Publication 4491

VITA/TCE **Training Guide**

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

Volume 7 of 16

2023 RETURNS

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What other retirement income issues are there?

There are a few other issues related to reporting retirement income that you may encounter. Some of the following distributions are subject to various additional taxes that are computed on Form 5329. If certain exceptions are met, the additional tax does not apply.

Only the exceptions for early distributions not subject to the additional tax (Part I of Form 5329) are included in scope for the VITA/TCE training. Refer taxpayers who must complete other information on Form 5329 to a professional tax preparer. Form 5329 and exceptions are covered in the Other Taxes lesson.

Lump-Sum Distributions

A lump-sum distribution is the distribution or payment within one tax year of an employee's entire balance from all qualified pension, stock bonus, or profit-sharing plans that the employer maintains.

Lump-sum distributions are reported on Form 1099-R like any other pension distribution. Some lump-sum distributions qualify for special tax treatments. If Form 1099-R indicates a distribution code of A, it is a lumpsum distribution qualifying for special tax treatments. Taxpayers with this situation should be referred to a professional tax preparer.

Early Distributions

An early distribution is a withdrawal from a retirement fund by a taxpayer who is under age 59½. Early distributions can be subject to an additional 10% tax. The additional tax applies to the taxable portion of the distribution or payment.

Certain early distributions are not subject to the early distribution tax. When the distribution code on Form 1099-R is 1, the taxpayer will not be subject to the additional 10% tax if an exception applies.

If the distribution code is 2, 3, or 4, the taxpayer does not have to pay the additional tax. The exceptions for excluding early distributions, from the additional tax are covered in more detail in the Other Taxes lesson.

Minimum Distributions

To avoid an additional tax for excess accumulation, participants in retirement plans must begin taking a Required Minimum Distribution (RMD) by a specified date. That date is April 1 of the calendar year following the year in which the taxpayers either reached age 72 (73 if they reach age 72 after Dec. 31, 2022), or retired, whichever is later. For IRAs, it does not matter whether the taxpayer has retired. These rules do not apply to Roth IRAs. The trustee of the qualified plan will contact the taxpayer at the appropriate time to begin their RMD.

After the starting year for RMDs, taxpayers must receive the minimum distribution for each year by December 31 of that year. (The starting year is the year in which the taxpayer reaches age 72, 73 if they reach age 72 after Dec. 31, 2022, or retires.) If no distribution is received during the taxpayer’s starting year, the required minimum distributions for two years must be received the following year, one of which must be taken by April 1.

If the taxpayer reaches age 73 in 2023, they were 72 in 2022 and subject to the age 72 RMD rule in effect for 2022. If the taxpayer reaches age 72 in 2022, their first RMD is due by April 1, 2023, and their second RMD is due by December 31, 2023.

If the taxpayer reaches age 72 in 2023, the required beginning date for their first RMD is delayed until April 1, 2025. They must take another RMD by December 31, 2025.

Prior to tax year 2020, the RMD date was April 1 following the year in which the taxpayer reached age $70\frac{1}{2}$, or retired, whichever is later.

The RMD rules for inherited retirement accounts depend on the relationship and age of the beneficiary and are beyond the scope of the VITA/TCE programs. Refer taxpayers to their trustee if they have questions.

If the taxpayer does not receive the minimum distribution, an additional tax may be imposed. This additional tax is discussed in the Other Taxes lesson.

Peter turned 72 on August 20, 2021. He must receive the first required minimum distribution from his pension by April 1, 2022. He must receive a second required minimum distribution by December 31, 2022.

Ralph turned 72 March 15, 2021. He retired March 30, 2022. He must begin taking minimum distributions from his traditional IRA by April 1 following the year he reaches age 72 and another one by December 31 (April 1 and December 31, 2022).

Myrna was 72 when she retired in 2018. She was required to begin taking minimum distributions from her traditional IRA by April 1 of the year following the year she turned 70½ even though she had not retired. Myrna had to take *a second required distribution by December 31 of the same year.*

This information is provided for your information only, to help you answer any questions a taxpayer may ask about RMD. RMD distributions are reported on Form 1099-R and included on the return using the procedures previously discussed.

Withdrawal of Excess IRA Contributions

An excess IRA contribution is the amount contributed to a traditional and/or Roth IRA during the year that is more than the smaller of the:

- Maximum IRA amount for the year based on the taxpayer's age, or
- Taxable compensation for the year

The taxpayer may not know that a contribution is excess until the tax return is completed after the end of the year. In this situation, the excess amount, with any earnings on that amount, must be withdrawn by the due date of the return (including extensions). If the excess amount is not withdrawn by the due date of the return, the taxpayer will be subject to an additional 6% tax on this amount, and the return is out of scope.

The withdrawn excess contribution is not included in the taxpayer's gross income if both of the following conditions are met:

- No deduction was allowed for the excess contribution
- All interest or other income earned on the excess contribution is withdrawn by the due date of the return, including extensions

However, taxpayers must include the earnings on the excess contribution as income on the return. This income is reported on the return for the year in which the excess contribution was made. The withdrawal of interest or other income is no longer subject to an additional 10% tax on early distributions. If the taxpayer is subject to an additional tax due to excess IRA contributions, refer them to professional tax preparer.

Question 7: Taxpayers who withdraw excess contributions and earnings on the excess contributions by the due date of the tax return are not subject to an additional 6% tax on the excess contribution.

a. True

b. False

Question 8: Helen turned 72 March 17, 2021. She retired in 2022. She has never taken any distribution from her traditional IRA accounts. Assuming that her RMD for each year amount is $1,479, Helen is required to:

a. Take a distribution of $1,479 by April 1, 2021.

b. Take a distribution of $1,479 by December 31, 2021.

c. Take a distribution of $2,958 by December 31, 2021.

d. Take a distribution of $1,479 by April 1, 2022, and another $1,479 by December 31, 2022.

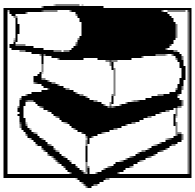
Question 9: Trevor turned 72 on February 14, 2023. He retired in 2021. Trevor is required to take his first RMD from his traditional IRA accounts by _.

a. April 1 , 2022

b. April 1 , 2023

c. April 1, 2024

d. April 1, 2025



What retirement distributions qualify for tax-favorable treatment?

Special CARES Act Provisions and Tax-Favorable Treatment of Retirement Fund Distributions

The CARES Act of 2020 provided for three special rules for up to $100,000 of coronavirus-related distributions from eligible retirement plans to qualified individuals for 2020: exception to the additional tax on early distributions; distributions may be included in income over a 3-year period; and, to the extent the distribution is eligible for tax-free rollover treatment, the distribution may be repaid. If the retirement distribution recipient is not a qualified individual, none of these provisions apply.

What are the rules for the 3-year spread of eligible distributions?

There are no coronavirus-related distributions in 2023. Taxpayers will use Form 8915-F, Qualified Disaster Retirement Plan Distributions and Repayments, to report repayments of all or a portion of the 2020 coronavirus-related distribution in 2023. Each spouse who is a qualified individual will file a separate Form 8915-F.

What are the rules for repayments of eligible distributions?

A qualified individual may repay part or all of their eligible designated coronavirus-related distributions to an eligible retirement plan (up to an aggregate limit of $100,000), but not an amount in excess of the amount of the distribution. Repayment is permitted whether or not the 3-year spread is elected. The repayment must be completed within three years beginning with the day after the date that the distribution was received.

Not all coronavirus-related distributions may be repaid. That is, a distribution that is eligible for the 3-year spread may or may not be eligible for repayment. In general, distributions that would be eligible for tax-free rollover treatment are eligible for repayment under the CARES Act. The following distributions are not eligible for repayment:

1. Any coronavirus-related distribution (whether from an employer retirement plan or an IRA) paid to a qualified individual as a beneficiary of an employee or IRA owner (other than the surviving spouse of the employee or IRA owner).
2. Any distribution (other than from an IRA) that is one of a series of substantially equal periodic payments made (at least annually) for:

a. A period of 10 years or more,

b. The individual’s life or life expectancy, or

c. The joint lives or joint life expectancies of the individual and the individual’s beneficiary.

A pension is a periodic payment and cannot be repaid, even if the taxpayer elects to use the 3-year spread of the income.

The repayment can be made to any qualified account that will accept the repayment. In general, it is anticipated that eligible retirement plans will accept repayment of coronavirus-related distributions, which are to be treated as rollover contributions. However, a repayment under this CARES Act provision will not be treated as a rollover contribution for the one-in-12-months limitation.

Repayments made in 2023 after the due date of the 2022 return and within the 3 year period will result in an excess repayment, since there is no income to report. The excess repayment will need to be carried back via an amended return.

Joe is a qualified individual and treated his 2020 distribution as a coronavirus distribution. Joe includes the $30,000 distribution ratably over a 3-year period . Without any repayments, Joe would include $10,000 in income on his 2020, 2021 and 2022 tax returns. In June 2023, Joe repays $12,000 to an IRA. He made no other repayments in the 3-year period. Joe is permitted to file an amended return for any of the three years in which he reported a taxable amount. He chooses 2022 to exclude the $10,000 he included in income as a coronavirus distribution. Joe also chooses to file an amended return to claim the remaining $2,000 excess repayment in 2021, reducing his coronavirus distribution to $8,000.

How are these provisions reported on a tax return?

Qualified individuals will use Form 8915-F to report any repayments made in 2023 within the 3 year period. Taxpayers will also need to file an amended return to claim the repayment.

Review the taxpayer's prior year returns. If a Form 8915-F is present:

- Check Form 13614-C, Intake/Interview and Quality Review Sheet, Part IV, to see if taxpayer indicated a contribution or repayment to a retirement account. If a repayment, determine if it's repayment of a coronavirus distribution.
- *Ask the taxpayer if they repaid any amount in 2023. If so, see the Repayment section on the previous page. For additional details, see the Instructions for Form 8915-F.*

Taxpayer Interview and Tax Law Application

Sample Interview

Volunteer says...	James responds...
I see in your 2020 return that you elected to spread your retirement distribution over three years.	Yes, I had to take extra money out of my IRA. Being able to spread the tax seemed like a good idea.
You had the ability to repay some or all of the distribution. If you did so, you can reduce the amount taxable in 2022, 2021 or 2020 for any repayments made after you filed your 2022 return up through	No, I did not.

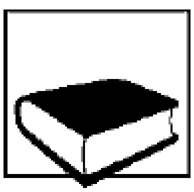
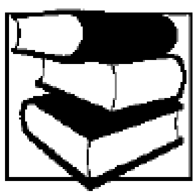
the day that is 3 years and a day after the date of the distribution. Did you make any repayments during that time?	

What is not in scope?

Disaster-related distributions that are not coronavirus-related distribution are out of scope. For more information, refer to:

- Disaster Assistance and Emergency Relief for Individuals and Businesses at: **www.irs.gov/businesses/ small-businesses-self-employed/disaster-assistance-and-emergency-relief-for-individuals-and- businesses**
- Publication 5396, Fact Sheet for VITA/TCE Sites Impacted by Federally Declared Disasters (January 1, 2018 – December 20, 2019) (**www.irs.gov/pub/irs-pdf/p5396.pdf**)

- Publication 5396-A, Job Aid for VITA/TCE Volunteers: Using Form 4852 when Missing the Form W-2 or 1099-R (**www.irs.gov/pub/irs-pdf/p5396a.pdf**)
- Publication 5396-B, VITA and Tax Counseling for the Elderly Casualty Loss Screening Tool (**www.irs.gov/ pub/irs-pdf/p5396b.pdf**)

How do I determine when an adjustment to withholding should be made?

Taxpayers may choose to have income tax withheld from their retirement distributions. Be sure to enter any amount of federal (and state) income tax withheld shown on Form 1099-R. After the completion of the return, if the taxpayer owes $1,000 or more on the tax return, you should discuss their withholding and estimated tax options with them. This is covered in more detail in the Completing the Return lesson.

Sometimes taxpayers are not aware they can request that federal income tax be withheld from their retirement income by filing Form W-4P, Withholding Certificate for Periodic Pension or Annuity Payments or Form W-4R, Withholding Certificate for Nonperiodic Payments and Eligible Rollover Distributions. This form is sent to the payer. Also, Form W-4V, Voluntary Withholding Request, is used to request withholding from Social Security benefits. This form is sent to the Social Security Administration. Every year, the Social Security Administration reports taxpayers' retirement benefits and/or voluntary withholdings on Form 1099-SSA.

Taxpayers who receive a very large refund may make better use of their funds if tax withholding is lowered. Explain ways they can reduce their withholding.

For additional help, taxpayers can refer to Publication 17, Withholding, Form W-4, or visit the IRS website and use the "Tax Withholding Estimator." A taxpayer who chooses not to have tax withheld may have to pay estimated tax each quarter. Failure to pay enough federal income tax throughout the year can result in a large amount of tax being owed when the return is due. It can also result in a penalty. Form 1040-ES, Estimated Tax for Individuals, is used to calculate the estimated quarterly payment and provides vouchers with which to remit the payments.

Question 10: Faith comes to your site to get her tax return done. When you finish her return, you explain to her that she owes

$985, and that she needs to pay this amount by the due date. She says that she will pay the amount, but wants to know if there is some way to have more tax withheld from her monthly pension so that she doesn't owe so much at the end of the year. Which form should she complete to increase the withholding from her pension?

a. Form W-4P

b. Form W-4V

c. Form W-4R

Summary

This lesson helped you identify, calculate, and report the taxable portion of retirement income received by the taxpayer. It reviewed the types of retirement income and the forms used to report them. You learned when taxpayers of retirement age are required to take a minimum distribution from a retirement plan and when they may need to adjust their withholding.

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

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

- The taxpayer needs to file Form 8606
- Taxpayers who made nondeductible contributions to a traditional IRA
- Taxpayers subject to additional tax due to excess IRA contributions
- Roth IRA distributions that are taxable or partially taxable, and distributions with Form 1099-R, code J or T
- IRA rollovers that do not meet the tax-free requirements

- Taxpayers who used the General Rule to figure the taxable portion of pensions and/or annuities for past years
- Form 1099-R, distribution code A (lump-sum distribution qualifying for special tax treatments) and other rarely seen distributions codes on Form 1099-R as specified in the Volunteer Resource Guide, Scope of Service chart

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. You may not be able to complete the entire exercise if some of the technical issues in the exercise are not covered until later lessons in the training. In these instances, complete as much of the exercise as you can. Come back later to finish the exercise after you cover all the technical topics.

EXERCISE Answers

Answer 1: b. False. In addition to Roth IRAs, nondeductible contributions to traditional IRAs are also not taxed when they are distributed.

Answer 2: b. False. Mary's distribution was not made after the 5-year period beginning with the first taxable year she made a contribution to her Roth IRA. The distribution is not a qualified distribution and is out of scope for the VITA/TCE programs.

Answer 3: a. True. Amy's distribution can be excluded from her taxable income because it was made more than five years after the beginning of the taxable year of her first contribution, and it was made on or after age 59½.

Answer 4: b. Andrew can exclude the entire distribution from income because it was rolled over into an IRA within the allowed 60-day period.

Answer 5: c. Dotty’s entire pension amount of $10,074 (6 x $1,679) is fully taxable because she has never paid income taxes on her employer’s contribution to her pension.

Answer 6: d. Because Annie Jo has not reached the minimum retirement age set by her employer, you should report her disability income as wages on her Form 1040.

Answer 7: a. True. Taxpayers must withdraw excess contributions and any earnings by the due date of the return (including extensions) to avoid the additional 6% tax on the excess contribution.

Answer 8: d. Helen turned 72 in 2021, which is her required start year.

Answer 9: d. Taxpayers are required to begin receiving distributions from their qualified plan by April 1 of the calendar year following the year in which they reach age 72 (73 if they reach age 72 after December 31, 2022), or retire, whichever is later. Since Trevor turned 72 in 2023, he meets the exception to delay his first RMD until April 1, 2025. He must take another RMD by December 31, 2025.

Answer 10: a. Generally, Form W-4P, Withholding Certificate for Periodic Pension and Annuity Payments, is used to request a change in withholding on a pension.

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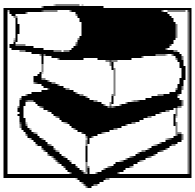
Income – Schedules K-1 and Rental



Introduction

This lesson covers the reporting of:

- Certain income from Schedules K-1 (Forms 1065, 1120S, and 1041). Volunteers who certify at the Advanced level are permitted to prepare a Schedule E, Supplemental Income and Loss, only with Schedule K-1 income items identified in this lesson or Form 1099-MISC, Box 2, Royalties, with no associated expenses.
- Rental income and expenses are in scope only for military families renting their personal residence. Taxpayers are not required to report income and expenses if

their home is rented less than 15 days during the year.

- Rental income and expenses are in scope only for the Military course. Volunteers must certify at Military level to prepare Schedule E for rental income.

Rental income and expenses are in-scope only for military families renting their personal residence. Generally, the at-risk and passive activity issues in this lesson are beyond the scope of the VITA/TCE programs. These issues are referenced for those assisting military members living abroad who have limited access to resources and professional preparers.

It is important to ensure that all income is accurately reported on the return. Ask taxpayers if they rented out their home during the tax year or if they received a Schedule K-1 (Form 1041, Form 1065, or

Form 1120S) from an estate, trust, partnership, or S corporation.

This lesson does not apply to taxpayers who are in the business of renting properties.

Objectives

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

- Identify Schedule K-1 income items that are within the scope of the VITA/TCE programs
- Determine how to report Schedule K-1 income items
- Determine which types of rental income must be reported
- Identify how to report rental expenses

Schedule K-1 may report information that is not needed for an in-scope return, such as investment income or *foreign tax credit per-country detail. It is not necessary to enter that information into the software. Items of taxable income, expense, or credits on a Schedule K-1 other than those listed in this lesson makes the tax return out of scope.*

What do I need?

- Form 13614-C
- Publication 4012
- Publication 17
- Schedule A
- Schedule E

Optional*:*

- Publication 527
- Publication 541
- Publication 551
- Publication 559

- Publication 925
- Publication 946
- Form 8582
- Form 1099-Misc
- Schedule K-1 (Form 1041 and Instructions)
- Schedule K-1 (Form 1065 and Instructions)
- Schedule K-1 (Form 1120S and Instructions)

Schedule K-1, Taxpayer’s Share of Income, Deductions, Credits, etc.

What is reported on Schedule K-1?

Schedule K-1 is used to report the taxpayer’s share of income, other distributions, deductions, and credits from partnerships, S corporations, and some estates and trusts. One copy of Schedule K-1 is sent to the IRS and is later matched with individual returns. Another copy of Schedule K-1 is sent to the taxpayer. Ask taxpayers if they received a Schedule K-1 from such an entity that reflects their share of income, reportable on their Form 1040. It is important to correctly report this income to avoid notices or correspondence from the IRS.

How and where can income be reported?

Income reported on Schedule K-1 will be included on the taxpayer's return in various places depending upon the type of income. Income reported on Schedule K-1 that is within the scope of the VITA/TCE programs includes:

- Interest income
- Dividend income
- Qualified dividends income
- Section 199A dividends

- Net short-term capital gains and losses (Schedule D, line 5)
- Net long-term capital gains and losses (Schedule D, line 12)
- Tax-exempt interest income
- Royalty income (Schedule E)

Foreign taxes reported on Schedule K-1 may be within scope. See the Foreign Tax Credit lesson for more information.

Schedule K-1 (Form 1041)

The fiduciary of a domestic decedent's estate, trust, or bankruptcy estate uses Form 1041 to report income, gains, losses, etc., of the estate or trust.

Taxpayers receive Form 1041, Schedule K-1, to report their share of income from interest, dividends (ordinary, qualified, and Section 199A), and capital gains (net short-term and net long-term). The taxpayer's income from these sources should be reported on the appropriate forms and schedules as listed on Form 1041, Schedule K-1, page 2.

Schedule K-1 (Forms 1065 and 1120S)

Partnerships use Form 1065, Schedule K-1, to report the taxpayers’ share of the partnership’s income, deductions, credits, etc. In general, a partnership is not subject to income tax and is a flow-through entity. This means the income flows through to the partners, who pay tax on their allocated share of the partnership income on their individual Forms 1040.

S corporations use Form 1120S, Schedule K-1, to report the taxpayers’ share of the corporation’s income (reduced by any tax the corporation paid on the income), as well as any deductions, credits, etc. The S corporation is also a flow-through entity with the reported income flowing through to each shareholder.

Shareholders pay tax on their allocated share of the income on their individual Forms 1040.

Taxpayers receive a Schedule K-1 (Form 1065 or Form 1120S) reporting their share of income from interest, dividends, and capital gains (net short-term and net long-term) from partnerships and corporations. Schedule K-1, page 2, lists the appropriate forms and schedules where taxpayers' income from these sources should be reported.

Schedules K-1 are not filed with the tax return. Advise taxpayers to keep Schedules K-1 with their records.

Additional information may be present in various parts of Schedule K-1 for which you may need to look up the codes on the back of the form (or refer to your Volunteer Resource Guide, Tab D). These include creditable foreign taxes, exempt interest income, and

Sec. 199A dividends. Other codes and Schedules K-2 and K-3 provide information that does not need to be entered in the software for in-scope returns.

How do I handle royalties reported on Form 1099-MISC?

Royalty income is in scope for the VITA/TCE programs only when the source document of the royalty income is reported on Schedule K-1 or Form 1099-MISC, Box 2, Royalties, with no associated expenses. Depletion allowances and any other income, deductions, credits, etc., reported on Schedule K-1 are out of scope for the VITA/TCE programs, and the taxpayer should be referred to a professional tax preparer.

What is rental income?

Generally, payment received for renting a room or a home to a tenant is rental income reportable on Form 1040, Schedule E. U.S. citizens and resident aliens must report rental income, regardless of whether the rental property is located in the U.S. or in a foreign country. Gross rental income may include other payments in addition to the normal and ordinary rents received, such as:

- Advanced rent
- Security deposits, if it represents rental income
- Payments for breaking a lease
- Expenses paid by the tenant
- Fair market value of property or services received instead of rental payments

A cost-sharing arrangement, such as a roommate, is not a rental arrangement.

Residential rentals are in scope with Military certification when the taxpayer is active military only.

The security deposit is not included in income when the taxpayer plans on returning the deposit at the end of the lease. However, if the security deposit is intended to serve as the last month's rent, then it should be included in income when received.

The taxpayer's method of accounting affects when the rental income is reported. The cash method reports income when received and expenses when paid; most individuals use this method. The accrual method reports income when earned and expenses when incurred, and is out of scope for the VITA/TCE programs. Refer taxpayers using the accrual method of accounting to a professional tax preparer.

Rental of a residence only is in scope. Renting personal property, such as equipment or vehicles, is out of scope for the VITA/TCE Programs.

In completing Schedule E, the following should be answered:

- Question A – Check the box "Yes" or "No" to the question: Did the taxpayer make any payments in the current year that would require the filing of Form 1099? If Yes, the return is out of scope.
- Question B – If Yes, did or will the taxpayer file all required Forms 1099? Check the box "Yes" or "No."
- In Part I, line 2 – The number of fair rental value days and number of personal use days is reported on Schedule E.

For software entries, see the Volunteer Resource Guide, Tab D, Income.

It is important that property be rented at fair rental value. If a property is rented at less than fair rental value, the income and expenses are reported in a different manner than discussed in this lesson. Refer taxpayers who rent their property at less than fair rental value to a professional tax preparer.

What qualifies as a rental expense?

Taxpayers who reside in homes they own generally itemize and deduct mortgage interest and property taxes on Schedule A. However, when a taxpayer rents out a home, those become rental expenses along with the cost of certain other operating expenses.

Taxpayers who do not use the rental home as their residence should:

- Include the rent as income and
- Deduct all of the rental expenses, even if they exceed income

Mortgage interest and property taxes

Mortgage interest on a loan used to buy or improve the property and property taxes are deductible as rental expenses. If the residence (or a portion of the residence) was used as rental property for any part of the year, the taxpayer must allocate the property tax and mortgage interest deductions between Schedule A and Schedule E.

In general, taxpayers use Schedule A, Itemized Deductions, to report the portion of the mortgage interest and property taxes that apply to their use of the home. That portion can be based on a percentage of time (4 months as a residence and 8 months used as rental) or based on an area (1,500 sq. ft. as a residence and 500 sq. ft. as the rental portion). For the part of the year and/or the portion of the home that is rented out, taxpayers report rental income and expenses (including a portion of the mortgage interest, property taxes, and other expenses that relate to the rental time/portion of the home) on Schedule E, Supplemental Income and Loss.

If any part of the property tax is designated for local benefits that increase the value of the property, such as streets and sidewalks, that portion of the tax is added to the basis of the property rather than deducted as an ordinary rental expense or an itemized deduction.

Mortgage interest is reported to the taxpayer on Form 1098, Mortgage Interest Statement. This statement may also include property taxes. If it does not, the taxpayer should have a document from the local taxing authority.

Generally, mortgage interest expense is fully deductible. However, refer taxpayers with rental-related interest expenses other than mortgage interest to a professional tax preparer.

Taxpayers who received a Mortgage Credit Certificate must be referred to professional tax preparer.

Paul Kingman lived in his home through September, when he was notified he was being transferred overseas. He rented his home beginning in October. The total amount of Paul's mortgage interest for the tax year was $2,400 and his property taxes were $600. Report nine months (January– September) of mortgage interest and property taxes as itemized deductions on Schedule A, that is,

$1,800 and $450, and the other three months (October–December) as expenses on Schedule E, that is, $600 and $150.

What are other deductible rental expenses?

In addition to mortgage interest and property taxes, deductible rental property expenses may include these items listed on Schedule E:

- Advertising
- Auto and travel expenses to check on the property or to collect rents
- Cleaning and maintenance
- Commissions paid for collecting rental income
- Insurance premiums
- Mortgage points
- Legal and professional fees
- Property management fees

- Repairs
- Utilities
- Other rental-related expenses, such as rental of equipment, long distance phone calls, and condominium/ cooperative maintenance fees

Transportation expenses incurred to travel between a taxpayer's home and rental property generally constitute nondeductible commuting costs unless the home is the taxpayer's principal place of business.

When a tenant does not pay the rent, a cash-basis landlord cannot take a deduction for the unpaid rent. Taxpayers cannot take a deduction for a payment they did not include in income.

EXERCISES

Question 1: John Princeton was transferred overseas and began renting out his residence on September 1 of the tax year. How much of his mortgage interest and property taxes should be reported on his Schedule E?

a. All of it

b. Eight-twelfths (2/3 or 67%)

c. Four-twelfths (1/3 or 33%)

d. None of it

What about property insurance?

The property insurance that taxpayers pay on their residence is deductible as a rental expense for the time it is considered rental property. If the residence is rented for part of the year, only the amount that covers the rental period is deductible. If a portion of the residence is rented, the deductible portion must be allocated and deducted on Schedule E.

Insurance premiums paid more than one year in advance cannot be deducted in one year. All taxpayers must prorate advanced premium payments over the period covered by the policy. The only portion deductible in the current year is that amount that covers the current year. The remainder is spread out over the life of the insurance coverage.

Can travel expenses away from home be deducted as rental expenses?

Taxpayers can deduct ordinary and necessary travel and transportation expenses of traveling away from home if the primary purpose of the trip is to collect rental income or to manage, conserve, or maintain the rental property. If the travel was in or outside of the U.S., taxpayers should substantiate the pleasure vs. business portions of the trip and allocate the expenses accordingly.

Taxpayers who use their personal automobile for rental-related trips may use either the standard mileage rate or the actual expense method for business mileage. However, if the taxpayers wish to use the actual expense method, refer them to a professional tax preparer.

The standard mileage method multiplies the miles driven for business by a standard rate. The standard rate includes all expenses of operating the vehicle. Only parking and tolls can be added to the standard mileage deduction. See Publication 463, Travel, Gift, and Car Expenses, for the current year standard mileage rate. Taxpayers may use the standard mileage rate only if they meet one of these requirements:

- The vehicle was owned and used the standard method the first year the vehicle was placed into service or

- The vehicle was leased and used the standard method for the life of the lease

The actual expense method figures the deduction based on a variety of factors, including gasoline, oil, repairs, insurance, and rentals and may even involve depreciation or the value of a vehicle provided by the taxpayer's employer.

This lesson discusses only the standard mileage rate. If taxpayers wish to use the actual method, refer them to a professional tax preparer.

Are repairs and improvements deductible?

Taxpayers often misunderstand when an expense qualifies as a repair or an improvement. A repair keeps the property in good operating condition; the cost is a current year deduction. An improvement adds to the life or material value of the property, prolongs its useful life, or adapts it to new uses. This cost must be depreciated over the recovery period for the improvement. The total cost of an improvement includes material, labor, and installation.

Taxpayers can elect to include as expenses repairs, improvements, or purchased items that might otherwise have to be capitalized on their tax return. Items that cost $2,500 or less can be expensed immediately by using the de minimis election in the regulations. When the taxpayer makes this election, it applies to all eligible items paid during the year. Note that this is not a Section 179 expense election, which is shown on Form 4562, Depreciation and Amortization. Instead, the expense is shown as repairs or other expense on Schedule E.

Taxpayers cannot deduct the cost of their own labor when making repairs.

See the table below for examples of repairs and improvements.

Repairs (Deduction)	Improvements (Depreciation)
Painting	Adding a room
Fixing gutters	Installing a new fence
Repairing driveways	Putting in plumbing or wiring
Replacing window glass	Replacing a hot water tank
Repairing the roof	Putting on a new roof
Repairing appliances	Replacing/adding major appliances

For software entries, go to the Volunteer Resource Guide, Tab D, Income.

Additional information on rental income can be found in Publication 527, Residential Rental Property and Publication 946, How to Depreciate Property.

How do I handle depreciation of rental property?

The cost of property with a useful life of one year or more, and used in a trade or business or held for the production of income (such as rent), is recovered by deducting an expense called depreciation.

“Depreciable property” includes buildings, machinery, furniture, equipment, vehicles, and any cost for additions or improvements to rental property. The value of land, however, is not depreciable; therefore, the cost of clearing, grading, planting, or other land improvements are also not depreciable.

Depreciation allows the taxpayers to deduct some of the cost of the property each year on their tax return. The annual amount of depreciation on property reduces the taxpayers' basis in that property. Taxpayers should claim the correct amount of depreciation expense every year. Even if they did not deduct the depreciation expense during any tax year, they must still reduce their basis in the property by the amount of depreciation that they should have deducted.

What factors determine the amount of depreciation to deduct?

The factors that determine the depreciation amount are:

- Depreciation method used
- Basis of the property
- Recovery period for the property

Depreciation Method

The most common methods for determining depreciation are:

- Straight line or declining balance: Property placed in service before 1981
- ACRS (Accelerated Cost Recovery System): Property placed in service after 1980, but before 1987
- MACRS (Modified Accelerated Cost Recovery System): Property placed in service after 1986

What is considered the basis and adjusted basis for depreciation purposes?

Generally, the basis for depreciation is the purchase price of the property, including the cost of improvements, but not including the value of the land. When property is converted from personal use to rental use, the basis is the lesser of the adjusted basis or fair market value (FMV) at the time of conversion. The total of the yearly expense deductions for depreciation can never total more than the basis of the property.

Form 4562, Depreciation and Amortization

Taxpayers must complete and attach Form 4562 for rental activities only if claiming:

- Depreciation, including the special depreciation allowance, on property placed in service during the year (out of scope)
- Depreciation on listed property (such as a car), regardless of when it was placed in service (out of scope)
- Any other car expenses, including the standard mileage rate or lease expenses (out of scope)

Otherwise, taxpayers should figure the depreciation on their own worksheet. Do not attach these computations to the return, but taxpayers should keep them in their records for future reference.

Question 2: All of the following are examples of deductible rental expenses except _____.

a. Carpet cleaning fees

b. Charges for phone calls made to the property manager

c. Gas and electric bills paid for the rental property

d. Repairs made to the homeowner’s personal residence

Question 3: Which of the following rental expenses must be recovered by taking depreciation?

a. Home insurance premiums

b. Painting

c. Installing a backyard fence at a cost of $3,500

d. Repairing a broken furnace

For depreciation software entries, go to the Volunteer Resource Guide, Tab D, Income

How do I handle rental property that the taxpayer also uses?

When the rental property is a portion of the taxpayer’s residence, the rental income and expenses must be allocated separately from the taxpayer’s personal expenses.

How do I differentiate between rental expenses and personal use expenses?

Expenses that apply to only the rental part of a property are direct business expenses and should be reported in full on Schedule E. The cost of installing a second phone line strictly for a tenant’s use, for example, is deductible as a rental expense. However, the taxpayer cannot deduct any part of the cost of the first phone in a partially-rented property, even if tenants use it.

Expenses that benefit the entire property (indirect expenses) must be allocated between rental use and personal use; the rental portion is reported on Schedule E.

If deductions are itemized, the personal portion of home mortgage interest and property tax may be reported on Schedule A. The taxpayer can choose any reasonable method to allocate the expenses. The most common methods are based on the number of rooms in the dwelling or on the total area of the dwelling. On Schedule E, report expenses that apply exclusively to the rental portion and the applicable percentage of expenses that benefit the entire house. For example, if the rented portion is 10% of the property, the taxpayer could deduct:

- 100% of the cost to wallpaper the tenant’s room

- 10% of property taxes, utilities, mortgage interest, and depreciation

Gloria rents one room in her 1,200 square foot house to a tenant. The rental room measures 10 feet by 12 feet (120 square feet, or 10% of the total house).

When taxpayers can itemize personal deductions on Schedule A, they can report the deductible expenses that benefit the entire house minus the percentage that applies to the rental portion. In Gloria's case, if she is treating the rental portion as 10% of the residence, she can deduct the following on Schedule A:

- *90% of the mortgage interest*
- *90% of the property taxes*

Expenses related to days of personal use do not qualify as rental expenses. The taxpayer must allocate the expenses based on the number of days of personal use to total use of the property.

Charles used his rental property for personal use 7 days and rented it for 63 days. In most cases, 10% of Charles' expenses are not rental expenses and cannot be deducted on Schedule E (7 = 10% of 70 total days: 7 personal days + 63 rented days).

Question 4: For taxpayers who rent part of a property in which they live, which expenses are reported only on Schedule E and not on Schedule A?

a. Home insurance and mortgage interest

b. Property taxes and repairs

c. Utilities and home insurance

d. Depreciation and property taxes

How should taxpayers report rental expenses that exceed their rental income when they live in the home for part of the year?

Questions in Part I, line 2 of Schedule E ask for information on the number of rental days at fair rental value and the number of days for personal use. If taxpayers rented out a dwelling unit that they also used for **personal purposes** during the year, they may not be able to deduct all the expenses for the rental part.

Dwelling unit (the unit) means a house, apartment, condominium, or similar property. A day of personal use is any day, or part of a day, that the unit was used by:

- The taxpayer for personal purposes,
- Any other person for personal purposes, if that person owns part of the unit (unless

rented to that person under a “shared equity” financing agreement),

- Anyone in the taxpayer’s family (or in the family of someone else who owns part of the unit), unless the unit is rented at a fair rental price to that person as his or her main home,
- Anyone who pays less than a fair rental price for the unit, or
- Anyone under an agreement that lets the taxpayer use some other unit

Are there any exceptions?

Taxpayers who used a dwelling unit as their main home may not have to count all that time as “days of personal use.” Do not count as personal use any day the taxpayer:

- Spends working substantially full time repairing and maintaining the unit, even if a family member used it for recreational purposes on that day, or

- Used the unit as the taxpayer’s main home before or after renting it or offering it for rent, if the taxpayer rented or tried to rent it for at least 12 consecutive months (or for a period of less than 12 consecutive months at the end of which the taxpayer sold or exchanged the home).

However, this special rule doesn’t apply when dividing expenses between rental and personal use.

On February 28, Trent moved out of the house he had lived in for six years because he was deployed overseas. He rented his house at a fair rental price from March 15 last year to May 14 this year. On June 1 this year, he returned from his deployment and moved back into his house. Because he rented his property for 12 or more consecutive months, his use of the house is not counted as personal use. Since these days *are not counted as days of personal use, the limitations on deductions do not apply.*

Are there any limitations?

There are limitations based on whether the taxpayer used the dwelling unit as a home and it meets the personal use test. The personal use test is met if the taxpayer used the unit for personal purposes in the current tax year **more than the greater of:**

- 14 days or
- 10% of the total days it was rented to others at a fair rental price

Fair rental days and personal use days are reported in Part I, line 2, of Schedule E.

If the taxpayer did not use the dwelling unit as a home, the taxpayer can deduct all the expenses for the rental part, subject to the At-Risk Rules and the Passive Activity Loss Rules. For more details on these rules, refer to Publication 527, Residential Rental

Property (Including Rental of Vacation Homes).

If the taxpayer used the dwelling as a home and rented the unit for **fewer than 15 days** in the current tax year, do not report the rental income and do not deduct any rental expenses. If the taxpayer itemizes deductions on Schedule A, the taxpayer can deduct allowable interest, taxes, and casualty losses. (Remember that the topic of casualty losses is out of scope for the VITA/TCE programs.)

If the taxpayer used the dwelling as a home and rented out the unit **at least 15 days** in the current tax year, the taxpayer may not be able to deduct all of the rental expenses. The taxpayer can deduct all of the following expenses for the rental part on Schedule E:

- Mortgage interest
- Real estate taxes
- Casualty losses (out of scope)

- Other rental expenses not related to the taxpayer’s use of the unit as a home, such as advertising expenses and rental agents’ fees

If there is rental income left after deducting these expenses, the taxpayer can deduct other expenses, including depreciation, up to the amount of remaining income. The taxpayer can carry over to the following tax year the unused expense amounts.

If the property was used as a rental for the entire year, the income and expenses can be reported on Schedule E. If the property was used partially as a rental and partially as a residence, some expenses may need to be allocated. For software entries, go to the Volunteer Resource Guide, Tab D, Income.

How do I handle rental losses?

Deducting all rental expenses and depreciation from the rent received may result in a net loss. Rental losses are not always fully deductible. There are two restrictions on how much a loss can offset other sources of income:

- At-risk rule
- Passive activity rules

What is the at-risk rule?

The at-risk rule places a limitation on the amount the taxpayer can deduct as losses from activities often described as tax shelters. Generally, any loss from an activity subject to the at-risk rules is allowed only to the extent of the total amount the taxpayer has at risk in the activity at the end of the tax year.

What are the passive activity rules?

The passive activity rules state that passive activity losses can be deducted only from passive activity income. Passive income does not include salary, dividends, or other investment income but is generally attributed to such things as rental income. Therefore, losses that exceed rental income (the passive activity) are not deductible. However, some losses may be deductible if an exception is met.

Passive income and active participation

The limits on deducting rental losses are affected by the degree to which renting out the property is a passive activity or involves active participation:

- Passive rental activity means receiving income mainly from the use of property rather than for services.

- Active participation means making significant management decisions, such as approving rental terms, repairs, expenditures, and new tenants. Taxpayers who use a leasing agent or property manager could be considered active participants if they retain final management rights.

Exception

Rental activities are generally considered passive activities. For this reason, rental losses are not fully deductible. However, an exception to the passive activity rule provides that taxpayers who actively participate in the rental activity can use up to $25,000 of their rental losses to offset any other nonpassive income ($12,500 for married taxpayers filing separately and living apart for the entire year). Examples of nonpassive income are salaries, wages, commissions, tips, self-employment income, interest, dividends, annuities, and some royalties. (This deduction is reduced if the taxpayer's adjusted gross income (AGI) exceeds certain limits.)

What is active participation?

It is considered active participation when taxpayers own at least 10% of the rental property and make management decisions in a significant and bona fide sense. Management decisions include approving new tenants, deciding on rental terms, approving expenditure, and similar decisions.

For more information, see Publication 925, Passive Activity and At-Risk Rules.

Phase-Out of Offset

The amount allowed to offset nonpassive income is reduced if taxpayers' modified adjusted gross income exceeds certain amounts. See Publication 925 for the AGI limits.

Question 5: Which restriction limits the deductibility of rental loss to the amount of rental income?

a. Phase-out of offset

b. Passive activity rules

c. Active participation rule

How are passive rental losses reported?

Taxpayers use Form 8582, Passive Activity Loss Limitations, to figure the amount of any passive activity loss allowed for the current tax year. Form 8582 summarizes losses and income from all passive activities.

Generally, taxpayers are not required to file Form 8582 if they have:

- Only one passive loss generated from a rental activity and
- MAGI of less than $100,000 (not more than $50,000 if MFS).

Completing Form 8582 is out of scope if volunteers are required by the software to enter additional data in Form 8582. For example, if passive activity losses exceed $25,000 ($12,500 for Married Filing Separately) and require a computation of unallowed passive activity losses, then the return is out of scope.

Summary

Taxpayers receive Schedule K-1 (Form 1065, Form 1041, or Form 1120S) reporting their share of income from flow-through entities. Interest, dividends (ordinary and qualified), and capital gains (net short-term and net long-term) are in scope. Schedule K-1, page 2, lists the appropriate forms and schedules where the taxpayers’ income from these sources should be reported. Additionally, royalties on Schedule K-1, Forms 1065 and 1120S are within scope. Volunteers who certify to the Advanced level are permitted to prepare a Schedule E only with Schedule K-1 and limited Form 1099-MISC income items.

Rental income and deductible rental expenses are reported on Part I of Schedule E, Supplemental Income and Loss. Volunteers must certify at the Military level to prepare a Schedule E for rental income. Rental income and expenses are in-scope **only** for military families renting their personal residence.

U.S. citizens and resident aliens must report rental income for the months their home is rented, regardless of whether the rental property is located in the U.S. or in a foreign country.

When renting out part of the property, certain expenses must be allocated between rental use and personal use. Some are reported on Schedule A and some on Schedule E.

Taxpayers who do not use a dwelling unit as a home (for personal purposes) should include all the rent in their income and deduct all the rental expenses. There are special rules and limitations if the taxpayer used the dwelling unit as a home and it meets the personal use test.

Rental income and expenses are not reported if the taxpayer used the dwelling as a home and rented the unit for fewer than 15 days in the current tax year. If the taxpayer itemizes deductions on Schedule A, the taxpayer can deduct allowable interest, taxes, and casualty losses. (Remember that the topic of casualty losses is out of scope for the VITA/TCE programs.)

Because rental activities are generally considered passive activities, rental losses are not fully deductible. However, taxpayers who actively participated in the renting of the property may deduct up to $25,000 of their rental losses, up to $12,500 for married taxpayers filing separately and living apart. This deduction is subject to phase-out rules if the taxpayer's AGI exceeds certain limits.

The passive activity rules state that passive activity losses can be deducted only from passive activity income. Taxpayers with rental losses may be required to file Form 8582, Passive Activity Loss Limitations.

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

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

- Income reported on Schedules K-1 (other than what is listed in the introduction to this lesson)
- Deductions, credits, and other items reported on Schedules K-1 (other than listed above)
- Royalty income reported on Form 1099-MISC when there are associated expenses (other than royalties for personal services,

such as an author or composer, that are reported on Schedule C)

- Rental income and expenses for non-military taxpayers
- Taxpayers who rent their property at less than fair rental value
- Rental-related interest expenses other than mortgage interest
- The actual expense method (auto expense deductions)
- Casualty loss
- Completing Form 8582 if volunteers are required to enter additional data in Form 8582 in the software
- Completing Form 4562
- Taxpayers who filed or need to file Form(s) 1099

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. You would deduct four-twelfths (33%) of his mortgage interest and taxes on Schedule E, and report the other 67% on Schedule A.

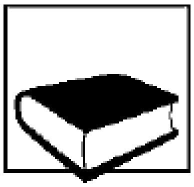
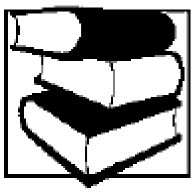
Answer 2: d. Repairs made to the homeowner’s personal residence are not deductible as rental expenses. However, the other expenses are deductible, along with repairs made to rental property, legal and professional fees, and property management fees.

Answer 3: c. The fencing adds value to the property and would have to be capitalized and depreciated.

Answer 4: c. The rental portions of utilities, home insurance, repairs, and depreciation are rental deductions on Schedule E, but the personal portions are not a deductible expense reported on Schedule A. Taxpayers who rent out part of a property allocate mortgage interest and property taxes separately on both schedules.

Answer 5: b. Passive activity losses can be deducted only from passive activity income. Taxpayers who are not active participants may not deduct rental losses that exceed rental income.

Income – Unemployment Compensation

Introduction

This lesson will help you assist taxpayers who have unemployment compensation income.

Objectives

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

- Identify unemployment compensation income
- Determine how to report unemployment compensation on the tax return

What is unemployment compensation?

Unemployment compensation generally includes any amount received under an unemployment compensation law of the United States or of a state in the U.S. In most cases, unemployment compensation is taxable. If taxpayers contribute to a governmental unemployment compensation program or a governmental paid family leave program and the contributions are not deductible, amounts received under the program are not included as unemployment compensation until the taxpayers recover their contributions. If the taxpayer has already deducted all of the contributions to the program, the entire amount received under the program is taxable.

Where can I get unemployment compensation information?

Begin with the unemployment question on the intake and interview sheet. Ask the taxpayer for any Form(s) 1099-G, Certain Government Payments, that document unemployment compensation payments from each government entity.

In most states, taxpayers can elect to have federal income taxes withheld from their unemployment compensation benefits. Be sure to review Form 1099-G, Box 4, for any federal income tax withheld.

What if the taxpayer did not get the unemployment benefits shown on 1099-G?

Generally, taxpayers must include in income all unemployment compensation received. If the Form 1099G shows the wrong amount of unemployment compensation, the taxpayer should contact their state unemployment agency to correct it.

What if the taxpayer repaid some of their unemployment benefits?

If the taxpayer repaid unemployment compensation received in the same tax year, the software will subtract the amount repaid from the total amount received and enter the difference on Schedule 1 (Form 1040). Refer to the Publication 4012, Volunteer Resource Guide for the software entries.

If the unemployment compensation repaid in the current tax year was included in income in a prior year:

- and the amount of repayment is $3,000 or less, no deduction or credit is available.
- and the amount of repayment is more than $3,000, the return is out of scope for the VITA/TCE Programs.

How do I report unemployment compensation and other state payments shown on Form 1099-G?

The total for all unemployment compensation received in Form(s) 1099-G, Box 1 or Box 5 RTAA, should be entered on Form 1040, Schedule 1.

RTAA payments (reemployment trade adjustment assistance) are shown in Box 5 of Form 1099-G. These are reported as other income on Form 1040, Schedule 1, not unemployment. Taxable grants shown in Box 6 are also generally reported as other income on Form 1040, Schedule 1.

The amount of withholding from Form 1099-G, Box 4 should be entered on the Federal income tax withheld from Forms W-2 and 1099 line of Form 1040.

To review information related to the software, go to the Volunteer Resource Guide, Tab D, Income.

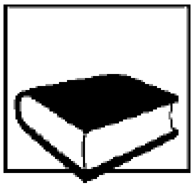
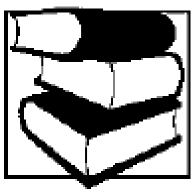
Summary

This lesson explained:

- How to identify unemployment compensation
- How to report unemployment compensation
- How to report other taxable state payments shown on Form 1099-G.

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.

Income Social Security Benefits

Introduction:

This lesson will help you assist taxpayers who have Social Security and equivalent railroad retirement benefits. These benefits may or may not be taxable.

The intake and interview sheet lists Social Security and Railroad Retirement Benefits in the Income section.

Ask the taxpayer about the receipt of either of these benefits. The Social Security Administration issues Form SSA-1099, Social Security Benefit Statement, to Social Security benefit recipients. The Railroad Retirement Board issues Form RRB-1099, Payments by the Railroad Retirement Board, and Form

RRB-1099-R, Annuities or Pensions by the Railroad Retirement Board.

See Publication 575, Pension and Annuity Income, and Publication 915, Social Security and Equivalent Railroad Retirement Benefits, for additional information on the topics discussed in this lesson.

Objectives

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

- Determine the taxable portion of Social Security and railroad retirement benefits
- Determine the most advantageous method of reporting lump-sum Social Security benefits
- Report Social Security and railroad retirement benefits on the tax return

What do I need?

- Form 13614-C

- Publication 4012
- Publication 17

Optional:

- Publication 575
- Publication 915
- Form RRB-1099
- Form RRB-1099-R
- Form SSA-1099

What are Social Security and Railroad Retirement Benefits?

Social Security Benefits

Social Security benefits are payments made under Title II of the Social Security Act. They include Old-Age, Survivor, and Disability Insurance (OASDI) benefits.

Social Security benefits include monthly retirement, survivor, and disability benefits.

They do not include Supplemental Security Income (SSI). Certain government retirees who receive a pension from work are not covered by Social Security.

Some portion of the Social Security benefits received may be taxable. Generally, if Social Security benefits are the only source of income, then the benefits are not taxable. In this instance, taxpayers may not be required to file a return. However, if the taxpayers are Married Filing Separately and lived with their spouse at any time during the tax year, 85% of the benefits will be taxable.

Railroad Retirement Benefits (RRBs)

Railroad Retirement Benefits (RRBs) are benefits paid to railroad employees working in jobs that are covered by the Railroad Retirement Act (RRA). The RRA benefits have two components: tier 1 (Social Security equivalent benefits) and tier 2 (treated as a qualified employee plan). Tier 1 railroad retirement benefits are reported on Form RRB 1099. The tier 2 benefits are reported on the green Form RRB 1099-R. These funds are discussed in the previous lesson on Retirement Income.

How are these benefits reported to the taxpayer?

Form SSA-1099

Social Security benefits are reported on Form SSA-1099. Box 5 shows the amount of net benefits. Taxpayers who did not receive Form SSA-1099, or have misplaced it, may be able to get an instant printout of benefits from their personal "my Social Security" account on the Social Security Administration website at SSA.gov.

Or taxpayers may call toll-free to request a benefit statement to be sent by mail. Social Security no longer provides benefit verification letters in their offices.

Form RRB-1099

Tier 1 railroad retirement benefits are equal to the Social Security benefit that a railroad employee or beneficiary would have been entitled to receive under the Social Security system. These benefits are called "Social Security equivalent benefits" and, for tax purposes, are treated like Social Security benefits. They are shown on the blue Form RRB-1099. Box 5 shows the net Social Security equivalent benefits for tier 1.

Jacob is a retired railroad switchyard operator. Using the intake and interview sheet, the volunteer determined Jacob received Railroad Retirement Benefits. He received Form RRB-1099 and Form RRB-1099-R. The amount from Form RRB-1099 will be added to any amount of Social Security benefits that he may have received from other employment.

When are Social Security benefits and tier 1 RRBs taxable?

Part of the following benefits received by the taxpayer may be taxable:

- Social Security benefits
- Railroad retirement benefits, tier 1 (Social Security equivalent portion)

To correctly calculate the taxable portion, you need to know the amount in Box 5 of Form SSA-1099 or Form RRB-1099. The taxable amount, if any, of a taxpayer's Social Security benefits depends upon filing status and other reportable income. Generally, if Social Security (or Social Security equivalent) benefits were the taxpayer's only source of income, the benefits are not taxable and the taxpayer does not need to file a federal income tax return.

A portion of the benefits is taxable if total income (including tax-exempt interest), plus one-half of the benefits received, is more than certain base income amounts, which vary based upon the taxpayer's filing status. If the taxpayers are Married Filing Separately and lived with their spouse at any time during the year 85% of the benefits are taxable.

The taxable portion of Social Security benefits is never more than 85% of the net benefits the taxpayer received. In many cases, the taxable portion is less than 50%.

Enter the amounts from each Form SSA-1099 and the software will compute the portion that is taxable, if any.

Taxpayers can use Form W-4V, Voluntary Withholding Request, to request withholding from Social Security benefits.

Wanda and Dan are both retired and will file a joint return. Wanda received Form SSA-1099 with an amount of $4,300 appearing in Box 5. Dan retired from the railroad, and Box 5 of his Form RRB1099 shows an amount of $6,800. Wanda and Dan will use the combined benefits of $11,100 and only one calculation to see if any of their benefits are taxable.

How do I report Social Security or railroad tier 1 benefits?

The tax software will perform all the calculations to determine the taxable amount based on other information on the return. Be sure to enter all income, including tax-exempt interest, in order for the software to correctly calculate taxability of benefits. Medicare premiums (Part B and D) from Forms SSA-1099 and RRB-1099 may be claimed as a self-employed health insurance deduction if *the taxpayer is filing Schedule C. Otherwise, enter the total Medicare premiums so they flow to Schedule A if the taxpayer is itemizing deductions. Additionally, be sure to enter any federal income tax withholding. Go to the Volunteer Resource Guide, Tab D, Income, for software entries.*