Publication 4491

VITA/TCE **Training Guide**

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

Volume 13 of 16

2023 RETURNS

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What documentation will taxpayers receive to claim the PTC?

By January 31 of the year following the year of coverage, the Marketplace will send Form 1095-A to taxpayers who purchased qualified health coverage through the Marketplace. The Marketplace also reports this information to the IRS.

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

How is the PTC claimed on the tax return?

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

A taxpayer computes the amount of PTC on Form 8962 and reconciles it with the APTC payments for the year. If the PTC computed on the return is more than the APTC payments made on the taxpayer's behalf during the year, the difference will increase the refund or lower the amount of tax owed.

If the APTC payments are more than the PTC (excess APTC), some or all of the difference will increase the taxpayer's tax liability and result in either a smaller refund or a larger balance due. Taxpayers with household income below 400 percent of the FPL for their family size may be allowed a limitation on their excess APTC repayment. The limitation is based on the taxpayer’s household income as provided in the repayment limitation table, which can be found in the Important Changes lesson in this publication and in the Volunteer Resource Guide, Tab H, Other Taxes, Payments, and Refundable Credits.

For taxpayers who use the Married Filing Separately filing status, the repayment limitation applies to the spouses separately based on the household income reported on each return. There are situations where the cap does not apply; for example, the repayment cap is not allowed for APTC paid on behalf of individuals not lawfully in the U.S. Refer to Instructions for Form 8962 and Publication 974 for additional information. The repayment cap applies in all other situations in which a taxpayer’s household income is below 400 percent of the applicable FPL and the applicable repayment cap amount is less than the taxpayer’s excess APTC.

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

The itemized deduction for health insurance premiums is net of PTC meaning that only the portion of the premiums that exceeds the PTC is deductible. For taxpayers who itemize their deductions, the deduction for health premiums is increased for any APTC repayment and decreased for additional PTC as shown on Form 8962.

For taxpayers who are self-employed claiming the self-employed health insurance adjustment to gross income, the calculation becomes circular and their returns are out of scope for VITA/TCE. Refer such taxpayers to a professional tax preparer or Publication 974.

Brandon is single with no dependents. When he enrolled through the Marketplace, Brandon was approved for APTC based on his projected household income. Brandon's Form 1095-A shows APTC of $1,486. Based on Brandon's actual modified AGI, he is eligible for a PTC of $500. Brandon's income is household income is at 310 percent of the FPL, so he is allowed a repayment limitation. Brandon must increase his tax liability by the lesser of the excess of his APTC over his PTC, $986, or the repayment limitation.

Question 5: Pedro is retired and covered by Medicare. His wife Camilla is too young for Medicare. Both are U.S. citizens. Even though Pedro is on Medicare, can Camilla get a PTC if she enrolls in coverage through the Marketplace (and is otherwise eligible for a PTC)?

a. Yes

b. No

Question 6: You are completing the return for Antonio, who purchased health coverage through the Marketplace and received the benefit of APTC. In completing Form 8962, you note that Antonio's MAGI is 401 percent of the FPL and the calculation shows that he has to repay most of his APTC. Assuming that Antonio would be entitled to an IRA deduction if he made an IRA contribution, can Antonio reduce his MAGI for the PTC calculation even though the tax year has ended?

a. Yes

b. No

Question 7: Piper's income is 300 percent of the FPL for her family size. She purchased health insurance through her employer. Is Piper eligible to take the PTC for her coverage? □ Yes □ No

Question 8: Harry purchased insurance through the Marketplace. What form will he receive from the Marketplace to prepare his tax return?

a. Form 8962

b. Form 1095-A

c. Form W-2

Question 9: Roger’s APTC is $2,500. He is single with no dependents, and lives in Mississippi. On Form 8962, he calculates an actual PTC of $1,000. His household income is over 300 percent of the FPL but under 400 percent of the FPL for a family size of one. Does the repayment limitation apply to Roger?

a. Yes

b. No

Question 10: Judy is single with no dependents. In December, Judy enrolled through the Marketplace in a qualified health plan for the following year. On July 14, Judy enlisted in the Army and was immediately eligible for government sponsored minimum essential coverage. For what period is Judy able to claim a PTC (if she meets all of the eligibility criteria)?

a. The entire tax year

b. January through June

c. January through July

d. Judy is not eligible for the PTC

What about unusual situations?

This lesson does not cover all the situations you may encounter. For situations listed below, consult the Volunteer Resource Guide, Tab H, Other Taxes, Payments, and Refundable Credits, instructions for Form 8962 and Publication 974.

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

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

What if taxpayers must allocate policy amounts for a policy purchased through the Marketplace?

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

The following taxpayers may have to do a shared policy allocation:

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

Taxpayers allocate policy amounts on Form 8962, Part IV. Returns that require an allocation of policy amounts are out of scope for the VITA/TCE programs.

What if the taxpayer becomes eligible for employer coverage?

Generally, a taxpayer is not eligible for the premium tax credit if an employer offers affordable self-only coverage. The employee safe harbor provides an exception as discussed above. That is, the employer-sponsored coverage is treated as unaffordable if (1) accurate information was provided to the Marketplace about the cost of employer-sponsored coverage and (2) the Marketplace determined that the taxpayer was eligible for advance payments of the premium tax credit (APTC) because employer-sponsored coverage was unaffordable. The employee safe harbor does not apply if, with reckless disregard for the facts, the taxpayer provided incorrect information to a Marketplace concerning the portion of the annual premium for self-only coverage for the employee under the plan. In this case, the SLCSP benchmark cost should be set to zero for months of ineligibility and the full amount of APTC will be repaid (subject to the appropriate cap).

What about an individual the taxpayer enrolled who does not file a return and is not claimed as a dependent by anyone?

If an individual for whom APTC was paid neither files a tax return for the year the APTC was paid, nor is claimed as a dependent on a tax return for the year the APTC was paid, the taxpayer who indicated to the Marketplace at enrollment that the individual would be in the taxpayer's tax family for the year the APTC was paid must report the APTC paid for that individual's coverage. See the instructions for Form 8962 and Publication 974 for more information.

What if taxpayers get married during the year?

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

What about individuals not lawfully present?

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

Summary

The Affordable Care Act addresses health insurance coverage and financial assistance options for individuals and families, including the PTC.

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

The PTC is claimed on Form 1040, Schedule 3. Any excess APTC that must be repaid is entered on Form 1040, Schedule 2.

Through 2025, a taxpayer’s required contribution is less than in prior years. Also, taxpayers with household income over 400% of the FPL may be allowed a PTC through 2025. Thus, more taxpayers who purchase their health coverage through the Marketplace will be able to claim PTC for these years.

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

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

- Self-employed health coverage deductions for taxpayers who are also allowed a PTC
- Form 8962 Part IV, Allocation of Policy Amounts, and Part V, Alternative Calculation for Year of Marriage
- If there is a code FF on Form W-2, Box 12 and the employee has a Marketplace policy and is otherwise eligible for PTC, if extended,
- Individual Coverage Health Reimbursement Arrangement (ICHRA) with Marketplace coverage

EXERCISE Answers

Answer 1: b, No. Hank's income is below the filing threshold for a dependent with earned income so his parents will not include his MAGI in the Household Income for ACA purposes.

Answer 2: a, Yes. Hank's income is above the filing threshold for a dependent with earned income, so his parents will include his MAGI in the Household Income for ACA purposes.

Answer 3: b, No. Leana has her own household.

Answer 4: a. As Married Filing Separately, she could only claim PTC if she qualifies under the exception for abused or abandoned spouses.

Answer 5: a, Yes. Camilla is eligible for a PTC if she enrolls in coverage through the Marketplace (and is otherwise eligible).

Answer 6: a, Yes. Antonio can make a deductible IRA contribution up until the April due date of the return.

Answer 7: b, No. the coverage must have been purchased through the Marketplace.

Answer 8: b. Form 1095-A.

Answer 9: a, Yes. His applicable repayment cap amount is less than his excess APTC of $1,500.

Answer 10: c. Judy is eligible for the PTC from January through July.

Terms You May Need to Know

Applicable taxpayer (for purpose of premium tax credit) – A taxpayer must be an applicable taxpayer to claim the premium tax credit (PTC). Generally, an applicable taxpayer is one who has household income of at least 100 percent of the federal poverty line (FPL) for his or her family size. An individual who can be claimed as a dependent by another taxpayer and a taxpayer who is married at the end of the year but doesn’t file a joint return cannot claim a PTC, although there are exceptions for head of household filers and victims of spousal abuse or abandonment.

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

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

Domestic abuse – Domestic abuse includes physical, psychological, sexual, or emotional abuse, including efforts to control, isolate, humiliate, and intimidate, or to undermine the victim's ability to reason independently. All the facts and circumstances are considered in determining whether an individual is abused, including the effects of alcohol or drug abuse by the victim's spouse. Abuse of the victim's child or any family member living in the household may constitute abuse of the victim. If the taxpayer is a victim of domestic abuse or abandonment and does not qualify to use Head of Household filing status, the taxpayer may be able to claim a premium tax credit if he or she files a return as Married Filing Separately and meets the exceptions as listed in Exception 2 of the married taxpayer definition later in this section. See Publication

974 for a list of documentation that the taxpayer should retain.

Employee safe harbor – If the Marketplace determines that, based on projected household income, an individual's employer coverage would be unaffordable for the year of coverage, the employer coverage is considered unaffordable for the employer's plan year even if the amount the employee must pay for the employer coverage does not exceed the applicable percentage of household income reported on the tax return.

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

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

- The taxpayer, the taxpayer's spouse, or a dependent enrolled in a policy through a Marketplace
- The Marketplace estimated at the time of enrollment that the taxpayer's household income would be at least 100 percent of the FPL for the taxpayer's family size; and
- Advance credit payments were made for the coverage for one or more months of the year

Family/Family size – For the purposes of Form 8962, a taxpayer's tax family consists of the taxpayer (unless the taxpayer qualifies as a dependent of another taxpayer), the taxpayer's spouse if a joint return is filed (unless the spouse qualifies as a dependent of another taxpayer) and the individuals who qualify as dependents of the taxpayer and whom the taxpayer claims by putting the individual's name and TIN on the Form 1040 or Form 1040NR the taxpayer files for the year.

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

FPL – Federal Poverty Line – An income amount considered poverty level for the year, adjusted for family size. Department of Health and Human Services (HHS) determines the federal poverty guideline amounts annually. The government adjusts the income limits annually for inflation. For purposes of the PTC, eligibility for a certain year is based on the most recently published guidelines as of the first day of open enrollment for the year of coverage. The FPL tables are in the Volunteer Resource Guide, Tab H, Other Taxes, Payments, and Refundable Credits.

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

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

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

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

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

MAGI – See Modified Adjusted Gross Income.

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

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

- Exception 1 (Head of Household filing status). The taxpayer may file a return as if he or she is unmarried and take the PTC if one of the following applies:
    - The taxpayer files a separate return from the taxpayer's spouse on Form 1040 because the taxpayer meets the requirements for married persons who live apart under Head of Household in the instructions for Form 1040.
    - The taxpayer files as Single on Form 1040NR because the taxpayer meets the requirements for married persons who live apart under Were You Single

or Married? in the instructions for Form 1040NR.

- Exception 2. If taxpayer is a victim of domestic abuse or abandonment and does not qualify to use Head of

Household filing status, the taxpayer may claim a premium tax credit if he or she files a return as Married Filing Separately and meets the following:

  - The taxpayer is living apart from his or her spouse at the time the taxpayer files the current year tax return.
  - The taxpayer is unable to file a joint return because he or she is a victim of domestic abuse or spousal abandonment.
  - The taxpayer checks the box on Form 8962 to certify that he or she is a victim of domestic abuse or spousal abandonment.

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

Modified Adjusted Gross Income (MAGI) for PTC – MAGI is a taxpayer's adjusted gross income plus his or her untaxed foreign earned income, tax-exempt interest, and Social Security benefits not included in

income. The taxpayer's MAGI is increased by the MAGI of a claimed dependent who is required to file a tax return because their income meets the filing threshold.

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

Qualified health plan – A health plan certified by the Department of Health and Human Services to be offered through the Marketplace. Plans in the Marketplace are offered in different categories: Bronze, Silver, Gold, and Platinum ("catastrophic" plans are also available to some people, but do not qualify for PTC and no Form 1095-A will be issued). See **www.healthcare.gov** for additional information about plan levels.

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

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

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

Spousal abandonment – A taxpayer is a victim of spousal abandonment for a taxable year if, taking into account all facts and circumstances, the taxpayer is unable to locate his or her spouse after reasonable diligence. If taxpayer is a victim of domestic abuse or abandonment and does not qualify to use Head of Household filing status, the taxpayer may claim a premium tax credit if he or she files a return as Married Filing Separately and meets the exceptions as listed in Exception 2 of the **Married taxpayer** definition above. See Publication 974 for documentation that the taxpayer should retain.

Tax family – For the purposes of Form 8962, a taxpayer’s tax family consists of the taxpayer (unless the taxpayer qualifies as a dependent of another taxpayer), the taxpayer’s spouse if a joint return is filed (unless the spouse qualifies as a dependent of another taxpayer), and the individuals who qualify as dependents of the taxpayer and whom the taxpayer claims by putting the individual’s name and TIN on the Form 1040 or Form 1040NR the taxpayer files for the year. The tax family does not include individuals a taxpayer can but does not claim as dependents.

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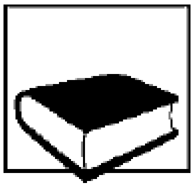
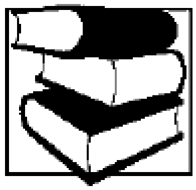
Other Taxes

Introduction

This lesson covers the Other Taxes reported on the return. You will determine if taxpayers owe additional taxes, which can decrease a refund or increase a balance due.

Objectives

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

- Identify the different types of other taxes on a return
- Determine if a taxpayer is liable for other taxes that are within scope of the VITA/TCE programs

- Determine how to report these additional taxes on the tax return and complete the applicable forms or schedules

What do I need?

- Form 13614-C
- Publication 4012
- Publication 17

Optional:

- Publication 1244
- Form 1040 Instructions
- Form 4137
- Form 5329 and Instructions
- Form 5405 and Instructions
- Form W-2
- Schedule SE

What are other taxes?

“Other taxes” are different from the income tax from the tax tables or figured using one of the tax computation worksheets. They include, but are not limited to:

- Self-employment tax
- Social Security and Medicare taxes on tip income
- Additional taxes on IRAs and other qualified retirement plans
- Additional tax on taxable HSA distributions
- Repayment of first-time homebuyer credit

These amounts are usually calculated on their own form or schedule and entered on Form 1040, Schedule 2. The taxes are added after the nonrefundable credits are calculated; the nonrefundable credits do not reduce the other taxes.

Household employment taxes are also included in Other Taxes. However, this topic is beyond the scope of the VITA/TCE programs. Taxpayers who must file household employment taxes should be referred to a professional tax preparer.

Two additional taxes may apply to taxpayers with higher income. These are the additional Medicare tax on wages (Form 8959, Additional Medicare Tax) and the net investment income tax (Form 8960, Net Investment Income Tax Individuals, Estates, and Trusts). Taxpayers with income levels large enough to incur these taxes should be referred to a paid professional preparer.

Additional tax on early distributions from IRAs is covered under Basic certification if the additional tax applies. Advanced certification is required if exceptions to the additional tax apply and for other topics in this lesson. If an issue related to an Advanced-level topic arises at a *volunteer site, be sure that a volunteer with required certification provides assistance.*

Refer to the Premium Tax Credit lesson contained in this publication for information on the repayment of the advanced premium tax credit.

What is self-employment tax?

Self-employment (SE) tax is Social Security and Medicare taxes collected primarily from individuals who work for themselves. It is similar to the Social Security and Medicare taxes withheld from the pay of most wage earners except a self-employed individual pays both the employee part and what would be the employer part. Payments of SE tax contribute to the taxpayer's coverage under the Social Security system. Social Security coverage provides the taxpayer with retirement, disability, survivor, and hospital insurance (Medicare) benefits.

Who must pay self-employment tax?

SE tax must be paid if either of the following applies:

- The taxpayer had income as a church employee of $108.28 or more.
- The taxpayer receives net earnings from self-employment income in the amount of $400 or more (excluding church employee income).

The VITA/TCE programs' scope includes Schedule C, with limits.

Generally, taxpayers who are independent contractors or sole proprietors must file Schedule C and Schedule SE. Since taxes are not withheld from independent contractors' pay, it is the taxpayer's responsibility to pay income and SE tax. Taxpayers should make quarterly estimated tax payments during the year to pay these taxes.

The Social Security Administration uses the information from Schedule SE to figure a person's benefits under the Social Security program. Not reporting all of a taxpayer's self-employment income could cause their Social Security benefits to be lower when they retire.

This tax applies no matter how old the taxpayer is and even if they are already getting Social Security or Medicare benefits.

Self-employed taxpayers who receive tips should include the tips in gross receipts on Schedule C.

How do I complete Schedule SE?

Net Profit from Business was covered in an earlier lesson. When assisting a taxpayer with self-employment income, first complete Schedule C. Schedule SE is used to calculate the self-employment tax. The deductible part of the self-employment tax is reflected as an adjustment to income on Form 1040, Schedule 1. The adjustment to income is similar to the benefit that employers receive when they deduct their share of the Social Security and Medicare taxes as payroll taxes.

Self-employment tax is Social Security and Medicare taxes collected primarily from individuals who work for themselves, similar to the Social Security and Medicare taxes withheld from the pay of most wage earners.

The self-employment tax rate on net earnings is 15.3% (12.4% Social Security tax plus 2.9% Medicare tax).

The software automatically transfers the appropriate information from Schedule C to Schedule SE and calculates the self-employment tax and the adjustment for the deductible part of the self- employment tax.

Partial tax deferral for certain Schedule SE filers

Self-employed individuals may have deferred the employer portion of the Social Security tax on self- employment income earned from March 27, 2020 through December 31, 2020. Half of the deferred Social Security tax was due by December 31, 2021, and the remainder is due by January 3, 2023 unless paid earlier (the worksheet in the 2020 tax return shows the actual amounts deferred and when they are due). IRS mailed to affected taxpayers instructions, vouchers, and envelopes for the deferred payments. Refer taxpayers who have questions regarding payment of deferred tax to **www.irs.gov/newsroom/how-self-employed-individuals-and-household-employers-repay-deferred-social-security-tax**

Who does not pay self-employment tax?

Some professions do not have a requirement to pay the self-employment tax:

- Notaries public are not subject to the self-employment tax by law. Be sure to identify notaries on the input forms.
- Statutory employees have Social Security and Medicare tax withheld and do not have to pay the self- employment tax even though they report their income and expenses on Schedule C.

Enter the net profit from a notary's business on the SE Tax input screen so that SE tax is not computed.

What about taxes on unreported tip income?

All tip income is subject to federal income tax. However, tips of less than $20 per month that are not reported to the employer are not subject to Social Security and Medicare taxes.

Individuals who receive $20 or more per month in tips from any one job must report their tip income to their employer. The employer reports these tips as part of the wages on Form W-2, Box 1. The employer withholds Social Security and Medicare taxes and federal income tax on that income.

What about allocated tips?

An employer may "allocate" tips to an employee if the employee worked in a restaurant, cocktail lounge, or similar business and reported tips that were less than the employee's share of 8% of food and drink sales. If the employer allocates tips to employees, the amount is reported on Form

W-2, Box 8, and included in income on Form 1040. Social Security and Medicare taxes are not withheld on allocated tips. The employee

pays the Social Security and Medicare taxes by completing Form 4137, Social Security and Medicare Tax on Unreported Tip Income.

If the employee can show, using Publication 1244, Employee's Daily Record of Tips and Report to Employer, or some similar daily tip record, that the actual tips received are different from the allocated amount, then the actual amount is reported on Form 1040. The actual tips received are also reported on Form 4137 to calculate Social Security and Medicare taxes.

What about tips that the employee did not report to the employer?

If the employee received $20 or more in unreported cash and charge tips in any month from any job, the employee must report that income on Form 1040 and pay the Social

Security and Medicare taxes on that income. But, if the employee received less than $20 in tips in any month from any job, they are not required to report them to the employer. However, these amounts do need to be included on Form 1040. They will not be subject to Social Security or Medicare taxes and you will need to indicate that on Form 4137.

See Volunteer Resource Guide, Tab D, Income, for instructions on reporting tip income. The software calculates Social Security and Medicare taxes on the tips based on your entries on the W-2 input and Form 4137 input. The software will also add unreported tips to Form 1040 as wages.

Carla waits tables at a café. Her employer reports all tips that customers add to their credit card tabs, but she leaves it up to Carla to keep track of her *cash tips. Carla receives more than $20 per month in cash tips. Carla keeps a record but, because she doesn't report her cash tips to her employer, they are not included on her Form W-2. Carla includes the unreported tips as income on Form 1040. Carla also uses Form 4137 to calculate and pay the Social Security and Medicare taxes on those tips.*

How do I figure and report these taxes?

As part of your interview, explain to taxpayers that sometimes people do not realize they owe taxes on tips they do not report to their employer. Also explain the taxes paid on those tips actually boost the taxpayer's future Social Security benefits.

To figure the tax, determine if during any month the taxpayer received $20 or more in tips that were not reported to the employer.

Unreported tips are entered on the W-2 screen.

EXERCISES

Answers follow the lesson summary.

Question 1: Nancy had a summer job at a coffee hut. She made $18 in tips in May, $755 in June, $600 in July, and $45 in August. Until a co-worker told her, she didn’t realize she had to report her tips to their employer. She then reported $1,000 in tips to her boss.

What amount of tips will Nancy have to add to her Form 1040 as wages?

a. $1,418

b. $1,000

c. $418

d. $18

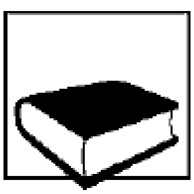
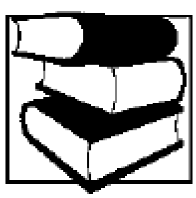
Question 2: What amount of unreported tips does Nancy have to pay Social Security and Medicare taxes on when she files her tax return?

a. $1,418

b. $400

c. $45

d. $18

What about taxes on IRAs and other qualified retirement plans?

Traditional IRAs and other qualified plans allow individuals to defer paying taxes on contributions and earnings until the funds are distributed.

If the rules for contributions and distributions are not followed, additional taxes may be due. For example, the taxpayer must pay income tax plus an additional tax if any of the following apply:

- A distribution is taken before the individual reaches the age of 59½, is not rolled over into another qualified plan or IRA, and no exception applies
- Minimum distributions are not withdrawn when required (out of scope)
- Excess contributions are not withdrawn by the due date of the return including extensions — out of scope if the 6% excess contribution additional tax applies

The additional tax for each situation is outlined on Form 5329, Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts.

Only Part I of Form 5329 is in scope. This part provides for the exceptions to the additional tax on part or all of the early distributions from IRAs or qualified pension plans. The other parts of Form 5329 are out of scope;

refer taxpayers with these issues to a professional tax preparer.

Some exceptions apply only to IRA distributions, some apply only to distributions from a qualified retirement plan, and some exceptions apply to both IRA and retirement plan distributions. Refer to the Volunteer Resource Guide, Tab H for the list of exceptions.

Refer to the intake and interview sheet, Part III – Income, for the question regarding retirement income or payments from pensions, annuities, and/or IRA. If yes is checked, review any Form 1099-R that reports these payments to determine if the taxpayer is subject to the additional tax or qualifies for an exception.

If Form 1099-R correctly shows code 1 in Box 7 indicating an early distribution, the additional tax applies unless the taxpayer qualifies for an exception. In some circumstances, Form 5329 is not required.

Tax software does this automatically based on entries on Form 1099-R.

Additional tax for early distributions

An additional tax of 10% applies to a distribution before age 59 1/2 unless an exception applies. If an exception applies, it is claimed on Form 5329, Part I. Exceptions include the following.

Early distribution in case of birth or adoption of child

An IRA owner or a participant in a workplace-defined contribution plan, such as a 401(k) or 403(b) plan, can withdraw up to $5,000 for the birth or adoption of a child without incurring the usual 10% additional tax on early distributions. The distribution must be made within one year after the child is born or the adoption is finalized and cannot be from a defined benefit plan. Within three years of receiving the distribution, the IRA owner or plan participant may generally repay any portion of the distribution as a rollover contribution to an eligible retirement plan, including an IRA.

A qualified distribution due to the birth or adoption of a child received prior to December 29, 2022, may be repaid before January 1, 2026.Taxpayers who repay a qualified birth or adoption distribution are required to file Form 8606 and are therefore out of scope.

Early distribution exception for public safety employees

Qualified public safety employees who receive distributions from a governmental defined benefit pension plan aren’t subject to the additional tax on early distributions. Qualified public safety employees include those who provide police protection, firefighting services, emergency medical services for a state or municipality, private sector firefighters, corrections officers and forensic security employees providing for the care, custody, and control of forensic patients. Further, they must have separated from service in or after the year they attained age 50 or reached 25 years of service, if earlier.

For purposes of the exception, the definition of qualified public safety employees also includes federal law enforcement officers, federal customs and border protection officers, federal firefighters, air traffic controllers, nuclear materials couriers, members of the United States Capitol Police or Supreme Court Police, and diplomatic security special agents of the Department of State.

Other early distribution exceptions

In addition to the two exceptions discussed above, other exceptions include:

- Unreimbursed medical expenses that are more than 7.5% of AGI
- The cost of medical insurance during a period of unemployment
- Qualified higher education expenses
- Total and permanent disability
- Terminal illness
- Being a beneficiary of a deceased IRA owner
- Receiving distributions in the form of a series of substantially equal periodic payments
- Distributions to buy, build, or rebuild a first home

- The distribution is due to an IRS levy of the IRA or retirement plan
- Qualified reservist distributions
- Qualified natural disaster distributions (up to $22,000) - requires the taxpayer to incur a disaster loss and is out of scope

Refer to the Volunteer Resource Guide or Publication 590-B for details.

How do you complete Form 5329, Part I?

If an exception to the additional tax on early distributions applies, Form 5329, Part I, must be completed. Refer to the Volunteer Resource Guide, Tab H for the software entries and exception codes.

When the early distribution is from a SEP IRA and it is made within two years from when participation in the plan began, the addition to tax is computed using a rate of 25% instead of 10%. Such a *distribution is designated by Code S in Box 7 of Form 1099-R.*

Do not reduce medical expenses or education expenses eligible for a deduction or credit for the amounts used to reduce the addition to tax on an early distribution. This is not a double dip situation and is allowable.

Laura is 41 years old and received an early distribution from her 401(k) account. The volunteer determines that Laura paid for unreimbursed qualified medical expenses in excess of 7.5% of her AGI, which is more than the amount of her distribution. In this case Form 5329, Part I, would be completed. Laura would not have to pay the additional tax on this distribution. If Laura is itemizing deductions, she can claim the whole amount of her medical expenses even though she used the expenses to reduce the additional tax.

What is the addition to tax for failing to take a minimum distribution?

An owner of a traditional IRA must generally start receiving distributions from their IRA when they reach a certain age.

The additional tax is 25% of the distribution shortfall. The additional tax can be further reduced to 10% if certain corrective distribution rules are satisfied. Taxpayers who have not taken their required minimum distribution are out of scope and should be referred to a professional tax preparer.

What is the additional tax on excess contributions?

Generally, an excess contribution is the amount contributed to a traditional IRA and/or a Roth IRA for the year that is more than the general limitation amount or the taxable compensation for the year. The additional tax is 6% of the excess each year the excess remains in the IRA. Application of the additional tax is out of scope for the VITA/TCE programs.

What about the addition to tax on taxable HSA distributions?

If distributions are not rolled over or offset by qualified medical expenses, the amount withdrawn will be included in income and reported on Form 1040. HSA distributions included in income are subject to an additional 20% tax unless the account beneficiary:

- Died
- Became permanently and totally disabled
- Turned age 65

If one of these exceptions applies, it is claimed on Form 8889, Part II.

An HSA distribution that is rolled over to another HSA is not taxable and not subject to the additional 20% tax. See the Adjustments lesson.

What about repayment of the first-time homebuyer credit?

Certain situations may require the first-time homebuyer credit to be repaid and reported on Form 1040, Schedule 2. Review the Life Events section of the intake and interview sheet to determine if the taxpayer claimed the 2008 homebuyer credit and must pay back a portion of the credit each year.

If the taxpayer received the first-time homebuyer credit for a home purchased in 2008, generally they must repay the credit over a 15-year period in 15 equal installments. The repayment period began in 2010.

However, if the home ceases to be the taxpayer's main home before the 15-year period is up, the taxpayer must repay all remaining annual installments.

The home ceases to be the main home if the taxpayer sells the home; converts the entire home to business or rental property; the home is destroyed, condemned, or disposed of under threat of condemnation; or the lender forecloses on the mortgage. There are certain exceptions to the repayment rule. See the general instructions for Form 5405 for details.

If the taxpayer dies, they do not have to repay the balance of the credit.

Special rules apply for taxpayers who filed a joint return for 2008 and claimed the first-time homebuyer credit. If the home is transferred to a spouse (or ex-spouse as part of a divorce), the spouse receiving the home is responsible for repaying the credit, unless an exception applies.

Or if one of the spouses dies, their half of the remaining credit is forgiven and does not need to be paid back.

The credit is repaid by including it as additional tax on the return for the year the home ceases to be the taxpayer’s main home. If the taxpayer is required to repay the credit, it is calculated on Form 5405 and reported on Form 1040, Schedule 2. Certain taxpayers who are repaying an installment of the credit claimed for homes purchased in 2008 are not required to file Form 5405. See Form 5405 Instructions for more information.

Summary

This lesson explained how to report Other Taxes on the return. Other taxes are not calculated using the income tax tables or the tax computation worksheets. They include:

- Self-employment tax

- Social Security and Medicare taxes on unreported tip income
- Additional taxes on IRAs and other qualified retirement plans
- Additional tax on taxable HSA distributions
- Repayment of first-time homebuyer credit

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

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

- Employment taxes for household employees
- IRA minimum distributions not withdrawn when required
- Excess contributions to an IRA that are not taken by the due date of the return including extensions if the excess contribution addition to tax applies

- Distributions or excess contributions shown on parts II through IX of Form 5329 (only Part I is in scope)
- Distribution from an ABLE account that exceeds the qualified disability expenses
- Individuals subject to the additional Medicare tax on Form 8959
- Individuals subject to the net investment income tax on Form 8960

To gain a better understanding of the tax law, complete the practice return(s) for your course of study using the Practice Lab on L&LT.

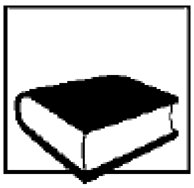
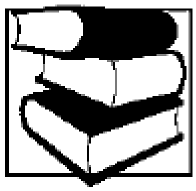
EXERCISE Answers

Answer 1: c. Nancy’s combined tips for May, June, July, and August were $1,418, and she reported only

$1,000 to her employer. She needs to add $418 as wages on her tax return.

Answer 2: b. Nancy does not have to pay Social Security and Medicare taxes on the tips she received in May, because they amounted to less than $20 for the month.

Payments and Miscellaneous Refundable Credits

Introduction

This is one of several lessons that cover the total payments on the return, which includes payments, additional child tax credit, the refundable education credit, and the earned income credit. After finishing these lessons, you will be able to complete the appropriate lines and schedules of the taxpayer’s return. This lesson covers income tax withholding, estimated tax payments, certain refundable credits, and other payments made by the taxpayer. Some of the credits will be entered on the appropriate lines of the return while some payments and credits may be entered on Schedule 3, Additional Credits and Payments.

Premium tax credit, additional child tax credit and the refundable education credit have already been covered. Earned income credit will be covered in the next lesson.

Objectives

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

- Identify the following types of payments and credits that are applicable for most low- and moderate-income taxpayers:
  - Federal income tax withheld from Forms W-2, Wage and Tax Statement
  - Federal income tax withheld from Forms 1099
  - Estimated tax payments and amounts applied from the prior year's return
  - Amount paid with a request for an extension to file

    - Excess Social Security and tier 1 RRTA tax withheld

- Report these payments and credits correctly on the taxpayer’s return

The information you obtain from the taxpayer’s Intake/Interview and Quality Review Sheet will help you determine the payments and credits that should be reported. Refer to the Volunteer Resource Guide, Tab H, Other Taxes, Payments, and Refundable Credits, to identify and review the payments reported on a return.

What do I need?

- Form 13614-C
- Publication 4012
- Publication 17
- Form W-2
- Form 1040

Optional:

- Publication 505
- Form 1040 Instructions
- Form 1040-ES
- Forms 1099
- Form 4868
- Form 8962

How do I report federal income tax withheld?

The federal income tax system is a “pay as you go” system. That means tax is paid as income is earned or received during the year and is referred to as withholding credit.

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

- Salaries and wages
- Tips

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

If taxpayers have income tax withheld during the tax year, they will receive one of the following forms showing the amount withheld:

- Form W-2, Wage and Tax Statement
- Form W-2G, Certain Gambling Winnings
- One or more of several different types of Forms 1099

The amounts withheld are entered on the lines for federal income tax withheld.

The unintentional omission of withheld income tax is a common error. To avoid this mistake, review your input on each form to ensure all income taxes withheld are included before proceeding to the next one.

The total amount withheld from income is included on the return. If a paper return must be filed, attach all Forms W-2 and any Forms W-2G and Forms 1099 if tax was withheld.

Freda worked as a clerk and received a Form W-2 that reported federal income tax withholding of $1,000. She also received Form 1099-INT from her bank, which reflected federal income tax withholding of $50. The correct total withholding reported on her return would be $1,050 ($1,000 + $50).

Refer to prior lessons for:

- *Education Credits*
- *Child Tax Credit*
- *Premium Tax Credit*

When you enter information from the taxpayer's Form(s) W-2 and Form(s) 1099, including the federal income tax withheld, the tax software calculates the total and displays it on the appropriate line of the return.

What about estimated taxes and amounts applied from the prior year's return?

What are estimated tax payments?

Many taxpayers have income from self-employment, dividends, interest, capital gains, rent, and royalties. The "pay as you go” system also applies to this income. If the tax due on this income exceeds certain limits, estimated tax must be paid quarterly by the taxpayer. If estimated tax payments are not paid when they

are required, a penalty could be imposed. This also applies if taxpayers do not have enough income tax withheld from their salary or wages. See the Refund and Amount of Tax Owed lesson for more information on estimated taxes.

Estimated tax is used to pay both income tax and self-employment tax, as well as other taxes and amounts reported on your tax return.

Where do I get this information?

Review the taxpayer’s Intake/Interview and Quality Review Sheet to determine if they had income from sources such as self-employment or investments for which taxes may not have been withheld. If so, ask, “Did you pay estimated taxes to the IRS?" Be sure to note the dates and amounts of the payments on the intake and interview sheet and enter them into the software.

If taxpayers need more information about estimated taxes, refer them to Form 1040-ES, which includes instructions and a worksheet for computing the amount of estimated taxes they should pay. Forms can be obtained on IRS.gov.

If a taxpayer paid substantially more or less than required in estimated tax, encourage them to recalculate it. They can adjust their estimated tax payments by following the instructions and worksheet on Form 1040-ES. Taxpayers who are wage earners should use the IRS Tax Withholding Estimator to determine whether they need to update their withholding.

What about tax payments applied from a previous year?

Taxpayers who overpay their income taxes in one year can apply all or part of their overpayment to the next year's estimated tax by indicating the amount they want to apply.

Where do I get this information?

This information should be included in the taxpayer's Intake/Interview and Quality Review Sheet, but confirm by asking the taxpayer:

- Did last year's return show an overpayment?
- Did you apply any part of the overpayment to this tax year?

If the answer is "yes" to both questions, ask to see last year's tax return to document the amount of tax applied to this year's tax return. Add this amount on the applicable line on Form 1040.

For software entries to record current year estimated tax payments, go to the Volunteer Resource Guide, Tab K, Finishing the Return.

Taxpayer Interview and Tax Law Application

Let's see how our volunteer helped a taxpayer, Ernie, with his payments.

Sample Interview

Volunteer Says...	Ernie Responds...
The tax software added up all the income tax withheld from your Forms W-2 we entered earlier. I know you had a little self-employment income and I see you	Yes, I did.

responded “yes” to the question on estimated tax payments on the intake and interview sheet. Is that correct?	
Do you have a record of your payments, perhaps on a Form 1040-ES?	Yeah, here it is.
Good, you paid each quarter. We’ll enter those payments. While we’re here, did last year’s return show an overpayment?	Yes, here it is: $150.
Did you apply any of that overpayment to this year’s tax return?	Yes, all of it.

Okay, we'll enter that too. Now we show the total of the withholding from your Forms W-2, your estimated tax paid and the refund amount from last year's return applied to this year.	Good!

What about amounts paid with an extension to file?

Taxpayers can get an automatic six-month extension of time to file by submitting Form 4868, Application for Automatic Extension of Time To File U.S. Individual Income Tax Return. This form extends the time to file until October 15. This is only an extension to *file*, not an extension to *pay*. If taxpayers do not pay their taxes by April 15, they will owe interest and may be charged penalties.

If the April 15 or October 15 deadline falls on a Saturday, Sunday, or legal holiday, the deadline is the next business day.

Later, when taxpayers file their return, they report the payment made with Form 4868 on the applicable line on Form 1040, Schedule 3.

One of Bernice's Forms W-2 was lost in the mail. She requested a copy from her former employer, but it did not arrive by April 15. She filed for an extension, calculated the amount of taxes owed based on her final pay stub from that employer, and paid the $243 that was due. When she finally received her Form W-2, she filed her return and reported the $243 on the applicable line on Form 1040, Schedule 3.

How can taxpayers file the extension?

Taxpayers may file the extension electronically or on paper. The extension must be transmitted or mailed by the due date of the return. You can help taxpayers file for an extension using the tax software.

Go to the Volunteer Resource Guide, Tab M, Other Returns, to review the step-by-step procedures for filing for an extension or review the Completing the Return lesson for additional information.

What is excess Social Security and tier 1 RRTA tax withholding?

A taxpayer may have more than one employer and a combined income over the Social Security wage base. This means the taxpayer may have paid more in Social Security tax than is required. This excess amount is reported on the applicable line on Form 1040, Schedule 3, and is a refundable credit.

The software will calculate this automatically based on the amount entered for each Form W-2. Therefore, be sure the information from each Form W-2 is accurately entered.

How do I find the total payments?

Figuring the total tax payments is easy. Add the total amount of federal withholding, estimated tax payments and amount applied from prior year return, plus the other payments and refundable credits (which includes any amounts from Schedule 3).

The software totals all payments automatically.

Summary

Listing all the payments the taxpayer made during the year, and the taxpayer's refundable credits is critical to completing an accurate return. You must be able to identify the types of payments and credits that apply to each taxpayer when you are preparing their return.

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

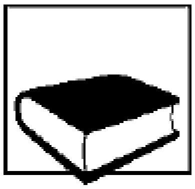
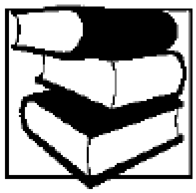
The following is out of scope for this lesson. While this list may not be all inclusive, it is provided for your awareness only.

- Taxpayers who choose to claim any of the following credits:
  - Form 4136, Credit for Federal Tax Paid on Fuels
  - Form 2439, Notice to Shareholder of Undistributed Long-Term Capital Gains

- Form 8839, Qualified Adoption Expenses
- Credit for repayment of amounts included in income in a previous year (IRC 1341)

To gain a better understanding of the tax law, complete the practice return(s) for your course of study using the Practice Lab on L&LT.

Earned Income Credit (EIC)

Introduction

This lesson covers the earned income credit (EIC). There are several common errors associated with claiming this credit on the return. The Volunteer Resource Guide and the intake and interview sheet are critical tools in avoiding these mistakes.

Objectives

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

- Determine if a taxpayer is eligible for the earned income credit
- Calculate the earned income credit

What do I need?

- Form 13614-C
- Publication 4012
- Publication 17
- Form 1040 and Instructions
- Form 8862

Optional:

- Publication 596
- Schedule EIC

What is the EIC?

The earned income credit (EIC) is a refundable tax credit for most people who work but do not earn high incomes. The purpose of the EIC is to reduce the tax burden and to supplement the wages of working families whose earnings are less than the maximums for their filing status. Eligible taxpayers can receive a refund with this credit, even if they have no filing requirement, owe no tax, and had no income tax withheld. All taxpayers and dependents must have valid Social Security numbers by the due date of the return (including extensions) to claim the credit. The refund for taxpayers claiming the EIC will not be issued prior to February 15.

The EIC can be a very valuable credit. The EIC was permanently expanded to allow families to claim credit for three or more children. The EIC amounts are adjusted for inflation every year as shown in the Important Changes lesson.

The EIC is reported on its own line on the tax return.

How does a taxpayer qualify for the EIC?

There are general sets of rules for claiming the earned income credit:

- Rules for everyone
- Rules for taxpayers with a qualifying child
- Rules for taxpayers who do not have a qualifying child

What rules apply to everyone?

The taxpayer must meet all the rules to qualify for the earned income credit. Turn to the chart titled Summary of EIC Eligibility Requirements in the Volunteer Resource Guide, Tab I, Earned Income Credit. Review Part A, Rules for Everyone, and Part D, Earned Income and AGI Limitations.

Both earned income and adjusted gross income must be below the income limits in order for the *taxpayer to qualify for the EIC. These amounts are adjusted for inflation every year.*

Taxpayers can claim EIC who are married, not filing a joint return, had a qualifying child living with them for more than 1/2 the year and either lived apart from their spouse for the last 6 months of the year or are legally separated according to state law under legal separation agreement or a decree of separate maintenance and didn't live in the same household as the spouse at the end of the year.

Taxpayers cannot file an amended return to retroactively claim EIC for any year in which they did not have a valid Social Security number by the due date of the return (including extensions).

Singles and couples who have Social Security numbers can claim the credit, even if their children don't have SSNs. In this instance, they would get *the smaller credit available to childless workers. In the past, these filers didn't qualify for the credit.*

James and Jill are filing a joint return and both have valid SSNs. They have two daughters; Susie has a valid SSN and Sally has an ITIN. Only the daughter with the valid SSN may qualify the tax return for EIC.

There is a limit to the amount of investment income a person can receive and still qualify for the EIC. See the Volunteer Resource Guide, Tab I, Earned Income Credit, Summary of EIC Eligibility Requirements for the investment income limit. Investment income includes such items as taxable interest and dividends, tax-exempt interest, capital gain net income, and income from residential rental property.

What is earned income for EIC purposes?

Earned income includes wages, salaries, tips, and other taxable employee pay and self-employment income. Turn to the Earned Income Table in the Volunteer Resource Guide, Tab I, Earned Income Credit, for examples of earned income.

One type of payment considered earned income is taxable long-term disability benefits received prior to minimum retirement age. Refer to the Retirement Income lesson earlier for additional information.

Volunteers using software must check the box in the Rollover or Disability section of the Form 1099- R input screen to report disability as wages. To review information on reporting disability income for a person under retirement age, go to the Volunteer Resource Guide, Tab D, Income.

What about combat pay?

Combat pay is never taxable to most soldiers. Members of the U.S. Armed Forces who served in a combat zone may elect to include their nontaxable combat pay in their earned income for the purposes of computing this credit. Doing this may increase or decrease the taxpayer’s EIC. If the election is made, *all* of the nontaxable combat pay must be included. If both spouses filing a joint return have combat pay, they can individually choose to make the election on the tax return.

If a taxpayer has combat pay listed in Box 12 of Form W-2 marked with code Q, the software will determine if the combat pay should or should not be added to the taxpayer’s income.

What about self-employment income?

Net earnings from self-employment are considered earned income. For most taxpayers within the scope of the VITA/TCE programs, "net earnings" for EIC purposes will be the amount reported as business income minus the deductible portion of the self-employment tax that is reported on Form 1040, Schedule 1.

Jeff's self-employment income reported on Form 1040 is $2,000. The deductible portion of his self-employment tax, which is recorded on Schedule 1 of Form 1040, is $142. His income for EIC purposes is $2,000 – $142 = $1,858.

Reminder: Nonwage income received for doing work (such as for side jobs or contract labor) is self- employment income, even for taxpayers who do not think of themselves as "self-employed." **All self- employment**

income and expenses are required to be reported on Schedule C, Profit or Loss from Business. Taxpayers not meeting the VITA/TCE programs' scope limitations for filing Schedule C will need to seek the assistance of a professional tax preparer.

An IRS certified volunteer tax preparer must exercise due diligence when preparing or assisting in the preparation of, approving, and filing tax returns. Although a volunteer tax preparer may rely in good faith on information provided by the taxpayer without requiring documentation as verification, the tax preparer must ask questions if the information furnished appears to be incorrect, inconsistent, or incomplete.

What about household employee income?

Domestic employees such as housekeepers are only issued Form W-2 if their earnings are more than a certain amount. Refer to Publication 926, Household Employer's Guide, for tax year amounts. Even if no W-2 is received, the income should be added to wages on Form 1040. This income should also be included when calculating the EIC.

What about Medicaid waiver payments?

Certain Medicaid waiver payments may be excluded from income under Notice 2014-7. Refer to the Wages, Interest, Etc. lesson for details. Even though excluded, these payments may be included in earned income if there is benefit from the inclusion. If both spouses earn Medicaid waiver payment income, each can make the election to include their MWP income as earned income for EIC purposes.

Earned income not qualifying for the EIC

One income item that is reported on Form W-2 but does not qualify as earned income for EIC purposes, is income received for work performed while an inmate in a penal institution.

A scholarship or fellowship grant that isn’t reported to the taxpayer on a Form W-2 also isn’t considered earned income for the EIC.

Generally, excluded income is not earned income for EIC purposes – exceptions are made for combat pay and Medicaid waiver payments as noted above. Refer to the Volunteer Resource Guide, Tab I, Earned Income Credit, for additional income that is not earned income.

Income received for work while an inmate is in a penal institution must be entered in the Less Common Income, Other Compensation, then Prisoner Earned Income line in addition to the Form W-2 entries.

EXERCISES

Use the Summary of EIC Eligibility Requirements Chart in the Volunteer Resource Guide, Tab I, Earned Income Credit, to answer the following questions. Answers follow the lesson summary.

Question 1: A taxpayer without a qualifying child is filing as Married Filing Separately. Does this taxpayer qualify for the EIC?

a. Yes

b. No

Question 2: A taxpayer has interest income of $4,500. His earned income is only $7,000. He is single, has a valid Social Security number and is not the qualifying child of anyone else. Does he qualify for the EIC?

a. Yes

b. No

What are the rules for taxpayers with qualifying children?

The taxpayer can file Form 1040 to claim the EIC with a qualifying child. The taxpayer has a qualifying child for EIC purposes if the child meets **all** the tests outlined in the Volunteer Resource Guide, Tab I, Earned Income Credit. A short version of the rules is shown in Part B, Rules If You Have a Qualifying Child.

EXAMPLE *Jane, 31, and Todd, 33, have an 8-year-old daughter, Amanda. All are U.S. citizens and have valid SSNs. Jane and Todd have never been married. Jane* *and Amanda lived together all year in an apartment. Todd lived alone. Jane earned $15,000 working as a clerk in a clothing store. Todd is an assistant manager of a hardware store and earned $48,000. He paid over half Jane's rent and utilities, and also gave Jane extra money for groceries. Todd does not pay any expenses or support for any other family member. Todd does not pay any expenses or support for any other family member.*

Although Todd provided over half the cost of a home for Jane and Amanda, he cannot file Head of Household and he cannot claim Amanda for EIC, since she did not live with him more than half the year. Jane cannot file as Head of Household either because she did not pay for more than half of her household costs. Jane is the only one who can claim Amanda as a qualifying child for EIC. Review the Earned Income Credit rules in the Volunteer Resource Guide, Tab I, Earned Income Credit.

For EIC purposes, a qualifying child does not have to be the taxpayer's dependent (unless the child is married). Specifically, there is no support test to be a qualifying child for EIC. Therefore, even if the child is not the taxpayer's dependent, the taxpayer may be able to claim the child for EIC if they meet the age, relationship and residency tests.

In the case of divorced or separated parents, the custodial parent (with whom the child lived for more than half the year) can qualify for the EIC regardless of whether or not they claim the child as a dependent. The noncustodial parent cannot qualify for EIC because the child did not live with them for more than half the year.