Effective rate. The effective rate is the actual percentage of taxes a taxpayer pays compared to his or her taxable income. Unless the taxpayer is in the lowest tax bracket (10%), the effective rate will be lower than the marginal rate.

Using the tax rate schedule. To calculate the amount of tax due using the tax rate schedule, locate the taxpayer's taxable income under his or her filing status and multiply it by the marginal rate. Because not all of the income is subject to the marginal rate, the amount indicated needs to be subtracted from the total to come up with the actual amount of tax.

NOTES

The effective rate is the actual percentage of taxes a taxpayer pays compared to his or her taxable income.

2019 Federal Tax Rate Schedules

Single Taxable Income										
$	0	to	9,700	x	10.0%	minus	$	0.00	=	Tax
	9,701	to	39,475	x	12.0%	minus		194.00	=	Tax
	39,476	to	84,200	x	22.0%	minus		4,141.50	=	Tax
	84,201	to	160,725	x	24.0%	minus		5,825.50	=	Tax
	160,726	to	204,100	x	32.0%	minus		18,683.50	=	Tax
	204,101	to	510,300	x	35.0%	minus		24,806.50	=	Tax
	510,301	and over		x	37.0%	minus		35,012.50	=	Tax
MFJ or QW Taxable Income										
$	0	to	19,400	x	10.0%	minus	$	0.00	=	Tax
	19,401	to	78,950	x	12.0%	minus		388.00	=	Tax
	78,951	to	168,400	x	22.0%	minus		8,283.00	=	Tax
	168,401	to	321,450	x	24.0%	minus		11,651.00	=	Tax
	321,451	to	408,200	x	32.0%	minus		37,367.00	=	Tax
	408,201	to	612,350	x	35.0%	minus		49,613.00	=	Tax
	612,351	and over		x	37.0%	minus		61,860.00	=	Tax
MFS Taxable Income										
$	0	to	9,700	x	10.0%	minus	$	0.00	=	Tax
	9,701	to	39,475	x	12.0%	minus		194.00	=	Tax
	39,476	to	84,200	x	22.0%	minus		4,141.50	=	Tax
	84,201	to	160,725	x	24.0%	minus		5,825.50	=	Tax
	160,726	to	204,100	x	32.0%	minus		18,683.50	=	Tax
	204,101	to	306,175	x	35.0%	minus		24,806.50	=	Tax
	306,176	and over		x	37.0%	minus		30,930.00	=	Tax
HOH Taxable Income										
$	0	to	13,850	x	10.0%	minus	$	0.00	=	Tax
	13,851	to	52,850	x	12.0%	minus		277.00	=	Tax
	52,851	to	84,200	x	22.0%	minus		5,562.00	=	Tax
	84,201	to	160,700	x	24.0%	minus		7,246.00	=	Tax
	160,701	to	204,100	x	32.0%	minus		20,102.00	=	Tax
	204,101	to	510,300	x	35.0%	minus		26,225.00	=	Tax
	510,301	and over		x	37.0%	minus		36,431.00	=	Tax

EXAMPLE: Jack and Diane are married and file a joint return. Their 2019 taxable income is $125,000 which puts them in the 22% tax bracket. Their total tax of $19,217 is calculated as follows:

$125,000 × 22% = $27,500 – $8,283 = $19,217

Even though Jack and Diane have a marginal rate of 22%, their effective rate is 15.4% ($19,217 ÷ $125,000).

[5] Capital Gains Tax Rates

Tax rates that apply to net capital gains are generally lower than tax rates that apply to other income and are referred to as maximum capital gain rates. Net capital gain is the amount by which net long-term capital gain for the year is more than net short-term capital loss.

2019 Long-Term Capital Gain and Qualified Dividends Tax Rates			
	0%	15%	20%
For Taxpayers with taxable income of:			
Single	$0 - $39,375	$39-376 - $434,550	$434,551 and above
MFJ/QW	$0 - $78,750	$78,751 - $488,850	$488,851 and above
MFS	$0 - $39,375	$39,376 - $244,425	$244,426 and above
HOH	$0 - $52,750	$52,751 - $461,700	$461,701 and above

NOTES

Note: Net short-term capital gains are taxed at ordinary income tax rates.

[6] **28% rate gain.** A 28% maximum capital gain rate specifically applies to gains from the sales of collectibles and small business stock.

[7] **25% rate gain.** All unrecaptured section 1250 gain is taxed at a 25% maximum capital gain rate.

KEY FACT: If tax is computed using the maximum capital gain rate and the regular tax computation results in a lower tax, the regular tax computation applies.

[8] Alternative Minimum Tax (AMT)

The alternative minimum tax (AMT) is a parallel tax system with its own definitions of income and expenses, rules for accounting and timing, and exemptions and tax rates. AMT limits the tax benefit of certain types of income and deductions otherwise available to some taxpayers under regular tax rules. Individuals compute AMT on Form 6251, *Alternative Minimum Tax Individuals.* AMT tax rates are 26% and 28%. If the AMT computation results in a higher tax than the regular income tax, the difference is reported on line 1, Schedule 2, *Additional Taxes.*

Learning Objective 3-E Self-Quiz

For answer, see *Chapter 3 Self-Quiz Answers,* below.
Test your knowledge and comprehension of information presented in Learning Objective 3-E.

Learning Objective 3-E.

Which of these taxpayers is not allowed to use the tax tables to calculate his or her income tax?

a) Herman has taxable income of $45,000. All of his income is from self-employment.
b) Lilly has taxable income of $45,000. Her income consists only of pension and interest income.
c) Marilyn has taxable income of $45,000. Her income consists only of W-2 wages and rental income.
d) Eddie has taxable income of $45,000. His income consists of W-2 wages and long-term capital gains.

Chapter 3 Self-Quiz Answers

Learning Objective 3-A.

What is the maximum amount an eligible educator can deduct for qualified out-of-pocket expenses paid during the year?

a) $0
   Incorrect. Eligible educators can deduct up to $250 of qualified out-of-pocket expenses paid during the year.
b) $250
   Correct. Eligible educators can deduct up to $250 of qualified out-of-pocket expenses paid during the year.

c) $500

Incorrect. Eligible educators can deduct up to $250 of qualified out-of-pocket expenses paid during the year. However, both if both spouses qualify, they each can deduct up to $250 for a total of $500.

d) No limit

Incorrect. Eligible educators can deduct up to $250 of qualified out-of-pocket expenses paid during the year.

NOTES

Learning Objective 3-B.

Rhonda and Ron file a joint return. Their AGI is $130,000. Rhonda pays $3,000 in student loan interest during the year. What is the maximum amount Rhonda and Ron can claim as a deduction on their 2019 return?

a) $0

Incorrect. The phaseout for the student loan interest deduction begins at $140,000 for the Married Filing Jointly filing status. Amounts paid by Rhonda are allowed up to the $2,500 limit.

b) $1,500

Incorrect. The maximum deduction allowable for taxpayers under the phaseout is $2,500

c) $2,500

Correct. The maximum student loan interest deduction that Rhonda and Ron can claim is $2,500 because they are under the phaseout range.

d) $3,000

Incorrect. The maximum deduction Rhonda and Ron can claim for student loan interest paid is $2,500.

Learning Objective 3-C.

Which of the following statements about an HSA is true?

a) To claim an HSA deduction, the participant must be covered by a high deductible health plan.

Correct. The participant must have an HDHP in order to take a deduction for contributions to his or her HSA.

b) Participants with self-only coverage must contribute a minimum of $1,350 to the HSA.

Incorrect. A participant in an HSA is not required to make any contributions for the tax year. To be eligible, a participant must have an HDHP with a minimum deductible of $1,350.

c) An HDHP must contain a prescription drug plan.

Incorrect. An HDHP is not required to have a prescription drug plan included. However, if a prescription drug plan is included, no prescription drug benefits can be provided until the minimum annual deductible of the plan has been met.

d) Contributions to an HSA must be made by December 31 of the year of the contribution.

Incorrect. Contributions for a tax year must be made by the return due date (no extensions).

Learning Objective 3-D.

John is 30 years old and single. He is also deaf. How much is his standard deduction for 2019?

a) $6,400

Incorrect. The standard deduction for a single taxpayer is $12,200 in 2019.

b) $12,200

Correct. As a single taxpayer, John's standard deduction for 2019 is $12,200.

c) $13,500

Incorrect. The standard deduction for a single taxpayer is $12,200 in 2019. Married taxpayers who are age 65 or older or blind get an addition $1,300 added to their standard deduction.

d) $13,850

Incorrect. As a single taxpayer, John's standard deduction for 2019 is $12,200. His deafness does not qualify him for the additional $1,650 that a blind individual would receive.

Learning Objective 3-E.

NOTES

Which of these taxpayers is not allowed to use the tax tables to calculate his or her income tax?

a) Herman has taxable income of $45,000. All of his income is from self-employment.
Incorrect. Taxpayers with self-employment income may use the tax tables if they meet the other criteria.

b) Lilly has taxable income of $45,000. Her income consists only of pension and interest income.
Incorrect. Taxpayers with pension or interest income may use the tax tables if they meet the other criteria.

c) Marilyn has taxable income of $45,000. Her income consists only of W-2 wages and rental income.
Incorrect. Taxpayers with W-2 wages or rental income may use the tax tables if they meet the other criteria.

d) Eddie has taxable income of $45,000. His income consists of W-2 wages and long-term capital gains.
Correct. Taxpayers with long-term capital gains cannot use the tax tables to calculate income tax.

4 Credits

Learning Objectives

NOTES

Successful completion of this course will enable the participant to:
4-A Recognize the difference between refundable and nonrefundable credits.
4-B Recognize the requirements for claiming the Earned Income Credit.
4-C Compute the Child and Dependent Care Credit
4-D Recognize who can claim the Child Tax Credit.
4-E Calculate the excess Social Security amount withheld for a taxpayer.

Glossary Terms

Nonrefundable credit. Nonrefundable credits cannot be more than the amount of tax that a taxpayer would otherwise pay in any year.
Refundable credit. A refundable credit, such as the Earned Income Credit, is a credit that is received as a refund even in the taxpayer did not otherwise owe any taxes.

Learning Objective 4-A

Recognize the difference between refundable and nonrefundable credits.

Credits

Unlike adjustments to income and deductions which are used to reduce a taxpayer's taxable income and indirectly reduce the taxes a taxpayer owes, credits directly reduce the amount of taxes the taxpayer owes. For a taxpayer in the 22% tax bracket, a $1,000 deduction only saves him or her $220 in taxes whereas a $1,000 credit saves him or her $1,000.
The two types of credits are nonrefundable and refundable.

Nonrefundable credits. Nonrefundable credits can only reduce a taxpayer's income tax to $0. They not will not reduce a taxpayer's self-employment tax or result in the taxpayer getting more back than was paid in. Depending on the credit, any unused amount might be lost or it might be carried over to a future year. Nonrefundable credits are reported on Part I, Schedule 3 (Form 1040), *Additional Credits and Payments*, with the exception of the Child Tax Credit and the Credit for Other Dependents which are reported directly on line 13a, Form 1040.

Nonrefundable credits can only reduce a taxpayer's income tax to $0.

[1] ***Child Tax Credit/Credit for Other Dependents.*** Taxpayers with qualifying children may be eligible for a credit of up to $2,000 per child. Taxpayers with other dependents may be eligible for a credit of up to $500 per dependent. *See Learning Objective 4-D*.

[2] ***Foreign Tax Credit.*** A taxpayer may be able to claim a credit for taxes paid to a foreign country on income that is also taxed by the United States.

[3] ***Credit for Child and Dependent Care Expenses.*** A taxpayer may be eligible for a credit of up to $2,100 if he or she has qualified child and dependent care expenses. See Learning Objective 4-C.

[4,5] ***Education Credits.*** A taxpayer may be eligible to claim one of two credits for higher education. The American Opportunity Credit is up to $2,500 per student whereas the Lifetime Learning Credit is a maximum of $2,000 per return regardless of the number of eligible students.

[6] ***Retirement Savings Contributions Credit.*** Lower income taxpayers may qualify for a credit for contributions made to a retirement account.

[7] ***Residential Energy Credit.*** The residential energy credit applies to solar and wind power property and geothermal heat pumps.

[8] ***Other credits.*** Other credits include those reported on Form 3800, General Business Credit, and Form 8801, *Credit for Prior Year Minimum Tax-Individuals, Estates, and Trusts*.

Refundable credits. Unlike nonrefundable credits, refundable credits can be used reduce other taxes, such as a taxpayer's self-employment tax. The can also result in the taxpayer getting more back than was paid in. The Earned Income Credit, Additional Child Tax Credit, and the refundable portion of the American Opportunity Credit are reported directly on Form 1040. The other refundable credits are shown on Part II of Schedule 3, Additional Credits and Payments.

NOTES

Unlike nonrefundable credits, refundable credits can be used reduce other taxes, such as a taxpayer's self-employment tax.

[9] ***Earned Income Credit (EIC).*** The EIC is a refundable credit for low-income earners. See Learning Objective 4-B.

[10] ***Additional Child Tax Credit.*** Taxpayers may be able to claim the Additional Child Tax Credit if any portion of the regular Child Tax Credit was disallowed because tax was reduced to zero before the entire credit was used.

[11] ***American Opportunity Credit.*** 40% of the American Opportunity Credit is refundable for most taxpayers.

[12] ***Premium Tax Credit (PTC).*** The PTC is a refundable credit for certain people who enroll, or whose family member enrolls, in a qualified plan offered through a Health Insurance Marketplace (also known as an Exchange).

[13] ***Credit for Federal Tax Paid on Fuels.*** Form 4136, Credit for Federal Tax Paid on Fuels, is used to claim a credit for certain nontaxable uses (or sales) of fuel during the tax year. Form 4136 is also used to claim the Alternative Fuel Credit and a credit for blending a diesel-water fuel emulsion.

[14] ***Health Coverage Tax Credit.*** The Health Coverage Tax Credit is a refundable credit of 72.5% of qualified health insurance coverage payments for qualified taxpayers.

Learning Objective 4-A Self-Quiz

For answer, see Chapter 4 Self-Quiz Answers.
Test your knowledge and comprehension of information presented in Learning Objective 4-A.

Learning Objective 4-A.

How much of the American Opportunity Credit is refundable for most taxpayers?

a) 0%
b) 40%
c) 60%
d) 100%

Learning Objective 4-B

Recognize the requirements for claiming the Earned Income Credit.

[1] Basics of the Earned Income Credit (EIC)

The EIC is a refundable credit for low-income earners. The maximum credit in 2019 is $6,557.

Qualifying Taxpayer

Requirements for everyone. The following requirements must be met whether or not the taxpayer has qualifying children.

Valid Social Security Numbers. The taxpayer and spouse (if filing jointly) must have valid Social Security Numbers. Qualifying children listed on Schedule EIC (Form 1040), Earned Income Credit, must also have valid Social Security Numbers except a child who was born and died during the year. Adoption and individual taxpayer identification numbers (ATINs and ITINs) do not qualify. A Social Security Number that reads "Not Valid for Employment" does not qualify. A Social Security Number on a card that reads "Valid for work only with DHS (or INS) authorization" qualifies.

Adoption and individual taxpayer identification numbers (ATINs and ITINs) do not qualify.

Prevention of retroactive claims of the EIC. The EIC cannot be claimed unless the SSN for the taxpayer, spouse, or qualifying child is issued before the due date of the return, including any valid extension. Retroactive claims of the EIC made by amending a return or filing an original return for any earlier year in which the individual or anyone listed on the return did not have a SSN valid for employment are not allowed.

The taxpayer must be a U.S. citizen or resident alien for the entire year. A nonresident alien can claim the credit if married to a U.S. citizen or resident alien, and the nonresident alien chooses to be treated as a resident for all of the year by filing a joint return.

Filing status. The taxpayer's filing status may not be Married Filing Separately. *Not a qualifying child.* The taxpayer may not be a qualifying child of another taxpayer.

Foreign income. The taxpayer may not file Form 2555, *Foreign Earned Income* (or Form 2555 EZ).

Investment income. The taxpayer's investment income for 2019 must not exceed $3,600.

Taxpayers without qualifying children. Taxpayers who meet all the requirements, above, and who do not have a qualifying child for the year, can claim EIC if the following additional requirements are met.

- The taxpayer must be at least age 25, but under age 65, at the end of the year. If Married Filing Jointly, either taxpayer can meet the age test.
- The taxpayer cannot be the dependent of another person.
- The taxpayer's principal place of abode is in the United States for more than half the year. Residence in U.S. possessions, such as Guam and Puerto Rico, does not qualify.

Qualifying Child

For purposes of the Earned Income Credit, a qualifying child must meet all of the following four tests.

1) *Relationship test.* The child must be the taxpayer's son, daughter, stepchild, foster child, or a descendant of any of them (for example, a grandchild); or brother, sister, half-brother, half-sister, stepbrother, stepsister, or a descendant of any of them (for example, niece or nephew).
2) *Age test.* The child must be under age 19 at the end of the year and younger than the taxpayer (or spouse if filing jointly); under age 24 at the end of the year, a full-time student, and younger than the taxpayer (or spouse if filing jointly); or permanently and totally disabled at any time during the year, regardless of age.
3) *Residency test.* The child must have lived with the taxpayer in the United States for more than half of the year.
4) *Joint return test.* The child cannot file a joint return for the year. ***Exception:*** The joint return test does not apply if the child and his or her spouse file a joint return only to claim a refund.

The support test for dependents does not apply for purposes of the EIC. A child who meets all requirements can be a qualifying child even if the child provides over half of his or her own support.

NOTES

The support test for dependents does not apply for purposes of the EIC.

KEY FACT: If the parents of a child can claim the child as a qualifying child but no parent claims the child, no one else can claim the child unless that person's AGI is higher than the highest AGI of any of the child's parents who can claim the child.

COURT CASE: In Rice vs. Commissioner, the taxpayer lived with his girlfriend and her son, claiming her son for the purpose of the Earned Income Credit. The taxpayer had not adopted the child, nor was the child a biological child of the taxpayer. The IRS disallowed the Earned Income Credit stating that the child was not a qualifying child for purposes of the Earned Income Credit. The court upheld the IRS' decision stating the relationship test was not met. (Rice, T.C. Summary 2009-83)

General Rules for Qualifying Children

NOTES

As a general rule, only one taxpayer can claim the Earned Income Credit for each qualifying child.

Children of divorced or separated parents. The noncustodial parent may claim the child as a dependent and the Child Tax Credit or Credit for Other Dependents if requirements are met. The custodial parent may still claim EIC, Head of Household filing status, and child and dependent care expenses.

The custodial parent may still claim EIC, Head of Household filing status, and child and dependent care expenses.

Schedule EIC (Form 1040), Earned Income Credit. Schedule EIC must be completed and attached to Form 1040 if the taxpayer is claiming the Earned Income Credit.

Qualifying child and no earned income. A taxpayer with qualifying children and no earned income will not qualify for the Earned Income Credit.

EXAMPLE: Steve and Wendy are divorced. Wendy has custody of their three children. Steve pays alimony and child support to Wendy and claims the children as dependents. Wendy has no other source of income. The children are qualifying children for Wendy based on the relationship, age, and residency test. However, because she has no earned income, she does not qualify for the Earned Income Credit. Steve does not qualify for the Earned Income Credit as the children do not meet the residency test for him.

Qualifying Child of More Than One Person

If the child is the qualifying child of more than one person, only one person can claim the child as a qualifying child for the Earned Income Credit. The other person cannot take the Earned Income Credit unless he or she has a different qualifying child.

Tiebreaker rules. If the taxpayer and another person claim the same child as a qualifying child, the IRS will apply the following tiebreaker rules.

- If only one of the persons is the child's parent, the child will be treated as the qualifying child of the parent.
- If two of the persons are the child's parents, the child will be treated as the qualifying child of the parent with whom the child lived for the longer period of time in the year. If the child lived with each parent for the same amount of time, the child will be treated as the qualifying child of the parent who had the higher AGI for the year.
- If none of the persons is the child's parent, the child will be treated as the qualifying child of the person who had the highest AGI for the year.
- If a parent can claim the child as a qualifying child, but no parent claims the child, the child is treated as the qualifying child of the person who had the highest AGI for the year, but only if that person's AGI is higher than the highest AGI of any of the child's parents who can claim the child. If the child's parents file a joint return with each other and do not claim the child, this rule can be applied by dividing the parents' combined AGI equally between the parents.

EXAMPLE #1: Holly lives with her mother, Jane. Holly's three-year-old daughter, Ashley, also lives with Jane. Ashley's father is Ralph. Holly does not know where Ralph lives and has had no contact with him since Ashley's birth. Ashley meets the conditions to be a qualifying child of both Holly and Jane, but not Ralph. Holly can claim Ashley as a qualifying child since she is Ashley's parent. If Holly does not claim Ashley as a qualifying child, Jane can claim Ashley as a qualifying child only if Jane's AGI is higher than Holly's AGI. Ralph's AGI is irrelevant since Holly is not his qualifying child.

EXAMPLE #2: Assume the same facts as Example #1, except that Ralph also lives with Holly, Jane, and Ashley. Holly and Ralph file a joint return with an AGI of $20,000. Jane's AGI is $15,000. If Holly and Ralph do not claim Ashley as a qualifying child, Jane can claim Ashley because her AGI is higher than one-half of Holly and Ralph's AGI.

Other Dependency Rules

NOTES

Temporary absences for special circumstances, such as for school, vacation, business, medical care, military service, or detention in a juvenile facility, count as time lived with the taxpayer.

Relationships established by marriage do not end by divorce or at the death of a spouse.

Exception to time lived with the taxpayer. A person is considered to have lived with the taxpayer for all of the year if the person was born or died during the year, and the taxpayer's home was this person's home for the entire time he or she was alive.
Temporary absences for special circumstances, such as for school, vacation, business, medical care, military service, or detention in a juvenile facility, count as time lived with the taxpayer. Exceptions to time lived with the taxpayer also apply under the rules for children of divorced or separated parents and for a kidnapped child.

Kidnapped child. A child kidnapped by a non-family member may still be a qualifying child for purposes of EIC.

Foster child. A foster child is any child placed with the taxpayer by an authorized placement agency or by judgment, decree, or other order of any court of competent jurisdiction.

Adopted child. An adopted child is always treated as the taxpayer's child. An adopted child includes a child lawfully placed with the taxpayer for legal adoption.

Relationships. Relationships established by marriage do not end by divorce or at the death of a spouse.

Student. A child who during any part of five calendar months was enrolled as a full time student at a school, or took a full-time, on-farm training course given by a school or a state, county, or local government agency is considered to be a student. A school includes a technical, trade, or mechanical school but does not include an on-the-job training course, correspondence school, or internet school. "Full-time" is defined by the school. A student who registered for classes on August 28 was considered a full time student in August even though classes started in September. (Ltr. Rul. 9838027) Permanently and totally disabled. A person who cannot engage in any substantial gainful activity because of a physical or mental condition that a doctor has determined has lasted, or can be expected to last, continuously for at least a year or can be expected to lead to death.

Due Diligence Requirements

Form 8867, Paid Preparer's Due Diligence Checklist, must be completed and attached to the tax return when claiming the Earned Income Credit. Requirements for paid return tax preparers include (not a complete list):

- Computing the tax credit per the tax credit worksheet or equivalent worksheet,
- Not know or have reason to believe that any of the information used is incorrect, incomplete, or inconsistent,
- Retain Form 8867 and the tax credit worksheets or equivalent, and
- Determine that the taxpayer is eligible to claim the EIC and explain the tiebreaker rules to the taxpayer and that a qualifying child must have lived with the taxpayer for more than half the year.

Preparer Penalties

If the IRS finds that a tax preparer did not meet all due diligence requirements, he or she can be fined:

- A $530 penalty for each failure to comply with the requirements.
- A minimum $1,000 penalty for preparing a client return on which the IRS finds any part of the taxes owed is due to an unreasonable position.
- A minimum $5,000 penalty for preparing a client return on which the IRS finds any part of the taxes owed is due to the preparer's reckless or intentional disregard of the rules or regulations.
- A tax preparer who receives a return-related penalty can also face disciplinary action by the IRS Office of Professional Responsibility.

Learning Objective 4-B Self-Quiz

For answer, see Chapter 4 Self-Quiz Answers.
Test your knowledge and comprehension of information presented in Learning Objective 4-B.

Learning Objective 4-B.

Which of the following would qualify a taxpayer to claim the Earned Income Credit in 2019?

a) Having a Social Security Number on a card that reads "Valid for work only with DHS (or INS) authorization."
b) A taxpayer who files as Married Filing Separate.
c) A taxpayer with investment income of $3,750.
d) A taxpayer who is 65 years old at the end of the year.

Learning Objective 4-C

Compute the Child and Dependent Care Credit.

[1] Child and Dependent Care Expenses

Child and dependent care. A taxpayer may be able to claim a nonrefundable credit, or an exclusion from income, based on expenses paid for care of a dependent under the age of 13. The credit or exclusion is also available for amounts paid for the care of a spouse or dependent who is not able to care for himself or herself. To qualify, a taxpayer must pay these expenses so the taxpayer can work or look for work.

NOTES

To qualify, a taxpayer must pay these expenses so the taxpayer can work or look for work.

Exclusion or Credit

File Form 2441, *Child and Dependent Care Expenses,* to:

- Exclude dependent care benefits received under an employer plan from income.
- Claim a Credit for Child and Dependent Care Expenses.

Exclusion. Dependent care benefits are reported in box 10, Form W-2. The amount of benefits that can be excluded from income is the smallest of:

- $5,000 ($2,500 if MFS and not considered unmarried).
- Qualified expenses incurred during the year. It does not matter when the expenses were paid.
- The taxpayer's earned income.
- The spouse's earned income.

If benefits received are more than the amount that can be excluded, the excess is included in taxable wages on line 1, Form 1040, labeled "DCB." Dependent care benefits are not subject to FICA and Medicare tax even if included in taxable wages.

Credit. The credit is 20% to 35% of the smallest of:

- $3,000 ($6,000 for two or more qualifying persons).
- Qualified expenses incurred and paid in the year. Include expenses for care during the year that were paid in a prior year. Reduce expenses by dependent care benefits excluded from income.
- Taxpayer's earned income.
- Spouse's earned income.

Percentages are based on AGI. The $6,000 limit does not need to be divided equally among persons receiving care. For example, if expenses are $4,000 for one child and $2,000 for a second child, the taxpayer can use $6,000 to compute the credit.

Requirements

The taxpayer must meet the following requirements (qualifying person, place of abode, work related) to claim a credit or exclusion for child and dependent care expenses.

1) Qualifying person. Expenses must be paid for the care of a qualifying person.

- The taxpayer's qualifying child who was under age 13 when the care was provided and who can be claimed as a dependent.
- The taxpayer's spouse who is disabled and could not care for himself or herself.

- Any person who was not physically or mentally able to care for himself or herself, lived with the taxpayer for more than half the year, and either:
  - Was the taxpayer's dependent, or
  - Would have been the taxpayer's dependent except that: (1) he or she received gross income of $4,200 or more, (2) he or she filed a joint return, or (3) the taxpayer (or spouse) could be claimed as a dependent on someone else's return.

Persons qualifying for part of the year. A person's qualifying status is determined each day. For example, if a child reaches age 13 during the year, expenses for care provided until that time can be counted.

Qualifying child vs. qualifying relative. The Internal Revenue Code allows taxpayers who have a qualifying child to claim the dependent care credit. A person who is a qualifying relative but not a qualifying child is not a qualifying person for purposes of the dependent care credit.

EXAMPLE: John lives with his girlfriend and her son. John provides more than 50% support for the household. The child's father is deceased and John has not adopted the child. Even though there is no legal relationship between John and the child, the child qualifies as a qualifying relative. However, as a qualifying relative and not a qualifying child, John is not eligible to claim the dependent care credit.

2) Place of abode. The qualifying person must have lived with the taxpayer for more than half the year.

3) Work-related. Expenses must be for care provided so the taxpayer and spouse can work or actively look for work. No credit is allowed if a taxpayer actively looking for work does not find a job and has no earned income for the year. Volunteer work does not produce earned income for the taxpayer and therefore does not qualify under work-related activity.

Work for part of a year. If the taxpayer (or spouse) meets the criteria for only part of the period covered by qualifying expenses, expenses are computed for each day.

Spouse who is a student. A taxpayer's spouse is deemed to be gainfully employed during each month that they are a full-time student at an educational institution. *See Earned Income*.

KEY FACT: If the taxpayer is employed or actively seeking employment, an absence of two weeks or less is considered a temporary absence, and the costs of care do not need to be allocated on a per-day basis.

EXAMPLE: Roger worked for the entire year, but his wife, Angie, worked only through June 15. They paid $500 each month for childcare throughout the year. Their qualifying expenses are limited to $2,750 ($500 × 5½ months).

4) Payments to relatives. Expenses cannot be paid to the taxpayer's spouse, to the parent of the taxpayer's qualifying child under age 13, to the taxpayer's dependent, or to the taxpayer's child who is under age 19 at the end of the year (whether or not a dependent). Payments to other relatives, even if living with the taxpayer, qualify.

5) Provider identification. The provider's name, address, and taxpayer identification number must be reported on Form 2441.

6) Taxpayers filing Married Filing Separately. A taxpayer can claim a credit only if considered unmarried.

- The taxpayer and spouse lived apart the last six months of the year,
- A qualifying person lived in the taxpayer's home more than half the year, and
- The taxpayer provided over half the cost of keeping up the home.

Exclusion. Married taxpayers filing separately can exclude dependent care benefits from income. Unless the taxpayer qualifies to be considered unmarried, the exclusion is the smallest of (1) $2,500, (2) qualified expenses, (3) the taxpayer's earned income, or (4) the

NOTES

A person who is a qualifying relative but not a qualifying child is not a qualifying person for purposes of the dependent care credit.

No credit is allowed if a taxpayer actively looking for work does not find a job and has no earned income for the year.

spouse's earned income.

Exclusion if considered unmarried. If a taxpayer meets the tests, above, to be considered unmarried, the exclusion is the smallest of (1) $5,000, (2) qualified expenses, or (3) the taxpayer's earned income.

Earned Income

Earned income includes employee compensation, net earnings from self-employment, strike benefits, disability pay reported as wages, and scholarships reported on Form W-2. A net loss from self-employment reduces earned income.

Spouse who is a student or who is disabled. A spouse is treated as having earned income for any month (or part of a month) that he or she is a full-time student or unable to care for himself or herself. Monthly income is the higher of actual income, or $250 (if there is one qualifying person in the home), or $500 (more than one qualifying person). The rule applies to only one spouse for any one month. A full-time student is enrolled at and attending a school full-time for some part of five calendar months during the year. Schools do not include on-the-job training, correspondence schools, and night schools.

Credit. For the credit, earned income also includes nontaxable employee compensation such as parsonage allowances, meals and lodging furnished by the employer, voluntary salary deferrals, military basic quarters and subsistence allowances and in-kind quarters and subsistence, and military combat pay.

Exclusion. For the exclusion, earned income includes only taxable compensation. ***Exception:*** The taxpayer can elect to include nontaxable combat pay in earned income.

Unearned income. Payments for dependent care from income that is not earned are not eligible for the credit or exclusion. Income that is not earned includes:

- Pensions and annuities.
- Social Security and railroad retirement benefits.
- Workers' compensation.
- Interest and dividends.
- Unemployment compensation.
- Scholarship or fellowship grants, except for those reported on Form W-2 and paid to the taxpayer for teaching or other services.
- Nontaxable workfare payments.
- Child support payments received by the taxpayer.
- Income of nonresident aliens that is not effectively connected with a U.S. trade or business.
- Any amount received for work while an inmate in a penal institution.

EXAMPLE: Mary is a young widow who receives pension income from her late husband and Social Security income for her children, ages four and seven. She pays dependent care expenses so she can volunteer. Because the income is not earned income, and she is paying dependent care expenses for a purpose other than to work or to seek work, her payments are not eligible for the dependent care credit.

NOTES

Earned income includes only taxable compensation. Exception: The taxpayer can elect to include nontaxable combat pay in earned income.

Child and Dependent Care Expenses	
Qualified	**Not Qualified**
- Care outside the taxpayer's home for a qualifying person who regularly spends at least eight hours each day in the taxpayer's home. - Amounts paid for items other than care (food and schooling) if they are incidental to the care and cannot be separated from the total cost. - Before and after school care. - Day camps and similar programs even if they specialize in a particular activity. - Transportation provided by a childcare provider to or from a place that care is provided. - Household services, including cooks, maids, babysitters, or cleaners, if services were partly for the care of a qualifying person. - Employment taxes, meals, and extra lodging expenses for household employees.	- Schooling for a child in kindergarten or above. ***Clarification:*** The IRS has confirmed that kindergarten costs are educational and do not qualify for the credit. This includes costs paid for a full day of kindergarten at a private school in a district where public schools have half-day classes. Costs of pre-school do qualify even if the programs have some educational content. (T.D. 9354) - Cost of an overnight camp. - Expenses reimbursed by a state social service agency not included in income. - Child support payments. - Transportation of the care provider and transportation of a qualifying person not provided by a childcare provider.

NOTES

Medical expenses. Expenses that qualify as both medical deductions and dependent care can be deducted on Schedule A (Form 1040) or used to claim a dependent care credit, but not both. Amounts excluded from income under employer plans cannot be claimed as medical deductions.

Timing of payments. Expenses qualify for the credit in the year incurred or the year paid, whichever is later.

Expenses qualify for the credit in the year incurred or the year paid, whichever is later.

Prepaid expenses. Expenses cannot be claimed until the year care is provided. Include 2018 payments for care provided in 2019 as qualified expenses in 2019. Do not include 2019 payment of 2020 expenses until 2020.

Credit for prior year's expenses-2019 expenses paid in 2020. Calculate the 2020 credit without including these expenses. The taxpayer may increase the 2020 credit for expenses paid for 2019, but the calculation is based on gross income and dollar limits in 2019.

EXAMPLE: In 2019, Doug's day care expenses for his son were $3,200. He paid $800 of the expenses in 2020. Doug's 2019 credit was based on expenses of $2,400. Since he used only $2,400 of his $3,000 limit, Doug can claim a credit for 2019 expenses paid in 2020 up to $600. Doug's AGI in 2019 was $50,000. The credit is $120 (20% of $600). Doug increases his 2020 credit on line 9, Form 2441, by $120 and enters "CPYE."

Qualifying Child of More Than One Person

If the child is the qualifying child of more than one person, only one person can claim the child as a qualifying child for credit or exclusion for child and dependent care expenses.

Tiebreaker rules. No other person can take the credit or exclusion unless he or she has a different qualifying child. If the taxpayer and another person claim the same child as a qualifying child, the IRS will apply the tiebreaker rules. See *Tiebreaker rules, Learning Objective 4-B*.

Multiple Support Agreements

NOTES

If no one person contributed over half of the support of a relative, including a person who lived with the taxpayer all year as a member of the household, but the taxpayer and another person(s) combined provided more than half of the person's support, special rules may apply that would treat the taxpayer as having provided over half of the support.

Learning Objective 4-C Self-Quiz

For answer, see Chapter 4 Self-Quiz Answers.
Test your knowledge and comprehension of information presented in Learning Objective 4-C.

Learning Objective 4-C.

Which of the following meets the qualifications for child and dependent care expenses to be eligible for an exclusion or credit?

a) The qualifying child must be under age 13 at the end of the tax year for expenses to be eligible.
b) A qualifying person must have lived with the taxpayer for the entire year for expenses to be eligible.
c) Payments to all relatives for child care are eligible expenses.
d) Payments for child care so a spouse can attend classes as a full-time student are eligible expenses.

Learning Objective 4-D

Recognize who can claim the Child Tax Credit.

[1] Child Tax Credit

The same rules apply for determining a qualifying child for purposes of the Child Tax Credit as apply in determining a qualifying child for dependency purposes, with some additional requirements. This includes children of divorced or separated parents. *See Dependency Chart, Learning Objective 1-D*.

The same rules apply for determining a qualifying child for purposes of the Child Tax Credit as apply in determining a qualifying child for dependency purposes, with some additional requirements.

Requirements for qualifying child. A qualifying child for purposes of the Child Tax Credit is a child who:

- Is the taxpayer's son, daughter, stepchild, foster child, brother, sister, stepbrother, stepsister, or a descendant of any of them (for example, grandchild, niece, or nephew),
- Was under age 17 at the end of the tax year,
- Did not provide over half of his or her own support during the year,
- Lived with the taxpayer more than half of the tax year,
- Is claimed as a dependent on the taxpayer's return,
- Was a citizen, national, or resident of the United States.
- Is younger than the taxpayer claiming the child, and
- Does not file a joint return unless the return is filed to claim a refund and no tax liability would have existed had the child and spouse filed separately.

Qualifying relative. A dependent that is a qualifying relative is not eligible for the Child Tax Credit.

EXAMPLE: Becky and Tom have lived together for three years, along with Becky's daughter. Becky and Tom are not married. Tom is eligible to claim Becky's daughter as a dependent under the qualifying relative rules. Although Tom is entitled to claim Becky's daughter as a dependent, he does not qualify to claim the Child Tax Credit because the dependency was based on qualifying relative rules instead of qualifying child rules.

Adopted child. An adopted child is always treated as the taxpayer's own child. An adopted child is a child legally placed with the taxpayer for adoption. If the taxpayer is a U.S. citizen or U.S. national, and the adopted child lived with the taxpayer all year as a member of the taxpayer's household, the child is a qualifying child for the Child Tax Credit.

Exceptions for time lived with the taxpayer. A child is considered to have lived with the taxpayer for the entire year if the child was born or died during the year, and the taxpayer's home was the child's home for the entire time he or she was alive. Temporary absences 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 the taxpayer.

Child tax credit tied to claim for dependency. Only the taxpayer who claims the child as a dependent is entitled to the Child Tax Credit. Although tax benefits involving children may be split in certain circumstances, such as when a custodial parent releases the dependency claim to a noncustodial parent, the dependency claim and the Child Tax Credit cannot be split.

EXAMPLE: Bernie and Betty are divorced and have a son, Richard. Betty is Richard's custodial parent. In accordance with the divorce decree, Betty releases her dependency claim, which allows Bernie to claim Richard as a dependent on his tax return. Only Bernie is allowed to claim the Child Tax Credit.

Credit amount. A taxpayer is entitled to a Child Tax Credit in the amount of $2,000 for each qualifying child. The regular Child Tax Credit is nonrefundable. Credit that is unused because tax liability is reduced to zero is lost.
Exception: For taxpayers below a certain income level, a portion of the Child Tax Credit can be claimed as an Additional Child Tax Credit, which is refundable.

AGI phaseout. The Child Tax Credit is reduced by $50 for each $1,000 (or fraction thereof) of modified AGI above:

- $400,000 Married Filing Jointly.
- $200,000 Single, Head of Household, or Qualifying Widow(er), and Married Filing Separately.

EXAMPLE: Denny has a child who is a qualifying child for purposes of the Child Tax Credit. Denny claims Head of Household filing status. His modified AGI for the year is $205,000. Denny's Child Tax Credit amount is $1,750 ($2,000 minus $50 for each thousands of modified AGI above $200,000).

Modified AGI. Modified AGI consists of AGI from line 8b, Form 1040, plus excluded income from Puerto Rico, foreign income from lines 45 and 50, Form 2555, *Foreign Earned Income,* and income from line 15, Form 4563, *Exclusion of Income for Bona Fide Residents of American Samoa.*

Tax ID required. To claim the Child Tax Credit or Additional Child Tax Credit, the taxpayer (and spouse if filing jointly) must have a Social Security number (SSN) or individual taxpayer identification number (ITIN) by the tax filing due date (including extensions). Any child use to claim the credit must also have an SSN valid for employment issued by the due date of the return (including extensions).
Note: A qualifying child who is ineligible for the Child Tax Credit because that child did not have a SSN may qualify for the Credit for Other Dependents. See *Credit for Other Dependents*.

Prevention of retroactive claims of the Child Tax Credit. The Child Tax Credit is denied to any taxpayer for any tax year for which his or her identification number was issued after the due date for filing the tax return for that year. A qualifying child is not taken into account for any tax year for which the child is associated with a Social Security Number that was issued after the due date for filing the tax return for that year.

Additional Child Tax Credit

Although the regular Child Tax Credit is not refundable, the portion that was not used because tax liability was reduced to zero may be allowed as an Additional Child Tax Credit, which is refundable.

Note: The portion of the Child Tax Credit phased out because of AGI cannot be used to claim the Additional Child Tax Credit.

NOTES

Although tax benefits involving children may be split in certain circumstances, such as when a custodial parent releases the dependency claim to a noncustodial parent, the dependency claim and the Child Tax Credit cannot be split.

The portion of the Child Tax Credit phased out because of AGI cannot be used to claim the Additional Child Tax Credit.

NOTES

Maximum Additional Child Tax Credit. The maximum amount allowed for the Additional Child Tax Credit is based on the number of qualifying children.

Taxpayers with one or two children. For taxpayers with one or two qualifying children, the maximum Additional Child Tax Credit is the lesser of:
- $1,400 per child,
- The disallowed portion of the regular Child Tax Credit, or
- 15% of the taxpayer's earned income in excess of $2,500.

Taxpayers with three or more children. For taxpayers with more than two qualifying children, the maximum Additional Child Tax Credit is the lesser of:
- $1,400 per child,
- The disallowed portion of the regular Child Tax Credit, or
- The larger of:
  - 15% of earned income in excess of $2,500.
  - FICA and Medicare tax paid minus Earned Income Credit. Calculate on lines 7 through 12, Schedule 8812.

KEY FACT: Earned income includes only taxable earned income and nontaxable combat pay.

EXAMPLE: Brenda is unmarried. She has two children and qualifies for Head of Household filing status. Brenda's only income for 2019 is $ 37,000 in wages. She claims the standard deduction. Brenda's regular Child Tax Credit and Additional Child Tax Credit are computed as follows.

AGI		**$ 37,000**
Standard deduction		**($ 18,350)**
Taxable income		**$ 18,650**
Federal income tax		**$ 1,964**
Regular Child Tax Credit	**($ 4,000 limited to tax liability)**	**$ 1,964**
Unused portion of regular Child Tax Credit	**($ 4,000 minus $ 1,964)**	**$ 2,036**
15% of earned income in excess of $ 2,500	**($ 34,500 × 15%)**	**$ 5,175**
Additional Child Tax Credit (refundable, $2,800 limit)		**$ 2,036**

Schedule 8812 (Form 1040), *Additional Child Tax Credit*. The Child Tax Credit and Credit for Other Dependents are claimed directly on line 13a, Form 1040. No additional form needs to be filed.
Schedule 8812 (Form 1040) is used to compute the refundable Additional Child Tax Credit.

Foreign earned income exclusion rules. The Additional Child Tax Credit is not allowed for any taxpayer if the taxpayer elects to exclude income under the foreign earned income exclusion rules.

Effect on welfare benefits. Any refund received as a result of taking the Additional Child Tax Credit will not be used to determine if the taxpayer is eligible for the following programs or how much the taxpayer can receive from them. However, if the refund received from the Additional Child Tax Credit is not spent within a certain period of time, it may count as an asset or resource and affect eligibility.

- Temporary Assistance for Needy Families (TANF).
- Medicaid and Supplemental Insurance Income (SSI).
- Supplemental Nutrition Assistance Program (SNAP) (food stamps) and low-income housing.

Credit for Other Dependents

For tax years 2018 through 2025, a $500 nonrefundable credit is available for qualifying dependents other than dependents who qualify for the Child Tax Credit. Generally, the definition of dependent remains the same, except that a dependent for purposes of claiming this credit does not include a resident of Canada or Mexico.

Note: The Social Security Number requirement for the Child Tax Credit and Additional Child Tax Credit does not apply for the Credit for Other Dependents.

Due Diligence Requirements

Due diligence requirements must be met for taxpayers claiming the Child Tax Credit (CTC), Additional Child Tax Credit (ACTC), or the Credit for Other Dependents (ODC). The tax preparer must complete Form 8867, *Paid Preparer's Due Diligence Checklist,* and attach it to the return.

In the case of these credits, the tax preparer must:

- Determine that each qualifying person for the CTC/ACTC/ODC is the taxpayer's dependent who is a citizen, national, or resident of the United States,
- Explain to the taxpayer that he or she may not claim the CTC/ACTC if the taxpayer has not lived with the child for over half of the year, even if the taxpayer has supported the child, unless the child's custodial parent has released a claim to exemption for the child, and
- Explain to the taxpayer the rules about claiming the CTC/ACTC/ODC for a child of divorced or separated parents (or parents who live apart), including any requirement to attach a Form 8332, *Release/Revocation of Claim to Exemption for Child by Custodial Parent,* or similar statement.

Learning Objective 4-D Self-Quiz

For answer, see *Chapter 4 Self-Quiz Answers*.

Test your knowledge and comprehension of information presented in Learning Objective 4-D.

Learning Objective 4-D.

Under what circumstances must Schedule 8812 (Form 1040) be used?

a) If a qualifying relative is claimed for the Child Tax Credit.
b) If an adopted child is being claimed for the Child Tax Credit.
c) If the Additional Child Tax Credit is claimed.
d) If the Child Tax Credit is to be claimed by a parent who does not claim the child as a dependent.

Learning Objective 4-E

Calculate the excess Social Security amount withheld for a taxpayer.

[1] Social Security Earnings Records

Social Security benefits are based upon an individual's earnings as reported to the Social Security Administration (SSA). These earnings are used to determine whether an individual is eligible to retirement, survivors, disability, and health insurance benefits. They are also used to calculate cash benefit rates.

An individual's earnings record shows the amount of earnings reported by his or her employer or by the individual, if he or she is self-employed. It also shows the periods for which the earnings were reported.

Employees. Reports of earnings must be filed annually with SSA by every employer who:

- Is required to withhold income tax from wages, and/or
- Is liable for Federal Insurance Contributions Act (FICA) taxes (also known as Social Security and Medicare taxes).

An individual's Social Security and Medicare taxes are deducted when wages are paid and reported to the employee annually on Form W-2, *Wage and Tax Statement.*

NOTES

The Social Security Number requirement for the Child Tax Credit and Additional Child Tax Credit does not apply for the Credit for Other Dependents.

An individual's Social Security and Medicare taxes are deducted when wages are paid and reported to the employee annually on Form W-2, Wage and Tax Statement.

NOTES

More than one employer. If an individual works for more than one employer, he or she may not have to pay all the taxes deducted by the employers. This is due to the fact that the tax is deducted on wages paid by each employer up to the maximum wages creditable for Social Security. The total deducted may be more than the individual owes. Any excess may be claimed as a credit against the individual's income tax when filing his or her income tax return for that year.

Self-employed. A self-employed individual must pay the self-employment tax quarterly to the IRS. He or she must pay any remaining balance due when he or she files a federal income tax return for the taxable year. The IRS reports the earnings to SSA for posting to the individual's earnings record.

Self-employment tax. Social Security taxes are paid on self-employment income up to the maximum amount creditable for the year. Medicare taxes are paid on all self-employment income as there is no yearly maximum.

Partnership earnings. A partner in a partnership should include his or her share of the partnership net earnings or loss from self-employment on his or her individual tax return.

Excess Social Security and RRTA Tax Withheld

Excess Social Security and Tier 1 RRTA. Most employers must withhold Social Security tax from a taxpayer's wages. If the taxpayer works for a railroad employer, that employer must withhold Tier 1 railroad retirement (RRTA) tax and Tier 2 RRTA tax.

If a taxpayer earned more than $132,900 in 2019 and had more than one employer, he or she can claim the excess Social Security or Tier 1 RRTA tax withheld as a credit against his or her income tax.

Tier 2. If a taxpayer had two railroad employers, see IRS Pub. 505, *Tax With-holding and Estimated Tax,* to calculate any excess Tier 2 tax. The excess must be claimed using Form 843, *Claim for Refund and Request for Abatement,* and cannot be claimed on Form 1040.

KEY FACT: All wages are subject to Medicare tax withholding.

Employer's error. If anyone employer withheld too much Social Security or Tier 1 RRTA tax, the taxpayer cannot take the excess as a credit against his or her income tax. The employer should adjust the tax for the taxpayer. If the employer doesn't adjust the over collection, the taxpayer can file a claim for refund using Form 843, *Claim for Refund and Request for Abatement.*

If anyone employer withheld too much Social Security or Tier 1 RRTA tax, the taxpayer cannot take the excess as a credit against his or her income tax.

Joint return. If the taxpayer is filing a joint return, he or she cannot add the Social Security or Tier 1 RRTA tax withheld from his or her spouse's wages to the amount withheld from the taxpayer's wages. Compute the withholding separately for both the taxpayer and his or her spouse to determine if either has excess withholding.

How to calculate the credit if the taxpayer did not work for a railroad.

If the taxpayer did not work for a railroad during 2019, compute the credit as follows:

1) Add all Social Security tax withheld (but not more than $8,239.80 for each employer).
2) Enter any uncollected Social Security tax on tips or group-term life insurance included in the total on line 8, Schedule 2 (Form 1040), *Additional Taxes,* identified by "UT."
3) Add the amounts from 1 and 2. If the total is $8,239.80 or less, stop here. The taxpayer does not get a credit.
4) Subtract $8,239.80 from the amount in step 3 and include the result on line 11, Schedule 3 (Form 1040), *Additional Credits and Payments.*

EXAMPLE: Fred and Ethel are married and file a joint return. Ethel had no gross income in 2019. During 2019, Fred worked for the Brown Technology Company and earned $80,000 in wages. Social Security tax of $4,960.00 was withheld. Fred also worked for another employer in 2019 and earned $60,000 in wages. $3,720.00 of Social Security tax was withheld from these wages. Because Fred worked for more than one employer and his total wages were more than $132,900, he can take a credit of $440.20 [($4,960.00 + $3,720.00) - $8,239.80] for the excess Social Security tax withheld.

How to calculate the credit if the taxpayer worked for a railroad. If the taxpayer was a railroad employee at any time during 2019, compute the credit as follows:

NOTES

1) Add all Social Security and Tier 1 RRTA tax withheld at the 6.2% rate (but not more than $8,239.80 for each employer).
2) Enter any uncollected Social Security and Tier 1 RRTA tax on tips or group term life insurance included in the total on line 8, Schedule 2 (Form 1040), *Additional Taxes,* identified by "UT."
3) Add the amounts from 1 and 2. If the total is $8,239.80 or less, stop here. The taxpayer does not get a credit.
4) Subtract $8,239.80 from the amount in step 3 and include the result on line 11, Schedule 3 (Form 1040), *Additional Credits and Payments.*

Learning Objective 4-E Self-Quiz

For answer, see *Chapter 4 Self-Quiz Answers,* below.

Test your knowledge and comprehension of information presented in Learning Objective 4-E.

Learning Objective 4-E.

Marcus only had one employer in 2019. His employer withheld $8,680.00 of Social Security tax. How does Marcus handle the $440.20 of excess Social Security tax withheld?

a) Marcus can take a $440.20 deduction on line 14, Schedule 1, *Additional Income and Adjustments to Income.*

b) Marcus can take a $440.20 credit on line 11, Schedule 3, *Additional Credits and Payments.*

c) Marcus needs to ask his employer to correct the error.

d) There was no excess Social Security tax withheld because all wages are subject to Social Security tax withholding.

Chapter 4 Self-Quiz Answers

Learning Objective 4-A.

How much of the American Opportunity Credit is refundable for most taxpayers?

a) 0%
Incorrect. 40% of the American Opportunity Credit is refundable for most taxpayers.

b) 40%
Correct. 40% of the American Opportunity Credit is refundable for most taxpayers. (pg. 64)

c) 60%
Incorrect. Only 40% of the American Opportunity Credit is refundable for most taxpayers.

d) 100%
Incorrect. Only 40% of the American Opportunity Credit is refundable for most taxpayers.

Learning Objective 4-B.

Which of the following would qualify a taxpayer to claim the Earned Income Credit in 2019?

a) Having a Social Security Number on a card that reads "Valid for work only with DHS (or INS) authorization."
Correct. A taxpayer with a Social Security Number on a card that reads "Valid for work only with DHS (or INS) authorization" is one of the criteria that qualifies for claiming the Earned Income Credit.

b) A taxpayer who files as Married Filing Separate.
Incorrect. A taxpayer who files as Married Filing Separate does not qualify for the Earned Income Credit.

c) A taxpayer with investment income of $3,750.
Incorrect. In 2019, a taxpayer's investment income must not exceed $3,600 to qualify for the Earned Income Credit.

d) A taxpayer who is 65 years old at the end of the year.
Incorrect. A taxpayer must be under age 65 to qualify for the Earned Income Credit.

Learning Objective 4-C.

NOTES

Which of the following meets the qualifications for child and dependent care expenses to be eligible for an exclusion or credit?

a) The qualifying child must be under age 13 at the end of the tax year for expenses to be eligible.
   Incorrect. There is no requirement that the child be under 13 at the end of the year. If the child reaches age 13 during the year, expenses for care until that time can be counted.

b) A qualifying person must have lived with the taxpayer for the entire year for expenses to be eligible.
   Incorrect. The qualifying person must have lived with the taxpayer more than half of the year, but is not required to live with the taxpayer for the entire year.

c) Payments to all relatives for child care are eligible expenses.
   Incorrect. Expenses cannot be paid to the taxpayer's spouse, to the parent of the qualify child, to a taxpayer's dependent, or to a taxpayer's child who is under age 19 at the end of the year. Payments to other relatives qualify.

d) Payments for child care so a spouse can attend classes as a full-time student are eligible expenses.
   Correct. A taxpayer's spouse is deemed to be gainfully employed during each month they are a full-time student at an educational institution. Expenses for child care incurred so the spouse can attend classes are eligible expenses.

Learning Objective 4-D.

Under what circumstances must Schedule 8812 (Form 1040) be used?

a) If a qualifying relative is claimed for the Child Tax Credit.
   Incorrect. Only qualifying children can be claimed for the Child Tax Credit. If a child is a qualifying relative but not a qualifying child, the Credit for Other Dependents may be claimed.

b) If an adopted child is being claimed for the Child Tax Credit.
   Incorrect. An adopted child is a child legally placed with the taxpayer for adoption. An adopted child is always treated as the taxpayer's own child. The taxpayer does not have to complete Schedule 8812 in this case.

c) If the Additional Child Tax Credit is claimed.
   Correct. Schedule 8812 (Form 1040) must be completed to claim the Additional Child Tax Credit.

d) If the Child Tax Credit is to be claimed by a parent who does not claim the child as a dependent.
   Incorrect. Only the parent who claims a child as a dependent can claim the Child Tax Credit.

Learning Objective 4-E.

Marcus only had one employer in 2019. His employer withheld $8,680.00 of Social Security tax. How does Marcus handle the $440.20 of excess Social Security tax withheld?

a) Marcus can take a $440.20 deduction on line 14, Schedule 1, *Additional Income and Adjustments to Income.*
   Incorrect. Line 14, Schedule 1 is where the taxpayer includes the deductible part of his or her self-employment tax. Because the excess Social Security was withheld by only one employer, the employer must correct the error.

b) Marcus can take a $440.20 credit on line 11, Schedule 3, *Additional Credits and Payments.*
   Incorrect. This would be correct if the excess Social Security had been due to Marcus having more than one employer. However, since the excess Social Security was withheld by only one employer, the employer must correct the error.

c) Marcus needs to ask his employer to correct the error.
   Correct. Since the excess Social Security was withheld by only one employer, the employer must correct the error. If the employer does not correct the error, Marcus can claim a refund by filing Form 843, *Claim for Refund and Request for Abatement.*

d) There was no excess Social Security tax withheld because all wages are subject to Social Security tax withholding
Incorrect. All wages are subject to Medicare tax withholding but only $132,900 of wages in 2019 are subject to Social Security tax withholding. Since the excess Social Security was withheld by only one employer, the employer must correct the error.

NOTES

5 Miscellaneous Topics

Learning Objectives

NOTES

Successful completion of this course will enable the participant to:

5-A Identify who might need to make estimated tax payments.
5-B Recognize the various options a taxpayer has when he or she has a balance due.
5-C Identify situations when someone other than the taxpayer may sign the return on behalf of the taxpayer.
5-D Recognize unique tax situations for various occupations.
5-E Recognize various misconceptions taxpayers have regarding taxes.

Glossary Terms

Parsonage allowance. A parsonage allowance is housing specifically provided as part of the compensation for the services performed as a minister of the gospel.

Refund offset. A refund offset is when all or part of a refund is used to pay a past-due debt.

Learning Objective 5-A

Identify who might need to make estimated tax payments.

The federal income tax system is a pay as you go system. This means that taxpayers are supposed to pay tax as income is earned throughout the year. Taxpayers can do this through withholdings, estimated tax payments, or a combination of the two.

This means that taxpayers are supposed to pay tax as income is earned throughout the year.

KEY FACT: The actual amount of tax due on income is not known until a tax return is completed.

Withholdings

Income tax is generally withheld from the following types of income:

- Salaries and wages.
- Tips.
- Taxable fringe benefits.
- Sick pay.
- Pensions and annuities.
- 401(k) and IRA distributions.
- Gambling winnings.
- Unemployment compensation.
- Certain federal payments such as Social Security benefits.

If taxpayers have income tax withheld, 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 Form 1099.

KEY FACT: If a paper return must be filed, any form (W-2, W-2G, etc.) that shows taxes withheld needs to be attached to the return.

[1] Estimated Tax Payments

Estimated tax is the method used to pay tax on income that is not subject to withholding. This includes income from self-employment, interest, dividends, rent, gains from the sale of assets, prizes, and awards. A taxpayer also may have to pay estimated tax if the amount of income tax being withheld from his or her salary, pension, or other income is not enough.

Estimated tax is used to pay both income tax and self-employment tax, as well as other taxes and amounts reported on the tax return. If a taxpayer does not pay enough tax, either through withholding, estimated tax, or a combination of both, he or she may have to pay a penalty. If a taxpayer does not pay enough by the due date of each payment period, he or she may also be charged a penalty even if he or she is due a refund when the tax return is filed.

NOTES

If a taxpayer does not pay enough tax, either through withholding, estimated tax, or a combination of both, he or she may have to pay a penalty.

Who does not have to pay estimated tax? If a taxpayer receives salaries and wages, he or she may be able to avoid paying estimated tax by asking his or her employer to take more tax out of his or her earnings. Taxpayers receiving a pension or annuity can similarly increase the amount they are having withheld.

Estimated tax not required. A taxpayer does not have to pay estimated tax if he or she meets all three of the following conditions.

1) The taxpayer had no tax liability for the previous year,
2) The taxpayer was a U.S. citizen or resident alien for the whole year, and
3) The taxpayer's previous tax year covered a 12-month period.

Who must pay estimated tax? In most cases, a taxpayer must pay estimated tax for the year if both of the following apply.

1) The taxpayer expects to owe at least $1,000 in tax for the year, after subtracting his or her withholding and refundable credits, and
2) The taxpayer expects his or her withholding and refundable credits to be less than the smaller of:
   a) 90% of the tax to be shown on his or her current year's tax return, or
   b) 100% of the tax shown on his or her prior year tax return (110% if prior year's adjusted gross income was greater than $150,000/$75,000 MFS).

Farmers and fishermen have different estimated tax payment requirements

Married taxpayers. If a taxpayer and his or her spouse qualify to make joint estimated tax payments, apply the following rules to the joint estimated income. A taxpayer and his or her spouse can make joint estimated tax payments even if they are not living together. However, the taxpayer and spouse cannot make joint estimated tax payments if:

- They are legally separated under a decree of divorce or separate maintenance,
- They have different tax years, or
- Either spouse is a nonresident alien (unless that spouse elected to be treated as a resident alien for tax purposes).

If the taxpayer and spouse do not qualify to make joint estimated tax payments, apply these rules to each spouse's separate estimated income. Making joint or separate estimated tax payments will not affect the choice of filing a joint tax return or separate returns for the tax year.

Current year separate returns and next year joint return. If the taxpayer and spouse plan to file a joint return for the upcoming year, but they filed separate returns for the current year, their current year tax is the total of the tax shown on their separate returns. The taxpayer and spouse filed separate returns if they filed as Single, Head of Household, or Married Filing Separately.

Current year joint return and next year separate returns. If the taxpayer and spouse plan to file separate returns for the upcoming year, but they filed a joint return for the current year, their current year's tax is their share of the tax on the joint return.

To compute the taxpayer's and spouse's share of the tax on the joint return, first figure the tax both would have paid had they filed separate returns for the current year using the same filing status as for the upcoming year. Then multiply the tax on the joint return by the following fraction.

$$\frac{\text{The tax that would have been paid by the spouse had each spouse filed a separate return}}{\text{The total tax the spouses would have paid had they filed separate returns}}$$

EXAMPLE: Joe and Heather filed a joint return for 2019 showing taxable income of $48,500 and a tax of $5,432. Of the $48,500 taxable income, $40,100 was Joe's and the rest was Heather's. For 2020, they plan to file Married Filing Separately. Joe computes his share of the tax on the 2019 joint return as follows.

Tax on $40,100 based on a separate return..$4,686
Tax on $8,400 based on a separate return.. 843
Total $5,529
Joe's percentage of total ($4,686 ÷ $5,529) 85%
Joe's share of tax on joint return ($5,432 × 85%) $4,617

NOTES

Overpayment applied from prior year. Taxpayers who overpay their income taxes in one year can apply all or part of their refund to the next year's estimated tax.

Taxpayers who overpay their income taxes in one year can apply all or part of their refund to the next year's estimated tax

Learning Objective 5-A Self-Quiz

For answer, see *Chapter 5 Self-Quiz Answers*.
Test your knowledge and comprehension of information presented in Learning Objective 5-A.

Learning Objective 5-A.

Which of the following taxpayers should pay estimated tax for 2019?

a. After subtracting his withholding and refundable credits of $4,000 from the $5,000 of tax expected on his 2019 return, Howard is going to owe $1,000. The tax shown on Howard's 2018 return was $4,500.
b. After subtracting his withholding and refundable credits of $11,000 from the $12,000 of tax expected on his 2019 return, Raj is going to owe $1,000. The tax shown on Raj's 2018 return was $12,000.
c. After subtracting his withholding and refundable credits of $15,000 from the $17,000 of tax expected on his 2019 return, Sheldon is going to owe $2,000. Sheldon's AGI in 2018 was $100,000 and the tax shown on his 2018 return was $15,000.
d. After subtracting his withholding and refundable credits of $1,000 from the $2,000 of tax expected on his 2019 return, Leonard is going to owe $1,000. Leonard is a US citizen for all of 2019 and he had no tax liability on his 2018 return which covered a 12-month period.

Learning Objective 5-B

Recognize the various options a taxpayer has when he or she has a balance due.

Once the return is completed, a taxpayer may be entitled to a refund or owe additional tax. In either case, he or she has several choices on how to receive the refund or pay the amount owed.

[1] Refunds

If a taxpayer is receiving a refund, he or she as the following options.

- Apply all or a portion of the refund to the following tax year.
- Receive all or part of the refund using direct deposit to a checking or savings account.
- Receive all or part of the refund as a check.
- Purchase Series I Savings Bonds.

Direct deposit. A taxpayer may choose to have his or her refund deposited directly into his or her account at a bank, credit union, or other financial institution, or to an IRA. Direct deposits are usually received within three weeks of the return being accepted. A check on the other hand is usually not mailed until six to eight weeks after the return is filed.

Direct deposits are usually received within three weeks of the return being accepted.

KEY FACT: Direct deposit refunds are received faster than checks and eliminate the possibility of a check being lost or stolen.

Multiple accounts. A taxpayer may choose to have his or her refund deposited in up to three accounts. Form 8888, *Allocation of Refund (Including Savings Bond Purchases),* is used to split the refund into more than one account, or to purchase paper Series I Savings Bonds.

Note: A tax preparer cannot use Form 8888 to allow a taxpayer to pay the preparation fee from his or her refund. IRC section 6695(f) imposes a $530 (2019) penalty per check for tax preparers who endorse or negotiate the taxpayer's refund check. Even though the IRC, and Circular 230, mention a check, Treasury Decision 9668 clarified this by adding "including directing or accepting payment by any means, electronic or otherwise, into an account owned or controlled by the practitioner or any firm or other entity with whom the practitioner is associated."

Delayed refunds for returns claiming certain credits. By law, the IRS cannot issue refunds before February 15 for returns that claim the Earned Income Credit and/or the Additional Child Tax Credit. This allows additional time to help prevent revenue lost due to identity theft and refund fraud related to fabricated wages and withholdings.

[2] **Refund offsets.** If the taxpayer owes past-due federal tax, state income tax, state unemployment compensation debts, child support, spousal support, or certain federal nontax debts, such as student loans, all or part of the overpayment may be used to pay the past-due amount. The taxpayer will receive a written notice of the offset.

Amount Due

If a taxpayer owes additional on his or her return, there are several options for payment available.

Direct debit. The taxpayer can e-file and authorize an electronic funds withdrawal by providing account and routing numbers for his or her financial institution. The payment may be scheduled for withdrawal on a future date, but must be effective on or before the return due date. If a return is filed after the due date, then the date must be the same as the date the return is filed or within the previous five days of that date.

Direct Pay. The IRS Direct Pay website allows taxpayers to pay a 1040 tax bill or make estimated payments directly from their checking or savings account. The taxpayer receives instant confirmation the payment has been submitted. The system allows payments for current and prior years.

Check or money order. Checks or money orders should be made payable to "United States Treasury." The tax year, form, name, address, daytime phone number and the SSN shown first on the return should be written on the payment.

Pay by cash. Cash is a payment option provided through retail partners with a maximum of $1,000 per day per transaction. To pay by cash, the taxpayer must make the payment in person and must be registered online at www.officialpayments.com/fed.

Credit card or debit card. The taxpayer can pay via credit card or debit card. The various service providers can be found online at: www.irs.gov/payments/pay-taxes-by-credit-or debit-card. Each service provider charges a fee that varies by provider, card type, and payment amount.

Unable to Pay

If a taxpayer cannot pay the amount due, he or she should pay as much as possible with the return. This will reduce penalties and interest. Once the taxpayer receives a notice, he or she can pay the remaining amount in full or choose another payment option if more time is needed.

Form 9465, *Installment Agreement Request.* A taxpayer requesting a monthly installment plan should file Form 9465 or apply online. Even if a taxpayer enters into a payment plan with the IRS, interest and penalties continue to accrue until the amount owed is paid in full. There are a number of payment plans available for taxpayers who cannot pay the full amount owed.

Short-term payment plan. Short-term payment plans are for taxpayers who can pay the full amount within 120 days of the return due date. To apply taxpayers can call the IRS or fill out an online application. There is no setup fee for a short-term payment plan.

NOTES

The payment may be scheduled for withdrawal on a future date, but must be effective on or before the return due date.

If a taxpayer cannot pay the amount due, he or she should pay as much as possible with the return.

NOTES

3-year installment agreement. Taxpayers who owe $10,000 or less may enter into a 3-year installment agreement with the IRS. Approval for 3-year installment agreements is guaranteed if certain conditions are met.

6-year installment agreement. For taxpayers needing more than three years or who owe more than $10,000, a 6-year installment agreement option is available. If a taxpayer owes more than $25,000, direct debit is required.

Fees. Except for the short-term (120 days or less) payment plan, the IRS charges a user fee to enter into or change an installment agreement. The fee varies depending on how the taxpayer applies (online or by phone, mail, or in person) and whether or not the taxpayer agrees to have the payments directly debited from his or her account.

Installment Agreement User Fees*	
Direct debit via online payment agreement.	$31
Direct debit without online payment agreement.	$107
Online payment agreement without direct debit.	$149
No online payment agreement and no direct debit.	$225
Online change to an existing installment agreement.	$10
Change to an existing installment agreement by phone, mail, or in-person.	$89
*Taxpayers who have been identified as low-income may have the fees waived or reduced. Taxpayers not identified as low-income, but who believe they are, may submit Form 13844, *Application for Reduced User Fee for Installment Agreements*, to the IRS within 10 days from the date of the installment agreement acceptance letter to request the IRS reconsider their status.	

Learning Objective 5-B Self-Quiz

For answer, see *Chapter 5 Self-Quiz Answers*.
Test your knowledge and comprehension of information presented in Learning Objective 5-B.

Learning Objective 5-B.

Which of the following is not an option for paying a balance due?

a. Direct debit.
b. Cash.
c. Credit card.
d. Cryptocurrency.

Learning Objective 5-C

Identify situations when someone other than the taxpayer may sign the return on behalf of the taxpayer.

Signatures

For a joint return, both the taxpayer and spouse must sign the return, even if only one of them had income.

The taxpayer must sign and date the return. For a joint return, both the taxpayer and spouse must sign the return, even if only one of them had income.

KEY FACT: **If the taxpayer is due a refund, it cannot be issued unless he or she signed the return.**

When someone can sign on behalf of the taxpayer. A taxpayer can appoint an agent to sign his or her return if the taxpayer is:

- Unable to sign the return because of disease or injury,
- Absent from the United States for a continuous period of at least 60,
- Days before the due date for filing the return, or
- Given permission to do so by the IRS office in the taxpayer's area.

Power of attorney. A return signed by an agent in any of these cases must have a power of attorney (POA) attached that authorizes the agent to sign for the taxpayer. The taxpayer can use a POA that states that the agent is granted authority to sign the return, or the taxpayer can use Form 2848, *Power of Attorney and Declaration of Representative.* Part I of Form 2848 must state that the agent is granted authority to sign the return.

NOTES

Court-appointed, conservator, or other fiduciary. If the taxpayer is a mentally or physically incompetent individual who has to file a tax return, a court-appointed conservator, guardian, or other fiduciary may sign his or her name for the individual. The individual should also file Form 56, *Notice Concerning Fiduciary Relationship,* with the IRS.

Unable to sign. If the taxpayer is mentally competent but physically unable to sign the return or POA, a valid "signature" is defined under state law. It can be anything that clearly indicates the taxpayer's intent to sign. For example, the taxpayer's "X" with the signatures of two witnesses might be considered a valid signature under a state's law.

Signing a joint return. For a return to be considered a joint return, both spouses generally must sign the return.

Spouse died before signing. If a spouse died before signing the return, the executor or administrator must sign the return for the spouse. If neither the surviving taxpayer nor anyone else has yet been appointed as executor or administrator, the surviving taxpayer can sign the return for his or her spouse and enter "Filing as surviving spouse" in the area where the return is signed.

Spouse away from home. If one of the spouses is away from home, the return should prepare and signed, and it should then be sent to the other spouse to sign so that it can be filed on time.

Injury or disease prevents signing. If a spouse cannot sign because of disease or injury and tells the other spouse to sign for him or her, the signing spouse can sign his or her spouse's name in the proper space on the return followed by the words "By (signor's name), Husband (or Wife)." The signing taxpayer also needs to be sure to sign in the space provided for his or her signature. A dated statement, signed by signing taxpayer, should be attached to the return. The statement should include the form number of the return being filed, the tax year and the reason the other spouse cannot sign, and it should state that the one spouse has agreed to the other spouse signing for him or her.

Signing as guardian of spouse. If one taxpayer is the guardian of his or her spouse who is mentally incompetent, he or she can sign the return for his or her spouse as guardian.

If one taxpayer is the guardian of his or her spouse who is mentally incompetent, he or she can sign the return for his or her spouse as guardian.

Spouse in combat zone. A taxpayer can sign a joint return for his or her spouse if his or her spouse cannot sign because he or she is serving in a combat zone (such as the Persian Gulf Area, Serbia, Montenegro, Albania, or Afghanistan), even if the signing taxpayer does not have a power of attorney or other statement. Attach a signed statement to the return explaining that the spouse is serving in a combat zone.

Other reasons spouse cannot sign. If one of the spouses cannot sign the joint return for any other reason, the other spouse can sign for his or her spouse only if he or she is given a valid power of attorney. Attach the power of attorney (or a copy of it) to the tax return. Form 2848, *Power of Attorney and Declaration of Representative,* can be used.

Child's return. If a child has to file a tax return but cannot sign the return, the child's parent, guardian, or another legally responsible person must sign the child's name, followed by the words "By (name of signer), parent for minor child."

Paid Preparer

Generally, anyone paid to prepare, assist in preparing, or review a tax return must sign it and complete the other information, including providing his or her Preparer Tax Identification Number (PTIN), in the paid preparer's area of your return.

Most preparers are required to e-file the tax returns they prepare. They sign these e-filed returns using their tax preparation software. However, a taxpayer can choose to have his or her return completed on paper if he or she would prefer. In that case, the paid preparer can sign the paper return manually or use a rubber stamp or mechanical device. The preparer is personally responsible for affixing his or her signature to the return.

If the preparer is self-employed (that is, not employed by any person or business to prepare the return), he or she should check the self-employed box in the Paid Preparer Use Only space on the return.

The preparer must give the taxpayer a copy of the tax return in addition to the copy filed with the IRS.

NOTES

Electronic Returns

Signature options. Taxpayers may sign electronic returns one of two ways.

1) ***Self-select PIN.*** The taxpayer enters a personal identification number (PIN) directly into the electronic return (using the practitioner's keyboard). When using a self-select PIN, signature documents are not required. However, the taxpayer must provide prior-year AGI for use by the IRS to authenticate the taxpayer.

2) ***Practitioner PIN.*** Form 8879, *IRS e-file Signature Authorization,* authorizes an ERO to enter a taxpayer's PIN on an electronic return. The taxpayer must sign and date Form 8879 and return the completed Form 8879 to the ERO in person, by mail, private delivery service, fax, email, or a website prior to the return being transmitted to the IRS. The practitioner must retain Form 8879 for three years from the return due date or the IRS received date, whichever is later, but the form is not required to be sent in unless requested by the IRS.

Stockpiling of returns. Stockpiling is waiting more than three calendar days to submit returns to the IRS after the preparer has all necessary information for origination. Collecting tax returns prior to the startup of IRS e-file is not stockpiling. However, preparers must advise taxpayers that returns cannot be transmitted prior to the startup date. An ERO must ensure that stockpiling of returns does not occur at its offices.

Stockpiling is waiting more than three calendar days to submit returns to the IRS after the preparer has all necessary information for origination.

Tax return changes require new signature. If Form 8879 has already been signed by a client, and a correction is made on the return, a new signature is required if the correct amounts differ by more than either $50 to total income or AGI, or $14 to total tax, federal income tax withheld, refund, or amount owed.

Learning Objective 5-C Self-Quiz

For answer, see *Chapter 5 Self-Quiz Answers*.
Test your knowledge and comprehension of information presented in Learning Objective 5-C.

Learning Objective 5-C.

In which of the following scenarios can a taxpayer sign joint return on behalf of his or her spouse?

a) Ella and Grace are married. Ella is in the Army and is stationed abroad in a non-combat zone. Ella has given Grace verbal permission to sign the return on his behalf.
b) Richard and Terri were married for the year but Richard died before the return could be filed. Richard's daughter Kimberly was appointed the executrix of Richard's estate. Kimberly is very busy and tells Terri to just sign the return and write "Filing as Surviving Spouse" on the line for Richard's signature.
c) David and Shane Smith are married. Shane was in a serious accident and he cannot sign the return due to his injuries. Shane tells David to sign the return on his behalf.
d) Ward and June are married. June is a stay at home mother with no income. Because all of the income is Ward's he can sign on June's behalf.

Learning Objective 5-D

Recognize unique tax situations for various occupations.

[1] U.S. Armed Forces

For federal tax purposes, the U.S. Armed Forces includes commissioned officers, warrant officers, and enlisted personnel in regular and reserve units under the control of the Secretaries of Defense, Army, Navy, and Air Force.

KEY FACT: **The U.S. Armed Forces also includes the Coast Guard, but not the U.S. Merchant Marine or the American Red Cross.**

Income exclusions for Armed Forces members in a combat zone. Gross income does not include compensation a taxpayer received for active service in the Armed Forces for any month during any part of which he or she served in a combat zone or qualified hazardous duty area. The exclusion available to a taxpayer may depend on his or her rank.

NOTES

Gross income does not include compensation a taxpayer received for active service in the Armed Forces for any month during any part of which he or she served in a combat zone or qualified hazardous duty area.

Enlisted members, warrant officers, and commissioned warrant officers.
If a taxpayer is an enlisted member, warrant officer, or commissioned warrant officer, he or she can exclude the following amounts from his or her income.

- Active duty pay earned in any month he or she served in a combat zone.
- Imminent danger/hostile fire pay.
- A reenlistment bonus if the voluntary extension or reenlistment occurs in a month the taxpayer served in a combat zone.
- Pay for accrued leave earned in any month he or she served in a combat zone.
- Pay received for duties as a member of the Armed Forces in clubs, messes, post and station theaters, and other non-appropriated fund activities. The pay must be earned in a month the taxpayer served in a combat zone.
- Awards for suggestions, inventions, or scientific achievements the taxpayer is entitled to because of a submission he or she made in a month he or she served in a combat zone.
- Student loan repayments. If the entire year of service required to earn the repayment was performed in a combat zone, the entire repayment made because of that year of service is excluded. If only part of that year of service was performed in a combat zone, only part of the repayment qualifies for exclusion. For example, if the taxpayer served in a combat zone for five months, 5/12 of his or her repayment qualifies for exclusion.

Commissioned officers (other than commissioned warrant officers). If a taxpayer is a commissioned officer (other than a commissioned warrant officer), he or she may exclude part of his or her combat pay. There is a limit to the amount of combat pay that can be exclude.

Extensions and deferrals. Deadlines for filing tax returns and claims for refunds, paying taxes, and taking any other actions with the IRS are automatically extended for:

- Members of the Armed Forces performing qualified service in or out of a combat zone, including time spent in a missing status.
- Members of the Armed Forces deployed on a contingency operation, outside the United States and away from the permanent duty station.
- Support personnel serving in a combat zone or contingency operation in support of the Armed Forces, including the Red Cross, accredited correspondents, and civilians acting under Armed Forces direction.

Length of automatic extension. Extensions are determined as follows:

180 days after the later of the last day of either qualifying service or continuous qualified hospitalization, *plus* Days remaining before the usual due date as of day of deployment.

Qualified hospitalization. Hospitalization outside the United States or up to five years in the United States is qualified if it is due to an injury received while serving in a combat zone or a contingency operation.

Hospitalization outside the United States or up to five years in the United States is qualified if it is due to an injury received while serving in a combat zone or a contingency operation.

Deferring payment of taxes. Income tax that becomes due before or during military service may be deferred without interest if:

- The taxpayer is performing military service, and
- The taxpayer properly notifies the IRS that his or her ability to pay income tax has been materially affected by military service, and
- The taxes are paid in full by the end of 180 days after the taxpayer terminates or is released from military service. This exception does not apply to the taxpayer's share of Social Security and Medicare taxes.

Note: Taxes payable under an installment agreement may be deferred by making a written request for deferment to the IRS office where the taxpayer has the agreement.

Military spouses. Under the Military Spouses Residency Relief Act, a military spouse's state of residence does not change when moving to a new state to be with a servicemember stationed there if the residence or domicile is the same for the servicemember and spouse.

NOTES

2 Ministers

Ministers are individuals duly ordained, commissioned, or licensed by a church. "Church" is used generically and does not refer to any particular religion. Most ministers who receive compensation are treated as dual-status taxpayers-employees for income tax purposes but not for Social Security and Medicare tax. Many ministers also receive a parsonage allowance.

Ministerial income. Total ministerial income includes church wages, gross self-employment income from ministerial service, and tax-exempt allowances.

Total ministerial income includes church wages, gross self-employment income from ministerial service, and tax exempt allowances.

Employee income and expenses. The minister receives Form W-2 from the church employer.

- The minister's income is reported as wages in box 1, Form W-2.
- Social Security and Medicare taxes are not withheld, and Form W-2 shows no amounts in boxes 3-6. The wages will be included in the minister's self-employment (SE) tax computation.
- Ministers are not subject to federal income tax withholding on income from ministerial services. A minister and employer may agree to voluntary withholding to cover income and SE tax. All withheld tax is reported as federal income tax withheld in box 2, Form W-2. A minister may need to make estimated tax payments to avoid late-payment penalties.
- Parsonage or housing allowances are reported in box 14, Form W-2.

Self-employment income and expenses. Amounts received by a minister for performing marriages, baptisms, funerals, etc., are self-employment income, even if no Form 1099 MISC, *Miscellaneous Income,* is received by the minister.

- Report self-employment income on Schedule C (Form 1040).
- Self-employment expenses are deductible on Schedule C (Form 1040), prorated to the extent the minister has tax-exempt income from a parsonage allowance.

Exemption from SE tax. Certain members of the clergy and members of recognized religious sects may request exemption from SE tax.

Parsonage (housing) allowance. A church or congregation may provide for a minister's residence in the form of a parsonage or a housing allowance. The value of a parsonage (plus utilities, if paid by the church) and housing allowances are subject to SE tax but may generally be excluded from income tax.

Parsonage provided to a minister. The value of the home, including utilities, is excluded from income for income tax purposes. The exclusion cannot be more than reasonable pay for the minister's services. However, the fair rental value of the home, including the cost of utilities, is included in gross income when calculating self-employment tax.

Housing allowance paid to a minister. For income tax purposes, a minister can exclude from income the smallest of:

1) The amount officially designated by the employer as housing allowance. Amounts must be designated as housing allowance before payment is made.
2) The amount actually used to provide a home. Include amounts paid in the tax year for rent, mortgage payments (principal, interest, insurance, property tax, etc.), furnishings, appliances, repairs, utilities, and down payments. Do not include food, entertainment, servants, or home equity loan payments for items unrelated to the home.
3) The fair rental value of the home, including furnishings, utilities, garage, etc.
4) The minister's reasonable pay.

The entire housing allowance, including any allowance for utilities, is included in gross income when calculating self-employment tax.

The entire housing allowance, including any allowance for utilities, is included in gross income when calculating self-employment tax.

Learning Objective 5-D Self-Quiz

For answer, see *Chapter 5 Self-Quiz Answers*.

Test your knowledge and comprehension of information presented in Learning Objective 5-D.

Learning Objective 5-D.

NOTES

Maria is an ordained minister. She receives an annual salary from her church of $30,000 plus an $18,000 housing allowance. She paid $9,000 in mortgage payments, which also include her property taxes and insurance. Her utilities cost $3,000 for the year and she had $3,600 in repair costs. The fair rental value of her home, as furnished, is $12,000 for the year. How much of the housing allowance is Maria able to exclude from gross income?

a) $18,000
b) $15,600
c) $15,000
d) $12,000

Learning Objective 5-E

Recognize various misconceptions taxpayers have regarding taxes.

Common Misconceptions

There are many misconceptions taxpayers, and even some tax professionals, have regarding taxes. Some of the misconceptions are based on outdated tax law while others are simply based on hearsay.

[1] **Gain on the sale of a primary residence.** Until 1997, proceeds from the sale of a principal residence had to be used within two years to purchase a new principal residence of equal or greater value in order for the taxpayer to defer recognition of capital gains from the sale. Now, taxpayers can exclude up to $250,000 of gain ($500,000 for MFJ) on the sale of a principal residence if certain requirements are met.

Under the previous law, the taxpayer could only defer recognition of capital gains once during his or her lifetime. Under to current law, a taxpayer can exclude the gain every two years if he or she meets all of the requirements.

Under to current law, a taxpayer can exclude the gain every two years if he or she meets all of the requirements.

KEY FACT: Even though the new rules have been in place for over 20 years now, many taxpayers and realtors still have the misconception that they must purchase another principal residence with the proceeds from the sale of their primary residence.

Unrealized income. When a taxpayer has investments, he or she will often have taxable income even though he or she never received the money. For example, a taxpayer may receive dividends which are automatically reinvested or he or she might sell stock in a company and use the proceeds to purchase stock in a different company. Both of these situations are considered taxable events for the taxpayer even though he or she never physically received any of the money.

Income is only taxable if Form 1099 is received. Taxpayers are required to report all income unless specifically excluded under the Internal Revenue Code. This includes barter income (exchanging goods or services for other goods or services without the use of money) and other types of hard to trace income such as cash.

Big refunds are good. For some taxpayers the goal at tax time is to get the biggest refund possible. However, the ultimate goal should be to pay the least amount of tax possible under the law.

That being said, depending on how a taxpayer uses his or her money, can help determine if he or she is better off getting a bigger refund or breaking even (if not owing in a little) with the tax return. As an example, a taxpayer getting a $2,400 refund could have had $200 more each month to spend. For some taxpayers, $200 a month could really improve their standard of living. Whereas other taxpayers might prefer to use withholdings as a forced savings account and use a $2,400 refund to pay down debt or go on a vacation that they would never be able to save for on their own.

Certain items on a return will trigger an audit. A taxpayer's return may be examined for a variety of reasons. A return may be selected for examination on the basis of computer scoring, information received from third-party documentation that does not match the information reported on the return, or as a result of information received from other sources on potential noncompliance with the tax laws or inaccurate filing.

NOTES

While it is true that certain items might increase the possibility of an audit, the percentage of returns that are examined each year by the IRS is small. Most recent data show that only 0.6% of all individual returns filed in calendar year 2017 were examined by the IRS.

If a taxpayer cannot pay his or her taxes, he or she should file an extension.
Many taxpayers believe that filing an extension allows them more time to pay any taxes owed. However, an extension only gives the taxpayer additional time to file his or her return. Any amount that is owed should be paid by the original due date of the return and any amount that remains unpaid after that date is subject to interest and penalty.

Many taxpayers believe that filing an extension allows them more time to pay any taxes owed.

A return should not be filed until the taxpayer is ready to pay the amount due. Regardless of when the return is filed, any amount that is owed is due on April 15. If the taxpayer is requesting direct debit of what is owed, he or she can specify a date up to and including April 15. Many taxpayers wait until the last minute to actually file their returns which causes a backlog with the IRS systems and limits the amount of time a taxpayer would have to correct any potential e-file rejections.
For the 10 weeks beginning February 1, 2019 and ending April 12, 2019, the IRS processed 102,436,000 individual tax returns (10.2 million returns per week on average). However, the following week, which included April 15, 2019, the IRS processed over 15 million returns.

Bonuses are taxed at a higher rate. Taxpayers often complain about how much was withheld from a bonus check and believe that it is not good to receive a bonus because they are taxed at a higher rate. In reality, bonuses are taxed as regular income the same as normal wages.
The amount of income tax an employer withholds depends on three things.
- The amount earned in each payroll period.
- The payroll period (weekly, bi-weekly, semi-monthly, etc.).
- How the employee filled out Form W-4.

In general terms, the way the withholding tables work is that the taxable income for the pay period is multiplied by the total number of pay periods for the year to come up with yearly taxable income for the employee. Based on that amount, and how the employee completed his or her Form W-4, a projected amount of tax is then calculated and divided by the number of pay periods to arrive at how much should be withheld for that check.
Because of this, when an employee gets a bonus, commission, or any other form of compensation that increases his or her pay for a given pay period, the tables for withholding assume that taxpayer is going to have a lot more taxable income for the year and therefore withhold a larger percentage.

The opposite can also occur. If a taxpayer has a part-time job, because each check from that employer might be relatively small, the amount of withholdings from that one job might not be enough to cover the tax due on the income and the taxpayer might feel that the part-time job hurt their tax situation.

I do not need to include that, I already paid the taxes. Often times, a taxpayer will confuse taxes withheld with taxes owed or paid. This commonly happens with an early withdrawal from a retirement plan like an IRA. When a taxpayer under 59½ takes money out of a retirement plan he or she is subject to a 10% penalty, unless an exception applies. Usually, the payor will offer to withhold the 10% penalty and therefore the taxpayer assumes that is all that will be owed.

Often times, a taxpayer will confuse taxes withheld with taxes owed or paid.

Paying off a mortgage is not good tax planning. Many taxpayers bemoan the fact that their mortgage is getting close to being paid off and therefore they will not have a big tax advantage any more. It might be true that a taxpayer will owe more in taxes if he or she does not have a mortgage payment, however, the amount they save each month is much more than the increase in taxes.

EXAMPLE: Sally, a single taxpayer, pays $1,000 each month in interest and principal on her mortgage. Of the $12,000 that she paid for the year, $2,500 was interest. Assuming that she is in the 22% tax bracket and has enough state and local taxes and charitable contributions to be over the standard deduction and therefore benefits from the entire $2,500 of mortgage interest, all she is saving in taxes is $550. If she did not have the monthly mortgage payments, she would save $11,450 after taxes.

Learning Objective 5-E Self-Quiz

NOTES

For answer, see *Chapter 5 Self-Quiz Answers*.

Test your knowledge and comprehension of information presented in Learning Objective 5-E.

Learning Objective 5-E.

How often can a taxpayer exclude the gain on the sale of his or her principal residence?

a) Never.
b) Once.
c) Twice.
d) Unlimited as long as he or she meets all of the requirements.

Chapter 5 Self-Quiz Answers

Learning Objective 5-A.

Which of the following taxpayers should pay estimated tax for 2019?

a) After subtracting his withholding and refundable credits of $4,000 from the $5,000 of tax expected on his 2019 return, Howard is going to owe $1,000. The tax shown on Howard's 2018 return was $4,500.
   Correct. Howard should pay estimated tax because he expects to owe at least $1,000 and his withholding and refundable credits only equal 80% ($4,000 ÷ $5,000) of the tax expected on his 2019 return and 88% ($4,000 ÷ $4,500) of the tax shown on his 2018 return.
b) After subtracting his withholding and refundable credits of $11,000 from the $12,000 of tax expected on his 2019 return, Raj is going to owe $1,000. The tax shown on Raj's 2018 return was $12,000.
   Incorrect. Raj does not need to pay estimated tax because, even though he expects to owe $1,000, his withholding and refundable credits are greater than 90% of the tax expected on his 2019 return.
c) After subtracting his withholding and refundable credits of $15,000 from the $17,000 of tax expected on his 2019 return, Sheldon is going to owe $2,000. Sheldon's AGI in 2018 was $100,000 and the tax shown on his 2018 return was $15,000.
   Incorrect. Sheldon does not need to pay estimated tax because, even though he expects to owe $1,000 and his withholding and refundable credits are less than 90% of the tax expected on his 2019 return, his withholding and refundable credits are 100% of the tax shown on his 2018 return.
d) After subtracting his withholding and refundable credits of $1,000 from the $2,000 of tax expected on his 2019 return, Leonard is going to owe $1,000. Leonard is a US citizen for all of 2019 and he had no tax liability on his 2018 return which covered a 12-month period.
   Incorrect. Leonard does not need to pay estimated tax because, even though he expects to owe $1,000 and his withholding and refundable credits are less than 90% of the tax expected on his 2019 return, he had no tax liability on his 2018 return which covered a 12-month period.

Learning Objective 5-B.

Which of the following is not an option for paying a balance due?

a) Direct debit.
   Incorrect. A taxpayer can e-file and authorize an electronic funds withdrawal by providing account and routing numbers for his or her financial institution.
b) Cash.
   Incorrect. Cash is an in-person payment option provided through retail partners with a maximum of $1,000 per day per transaction.
c) Credit card.
   Incorrect. A taxpayer can pay via credit card or debit card.
d) Cryptocurrency.
   Correct. Taxpayers have many options to pay a balance due but cryptocurrency is not one.

Learning Objective 5-C.

NOTES

In which of the following scenarios can a taxpayer sign joint return on behalf of his or her spouse?

a) Ella and Grace are married. Ella is in the Army and is stationed abroad in a non-combat zone. Ella has given Grace verbal permission to sign the return on his behalf.
Incorrect. Because Ella is not in a combat zone, Grace would need a power of attorney or other statement in order to sign on Ella's behalf.

b) Richard and Terri were married for the year but Richard died before the return could be filed. Richard's daughter Kimberly was appointed the executrix of Richard's estate. Kimberly is very busy and tells Terri to just sign the return and write "Filing as Surviving Spouse" on the line for Richard's signature.
Incorrect. Because Kimberly was appointed the executrix of the estate, she must sign the return for Richard.

c) David and Shane Smith are married. Shane was in a serious accident and he cannot sign the return due to his injuries. Shane tells David to sign the return on his behalf.
Correct. Because Shane's injuries prevent him from signing the return, David can sign on his behalf. David should sign his name where Shane normally would and write "By David Smith, Husband." David also needs to be sure to sign in the space provided for his signature. A dated statement, signed by David, should be attached to the return. The statement should include the form number of the return being filed, the tax year and the reason the other spouse cannot sign, and it should state that the one spouse has agreed to the other spouse signing for him or her.

d) Ward and June are married. June is a stay at home mother with no income. Because all of the income is Ward's he can sign on June's behalf.
Incorrect. For a joint return, both the taxpayer and spouse must sign the return, even if only one of them had income.

Learning Objective 5-D.

Maria is an ordained minister. She receives an annual salary from her church of $30,000 plus an $18,000 housing allowance. She paid $9,000 in mortgage payments, which also include her property taxes and insurance. Her utilities cost $3,000 for the year and she had $3,600 in repair costs. The fair rental value of her home, as furnished, is $12,000 for the year. How much of the housing allowance is Maria able to exclude from gross income?

a) $18,000
Incorrect. The excludable amount is the lesser of: (1) the amount actually used to provide a home ($15,600), (2) the amount officially designated as a housing allowance ($18,000), or (3) the fair rental value of the home, including furnishings, utilities, garage, etc. ($15,000).

b) $15,600
Incorrect. The fair rental value of Maria's home plus utilities is less than her actual costs therefore she can only exclude that amount.

c) $15,000
Correct. Maria can only exclude $15,000 (the fair rental value of her home plus utilities) since that is the lesser of the three potential amounts.

d) $12,000
Incorrect. Maria can exclude the fair rental value of her home plus the cost of utilities.

Learning Objective 5-E.

How often can a taxpayer exclude the gain on the sale of his or her principal residence?

a) Never.
Incorrect. A taxpayer can exclude the gain on the sale of his or her principal residence every two years if he or she meets all of the requirements.

b) Once.
Incorrect. Under the previous law, the taxpayer could only defer recognition of capital gains on the sale of his or her principal residence once during his or her lifetime. Under to current law, a taxpayer can exclude the gain every two years if he or she meets all of the requirements.

NOTES

c) Twice.
Incorrect. A taxpayer can exclude the gain on the sale of his or her principal residence every two years if he or she meets all of the requirements.

d) Unlimited as long as he or she meets all of the requirements.
Correct. Under the previous law, the taxpayer could only defer recognition of capital gains on the sale of his or her principal residence once during his or her lifetime. Under to current law, a taxpayer can exclude the gain every two years if he or she meets all of the requirements.

Appendix

Form 1040	Department of the Treasury - Internal Revenue Service (99) **U.S. Individual Income Tax Return**	2019	OBM No. 1545-0074	IRS Use Only - Do not write or staple in this space.

Filing Status
Check only one box.

☐ Single ☐ Married filing jointly ☐ Married filing separately (MFS) ☐ Head of household (HOH) ☐ Qualifying widow(er) (QW)

If you checked the MFS box, enter the name of spouse. If you checked the HOH or QW box, enter the child's name if the qualifying person is a child but not your dependent.

Your first name and middle initial	Last name		**Your social security number**
If joint return, spouse's first name and middle initial	Last name		**Spouse's social security number**
Home address (number and street). If you have a P.O. box, see instructions.		Apt. no.	**Presidential Election Campaign** Check here if you, or your spouse if filing jointly, want $30 to go to this fund. Checking a box below will not charge your tax or refund. ☐ **You** ☐ **Spouse**
City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions).			
Foreign country name	Foreign province/state/county	Foreign postal code	If more than four dependents, see instructions and check here. ☐

Standard Deduction

Someone can claim: ☐ You as a dependent ☐ Your spouse as a dependent

☐ Spouse itemizes on a separate return or you were a dual-status alien.

Age / Blindness

You: ☐ Were born before January 2, 1955 ☐ Are blind **Spouse:** ☐ Was born before January 2, 1955 ☐ Is blind

Dependents (see instructions):		(2) Social security number	(3) Relationship you	(4) Check if qualifies for (see instructions):	
(1) First name	Last name			Child tax credit	Credit for other dependents
				☐	☐
				☐	☐
				☐	☐
				☐	☐

Standard Deduction for:

- **Single or Married filing separately, $12,200**
- **Married filing jointly or Qualifying widow(er), $24,400**
- **Head of household, $18,350**
- **If you checked any box under *Standard Deduction,* see instructions.**

1 Wages, salaries, tips, etc. Attach Form(s) W-2.				**1**	
2a Tax-exempt interest	**2a**		**b** Taxable interest. Attach Sch. B if required	**2b**	
3a Qualified dividends	**3a**		**b** Ordinary dividends. Attach Sch. B if required	**3b**	
4a IRA distributions	**4a**		**b** Taxable amount	**4b**	
c Pensions and annuities	**4c**		**d** Taxable amount	**4d**	
5a Social security benefits	**5a**		**b** Taxable amount	**5b**	
6 Capital gain or (loss). Attach Schedule D if required. If not required, check here ☐				**6**	
7a Other income from Schedule 1, line 9				**7a**	
b Add lines 1, 2b, 3b, 4b, 4d, 5b, 6, and 7a. This is your **total income**				**7b**	
8a Adjustments to income from Schedule 1, line 22				**8a**	
b Subtract line 8a from line 7b. This is your **adjusted gross income**				**8b**	
9 Standard deduction or itemized deductions (from Schedule A)			**9**		
10 Qualified business income deduction. Attach Form 8995 or Form 8995-A			**10**		
11a Add line 9 and 10				**11a**	
b Taxable income. Subtract line 11a from line 8b				**11b**	

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11320B **Form 1040 (2019)**

- If you have a qualifying child, attach Sch. EIC.
- If you have nontaxable combat pay, see instructions.

12 a Tax (see inst.) Check if any from Form(s): **1** ☐ 8814 **2** ☐ 4972 **3** ☐ ___________	12a			
b Add Schedule 2, line 3, and line 12a and enter the total			12b	
13a Child tax credit or credit for other dependents	13a			
b Add Schedule 3, line 7, and line 13a and enter the total			13b	
14 Subtract line 13b from line 12b. If zero or less, enter -0-			14	
15 Other taxes, including self-employment tax, from Schedule 2, line 10			15	
16 Add line 14 and 15. This is your **total tax**			16	
17 Federal income tax withheld from Forms W-2 and 1099			17	
18 Other payments and refundable credits:				
a Earned income credit (EIC)	18a			
b Additional child tax credit. Attach Schedule 8812	18b			
c American opportunity credit from Form 8863, line 8	18c			
d Schedule 3, line 14	18d			
e Add lines 18a through 18d. These are your **total other payments and refundable credits**			18e	
19 Add lines 17 and 18e. These are your **total payments**			19	

Refund

Direct deposit? See instructions.

20 If line 19 is more than line 16, subtract line 16 from line 19. This is the amount you **overpaid**			20	
21a Amount of line 20 you want **refunded to you.** If Form 8888 is attached, check here ☐			21a	
▸ **b** Routing number: ▸ **c** Type: Checking ☐ Saving ☐				
▸ **d** Account number:				
22 Amount of line 20 you want **applied to your 2020 estimated tax**	22			

Amount You Owe

23 Amount you owe. Subtract line 19 from line 16. For details on how to pay, see instructions			23	
24 Estimated tax penalty (see instructions)	24			

Third Party Designee

(Other than paid preparer)

Do you want to allow another person (other than you paid preparer) to discuss this return with the IRS? See instructions. ☐ **Yes.** Complete below. ☐ No

Designee's name ▸ Phone no. ▸ Personal identification number (PIN) ▸

Sign Here

Joint return? See instructions. 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	If the IRS sent you an Identity Protection PIN, enter it here (see inst.)
Spouse's signature. If a joint return, **both** must sign.	Date	Spouse's occupation	If the IRS sent your spouse an Identity Protection PIN, enter it here (see inst.)
Phone no.	Email address		

Paid Preparer Use Only

Preparer's name	Preparer's signature	Date	PTIN	Check if: ☐ 3rd Party Designee ☐ Self-employed
Firm's name ▸		Phone no.		
Firm's address ▸			Firm's EIN ▸	

Go to www.irs.gov/Form1040 for instructions and the latest information. Form **1040** (2019)

SCHEDULE 1 (Form 1040 or 1040-SR) Department of the Treasury Internal Revenue Service	**Additional Income and Adjustments to Income** ▸ Attach to Form 1040 or 1040-SR. ▸ Go to *www.irs.gov/Form1040* for instructions and the latest information.	OMB. No. 1545-0074 **2019** Attachment Sequence No. **01**

Name(s) shown on Form 1040 or 1040-SR	**Your social security number**

Part 1 Additional Income

1	Taxable refunds, credits, or offsets of state and local income taxes	1	
2a	Alimony received	2a	
b	Date of original divorce or separation agreement (see instructions) ▸		
3	Business income or (loss). Attach Schedule C	3	
4	Other gains or (losses). Attach Form 4797	4	
5	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E	5	
6	Farm income or (loss). Attach Schedule F	6	
7	Unemployment compensation	7	
8	Other income. List type and amount ▸	8	
9	Combine lines 1 through 8. Enter here and on Form 1040 or 1040-SR, line 7a	9	

Part 2 Adjustment to Income

10	Educator expenses	10	
11	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106	11	
12	Health savings account deduction. Attach Form 8889	12	
13	Moving expenses for members of the Armed Forces. Attach Form 3903	13	
14	Deductible part of self-employment tax. Attach Schedule SE	14	
15	Self-employed SEP, SIMPLE, and qualified plans	15	
16	Self-employed health insurance deduction	16	
17	Penalty on early withdrawal of savings	17	
18a	Alimony paid	18a	
b	Recipient's SSN ▸		
c	Date of original divorce or separation agreement (see instructions) ▸		
19	RA deduction	19	
20	Student loan interest deduction	20	
21	Reserved for future use	21	
22	Add lines 10 through 21. These are your **adjustments to income.** Enter here and on Form 1040 or 1040-SR, line 8a	22	

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 71479F **Schedule 1 (Form 1040 or 1040-SR) 2019**

SCHEDULE 2 (Form 1040 or 1040-SR) Department of the Treasury Internal Revenue Service	**Additional Taxes** ▸ Attach to Form 1040 or 1040-SR. ▸ Go to *www.irs.gov/Form1040* for instructions and the latest information.		OMB. No. 1545-0074 **2019** Attachment Sequence No. **02**
Name(s) shown on Form 1040 or 1040-SR		**Your social security number**	

Part 1 Tax			
1	Alternative minimum tax. Attach Form 6251	1	
2	Excess advance premium tax credit repayment. Attach Form 8962	2	
3	Add lines 1 and 2. Enter here and include on Form 1040 or 1040-SR, line 12b	3	
Part 2 Other Taxes			
4	Self-employment tax. Attach Schedule SE	4	
5	Unreported social security and Medicare tax from Form: a ☐ 4137 b ☐ 8919	5	
6	Additional tax on IRAs, other qualified retirement plans, and other tax-favored accounts. Attach Form 5329 if required	6	
7a	Household employment taxes. Attach Schedule H	7a	
b	Repayment of first-time homebuyer credit from Form 5405. Attach Form 5405 if required	7b	
8	Taxes from: **a** ☐ Form 8959 **b** ☐ Form 8960 **c** ☐ Instructions; enter code(s)	8	
9	Section 965 net tax liability installment from Form 965-A | 9 |		
10	Add lines 4 through 8. These are your total other taxes. Enter here and on Form 1040 or 1040-SR, line 15	10	

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 71478U **Schedule 2 (Form 1040 or 1040-SR) 2019**

SCHEDULE 3 (Form 1040 or 1040-SR) Department of the Treasury Internal Revenue Service	**Additional Credits and Payments** ▸ Attach to Form 1040 or 1040-SR. ▸ Go to *www.irs.gov/Form1040* for instructions and the latest information.		OMB. No. 1545-0074 **2019** Attachment Sequence No. **03**
Name(s) shown on Form 1040 or 1040-SR		**Your social security number**	

Part 1 Nonrefundable Credits			
1	Foreign tax credit. Attach Form 1116 if required	1	
2	Credit for child and dependent care expenses. Attach Form 2441	2	
3	Education credits from Form 8863, line 19	3	
4	Retirement savings contributions credit. Attach Form 8880	4	
5	Residential energy credit. Attach Form 5695	5	
6	Other credits from Form: **a** ☐ 3800 **b** ☐ 8801 **c** ☐	6	
7	Add lines 1 through 6. Enter here and include on Form 1040 or 1040-SR, line 13b	7	
Part 2 Other Payments and Refundable Credits			
8	2019 estimated tax payments and amount applied from 2018 return	8	
9	Net premium tax credit. Attach Form 8962	9	
10	Amount paid with request for extension to file (see instructions)	10	
11	Excess social security and tier 1 RRTA tax withheld	11	
12	Credit for federal tax on fuels. Attach Form 4136	12	
13	Credits from Form: **a** ☐ 2439 **b** ☐ Reserved **c** ☐ 8885 **d** ☐	13	
14	Add lines 8 through 13. Enter here and on Form 1040 or 1040-SR, line 18d	14	

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 71480G **Schedule 3 (Form 1040 or 1040-SR) 2019**

SCHEDULE B (Form 1040) Department of the Treasury Internal Revenue Service (99)	**Interest and Ordinary Dividends** ▸ Attach to Form 1040. ▸ Go to *www.irs.gov/ScheduleB* for instructions and the latest information.	OMB. No. 1545-0074 **2018** Attachment Sequence No. **08**

Name(s) shown on return	**Your social security number**

Part 1 Interest

(See instructions and the instructions for Form 1040, line 2b.)

Note: If you received a Form 1099-INT, Form 1099-OID, or substitute statement from a brokerage firm, list the firm's name as the payer and enter the total interest shown on that form.

			Amount
1	List name of payer. If any interest is from a seller-financed mortgage and the buyer used the property as a personal residence, see the instructions and list this interest first. Also, show that buyer's social security number and address ▸	1	
2	Add the amounts on line 1	2	
3	Excludable interest on series EE and I U.S. savings bonds issued after 1989. Attach Form 8815	3	
4	Subtract line 3 from line 2. Enter the result here and on Form 1040, line 2b ▸	4	
Note:	If line 4 is over $1,500, you must complete Part III.		**Amount**

Part 2 Ordinary Dividends

(See instructions and the instructions for Form 1040, line 3b.)

Note: If you received a Form 1099-DIV or substitute statement from a brokerage firm, list the firm's name as the payer and enter the ordinary dividends shown on that form.

5	List name of payer ▸	5	
6	Add the amounts on line 5. Enter the total here and on Form 1040, line 3b	6	
Note:	If line 6 is over $1,500, you must complete Part III.		

Part 3 Foreign Accounts and Trusts

(See instructions.)

	You must complete this part if you (a) had over $1,500 of taxable interest or ordinary dividends; (b) had a foreign account; or (c) received a distribution from, or were a grantor of, or a transferor to, a foreign trust.	**Yes**	**No**
7a	At any time during 2018, did you have a financial interest in or signature authority over a financial account (such as a bank account, securities account, or brokerage account) located in a foreign country? See instructions		
	If "Yes," are you required to file FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR), to report that financial interest or signature authority? See FinCEN Form 114 and its instructions for filing requirements and exceptions to those requirements		
b	If you are required to file FinCEN Form 114, enter the name of the foreign country where the financial account is located ▸		
8	During 2018, did you receive a distribution from, or were you the grantor of, or transferor to, a foreign trust? If "Yes," you may have to file Form 3520. See instructions		

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 71476N **Schedule B (Form 1040) 2018**

Circle the correct answer.

1. If a taxpayer has an amount due, how much can he or she pay in cash per day?
   a) A taxpayer cannot pay his or her amount due in cash.
   b) A taxpayer can pay a maximum of $1,000 per day in cash towards his or her amount due.
   c) A taxpayer can pay a maximum of $5,000 per day in cash towards his or her amount due.
   d) There is no limit on the amount a taxpayer can pay in cash per day.

2. A taxpayer can appoint an agent to sign his or her return if the taxpayer is absent from the United States for a continuous period before the due date for filing the return. How long must the continuous period be?
   a) At least 30 days.
   b) At least 45 days.
   c) At least 60 days.
   d) At least 90 days.

3. Which of the following taxpayers would qualify for an increased standard deduction?
   a) Davy is married filing a separate return. Instead of taking the standard deduction, Davy's wife itemizes her deductions.
   b) Micky may be claimed as a dependent by his parents. Micky's earned income is $1,650.
   c) Peter has 20/20 vision in his right eye but, due to a childhood accident, lost complete use of his left eye.
   d) Mike would have turned 65 on June 30, 2019 however he passed away on June 29, 2019.

4. Cindy had two different employers in 2019. The first one withheld $4,300.60 in Social Security taxes from her pay and the second one withheld $6,800.20 in Social Security taxes from her pay. How much of a credit for excess Social Security does Cindy get?
   a) $0
   b) $2,861.00
   c) $8,239.80
   d) $11,100.80

5. Tier 2 benefits paid under the Railroad Retirement Act are reported on what form?
   a) Form RRB-1099-R
   b) Form RRB-1099
   c) Form SSA-1099
   d) Form 1099-R

6. Which of the following taxpayers would not need to pay estimated tax for 2019?
   a) After subtracting her withholding and refundable credits of $8,000 from the $9,500 of tax expected on her 2019 return, Dorothy is going to owe $1,500. The tax shown on Dorothy's 2018 return was $10,000.
   b) After subtracting her withholding and refundable credits of $12,000 from the $15,000 of tax expected on her 2019 return, Rose is going to owe $3,000. The tax shown on Rose's 2018 return was $13,000.
   c) After subtracting her withholding and refundable credits of $10,000 from the $18,000 of tax expected on her 2019 return, Blanche is going to owe $8,000. The tax shown on Blanche's 2018 return was $5,000.
   d) After subtracting her withholding and refundable credits of $9,000 from the $10,000 of tax expected on her 2019 return, Sophia is going to owe $1,000. The tax shown on Sophia's 2018 return was $9,500.

7. Jim's brother, John, is 30 years old and lived with Jim for seven months during 2019. John is permanently and totally disabled and has annual income from an insurance settlement to cover two-thirds of his living expenses. Which of the following tests disqualifies Jim from claiming John as a qualifying child?
   a. Relationship test.
   b. Member of household Test.
   c. Age test.
   d. Support test.

8. When a taxpayer owes taxes, when is that amount due?
   a. By the original due date of the return.
   b. By the original due date of the return, unless a valid extension has been filed in which case it is the extended due date of the return.
   c. Within five business days of the return being filed or the original due date of the return, whichever is sooner.
   d. Within five business days of the return being filed or the original due date of the return, whichever is later.

9. Which of the following taxpayers does not qualify for the student loan interest deduction?
   a. John's filing status is Head of Household and his AGI is $60,000.
   b. Phil's filing status is Qualifying Widower and his AGI is $50,000.
   c. Rachel's filing status is Married Filing Separately and her AGI is $25,000.
   d. Jennie's filing status is Married Filing Joint. Her and her spouse's AGI is $135,00.

10. What impact do adjustments have on an individual's income tax return?
   a. Adjustments increase a taxpayer's income dollar for dollar.
   b. Adjustments decrease a taxpayer's income dollar for dollar.
   c. Adjustments increase a taxpayer's tax owed dollar for dollar.
   d. Adjustments decrease a taxpayer's tax owed dollar for dollar.

11. To be a qualifying child for purposes of the Child Tax Credit, the child must be the following age at the end of the year.
   a. Under age 17.
   b. Under age 19.
   c. Under age 24.
   d. There is no age limit as long as the child is totally and permanently disabled.

12. In which box of Form W-2 would a dollar amount and code "W" be reported indicating that there were employer contributions to a Health Savings Account (HSA) for the taxpayer?
   a. Box 10.
   b. Box 11.
   c. Box 12.
   d. Box 13.

13. Tom's parents are divorced. Tom lives with his father for 183 nights of the year and his mother for 182 nights of the year. His father's AGI is $75,000 and his mother's AGI is $80,000. Tom's dad pays 45% of Tom's expenses and his mother pays the remaining 55%. Who is Tom's custodial parent and why?
   a. Tom's father because Tom spend more nights with him.
   b. Tom's father because his AGI is lower than his mother's AGI.
   c. Tom's mother because her AGI is higher than his father's AGI.
   d. Toms mother because she paid 55% of Tom's expenses.

14. Which of the following statements about the Married Filing Separately (MFS) filing status is true?
    a. In a community property state, each spouse reports only his or her income.
    b. Only the parent who claims the child as a dependent can deduct medical expenses for the child.
    c. If both spouses file as MFS and one spouse itemizes deductions, the other spouse must itemize deductions.
    d. Spouses cannot amend separate returns to file jointly after the due date of the return.

15. Which of the following taxpayers can use the tax tables?
    a. Homer has taxable income of $75,000. His income consists of W-2 wages and qualified dividends.
    b. Ned has taxable income of $75,000 and he is subject to the Kiddie Tax.
    c. Lenny has taxable income of $75,000 and he is claiming the foreign earned income exclusion.
    d. Carl has taxable income of $75,000. All of his income is from self-employment.

16. Adjustments to income are subtracted from the total income on line 7b, Form 1040 to establish what?
    a. Adjusted gross income.
    b. Modified adjusted gross income.
    c. Taxable income.
    d. Nontaxable income.

17. Which set of payments counts toward paying more than half the cost of keeping up a home for the Head of Household filing status?
    a. Rent, utility charges, property insurance, and food consumed on premises.
    b. Property taxes, mortgage interest expenses, property insurance, and children's school expenses.
    c. Property taxes, utility charges, food consumed on the premises, and life insurance.
    d. Property taxes, mortgage interest expense, property insurance, and clothing for a child.

18. Which of the following statements is true for a taxpayer with a qualifying child claiming the Earned Income Credit?
    a. A noncustodial parent can claim the Earned Income Credit if Form 8332, *Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent,* is received from the custodial parent.
    b. Schedule EIC, *Earned Income Credit,* must be completed and attached to Form 1040 to claim the Earned Income Credit.
    c. A parent with no earned income can claim the Earned Income Credit if his or her child has earned income.
    d. A resident of Puerto Rico can claim the Earned income Credit.

19. John and Marie have two children enrolled in daycare and pay $15,000 for the daycare services. Both John and Marie have earned income and qualify for a 20% credit for the Child and Dependent Care Credit. Marie receives dependent care benefits of $4,000 as reported in box 10 of her Form W-2. What is their Child and Dependent Care Credit?
    a. $0
    b. $200
    c. $400
    d. $1,200

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20. Which of the following statements about the Military Spouses Residency Relief Act is true?
    a. A military spouse's income is excluded from while his or her spouse is serving in a combat zone, as long as their residence is the same.
    b. A military spouse's residency is based on whichever state the servicemember is stationed in.
    c. A military spouse has no state of residency and therefore must not pay any state taxes.
    d. A military spouse's state of residence does not change when moving to a new state to be with a servicemember stationed there if the residence or domicile is the same for the servicemember and spouse.

21. Schedule B is required to be filed in which of the following situations?
    a. If a taxpayer has over $1,000 of taxable interest or ordinary dividends.
    b. If a taxpayer has over $1,000 of capital gains.
    c. If a taxpayer is reporting the full amount of original issue discount (OID) shown on Form 1099-OID.
    d. If a taxpayer receives interest or dividends as a nominee.

22. Susan was unemployed for the entire year. Her income for the year totaled $30,000 and consisted of $15,000 of state unemployment benefits, a distribution of $10,000 from her IRA, and a $5,000 gift from her parents. How much income must Susan include on her tax return for the year?
    a. $30,000
    b. $25,000
    c. $15,000
    d. $10,000

23. What is the 2019 annual contribution limit for self-only HSA coverage if the taxpayer is age 55 or older?
    a) $1,350
    b) $3,500
    c) $4,500
    d) $6,750

24. A taxpayer is not always required to file a return. In which circumstance below would the taxpayer be required to file a return for 2019?
    a) Stan is 18 years old and a dependent of his parents. His only income was $2,500 in wages from a summer job and $1,400 of interest income from some savings bonds he cashed in.
    b) Caroline is 7 years old and a dependent of her parents. Caroline did a modeling job and received a 1099-MISC for $350. This was her only income.
    c) Ethan is 12 years old and a dependent of his parents. His only income was $950 of dividends.
    d) Audrey is 16 years old and a dependent of her parents. Her only income was $10,000 in wages from a part-time job.

25. What can reduce other taxes, such as a taxpayer's self-employment tax, or result in the taxpayer getting more back than was paid in?
    a) An adjustment.
    b) A deduction.
    c) A nonrefundable credit.
    d) A refundable credit.

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INSTRUCTIONS

Expiration Date Reminder: The Final Exam must be completed online before the next scheduled course update.
All Final Exams are administered online at www.thetaxbook.com. It is recommended that you review the Final Exam at the end of the course before taking it online. Final Exams mailed in will not be graded.

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3) Enter your User Name in the self-study CPE login location. The email address associated with your account at Tax Materials, Inc. is your User Name. If you do not have an email address, or have not provided one, please call our toll-free number at 1-866-919-5277 to be assigned a User Name.
4) Enter your Password. The zip code associated with your account is your password. If you are having difficulty logging onto the Final Exam, please call our toll-free number at 1-866-919-5277.
5) Select the Individual Tax Prep 101 course from the Course Catalog and click the "Take Final Exam" button once you are in the course details.
6) You will be taken to the Final Exam.
   - First confirm your First Name and Last Name are correct. This is how your name will appear on your Certificate of Completion should you achieve a score of 70% or higher.
   - Take the Final Exam. Read the questions carefully and answer them to the best of your ability. Click on "Submit Answers" when finished. You will instantly know if you have passed the test. If you failed, you are able to retake the test. If you passed, the Certificate of Completion will be available for you to print.

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