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Internal Revenue Service

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Older Americans' Tax Guide

For use in preparing

2002 Returns

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Contents

Important Changes for 2002

Standard deduction. For most people, the standard deduction has increased. See *Standard Deduction,* later.

Earned income credit. You may be eligible for the credit if you earn less than:

1) $29,201 ($30,201 if married filing jointly) and have one qualifying child living with you,
2) $33,178 ($34,178 if married filing jointly) and have more than one qualifying child living with you, or
3) $11,060 ($12,060 if married filing jointly), do not have a qualifying child, and are at least 25 years old and under 65.

For more information, see *Earned Income Credit,* later.

Important Reminders

Tax return preparers. Choose your preparer carefully. If you pay someone to prepare your return, the preparer is required, under the law, to sign the return and fill in the other blanks in the *Paid Preparer's* area of your return. Remember, however, that you are still responsible for the accuracy of every item entered on your return. If there is any underpayment, you are responsible for paying it, plus any interest and penalty that may be due.

Third party designee. You can check the *Yes* box in the *Third Party Designee* area of your return to authorize the IRS to discuss your return with a friend, family member, or any other person you choose. This allows the IRS to call the person you identified as your designee to answer any questions that may arise during the processing of your return. It also allows your designee to perform certain actions. See your income tax package for details.

Employment tax withholding. Your wages are subject to withholding for income tax, social security tax, and Medicare tax even if you are receiving social security benefits.

Voluntary withholding. You may be able to have federal income tax withheld from your social security and equivalent railroad retirement benefits. See *Tax Withholding and Estimated Tax* under *Social Security and Equivalent Railroad Retirement Benefits.*

Photographs of missing children. The Internal Revenue Service is a proud partner with the National Center for Missing and Exploited Children. Photographs of missing children selected by the Center may appear in this publication on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling **1–800–THE–LOST (1–800–843–5678)** if you recognize a child.

Introduction

The purpose of this publication is to provide a general overview of selected topics that are of interest to older Americans. The publication is divided into chapters to help you determine if you need to file a return and, if so, what items to report on your return. Each topic is discussed only briefly, so you will find references to other free IRS publications that provide more detail on these topics if you need it. Later in the *Introduction*, we also will explain how you can order ***large print tax forms*** or get help from a Volunteer Income Tax Assistance (VITA), Tax Counseling for the Elderly (TCE), or American Association of Retired Persons (AARP) program in your area.

Table I-1 has a list of questions you may have about filing your federal tax return. To the right of each question is the location in this publication where you will find the related discussion. Also, at the back of this publication there is an index to help you search for the topic you need.

While most federal income tax laws apply equally to all taxpayers, regardless of age, there are some provisions that give special treatment to older Americans. The following are some examples.

- ***Higher gross income threshold for filing.*** You must be age 65 or older at the end of the year to get this benefit. (You are considered 65 on the day before your 65th birthday. Therefore, you are considered 65 at the end of the year if your 65th birthday is on or before January 1 of the following year.)
- ***Higher standard deduction.*** If you do not itemize deductions, you are entitled to a higher standard deduction if you are age 65 or older at the end of the year. (You are considered 65 at the end of the year if your 65th birthday is on or before January 1 of the following year.)
- ***Credit for the elderly or the disabled.*** If you qualify, you may benefit from the credit for the elderly or the disabled. To determine if you qualify and how to figure this credit, see *Credit for the Elderly or the Disabled,* later.

Return preparation assistance. The IRS wants to make it easier for you to file your federal tax return. You may find it helpful to order large print tax forms or visit a VITA, TCE, or AARP site near you.

Large print tax forms. For easier reading and to practice preparing your return, you may order large print tax forms. Use them as worksheets to figure your tax, but ***do not file them***. Call **1–800–829–3676** and order:

- **Publication 1614**, which contains Form 1040, Schedules A, B, D, E, EIC, and R, and Forms 1040–V and 8812, and their instructions, or
- **Publication 1615**, which contains Form 1040A, Schedules 1, 2, 3, and EIC, and Form 8812, and their instructions.

CAUTION *When you file your actual return, do not send the large print tax forms to IRS. Use the standard forms.*

To order other free publications and forms, see chapter 7 in this publication.

Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE). These programs provide free help for low-income taxpayers and taxpayers age 60 or older to fill in and file their returns. For the VITA/TCE site nearest you, contact your local IRS office.

For the location of an American Association of Retired Persons (AARP) Tax-Aide site in your community, call **1–888–227–7669** or **1–877–227–7844**. When asked, be ready to press in or speak your 5-digit zip code. Or, you can visit their web site on the Internet at **www.aarp.org/taxaide/home.html.**

Comments and suggestions. We welcome your comments about this publication and your suggestions for future editions.

You can e-mail us while visiting our web site at **www.irs.gov**.

You can write to us at the following address:

Internal Revenue Service
Tax Forms and Publications
W:CAR:MP:FP
1111 Constitution Ave. NW
Washington, DC 20224

We respond to many letters by telephone. Therefore, it would be helpful if you would include your daytime phone number, including the area code, in your correspondence.

Table I–1. **What You Should Know About Federal Taxes**
(***NOTE:*** *The following is a list of questions you may have about filling out your federal income tax return. Chapters are given to help you find the related discussion in this publication.*)

What I Should Know	**Where To Find the Answer**
Do I need to file a return?	See chapter 1.
Is my income taxable or nontaxable? If it is nontaxable, must I still report it?	See chapter 2.
How do I report benefits I received from Social Security or the Railroad Retirement Board? Are these benefits taxable?	See *Social Security and Equivalent Railroad Retirement Benefits* in chapter 2.
Must I report the sale of my home? If I had a gain, is any part of it taxable?	See *Sale of Home* in chapter 2.
What are some of the items that I can report to reduce my income?	See chapters 3 and 4.
How do I report the amounts I set aside for my IRA?	See *Individual Retirement Arrangement (IRA) Contributions and Deductions* in chapter 3.
Would it be better for me to claim the standard deduction or itemize my deductions?	See chapter 4.
What are some of the credits I can claim to reduce my tax?	See chapter 5 for discussions on the credit for the elderly or the disabled, the child and dependent care credit, and the earned income credit.
Must I make estimated tax payments?	See chapter 6.
How do I contact the IRS or get more information?	See chapter 7.

1.

2002 Filing Requirements

If income tax was withheld from your pay, or if you qualify for the earned income credit or the additional child tax credit (see your tax package), you should file a return to get a refund even if you are not required to do so.

General Requirements

You must file a return if your gross income for the year was at least the amount shown on the appropriate line in *Table 1–1*. For more information, see the instructions for Form 1040, 1040A, or 1040EZ, and Publication 501, *Exemptions, Standard Deduction, and Filing Information*.

Gross income. Gross income is all income you receive in the form of money, goods, property, and services that is not exempt from tax. If you are married and live with your spouse in a community property state, half of any income defined by state law as community income may be considered yours. The community property states are Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin. For more information about community property, see Publication 555, *Community Property*.

For more information on what to include in gross income, see chapter 2.

Self-employed persons. If you are self-employed in a business that provides services (where products are not a factor), gross income is gross receipts from that business. If you are self-employed in a business involving manufacturing, merchandising, or mining, gross income is total sales from that business minus the cost of goods sold. To this figure, you add any income from investments, and from incidental or outside operations or sources.

Dependents. If you could be claimed as a dependent by another taxpayer, special filing requirements apply. See Publication 501.

Decedents

A personal representative of a decedent's estate can be an executor, administrator, or anyone who is in charge of the decedent's property.

If you are acting as the personal representative of a person who died during the year, you may have to file a final return for that decedent. You also have other duties, such as notifying the IRS that you are acting as the personal representative. **Form 56**, *Notice Concerning Fiduciary Relationship,* is available for this purpose.

When you file a return for the decedent, either as the personal representative or as the surviving spouse, you should write "DECEASED," the decedent's name, and the date of death, across the top of the tax return.

If no personal representative has been appointed by the due date for filing the return, the surviving spouse (on a joint return) should sign the return and write in the signature area "Filing as surviving spouse."

For more information, see Publication 559, *Survivors, Executors, and Administrators.*

Table 1–1. **2002 Filing Requirements Chart for Most Taxpayers**
NOTE: You must file a return if your gross income was at least the amount shown in the last column.

IF your filing status is	**AND at the end of 2002 you were***	**THEN file a return if your gross income** was at least . . . .**
Single	under 65	$ 7,700
	65 or older	$ 8,850
Head of household	under 65	$ 9,900
	65 or older	$11,050
Married filing jointly***	under 65 (both spouses)	$13,850
	65 or older (one spouse)	$14,750
	65 or older (both spouses)	$15,650
Married filing separately	any age	$ 3,000
Qualifying widow(er) with dependent child	under 65	$10,850
	65 or older	$11,750

* If you turned age 65 on January 1, 2003, you are considered to be age 65 at the end of 2002.

** Gross income means all income you received in the form of money, goods, property, and services that is not exempt from tax, including any income from sources outside the United States (even if you may exclude part or all of it). ***Do not*** include social security benefits unless you are married filing a separate return and you lived with your spouse at any time in 2002.

*** If you did not live with your spouse at the end of 2002 (or on the date your spouse died) and your gross income was at least $3,000, you must file a return regardless of your age.

Surviving spouse. If you are the surviving spouse, the year your spouse died is the last year you may file a joint return with that spouse. After that, if you do not remarry, you must file as a qualifying widow(er) with dependent child, head of household, or single. For more information about each of these filing statuses, see Publication 501.

If you remarry before the end of the year in which your spouse died, a final joint return with the deceased spouse cannot be filed. You can, however, file a joint return with your new spouse. In that case, the filing status of your deceased spouse for his or her final return is married filing separately.

CAUTION: *The level of income that requires you to file an income tax return changes when your filing status changes. Even if you and your deceased spouse were not required to file a return for several years, you may have to file a return for the year of death.*

2. Taxable and Nontaxable Income

Generally, income is taxable unless it is specifically exempted (not taxed) by law. Your taxable income may include compensation for services, interest, dividends, rents, royalties, income from partnerships, estate or trust income, gain from sales or exchanges of property, and business income of all kinds.

Under special provisions of the law, certain items are partially or fully exempt from tax. Provisions that are of special interest to older taxpayers are discussed in this chapter.

Compensation for Services

Generally, you must include in gross income everything you receive in payment for personal services. In addition to wages, salaries, commissions, fees, and tips, this includes other forms of compensation such as fringe benefits and stock options.

You need not receive the compensation in cash for it to be taxable. Payments you receive in the form of goods or services generally must be included in gross income at their fair market value.

Volunteer work. Do not include in your gross income amounts you receive for supportive services or reimbursements for out-of-pocket expenses under any of the following volunteer programs.

- Retired Senior Volunteer Program (RSVP).
- Foster Grandparent Program.
- Senior Companion Program.
- Service Corps of Retired Executives (SCORE).

Unemployment compensation. You must include in your income all unemployment compensation you receive.

More information. See Publication 525, *Taxable and Nontaxable Income,* for more detailed information on specific types of income.

Retirement Plan Distributions

This section summarizes the tax treatment of amounts you receive from certain individual retirement arrangements, employee pensions or annuities, and disability pensions or annuities. More detailed information can be found in Publication 590, *Individual Retirement Arrangements (IRAs),* or Publication 575, *Pension and Annuity Income*.

Individual Retirement Arrangements (IRAs)

In general, distributions from a traditional IRA are taxable in the year you receive them. A traditional IRA is any IRA that is not a Roth or SIMPLE IRA. Exceptions to the general rule are rollovers and tax-free withdrawals of contributions, and the return of nondeductible contributions discussed in Publication 590.

TIP: *If you made nondeductible contributions to a traditional IRA, you must file Form 8606,* Nondeductible IRAs. *If you do not file Form 8606 with your return, you may have to pay a $50 penalty. Also, when you receive distributions from your traditional IRA, the amounts will be taxed unless you can show, with satisfactory evidence, that nondeductible contributions were made.*

Early distributions. Generally, early distributions are amounts distributed from your traditional IRA account or annuity before you are age 59½, or amounts you receive when you cash in retirement bonds before you are age 59½. You must include early distributions of taxable amounts in your gross income. These taxable amounts are also subject to an additional 10% tax unless the distribution qualifies for an exception. See *Tax on Early Distributions,* later.

After age 59½ and before age 70½. After you reach age 59½, you can receive distributions from your traditional IRA without having to pay the 10% additional tax. Even though you can receive distributions after you reach age 59½, distributions are not required until April 1 of the year following the year in which you reach age 70½.

Required distributions. If you are the owner of a traditional IRA, you must receive the entire balance in your IRA or start receiving periodic distributions from your IRA by April 1 of the year following the year in which you reach age 70½. See *When Must I Withdraw IRA Assets? (Required Distributions)* in Publication 590. If distributions from your traditional IRA(s) are less than the required minimum distribution for the year, you may have to pay a 50% excise tax for that year on the amount not distributed as required. See *Tax on Excess Accumulation,* later.

Pensions and Annuities

Generally, if you did not pay any part of the cost of your employee pension or annuity, and your employer did not withhold part of the cost of the contract from your pay while you worked, the amounts you receive each year are fully taxable.

If you have a cost to recover from your pension or annuity plan (see *Cost,* later), you can exclude part of each annuity payment from income as a recovery of your cost. This tax-free part of the payment is figured when your annuity starts and remains the same each year, even if the amount of the payment changes. The rest of each payment is taxable.

You figure the tax-free part of the payment using one of the following methods.

- ***Simplified Method.*** You generally must use this method if your annuity is paid under a qualified plan (a qualified employee plan, a qualified employee annuity, or a tax-sheltered annuity plan or contract). You cannot use this method if your annuity is paid under a nonqualified plan.

- ***General Rule.*** You must use this method if your annuity is paid under a nonqualified plan. You generally cannot use this method if your annuity is paid under a qualified plan.

You determine which method to use when you first begin receiving your annuity, and you continue using it each year that you recover part of your cost.

Exclusion limit. If you contributed to your pension or annuity and your annuity starting date is before 1987, you can continue to take your monthly exclusion for as long as you receive your annuity. The total exclusion may be more than your cost.

If your annuity starting date is after 1986, the total amount of annuity income you can exclude over the years as a recovery of the cost cannot exceed your total cost.

In either case, any unrecovered cost at your (or the last annuitant's) death is allowed as a miscellaneous itemized deduction on the final return of the decedent. This deduction is not subject to the 2%-of-adjusted-gross-income limit on miscellaneous deductions.

Cost. Before you can figure how much, if any, of your pension or annuity benefits is taxable, you must determine your cost in the plan (your investment). In general, your cost is your net investment in the contract as of the annuity starting date. This includes amounts your employer contributed that were taxable to you when paid.

From this total cost paid or considered paid by you, subtract any refunded premiums, rebates, dividends, unrepaid loans, or other tax-free amounts you received by the later of the annuity starting date or the date on which you received your first payment.

The ***annuity starting date*** is the later of the first day of the first period for which you received a payment from the plan or the date on which the plan's obligations became fixed.

TIP *The amount of your contributions to the plan may be shown in box 9b of any Form 1099–R,* Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc, *that you receive.*

Foreign employment contributions. If you worked abroad, certain amounts your employer paid into your retirement plan may be considered part of your cost. For details, see *Foreign employment contributions* in Publication 575.

Withholding. Your pension, profit-sharing, stock bonus, annuity, or deferred compensation plan will withhold income tax on the taxable part of amounts paid to you. You can choose not to have tax withheld except for amounts paid to you that are eligible rollover distributions. See *Withholding Tax and Estimated Tax* and *Rollovers* in Publication 575 for more information.

For payments other than eligible rollover distributions, you can tell the payer how to withhold by filing a Form W–4P, *Withholding Certificate for Pension or Annuity Payments.*

Simplified Method. Under the Simplified Method, you figure the tax-free part of each annuity payment by dividing your cost by the total number of anticipated monthly payments. For an annuity that is payable over the lives of the annuitants, this number is based on the annuitants' ages on the annuity starting date and is determined from a table. For any other annuity, this number is the number of monthly annuity payments under the contract.

Who must use the Simplified Method. You generally must use the Simplified Method if your annuity starting date is after November 18, 1996, and you receive your pension or annuity payments from a qualified plan or annuity.

In addition, if your annuity starting date is after July 1, 1986, and before November 19, 1996, you generally ***could have chosen*** to use the Simplified Method for payments from a qualified plan.

Who cannot use the Simplified Method. You cannot use the Simplified Method and must use the General Rule if you receive pension or annuity payments from:

- A nonqualified plan (such as a private annuity, a purchased commercial annuity, or a nonqualified employee plan), or

- A qualified plan if you are age 75 or older on your annuity starting date and you are entitled to at least 5 years of guaranteed payments.

In addition, you must use the General Rule for payments from a qualified plan if your annuity starting date is after July 1, 1986, and before November 19, 1996, and you did not choose to use the Simplified Method. (You also must use the General Rule for payments from a qualified plan if your annuity starting date is before July 2, 1986, and you did not qualify to use the Three-Year Rule.)

Complete information on the General Rule, including the tables you need, is contained in Publication 939, *General Rule for Pensions and Annuities.*

Guaranteed payments. Your annuity contract provides guaranteed payments if a minimum number of payments or a minimum amount (for example, the amount of your investment) is payable even if you and any survivor annuitant do not live to receive the minimum. If the minimum amount is less than the total amount of the payments you are to receive, barring death, during the first 5 years after payments begin (figured by ignoring any payment increases), you are entitled to less than 5 years of guaranteed payments.

How to use the Simplified Method. Complete the *Simplified Method Worksheet* in the Form 1040 or Form 1040A instructions or in Publication 575 to figure your taxable annuity for 2002. If the annuity is payable only over your life, use your age on your annuity starting date to complete line 3 of the worksheet. If your annuity is payable over your life and the lives of other individuals, use your combined ages on the annuity starting date. (However, if your annuity starting date is before 1998, use the primary annuitant's age on the annuity starting date.) If the annuity does not depend on anyone's life expectancy, use the total number of monthly annuity payments under the contract.

TIP *Be sure to keep a copy of the completed worksheet; it will help you figure your taxable annuity in later years.*

Example. Dale Stanford, age 65, began receiving retirement benefits in 2002, under a joint and survivor annuity. Dale's annuity starting date is January 1, 2002. The benefits are to be paid over the joint lives of Dale and his wife, Kathy, age 65. Dale had contributed $31,000 to a qualified plan and had received no distributions before the annuity starting date. Dale is to receive a retirement benefit of $1,200 a month, and Kathy is to receive a monthly survivor benefit of $600 upon Dale's death.

Dale must use the Simplified Method to figure his taxable annuity because his payments are from a qualified plan and he is under age 75. See his illustrated completed *Simplified Method Worksheet*, later.

His annuity is payable over the lives of more than one annuitant, so Dale uses his and Kathy's combined ages and Table 2 at the bottom of the worksheet in completing line 3 of the worksheet. Dale's tax-free monthly amount is $100 ($31,000 ÷ 310 as shown on line 4 of the worksheet). Upon Dale's death, if Dale has not recovered the full $31,000 investment, Kathy will also exclude $100 from her $600 monthly payment. The full amount of any annuity payments received after 310 payments are paid must be included in gross income.

If Dale and Kathy die before 310 payments are made, a miscellaneous itemized deduction will be allowed for the unrecovered cost on the final income tax return of the last to die. This deduction is not subject to the 2%-of-adjusted-gross-income limit.

Survivors. If you receive a survivor annuity because of the death of a retiree who had reported the annuity under the ***Three-Year Rule***, include the total received in your income. (The retiree's cost has already been recovered tax free.)

If the retiree was reporting the annuity payments under the ***General Rule***, you must apply the same exclusion percentage the retiree used to your initial payment called for in the contract. The resulting tax-free amount will then remain fixed. Any increases in the survivor annuity are fully taxable.

If the retiree was reporting the annuity payments under the Simplified Method, the part of each payment that is tax free is the same as the tax-free amount figured by the retiree at the annuity starting date. See *Simplified Method,* earlier.

How to report. If you file Form 1040, report your total annuity on line 16a, and the taxable part on line 16b. If your pension or annuity is fully taxable, enter it on line 16b. Do not make an entry on line 16a. For example, if you received monthly payments totaling $1,200 during 2002 from a pension plan that was completely financed by your employer, and you had paid no tax on the payments that your employer made to the plan, the entire $1,200 is taxable. You include $1,200 only on line 16b, Form 1040.

If you file Form 1040A, report your total annuity on line 12a, and the taxable part on line 12b. If your pension or annuity is fully taxable, enter it on line 12b. Do not make an entry on line 12a.

Joint return. If you file a joint return and you and your spouse each receive one or more pensions or annuities, report the total of the pensions and annuities on line 16a, Form 1040, or line 12a, Form 1040A, and report the total of the taxable parts on line 16b, Form 1040, or line 12b, Form 1040A.

Form 1099–R. You should receive a Form 1099–R for your pension or annuity. Form 1099–R shows your pension or annuity for the year and any income tax withheld.

Nonperiodic Distributions

If you receive a nonperiodic distribution from your retirement plan, you may be able to exclude all or part of it from your income as a recovery of your cost. Nonperiodic distributions include cash withdrawals, distributions of current earnings, and certain loans. For information on how to figure the taxable amount of a nonperiodic distribution, see *Taxation of Nonperiodic Payments* in Publication 575.

CAUTION *The taxable part of a nonperiodic distribution may be subject to an additional 10% tax. See* Tax on Early Distributions, *later.*

Lump-sum distributions. If you receive a lump-sum distribution from a qualified employee plan or qualified employee annuity and the plan participant was born before 1936, you may be able to elect optional methods of figuring the tax on the distribution. The part from active participation in the plan before 1974 may qualify as capital gain

Filled-In Worksheet 2-A. **Simplified Method Worksheet for Dale Stanford**
Keep for Your Records

1. Enter the total pension or annuity payments received this year. Also, add this amount to the total for Form 1040, line 16a, or Form 1040A, line 12a	**1.**	$ 14,400
2. Enter your cost in the plan (contract) at the annuity starting date	**2.**	31,000
Note: *If your annuity starting date was **before this year** and you completed this worksheet last year, skip line 3 and enter the amount from line 4 of last year's worksheet on line 4 below. Otherwise, go to line 3.*		
3. Enter the appropriate number from Table 1 or 2 below. Use Table 2 if your annuity starting date is after 1997 and payments are for your life **and** the life of your beneficiary. Otherwise use Table 1	**3.**	310
4. Divide line 2 by line 3	**4.**	100
5. Multiply line 4 by the number of months for which this year's payments were made. If your annuity starting date was **before** 1987, enter this amount on line 8 below and skip lines 6, 7, 10, and 11. Otherwise go to line 6	**5.**	1,200
6. Enter any amounts previously recovered tax free in years after 1986	**6.**	0
7. Subtract line 6 from line 2	**7.**	31,000
8. Enter the **smaller** of line 5 or line 7	**8.**	1,200
9. Taxable amount for year. Subtract line 8 from line 1. Enter the result, but not less than zero. Also, add this amount to the total for Form 1040, line 16b, or Form 1040A, line 12b. If your Form 1099-R shows a larger amount, use the amount on this line instead	**9.**	$ 13,200
10. Add lines 6 and 8	**10.**	1,200
11. Balance of cost to be recovered. Subtract line 10 from line 2	**11.**	$ 29,800

Table 1 for Line 3 Above

IF the age at annuity starting date was . .	**AND your annuity starting date was—** ***before*** November 19, 1996, enter on line 3	***after*** November 18, 1996, enter on line 3 . . . .
55 or under	300	360
56–60	260	310
61–65	240	260
66–70	170	210
71 or over	120	160

Table 2 for Line 3 Above

IF the combined ages at annuity starting date were . .	**THEN enter on line 3** . . . . .
110 or under	410
111–120	360
121–130	310
131–140	260
141 or over	210

subject to a 20% tax rate. The part from participation after 1973 (and any part from participation before 1974 that you do not report as capital gain) is ordinary income. You may be able to use the 10-year tax option to figure tax on the ordinary income part.

Form 1099–R. If you receive a total distribution from a plan, you should receive a Form 1099–R. If the distribution qualifies as a lump-sum distribution, box 3 shows the capital gain. The amount in box 2a minus the amount in box 3 is the ordinary income.

More information. For more detailed information on lump-sum distributions, get Publication 575 or Form 4972, *Tax on Lump-Sum Distributions.*

Tax on Early Distributions

Most distributions you receive from your qualified retirement plan or deferred annuity contract before you reach age $59\frac{1}{2}$ are subject to an additional tax of 10%. The tax applies to the taxable part of the distribution.

For this purpose, a ***qualified retirement plan*** is:

1) A qualified employee plan,
2) A qualified employee annuity plan,
3) A tax-sheltered annuity plan (403(b) plan), or
4) An IRA.

5% rate on certain early distributions from deferred annuity contracts. If an early withdrawal from a deferred annuity is otherwise subject to the 10% additional tax, a 5% rate may apply instead. A 5% rate applies to distributions under a written election providing a specific schedule for the distribution of your interest in the contract if, as of March 1, 1986, you had begun receiving payments under the election. On line 4 of Form 5329, multiply by 5% instead of 10%. Attach an explanation to your return.

Exceptions to tax. The early distribution tax does not apply to any distribution that meets one of the following exceptions.

General exceptions. The tax does not apply to distributions that are:

- Made as part of a series of substantially equal periodic payments (made at least annually) for your life (or life expectancy) or the joint lives (or joint life expectancies) of you and your designated beneficiary (if from a qualified retirement plan, the payments must begin after separation from service),
- Made because you are totally and permanently disabled, or
- Made on or after the death of the plan participant or contract holder.

Additional exceptions for qualified retirement plans. The tax does not apply to distributions that are:

- From a qualified retirement plan after your separation from service in or after the year you reached age 55,
- From a qualified retirement plan to an alternate payee under a qualified domestic relations order,
- From a qualified retirement plan to the extent you have deductible medical expenses (medical expenses that exceed 7.5% of your adjusted gross income), whether or not you itemize your deductions for the year,
- From an employer plan under a written election that provides a specific schedule for distribution of your entire interest if, as of March 1, 1986, you had separated from service and had begun receiving payments under the election,
- From an employee stock ownership plan for dividends on employer securities held by the plan, or
- From a qualified retirement plan due to an IRS levy of the plan.

Additional exceptions for nonqualified annuity contracts. The tax does not apply to distributions that are:

- From a deferred annuity contract to the extent allocable to investment in the contract before August 14, 1982,
- From a deferred annuity contract under a qualified personal injury settlement,
- From a deferred annuity contract purchased by your employer upon termination of a qualified employee plan or qualified employee annuity plan and held by your employer until your separation from service, or
- From an immediate annuity contract (a single premium contract providing substantially equal annuity payments that start within one year from the date of purchase and are paid at least annually).

Reporting tax or exception. If distribution code 1 (early distribution, no known exception) is shown in box 7 of Form 1099–R, multiply the taxable part of the early distribution by 10% and enter the result on line 58 of Form 1040. Write “No” on the dotted line. You do not have to file Form 5329.

You do not have to file Form 5329 if you qualify for an exception to the 10% tax and distribution code 2, 3, or 4 is shown in box 7 of Form 1099–R. However, you must file Form 5329 if the code is not shown or the code shown is incorrect (for example, code 1 is shown although you meet an exception).

Tax on Excess Accumulation

To make sure that most of your retirement benefits are paid to you during your lifetime, rather than to your beneficiaries after your death, the payments that you receive from qualified retirement plans generally must begin no later than your ***required beginning date*** (unless the rule for 5% owners applies). This is April 1 of the year that follows the ***later*** of:

- The calendar year in which you reach age 70½, or
- The calendar year in which you retire.

For this purpose, a qualified retirement plan includes:

- A qualified employee plan,
- A qualified employee annuity plan,
- An eligible section 457 deferred compensation plan, or
- A tax-sheltered annuity plan (403(b) plan) (for benefits accruing after 1986).

5% owners. If you own (or are considered to own under section 318 of the Internal Revenue Code) more than 5% of the company maintaining your qualified retirement plan, you must begin to receive distributions by April 1 of the year after the calendar year in which you reach age 70½.

Amount of tax. If you do not receive the required minimum distribution, you are subject to an additional tax. The tax equals 50% of the difference between the amount that must be distributed and the amount that was distributed during the tax year. You can get this excise tax excused if you establish that the shortfall in distributions was due to reasonable error and that you are taking reasonable steps to remedy the shortfall.

Form 5329. You must file a Form 5329 if you owe a tax because you did not receive a minimum required distribution from your qualified retirement plan.

Additional information. For more detailed information on the tax on excess accumulation, see Publication 575.

Railroad Retirement Benefits

Benefits paid under the Railroad Retirement Act fall into two categories. These categories are treated differently for income tax purposes.

Tier 1. The first category is the amount of tier 1 railroad retirement benefits that equals the social security benefit that a railroad employee or beneficiary would have been entitled to receive under the social security system. This part of the tier 1 benefit is the social security equivalent benefit (SSEB) and is treated (for tax purposes) like social security benefits. (See *Social Security and Equivalent Railroad Retirement Benefits,* later.)

Non-social security equivalent benefits. The second category consists of the rest of the tier 1 benefits, called the non-social security equivalent benefit (NSSEB), and any tier 2 benefit, vested dual benefit (VDB), and supplemental annuity benefit. This category of benefits is treated as an amount received from a qualified employee plan. This allows for the tax-free (nontaxable) recovery of employee contributions from the tier 2 benefits and the NSSEB part of the tier 1 benefits. Vested dual benefits and supplemental annuity benefits are fully taxable.

More information. For more information about railroad retirement benefits, see Publication 575.

Military Retirement Pay

Military retirement pay based on age or length of service is taxable and must be included in income as a pension on lines 16a and 16b of Form 1040 or on lines 12a and 12b of Form 1040A. But, certain military and government disability pensions that are based on a percentage of disability from active service in the Armed Forces of any country generally are not taxable.

Veterans' benefits and insurance are discussed in Publication 525.

Social Security and Equivalent Railroad Retirement Benefits

This discussion explains the federal income tax rules for social security benefits and equivalent tier 1 railroad retirement benefits.

Social security benefits include monthly survivor and disability benefits. They do not include supplemental security income (SSI) payments which are not taxable.

Equivalent tier 1 railroad retirement benefits are the part of tier 1 benefits that a railroad employee or beneficiary would have been entitled to receive under the social security system. They commonly are called the social security equivalent benefit (SSEB) portion of tier 1 benefits.

If you received these benefits during 2002, you should have received a Form SSA–1099 or Form RRB–1099 (Form SSA–1042S or Form RRB–1042S if you are a nonresident alien).

Note. When the term ***benefits*** is used in this section, it applies to both social security benefits and equivalent tier 1 railroad retirement benefits.

Are Any of Your Benefits Taxable?

To find out whether any of your benefits are taxable, compare the ***base amount*** for your filing status to the total of:

1) One-half of your benefits, plus
2) All your other income, including tax-exempt interest.

Worksheet 2–B. **Base Amount**

A.	Write in the amount from ***box 5*** of all your Forms SSA–1099 and RRB–1099. Include the full amount of any lump-sum benefit payments received in 2002, for 2002 and earlier years. (If you received more than one form, combine the amounts from box 5 and write in the total.)	A. ________
	Note: *If the amount on line A is zero or less, stop here; none of your benefits are taxable this year.*	
B.	Enter one-half of the amount on line A	B. ________
C.	Add your taxable pensions, wages, interest, dividends, and other taxable income and write in the total	C. ________
D.	Write in any tax-exempt interest income (such as interest on municipal bonds) plus exclusions from income (listed earlier)	D. ________
E.	Add lines B, C, and D and write in the total	E. ________

Note. *Compare the amount on line E to your* **base amount** *for your filing status. If the amount on line E equals or is less than the* **base amount** *for your filing status, none of your benefits are taxable this year. If the amount on line E is more than your* **base amount** *some of your benefits may be taxable. You then need to complete the* Social Security Benefits Worksheet *in the instructions for either Form 1040 or Form 1040A.*

When making this comparison, do not reduce your other income by any ***exclusions*** for:

- Interest from qualified U.S. savings bonds,
- Employer-provided adoption benefits,
- Foreign earned income or foreign housing, or
- Income earned in American Samoa or Puerto Rico by bona fide residents.

Figuring total income. To figure the total of one-half of your benefits plus your other income, use the worksheet discussed later. If the total is more than your base amount, part of your benefits may be taxable.

If you are married and file a joint return for 2002, you and your spouse must combine your incomes and your benefits to figure whether any of your combined benefits are taxable. Even if your spouse did not receive any benefits, you must add your spouse's income to yours to figure whether any of your benefits are taxable.

TIP *If the only income you received during 2002 was your social security or SSEB portion of tier 1 railroad retirement benefits, your benefits generally are not taxable and you probably do not have to file a return. If you have income in addition to your benefits, you may have to file a return even if none of your benefits are taxable.*

Base Amount

Your base amount is:

- $25,000 if you are single, head of household, or qualifying widow(er),
- $25,000 if you are married filing separately and ***lived apart*** from your spouse for ***all*** of 2002,
- $32,000 if you are married filing jointly, or
- $–0– if you are married filing separately and ***lived with*** your spouse at any time during 2002.

Worksheet. You can use Worksheet 2–B to figure the amount of income to compare with your base amount. This is a quick way to check whether some of your benefits may be taxable.

Repayment of Benefits

Any repayment of benefits you made during 2002 must be subtracted from the gross benefits you received in 2002. It does not matter whether the repayment was for a benefit you received in 2002 or in an earlier year. If you repaid more than the gross benefits you received in 2002, see *Repayments More Than Gross Benefits,* later.

Your gross benefits are shown in box 3 of Form SSA–1099 or Form RRB–1099. Your repayments are shown in box 4. The amount in box 5 shows your net benefits for 2002 (box 3 minus box 4). Use the amount in box 5 to figure whether any of your benefits are taxable.

Tax Withholding and Estimated Tax

You can choose to have federal income tax withheld from your social security and/or the SSEB portion of your tier 1 railroad retirement benefits. If you choose to do this, you must complete a Form W–4V, *Voluntary Withholding Request.* You can choose withholding at 7%, 10%, 15%, or 27% of your total benefit payment.

If you do not choose to have income tax withheld, you may have to request additional withholding from other income, or pay estimated tax during the year. For details, get Publication 505, *Tax Withholding and Estimated Tax,* or the instructions for Form 1040–ES, *Estimated Tax for Individuals*.

How To Report Your Benefits

If part of your benefits is taxable, you must use Form 1040 or Form 1040A. You cannot use Form 1040EZ.

Reporting on Form 1040. Report your net benefits (the amount in box 5 of your Form SSA–1099 or Form RRB–1099) on line 20a and the taxable part on line 20b. If you are married filing separately and you lived apart from your spouse for all of 2002, also enter "D" to the right of the word benefits on line 20a.

Reporting on Form 1040A. Report your net benefits (the amount in box 5 of your Form SSA–1099 or Form RRB–1099) on line 14a and the taxable part on line 14b. If you are married filing separately and you lived apart from your spouse for all of 2002, enter "D" to the right of the word benefits on line 14a.

Benefits not taxable. If none of your benefits are taxable, do not report any of them on your tax return. However, if you are married filing separately and you lived apart from your spouse for all of 2002, make the following entries. On Form 1040, enter "D" to the right of the word benefits on line 20a and "–0–" on line 20b. On Form 1040A, enter "D" to the right of the word benefits on line 14a and "–0–" on line 14b.

How Much Is Taxable?

If part of your benefits is taxable, how much is taxable depends on the total amount of your benefits and other income. Generally, the higher that total amount, the greater the taxable part of your benefits.

Maximum taxable part. The taxable part of your benefits usually cannot be more than 50%. However, up to 85% of your benefits can be taxable if either of the following situations applies to you.

- The total of one-half of your benefits and all your other income is more than $34,000 ($44,000 if you are married filing jointly).
- You are married filing separately and ***lived with your spouse*** at any time during 2002.

Which worksheet to use. A worksheet to figure your taxable benefits is in the instructions for your Form 1040 or 1040A. You can use either that worksheet or *Worksheet 1* in Publication 915, *Social Security and Equivalent Railroad Retirement Benefits,* unless any of the following situations applies to you.

1) You contributed to a traditional individual retirement arrangement (IRA) and your IRA deduction is limited because you or your spouse is covered by a retirement plan at work. In this situation, you ***must*** use the special worksheets in *Appendix B* of Publication 590 to figure both your IRA deduction and your taxable benefits.
2) Situation (1) does not apply and you take an exclusion for interest from qualified U.S. savings bonds (Form 8815), for adoption benefits (Form 8839), for foreign earned income or housing (Form 2555 or Form 2555–EZ), or for income earned in American Samoa (Form 4563) or Puerto Rico by bona fide residents. In this situation, you ***must*** use *Worksheet 1* in Publication 915 to figure your taxable benefits.
3) You received a lump-sum payment for an earlier year. In this situation, also complete *Worksheet 2* or *3* and *Worksheet 4* in Publication 915.

Lump-Sum Election

You must include the taxable part of a lump-sum (retroactive) payment of benefits received in 2002 in your 2002 income, even if the payment includes benefits for an earlier year.

TIP *This type of lump-sum benefit payment should not be confused with the lump-sum death benefit that both the SSA and RRB pay to many of their beneficiaries. No part of the lump-sum death benefit is subject to tax.*

Generally, you use your 2002 income to figure the taxable part of the total benefits received in 2002. However, you may be able to figure the taxable part of a lump-sum payment for an earlier year separately, using your income for the earlier year. You can elect this method if it lowers your taxable benefits. See Publication 915 for more information.

Repayments More Than Gross Benefits

In some situations, your Form SSA–1099 or Form RRB–1099 will show that the total benefits you repaid (box 4) are more than the gross benefits (box 3) you received. If this occurred, your net benefits in box 5 will be a negative figure (a figure in parentheses) and none of your benefits will be taxable. If you receive more than one form, a negative figure in box 5 of one form is used to offset a positive figure in box 5 of another form for that same year.

If you have any questions about this negative figure, contact your local Social Security Administration office or your local U.S. Railroad Retirement Board field office.

Joint return. If you and your spouse file a joint return, and your Form SSA–1099 or RRB–1099 has a negative figure in box 5 but your spouse's does not, subtract the amount in box 5 of your form from the amount in box 5 of your spouse's form. You do this to get your net benefits when figuring if your combined benefits are taxable.

Repayment of benefits received in an earlier year. If the total amount shown in box 5 of all of your Forms SSA–1099 and RRB–1099 is a negative figure, you can take an itemized deduction for the part of this negative figure that represents benefits you included in gross income in an earlier year.

If this deduction is ***$3,000 or less***, it is subject to the 2%-of-adjusted-gross-income limit that applies to certain miscellaneous itemized deductions. Claim it on line 22, Schedule A (Form 1040).

If this deduction is ***more than $3,000***, you have some special instructions to follow. Get Publication 915 for those instructions.

Sickness and Injury Benefits

Most payments you receive as compensation for illness or injury are not taxable. These include the following.

Workers' compensation. Amounts you receive as workers' compensation for an occupational sickness or injury are fully exempt from tax if they are paid under a workers' compensation act or a statute in the nature of a workers' compensation act. The exemption also applies to your survivor(s).

If part of your workers' compensation reduces your social security or equivalent railroad retirement benefits received, that part is considered social security (or equivalent railroad retirement) benefits and may be taxable. For a discussion of the taxability of these benefits, see Social Security and Equivalent Railroad Retirement Benefits, *earlier.*

Return to work. If you return to work after qualifying for workers' compensation, payments you continue to receive while assigned to light duties are taxable as wages.

Federal Employees' Compensation Act (FECA). Payments received under this Act for personal injury or sickness, including payments to beneficiaries in case of death, are not taxable. However, you are taxed on amounts you receive under this Act as ***continuation of pay*** for up to 45 days while a claim is being decided. Also, pay for sick leave while a claim is being processed is taxable and must be included in your income as wages.

If part of the payments you receive under FECA reduces your social security or equivalent railroad retirement benefits received, that part is considered social security (or equivalent railroad retirement) benefits and may be taxable. For a discussion of the taxability of these benefits, see Social Security and Equivalent Railroad Retirement Benefits, *earlier.*

Benefits under an accident or health insurance policy. Benefits you receive under an accident or health insurance policy are not taxable if:

- You paid the premiums, or
- Your employer paid the premiums and you included the premiums in your gross income.

Long-term care insurance contracts. Long-term care insurance contracts generally are treated as accident and health insurance contracts. Amounts you receive from them (other than policyholder dividends or premium refunds) generally are excludable from income as amounts received for personal injury or sickness. However, the amount you can exclude may be limited. Long-term care insurance contracts are discussed in more detail in Publication 525.

Compensation for permanent loss or disfigurement. Compensation you receive for permanent loss or loss of use of a part or function of your body, or for your permanent disfigurement is not taxable. This compensation must be based only on the injury and not on the period of your absence from work. These benefits are not taxable even if your employer pays for the accident and health plan that provides these benefits.

Disability benefits. Benefits you receive for loss of income or earning capacity as a result of injuries under a ***no-fault*** car insurance policy are not taxable.

Disability Income

Generally, if you retire on disability, you must report your pension or annuity as income.

If you were 65 or older by the end of 2002, or you were retired on permanent and total disability and received taxable disability income, you may be able to claim the credit for the elderly or the disabled. See *Credit for the Elderly or the Disabled,* later.

Taxable disability pensions or annuities. Generally, you must report as income any amount you receive for your disability through an accident or health insurance plan that is paid for by your employer. However, certain payments may not be taxable to you. See *Sickness and Injury Benefits,* earlier.

Cost paid by you. If you pay the entire cost of a health or accident insurance plan, do not include any amounts you receive for your disability as income on your tax return. If your plan reimbursed you for medical expenses you deducted in an earlier year, you may have to include some, or all, of the reimbursement in your income.

Accrued leave payment. If you retire on disability, any lump-sum payment you receive for accrued annual leave is a salary payment. The payment is not a disability payment. Include it in your income in the year you receive it.

Workers' compensation. If part of your disability pension is workers' compensation, that part is exempt from tax. The exemption also applies to your survivors.

How to report. You must report all your taxable disability income as wages on line 7 of Form 1040 or Form 1040A, until you reach minimum retirement age. Generally, this is the age at which you can first receive a pension or annuity if you are not disabled.

Beginning on the day after you reach minimum retirement age, the payments you receive are taxable as a pension. Report them on lines 16a and 16b of Form 1040 or on lines 12a and 12b of Form 1040A.

Life Insurance Proceeds

Life insurance proceeds paid to you because of the death of the insured person are not taxable unless the policy was turned over to you for a price. This is true even if the proceeds were paid under an accident or health insurance policy or an endowment contract.

Proceeds not received in installments. If death benefits are paid to you in a lump sum or other than at regular intervals, include in your income only the benefits that are more than the amount payable to you at the time of the insured person's death. If the benefit payable at death is not specified, you include in your income the benefit payments that are more than the present value of the payments at the time of death.

Proceeds received in installments. If you receive life insurance proceeds in installments, you can exclude part of each installment from your income.

To determine the excluded part, divide the amount held by the insurance company (generally the total lump sum payable at the death of the insured person) by the number of installments to be paid. Include anything over this excluded part in your income as interest.

Installments for life. If, as the beneficiary under an insurance contract, you are entitled to receive the proceeds in installments for the rest of your life without a refund or period-certain guarantee, you figure the excluded part of each installment by dividing the amount held by the insurance company by your life expectancy. If there is a refund or period-certain guarantee, the amount held by the insurance company for this purpose is reduced by the actuarial value of the guarantee.

Surviving spouse. If your spouse died before October 23, 1986, and insurance proceeds paid to you because of the death of your spouse are received in installments, you can exclude up to $1,000 a year of the interest included in the installments. If you remarry, you can continue to take the exclusion.

Surrender of policy for cash. If you surrender a life insurance policy for cash, you must include in income any proceeds that are more than the cost of the life insurance policy. You should receive a Form 1099–R showing the total proceeds and the taxable part. Report these amounts on lines 16a and 16b of Form 1040, or lines 12a and 12b of Form 1040A.

Endowment Proceeds

Endowment proceeds paid in a lump sum to you at maturity are taxable only if the proceeds are more than the cost of the policy. To determine your cost, add the aggregate amount of premiums (or other consideration) paid for the contract and subtract any amount that you previously received under the contract and excluded from your income. Include the part of the lump-sum payment that is more than your cost in your income.

Endowment proceeds that you choose to receive in installments instead of a lump-sum payment at the maturity of the policy are taxed as an annuity. This is explained in Publication 575. For this treatment to apply, you must choose to receive the proceeds in installments before receiving any part of the lump sum. This election must be made within 60 days after the lump-sum payment first becomes payable to you.

Accelerated Death Benefits

Certain payments made as accelerated death benefits under a life insurance contract or viatical settlement before the insured's death are excluded from income if the insured is terminally or chronically ill. See *Exception* later. For a chronically ill individual, the payments must be for costs incurred for qualified long-term care services or made on a periodic basis without regard to the costs.

In addition, if any portion of a death benefit under a life insurance contract on the life of a terminally or chronically ill individual is sold or assigned to a viatical settlement provider, the amount received also is excluded from income. Generally, a viatical settlement provider is one who regularly engages in the business of buying or taking assignment of life insurance contracts on the lives of insured individuals who are terminally or chronically ill.

To claim an exclusion for accelerated death benefits made on a per diem or other periodic basis, you must file Form 8853, *Archer MSAs and Long-Term Care Insurance Contracts,* with your return.

Terminally or chronically ill defined. A terminally ill person is one who has been certified by a physician as having an illness or physical condition that reasonably can be expected to result in death within 24 months from the date of the certification. A chronically ill person is one who is not terminally ill but has been certified (within the previous 12 months) by a licensed health care practitioner as meeting either of the following conditions.

- The person is unable to perform (without substantial help) at least two activities of daily living for a period of 90 days or more because of a loss of functional capacity.
- The person requires substantial supervision to protect himself or herself from threats to health and safety due to severe cognitive impairment.

Exception. The exclusion does not apply to any amount paid to a person other than the insured if that other person has an insurable interest in the life of the insured:

- Because the insured is a director, officer, or employee of the other person, or
- Because the insured has a financial interest in the business of the other person.

Sale of Home

You may be able to exclude from income any gain up to $250,000 ($500,000 on a joint return in most cases) on the sale of your main home. If you can exclude all of the gain, you do not need to report the sale on your tax return.

Maximum Amount of Exclusion

You can exclude up to $250,000 of the gain on the sale of your main home if all of the following are true.

1) You meet the ownership test.
2) You meet the use test.
3) During the 2-year period ending on the date of the sale, you did not exclude gain from the sale of another home.

You can exclude up to $500,000 of the gain on the sale of your main home if all of the following are true.

1) You are married and file a joint return for the year.
2) Either you or your spouse meets the ownership test.
3) Both you and your spouse meet the use test.
4) During the 2-year period ending on the date of the sale, neither you nor your spouse excluded gain from the sale of another home.

Ownership and Use Tests

To claim the exclusion, you must meet the ownership and use tests. This means that during the ***5-year period*** ending on the date of the sale, you must have:

1) ***Owned*** the home for at least ***2 years*** (the ownership test), ***and***
2) ***Lived in*** the home as your main home for at least ***2 years*** (the use test).

Exception. If you owned and lived in the property as your main home for less than 2 years, you still can claim an exclusion in some cases. Generally, you must have sold the home due to a change in place of employment or health. The maximum amount you can exclude will be reduced. See Publication 523, *Selling Your Home,* for more information.

Married Persons

If you and your spouse file a joint return for the year of sale, you can exclude gain if either spouse meets the ownership and use tests. (See *Maximum Amount of Exclusion,* earlier.)

Death of spouse before sale. If your spouse died before the date of sale, you are considered to have owned and lived in the property as your main home during any period of time when your spouse owned and lived in it as a main home.

Home transferred from spouse. If your home was transferred to you by your spouse (or former spouse if the transfer was incident to divorce), you are considered to have owned it during any period of time when your spouse owned it.

Use of home after divorce. You are considered to have used property as your main home during any period when:

- You owned it, and
- Your spouse or former spouse is allowed to live in it under a divorce or separation instrument.

Business Use or Rental of Home

You may be able to exclude your gain from the sale of a home that you have used for business or to produce rental income. But, you must meet the ownership and use tests. See Publication 523 for more information.

Depreciation after May 6, 1997. If you were entitled to take depreciation deductions because you used your home for business purposes or as rental property, you cannot exclude the part of your gain equal to any depreciation allowed or allowable as a deduction for periods after May 6, 1997. See Publication 523 for more information.

Reporting the Gain

Do ***not*** report the 2002 sale of your main home on your tax return unless:

- You have a gain and you do not qualify to exclude all of it, or
- You have a gain and you choose not to exclude it.

If you have any taxable gain on the sale of your main home that cannot be excluded, report the entire gain on Schedule D (Form 1040). If you used your home for business or to produce rental income, you may have to use Form 4797, *Sale of Business Property*, to report the sale of the business or rental part. See Publication 523 for more information.

Other Items

The following items generally are excluded from taxable income. You should not report them on your return.

Gifts and inheritances. Generally, property you receive as a gift, bequest, or inheritance is not included in your income. However, if property you receive this way later produces income such as interest, dividends, or rents, that income is taxable to you. If property is given to a trust and the income from it is paid, credited, or distributed to you, that also is income to you. If the gift, bequest, or inheritance is the income from property, that income is taxable to you.

Veterans' benefits. Do not include in your income any veterans' benefits paid under any law, regulation, or administrative practice administered by the Department of Veterans Affairs (VA). See Publication 525.

Public assistance. Do not include in your income benefit payments from a public welfare fund, such as payments due to blindness.

Payments from a state fund for victims of crime. These payments should not be included in the victims' incomes if they are in the nature of welfare payments. Do not deduct medical expenses that are reimbursed by such a fund.

Mortgage assistance payments. Payments made under section 235 of the National Housing Act for mortgage assistance are not included in the homeowner's income. Interest paid for the homeowner under the mortgage assistance program cannot be deducted.

Payments to reduce cost of winter energy use. Payments made by a state to qualified people to reduce their cost of winter energy use are not taxable.

Nutrition Program for the Elderly. Food benefits you receive under the Nutrition Program for the Elderly are not taxable. If you prepare and serve free meals for the program, include in your income as wages the cash pay you receive, even if you also are eligible for food benefits.

3.

Adjustments to Income

You may be able to subtract amounts from your gross income (Form 1040, line 22 or Form 1040A, line 15) to get your ***adjusted gross income*** (Form 1040, line 35 or Form 1040A, line 21). Some adjustments to income follow.

- Contributions to your individual retirement arrangement (IRA) (Form 1040, line 24, or Form 1040A, line 17), explained later in this publication.
- Contributions to your Archer medical savings account (MSA) (Form 1040, line 27) if you are an employee of a small business (50 or fewer employees), or if you are self-employed and covered only by a high deductible health plan. See Publication 969, *Medical Savings Accounts (MSAs),* for more information.
- Certain moving expenses (Form 1040, line 28) if you changed job locations or started a new job in 2002. See Publication 521, *Moving Expenses,* or get Form 3903, *Moving Expenses,* and its instructions.
- Some health insurance costs (Form 1040, line 30) if you were self-employed and had a net profit for the year, or if you received wages in 2002 from an S corporation in which you were a more than 2% shareholder. For more details get Publication 535, *Business Expenses.*
- Payments to your self-employed SEP, SIMPLE, or qualified plan (Form 1040, line 31). For more information, including limits on how much you can deduct, see Publication 560, *Retirement Plans for Small Business.*
- Penalties paid on early withdrawal of savings (Form 1040, line 32). Form 1099–INT, *Interest Income,* or Form 1099–OID, *Original Issue Discount*, will show the amount of any penalty you were charged.
- Alimony payments (Form 1040, line 33a). For more information, see Publication 504, *Divorced or Separated Individuals.*

There are other items you can claim as adjustments to income. These adjustments are discussed in the Form 1040 instructions.

Individual Retirement Arrangement (IRA) Contributions and Deductions

This section explains the tax treatment of amounts you pay into traditional IRAs. A traditional IRA is any IRA that is not a Roth or SIMPLE IRA. For more detailed information, get Publication 590.

Contributions. An IRA is a personal savings plan that offers you tax advantages to set aside money for your retirement. Two advantages of a traditional IRA are:

- You may be able to deduct some or all of your contributions to it, depending on your circumstances, and
- Generally, amounts in your IRA, including earnings and gains, are not taxed until distributed.

CAUTION *Although interest earned from your traditional IRA generally is not taxed in the year earned, it is not tax-exempt interest. Do not report this interest on your tax return as tax-exempt interest.*

General limit. The most that can be contributed for any year to your traditional IRA is ***the lesser*** of the following amounts.

1) Your compensation that you must include in income for the year, or
2) $3,000 ($3,500 if you were age 50 or older by the end of 2002).

Contributions to spousal IRAs. In the case of a married couple filing a joint return, up to $3,000 ($3,500 for each spouse age 50 or older by the end of 2002) can be contributed to IRAs (other than SIMPLE IRAs) on behalf of each spouse, even if one spouse has little or no compensation.

For more information on the general limit and the spousal IRA limit, see *How Much Can Be Contributed?* in Publication 590.

Deductible contribution. Generally, you can deduct the lesser of the contributions to your traditional IRA for the year or the general limit (or spousal IRA limit, if applicable) for your IRA. However, ***if you or your spouse was covered by an employer retirement plan*** at any time during the year for which contributions were made, you may not be able to deduct all of the contributions. Your deduction may be reduced or eliminated, depending on your filing status and the amount of your income.

Nondeductible contribution. The difference between your total permitted contributions and your total deductible contributions, if any, is your nondeductible contribution. You must file **Form 8606**, *Nondeductible IRAs,* to report nondeductible contributions even if you do not have to file a tax return for the year.

Roth IRA. Regardless of your age, you may be able to establish and contribute to a Roth IRA. You cannot claim a deduction for any contributions to a Roth IRA. But, if you satisfy the requirements, all earnings are tax free and neither your nondeductible contributions nor any earnings on them are taxable when you withdraw them.

4. Deductions

Most taxpayers have a choice of taking a standard deduction or itemizing their deductions. You benefit from the standard deduction if your standard deduction is more than the total of your allowable itemized deductions. If you have a choice, you should use the method that gives you the lower tax.

Standard Deduction

The ***standard deduction*** is a dollar amount that reduces the amount of income on which you are taxed. It is a benefit that eliminates the need for many taxpayers to itemize actual deductions. The standard deduction is higher for taxpayers who are age 65 or older or blind.

The standard deduction amounts for most taxpayers under age 65 are shown in *Table 4–1*.

Persons not eligible for the standard deduction. Your standard deduction is ***zero*** and you should itemize any deductions you have if:

- You are married and filing a separate return, and your spouse itemizes deductions,
- You are filing a tax return for a short tax year because of a change in your annual accounting period, or
- You are a nonresident or dual-status alien during the year. You are considered a dual-status alien if you were both a nonresident alien and a resident alien during the year. If you are a nonresident alien who is married to a U.S. citizen or resident at the end of the year, you can choose to be treated as a U.S. resident. See Publication 519, *U.S. Tax Guide for Aliens.* If you make this choice, you can take the standard deduction.

Higher standard deduction for age 65 or older. You are entitled to a higher standard deduction if you are age 65 or older at the end of the year. You are considered 65 on the day before your 65th birthday. Therefore, you can take the higher standard deduction for 2002 if your 65th birthday was on or before January 1, 2003.

Use *Table 4–2* to find the amount of your standard deduction.

Higher standard deduction for blindness. If you are blind on the last day of the year and you do not itemize deductions, you are entitled to a higher standard deduction. Use *Table 4–2* to find the amount. You qualify for this benefit if you are totally or partly blind.

Partly blind. If you are partly blind, you must get a certified statement from an eye physician or registered optometrist that:

- You cannot see better than 20/200 in the better eye with glasses or contact lenses, or
- Your field of vision is not more than 20 degrees.

If your eye condition will never improve beyond these limits, the statement should include this fact. You must keep the statement in your records.

If your vision can be corrected beyond these limits only by contact lenses that you can wear only briefly because of pain, infection, or ulcers, you can take the higher standard deduction for blindness if you otherwise qualify.

Spouse 65 or older or blind. You can take a higher standard deduction if your spouse is age 65 or older or blind and:

1) You file a joint return, or
2) You file a separate return and can claim an exemption for your spouse because your spouse had no gross income and an exemption for your spouse could not be claimed by another taxpayer.

CAUTION *You cannot claim the higher standard deduction for an individual other than yourself and your spouse.*

Decedents. The amount of the standard deduction for a decedent's final return is the same as it would have been had the decedent continued to live. However, if the dece-

2002 Standard Deduction Tables

Caution: If you are married filing a separate return and your spouse itemizes deductions, or if you are a dual-status alien, you cannot take the standard deduction even if you were 65 or older or blind.

Table 4-1. Standard Deduction Chart for People Under Age 65*

If Your Filing Status is:	Your Standard Deduction is:
Single	$4,700
Married filing joint return or Qualifying widow(er) with dependent child	7,850
Married filing separate return	3,925
Head of household	6,900

*DO NOT use this chart if you were 65 or older or blind, OR if someone else can claim an exemption for you (or your spouse if married filing jointly). Use Table 4-2 or 4-3 instead.

Table 4-2. Standard Deduction Chart for People Age 65 or Older or Blind*

Check the correct number of boxes below. Then go to the chart.

You — 65 or older ☐ Blind ☐
Your spouse, if claiming spouse's exemption — 65 or older ☐ Blind ☐

Total number of boxes you checked ☐

If Your Filing Status is:	And the Number in the Box Above is:	Your Standard Deduction is:
Single	1 2	$5,850 7,000
Married filing joint return or Qualifying widow(er) with dependent child	1 2 3 4	8,750 9,650 10,550 11,450
Married filing separate return	1 2 3 4	4,825 5,725 6,625 7,525
Head of household	1 2	8,050 9,200

*If someone else can claim an exemption for you (or your spouse if married filing jointly), use Table 4-3, instead.

Table 4-3. Standard Deduction Worksheet for Dependents*

If you were 65 or older or blind, check the correct number of boxes below. Then go to the worksheet.

You — 65 or older ☐ Blind ☐
Your spouse, if claiming spouse's exemption — 65 or older ☐ Blind ☐

Total number of boxes you checked ☐

1. Enter your **earned income** (defined below). If none, enter -0-.	**1.** ______
2. Additional amount	**2.** $250
3. Add lines 1 and 2.	**3.** ______
4. Minimum standard deduction	**4.** $750
5. Enter the **larger** of line 3 or line 4.	**5.** ______
6. Enter the amount shown below for your filing status. ● Single, enter $4,700 ● Married filing separate return, enter $3,925 ● Married filing jointly or Qualifying widow(er) with dependent child, enter $7,850 ● Head of household, enter $6,900	**6.** ______
7. Standard deduction **a.** Enter the **smaller** of line 5 or line 6. If under 65 and not blind, stop here. This is your standard deduction. Otherwise, go on to line 7b. **b.** If 65 or older or blind, multiply $1,150 ($900 if married or qualifying widow(er) with dependent child) by the number in the box above. **c.** Add lines 7a and 7b. This is your standard deduction for 2002.	**7a.** ______ **7b.** ______ **7c.** ______

Earned income *includes wages, salaries, tips, professional fees, and other compensation received for personal services you performed. It also includes any amount received as a scholarship that you must include in your income.*

*Use this worksheet ONLY if someone else can claim an exemption for you (or your spouse if married filing jointly).

dent was not 65 or older at the time of death, the higher standard deduction for age cannot be claimed.

Examples. The following examples illustrate how to determine your standard deduction using *Tables 4–1* and *4–2*.

Example 1. Larry, 66, and Donna, 67, are filing a joint return for 2002. Neither is blind. They decide not to itemize their deductions. They use *Table 4–2*. Their standard deduction is $9,650.

Example 2. Assume the same facts as in *Example 1* except that Larry is blind at the end of 2002. They use *Table 4–2*. Larry and Donna's standard deduction is $10,550.

Example 3. Susan, 67, who is blind, qualifies as head of household in 2002. She has no itemized deductions. She uses *Table 4–2*. Her standard deduction is $9,200.

Standard Deduction for Dependents

The standard deduction for an individual for whom an exemption can be claimed on another person's tax return generally is limited to the greater of:

- $750, or
- The individual's earned income for the year plus $250 (but not more than the regular standard deduction amount, $4,700 for a single individual).

However, if the individual is age 65 or older or blind, his or her standard deduction may be higher. Use *Table 4–3* to determine your standard deduction.

Itemized Deductions

Some individuals should itemize their deductions because it will save them money. Others should itemize because they do not qualify for the standard deduction. See the discussion under *Standard Deduction,* earlier, to decide if it would be to your advantage to itemize deductions.

Medical and dental expenses, some taxes, certain interest expenses, charitable contributions, certain losses, and other miscellaneous expenses may be itemized as deductions on Schedule A (Form 1040).

CAUTION *You may be subject to a limit on some of your itemized deductions if your adjusted gross income (AGI) is more than $137,300 ($68,650 if you file married filing separately).*

You may benefit from itemizing your deductions on Schedule A of Form 1040 if you:

- Cannot take the standard deduction,
- Had uninsured medical or dental expenses that are more than 7.5% of your adjusted gross income (see *Medical and Dental Expenses*, later),
- Paid interest and taxes on your home,
- Had large unreimbursed employee business expenses or other miscellaneous deductions,
- Had large uninsured casualty or theft losses,
- Made large contributions to qualified charities (see Publication 526, *Charitable Contributions*), or
- Have total itemized deductions that are more than the highest standard deduction you can claim.

See the instructions for Schedule A in the Form 1040 instructions for more information.

Medical and Dental Expenses

You can deduct certain medical and dental expenses you paid for yourself, your spouse, and your dependents, if you itemize your deductions on Schedule A (Form 1040).

Table 4–4 shows items that you can or cannot include in figuring your medical expense deduction. More information can be found in Publication 502, *Medical and Dental Expenses.*

CAUTION *You can deduct only the amount of your medical and dental expenses that is more than 7.5% of your adjusted gross income shown on line 35, Form 1040.*

What to include. You can include only the medical and dental expenses you paid this year, regardless of when the services were provided. If you pay medical expenses by check, the day you mail or deliver the check generally is the date of payment. If you use a pay-by-phone or on-line account to pay your medical expenses, the date reported on the statement of the financial institution showing when payment was made is the date of payment. You can include medical expenses you charge to your credit card in the year the charge is made. It does not matter when you actually pay the amount charged.

Medical Insurance Premiums

You can include in medical expenses insurance premiums you pay for policies that cover medical care. Policies can provide payment for:

- Hospitalization, surgical fees, X-rays, etc.,
- Prescription drugs,
- Replacement of lost or damaged contact lenses,
- Qualified long-term care insurance contracts, or
- Membership in an association that gives cooperative or so-called free-choice medical service, or group hospitalization and clinical care.

You ***cannot*** deduct insurance premiums paid with pretax dollars because the premiums are not included in box 1 of your Form W–2.

If you have a policy that provides more than one kind of payment, you can include the premiums for the medical care part of the policy if the charge for the medical part is

Table 4–4. **Medical and Dental Expenses Checklist**

You can include:		You cannot include:	
• Birth control pills prescribed by your doctor • Capital expenses for equipment or improvements to your home needed for medical care (see Publication 502) • Cost of certain fertility enhancement procedures (see Publication 502) • Cost and care of guide dogs or other animals aiding the blind, deaf, and disabled • Cost of lead-based paint removal (see Publication 502) • Cost of vasectomy • Expenses of an organ donor • Eye surgery—to promote the correct function of the eye • Hospital services fees (lab work, therapy, nursing services, surgery, etc.) • Legal abortion • Legal operation to prevent having children • Long-term care contracts, qualified (see Publication 502) • Meals and lodging provided by a hospital during medical treatment • Medical and hospital insurance premiums • Medical services fees (from doctors, dentists, surgeons, specialists, and other medical practitioners)	• Oxygen equipment and oxygen • Part of life-care fee paid to retirement home designated for medical care • Prescription medicines (prescribed by a doctor) and insulin • Psychiatric care at a specially equipped medical center (includes meals and lodging) • Social Security tax, Medicare tax, FUTA, and state employment tax for worker providing medical care (see *Wages for nursing services*, later) • Special items (artificial limbs, false teeth, eyeglasses, contact lenses, hearing aids, crutches, wheelchair, etc.) • Special school or home for mentally or physically disabled persons (see Publication 502) • Stop-smoking programs • Transportation for needed medical care • Treatment at a drug or alcohol center (includes meals and lodging provided by the center) • Wages for nursing services (see Publication 502)	• Archer MSAs (see Publication 969) • Bottled water • Cost of nutritional supplements, vitamins, herbal supplements, "natural medicines," etc., unless you can obtain them legally only with a physician's prescription • Diaper service • Expenses for your general health (even if following your doctor's advice) such as— —Health club dues —Household help (even if recommended by a doctor) —Social activities, such as dancing or swimming lessons —Trip for general health improvement	• Funeral, burial, or cremation expenses • Illegal operation or treatment • Life insurance or income protection policies, or policies providing payment for loss of life, limb, sight, etc. • Maternity clothes • Medical insurance included in a car insurance policy covering all persons injured in or by your car • Medicine you buy without a prescription • Nursing care for a healthy baby • Surgery for purely cosmetic reasons (see Publication 502) • Toothpaste, toiletries, cosmetics, etc.

reasonable. The cost of the medical portion must be separately stated in the insurance contract or given to you in a separate statement.

Medicare A. If you are covered under social security (or if you are a government employee who paid Medicare tax), you are enrolled in Medicare A. The payroll tax paid for Medicare A is not a medical expense. If you are not covered under social security (or were not a government employee who paid Medicare tax), you can enroll voluntarily in Medicare A. In this situation, the premiums paid for Medicare A can be included as a medical expense on your tax return.

Medicare B. Medicare B is a supplemental medical insurance. Premiums you pay for Medicare B are a medical expense. If you applied for it at age 65 or after you became disabled, you can deduct the monthly premiums you paid. If you were over age 65 or disabled when you first enrolled, check the information you received from the Social Security Administration to find out your premium.

Prepaid insurance premiums. Insurance premiums you pay before you are age 65 for medical care after you reach age 65 for yourself, your spouse, or your dependents, are medical care expenses in the year paid if they are:

- Payable in equal yearly installments, or more often, and
- Payable for at least 10 years, or until you reach 65 (but not for less than 5 years).

Meals and Lodging

You can include in medical expenses the cost of meals and lodging at a hospital or similar institution if your main reason for being there is to receive medical care.

You may be able to include in medical expenses the cost of lodging not provided in a hospital or similar institution. You can include the cost of such lodging while away from home if you meet all of the following requirements.

1) The lodging is primarily for, and essential to, medical care.
2) The medical care is provided by a doctor in a licensed hospital or in a medical care facility related to, or the equivalent of, a licensed hospital.
3) The lodging is not lavish or extravagant under the circumstances.
4) There is no significant element of personal pleasure, recreation, or vacation in the travel away from home.

The amount you include in medical expenses for lodging cannot be more than $50 per night for each person. You can include lodging for a person traveling with the person receiving the medical care. For example, if a parent is traveling with a sick child, up to $100 per night is included as a medical expense for lodging. (Meals are not included.)

Nursing home. You can include in medical expenses the cost of medical care in a nursing home or a home for the aged for yourself, your spouse, or your dependents. This includes the cost of meals and lodging in the home if the main reason for being there is to get medical care.

Do not include the cost of meals and lodging if the reason for being in the home is personal. You can, however, include in medical expenses the part of the cost that is for medical or nursing care.

Transportation

Amounts paid for transportation primarily for, and essential to, medical care qualify as medical expenses.

You can include:

- Bus, taxi, train, or plane fares or ambulance service payments,
- Transportation expenses of a nurse or other person who can give injections, medications, or other treatment required by a patient who is traveling to get medical care and is unable to travel alone, and
- Actual car expenses, such as gas, oil, parking fees, and tolls. Instead of deducting actual car expenses, you can deduct ***13 cents a mile*** for use of your car for medical reasons. Add the cost of parking fees and tolls to this amount.

  You cannot include depreciation, insurance, or general repair and maintenance expenses on your car, no matter which method you choose to figure the deduction.

CAUTION *Do not include transportation expenses if, for nonmedical reasons, you choose to travel to another city, such as a resort area, for an operation or other medical care prescribed by your doctor.*

Home Improvements

Only reasonable costs to accommodate a personal residence to a person's disabled condition are considered medical care. Additional costs for personal motives, such as for architectural or aesthetic reasons, are not medical expenses. Publication 502 contains additional information and examples, including a capital expense worksheet, to assist you in figuring the amount of the capital expense that you can include in your medical expenses. Also, see Publication 502 for information about deductible operating and upkeep expenses related to such capital expense items, and for information about improvement, for medical reasons, to property rented by a person with disabilities.

5.

Credits

This chapter briefly discusses the credit for the elderly or disabled, the child and dependent care credit, and the earned income credit. You may be able to reduce your federal income tax by claiming one or more of these credits.

Credit for the Elderly or the Disabled

This section explains who qualifies for the credit for the elderly or the disabled and how to figure this credit. For more information, see Publication 524, *Credit for the Elderly or the Disabled*.

CAUTION *You can take the credit only if you file Form 1040 or Form 1040A. You cannot take the credit if you file Form 1040EZ.*

Credit figured for you. If you choose to have the IRS figure the credit for you, see Publication 524. If you want the IRS to figure your tax, see Publication 967, *The IRS Will Figure Your Tax.*

Can You Take the Credit?

You can take the credit for the elderly or the disabled if:

- You are a ***qualified individual***, and
- Your income is not more than certain limits.

See *Figures 5–A and 5–B*, later.

Qualified Individual

You are a qualified individual for this credit if you are a U.S. citizen or resident, and either of the following applies.

1) You were age 65 or older at the end of 2002.

2) You were under age 65 at the end of 2002 and all three of the following statements are true.

   a) You retired on permanent and total disability (explained later).

   b) You received taxable disability income for 2002.

   c) On January 1, 2002, you had not reached mandatory retirement age (defined later under *Disability income*).

TIP **Age 65.** *You are considered to be age 65 on the day before your 65th birthday. Therefore, you are age 65 at the end of the year if your 65th birthday is on or before January 1 of the following year.*

U.S. citizen or resident. You must be a U.S. citizen or resident (or be treated as a resident) to take the credit. Generally, you cannot take the credit if you were a nonresident alien at any time during the tax year.

Exceptions. You may be able to take the credit if you are a nonresident alien who is married to a U.S. citizen or resident at the end of the tax year and you and your spouse choose to treat you as a U.S. resident. If you make that choice, both you and your spouse are taxed on your worldwide income.

If you were a nonresident alien at the beginning of the year and a resident at the end of the year, and you were married to a U.S. citizen or resident at the end of the year, you may be able to choose to be treated as a U.S. resident for the entire year. In that case, you may be allowed to take the credit. For information on these choices, see chapter 1 of Publication 519, *U.S. Tax Guide for Aliens.*

Married persons. Generally, if you are married at the end of the tax year, you and your spouse must file a joint return to take the credit. However, if you and your spouse did not live in the same household at any time during the tax year, you can file either a joint return or separate returns and still take the credit.

Head of household. You can file as head of household and qualify to take the credit even if your spouse lived with you during the first 6 months of the year if you meet all of the tests. See Publication 524 and Publication 501.

Under age 65. If you are under age 65, you can qualify for the credit only if you are retired on permanent and total disability. You are retired on permanent and total disability if:

- You were permanently and totally disabled when you retired, and
- You retired on disability before the end of the tax year.

Even if you do not retire formally, you are considered retired on disability when you have stopped working because of your disability. If you retired on disability before 1977, see Publication 524.

Permanent and total disability. You are permanently and totally disabled if you cannot engage in any substantial gainful activity because of your physical or mental condition. A physician must certify that the condition has lasted or can be expected to last continuously for 12 months or more, or that the condition can be expected to result in death. See *Physician's statement,* later.

Substantial gainful activity. Substantial gainful activity is the performance of significant duties over a reasonable period of time while working for pay or profit, or in work generally done for pay or profit.

Full-time work (or part-time work done at the employer's convenience) in a competitive work situation for at least the minimum wage conclusively shows that you are able to engage in substantial gainful activity.

Substantial gainful activity is not work you do to take care of yourself or your home. It is not unpaid work on hobbies, institutional therapy or training, school attendance, clubs, social programs, and similar activities. However, doing this kind of work may show that you are able to engage in substantial gainful activity.

The fact that you have not worked for some time is not, of itself, conclusive evidence that you cannot engage in substantial gainful activity.

Physician's statement. If you are under 65, you must have your physician complete a statement certifying that you were permanently and totally disabled on the date you retired.

You do not have to file this statement with your Form 1040 or Form 1040A, but you ***must*** keep it for your records. The instructions for either Schedule R (Form 1040) or Schedule 3 (Form 1040A) include a statement your physician can complete and that you can keep for your records.

If you got a physician's statement in an earlier year ***and,*** due to your continued disabled condition, you were unable to engage in any substantial gainful activity during 2002, you may not need to get another physician's statement for 2002. For a detailed explanation of the conditions you must meet, see the instructions for Part II of Schedule R (Form 1040) or of Schedule 3 (Form 1040A). If you meet the required conditions, you must check the box on line 2 of Part II of Schedule R (Form 1040) or of Schedule 3 (Form 1040A).

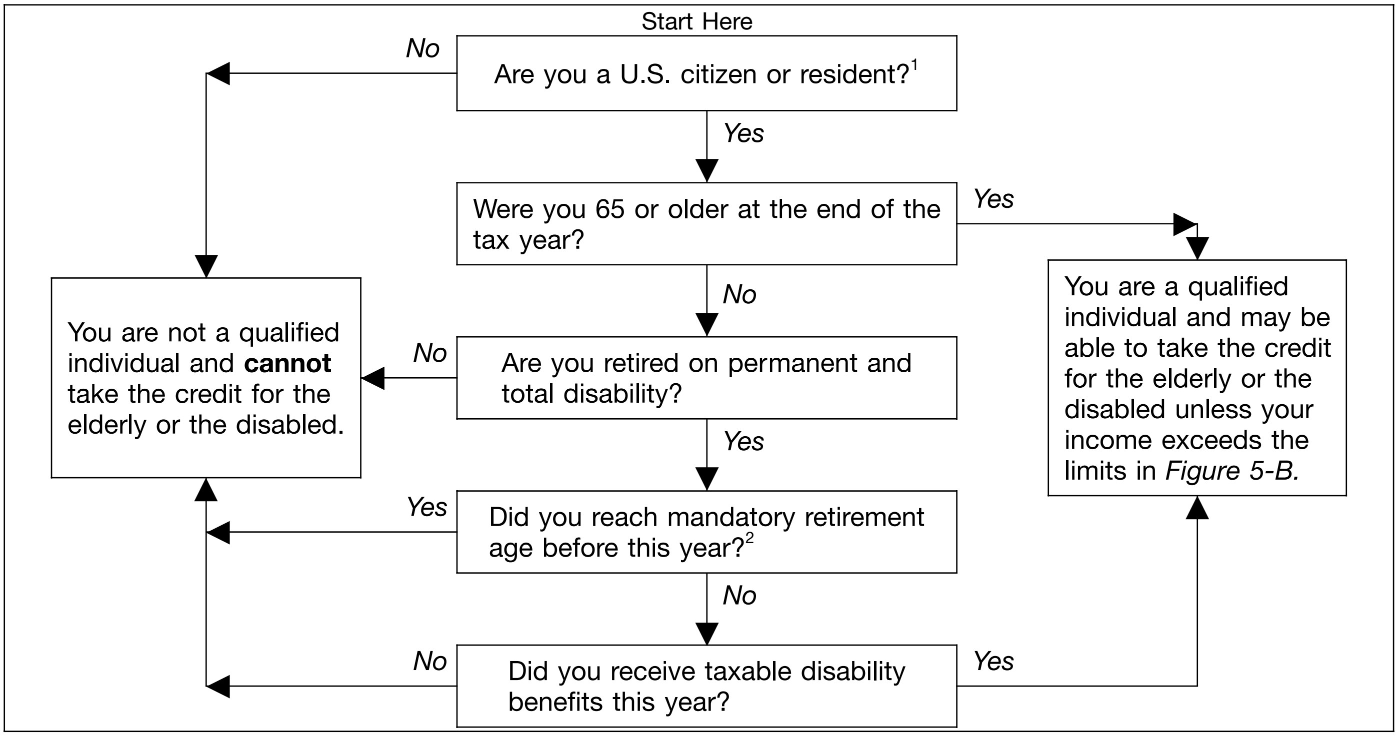
If you checked box 4, 5, or 6 in Part I of either Schedule R or Schedule 3, print in the space above the box on line 2 of Part II, the first name(s) of the spouse(s) for whom the box is checked.

Disability income. If you are under age 65, you can qualify for the credit only if you have taxable disability income.

Disability income must meet the following two requirements.

- The income must be paid under your employer's accident or health plan or pension plan, and
- The income must be wages (or payments in lieu of wages) for the time you are absent from work because of permanent and total disability.

Figure 5-A. **Are You a Qualified Individual?**



[1]If you were a nonresident alien at any time during the tax year and were married to a U.S. citizen or resident at the end of the tax year, see *U.S. citizen or resident* under *Qualified Individual.* If you and your spouse choose to treat you as a U.S. resident, answer "yes" to this question.

[2]Mandatory retirement age is the age set by your employer at which you would have been required to retire, had you not become disabled.

Figure 5-B. **Income Limits**

If your filing status is . . .	**THEN even if you qualify (see *Figure 5-A*), you CANNOT take the credit if:**	
	Your adjusted gross income (AGI)* is equal to or more than . . .	**OR the total of your nontaxable social security and other nontaxable pension(s) is equal to or more than . . .**
Single, Head of household, or Qualifying widow(er) with dependent child	$17,500	$5,000
Married filing a joint return **and** both spouses qualify in *Figure 5-A*	$25,000	$7,500
Married filing a joint return **and** only one spouse qualifies in *Figure 5-A*	$20,000	$5,000
Married filing a separate return **and** you did not live with your spouse at any time during the year	$12,500	$3,750

* AGI is the amount on Form 1040A, line 21, or Form 1040, line 35

Payments that are not disability income. Any payment you receive from a plan that does not provide for disability retirement is not disability income. Any lump-sum payment for accrued annual leave that you receive when you retire on disability is a salary payment and is not disability income.

For purposes of the credit for the elderly or the disabled, disability income does not include amounts you receive after you reach mandatory retirement age. ***Mandatory retirement age*** is the age set by your employer at which you would have had to retire had you not become disabled.

Figuring the Credit

If you figure the credit yourself, fill out the front of either Schedule R (if you are filing Form 1040) or Schedule 3 (if you are filing Form 1040A). Next, fill out Part III of either Schedule R or Schedule 3.

Child and Dependent Care Credit

You may be able to claim this credit if you pay someone to care for your dependent who is under age 13 or for your spouse or dependent who is not able to care for himself or herself. The credit can be up to 30% of your expenses. To qualify, you must pay these expenses so you can work or look for work.

CAUTION *If you claim this credit, you must include on your return the name and taxpayer identification number (generally the social security number) of each qualifying person. If the correct information is not shown, the credit may be reduced or disallowed.*

You also must show on your return the name, address, and the taxpayer identification number of the person(s) or organization(s) that provided the care.

For more information, see Publication 503, *Child and Dependent Care Expenses.*

Earned Income Credit

The earned income credit (EIC) is available to persons with or without a qualifying child. This section will list separately the rules that persons with a qualifying child and persons without a qualifying child must meet to get the credit. After you have read the rules, if you think you may qualify for the credit, get Publication 596, *Earned Income Credit.* You also can find information in the instructions for Form 1040 (line 64), Form 1040A (line 41), or Form 1040EZ (line 8).

Investment income more than $2,550. You cannot claim the earned income credit unless your investment income is $2,550 or less. For most people, **investment income** is taxable interest (line 8a of Form 1040 or 1040A, or line 2 of Form 1040EZ), tax-exempt interest (line 8b of Form 1040 or 1040A, or written to the right of the words Form 1040EZ on line 2 of Form 1040EZ), dividend income (line 9 of Form 1040 or 1040A), and capital gain net income (line 13 of Form 1040, if more than zero, or line 10 of Form 1040A). See Publication 596 for more information.

Credit has no effect on certain welfare benefits. The earned income credit and the advance earned income credit payments you receive generally will not be used to determine whether you are eligible for the following benefit programs, or how much you can receive from the programs.

- Medicaid and supplemental security income (SSI).
- Food stamps.
- Low-income housing.

Temporary assistance for needy families (TANF) benefits may be affected. Please check with your state.

Social security number. You must provide a correct and valid social security number (SSN) for yourself, your spouse, and any qualifying children. If an SSN is missing or incorrect, you may not get the credit. Publication 596 contains more detailed information.

CAUTION *The social security number must be issued by the Social Security Administration to a U.S. citizen or to a person who has permission from the Immigration and Naturalization Service to work in the United States. If your social security card says* **Not valid for employment***, you cannot get the earned income credit.*

Self-employed persons. If you are self-employed and your net earnings are $400 or more, be sure to fill out correctly Schedule SE (Form 1040), *Self-Employment Tax,* and pay the proper amount of self-employment tax. If you do not, you may not get all the credit to which you are entitled.

Who Can Claim the Credit?

The earned income credit is available to persons with or without a qualifying child. Some of the rules are the same, but some of the rules only apply to persons with a qualifying child or to persons without a qualifying child.

Persons Who Work and Have One or More Qualifying Children

Generally, if you are a nonresident alien for any part of the year, you cannot claim the credit. To claim the earned income credit under this section, you must meet all the following rules.

1) You must have a qualifying child who lived with you in the United States for more than half the year.
2) You must have earned income during the year.
3) Your earned income and adjusted gross income (AGI) each must be less than:

   a) $29,201 ($30,201 for married filing jointly) if you have one qualifying child, or

b) $33,178 ($34,178 for married filing jointly) if you have more than one qualifying child.

4) Your investment income cannot be more than $2,550.
5) Your filing status can be any filing status except married filing separately.
6) You cannot be a qualifying child of another person. If you file a joint return, neither you nor your spouse can be a qualifying child of another person.
7) Your qualifying child cannot be used by more than one person to claim the credit. If you and someone else have the same qualifying child, you and the other person(s) can decide who will claim the credit using that child. If you cannot agree, see Publication 596.
8) You are not filing Form 2555, *Foreign Earned Income* (or Form 2555–EZ, *Foreign Earned Income Exclusion*).

Who is a qualifying child? You have a qualifying child if your child meets three tests. The tests are:

- Relationship,
- Residency, and
- Age.

Relationship test. To meet the relationship test for a qualifying child, the child must be your:

- Son, daughter, stepson, stepdaughter, or adopted child (or a descendant of your son, daughter, stepson, stepdaughter, or adopted child—for example, your grandchild),
- Brother, sister, stepbrother, or stepsister (or the child or grandchild of your brother, sister, stepbrother, or stepsister) whom you cared for as your own child, or
- Eligible foster child.

See Publication 596 for an explanation of who is an eligible foster child.

Residency test. To meet the residency test, there are two rules.

- You must have a child who lived with you for more than half the year.
- The home must be in the United States (one of the 50 states or the District of Columbia). U.S. military personnel stationed outside the United States on extended active duty are considered to live in the United States for the purposes of the earned income credit.

Age test. To meet the age test, your child must be:

- Under age 19 at the end of the year,
- A full-time student under age 24 at the end of the year, or
- Permanently and totally disabled at any time during the tax year, regardless of age.

Persons Who Work and Do Not Have a Qualifying Child

Generally, if you are a nonresident alien for any part of the year, you cannot claim the earned income credit. In order to take the earned income credit under this section, you must meet all the following rules.

- You must have earned income during the year.
- Your earned income and adjusted gross income (AGI) each must be less than $11,060 ($12,060 if married filing jointly).
- Your investment income must be $2,550 or less.
- Your filing status can be any filing status except married filing separately.
- You cannot be a qualifying child of another person. If you file a joint return, neither you nor your spouse can be a qualifying child of another person.
- You (or your spouse if filing a joint return) must be ***at least age 25 but under age 65*** at the end of the year.
- You cannot be eligible to be claimed as a dependent on anyone else's return. If you file a joint return, neither you nor your spouse can be eligible to be claimed as a dependent on anyone else's return.
- Your main home (and your spouse's if filing a joint return) must be in the United States for more than half the year. U.S. military personnel stationed outside the United States on extended active duty are considered to live in the United States for the purposes of the earned income credit.
- You are not filing Form 2555 or Form 2555–EZ.

Advance Earned Income Credit Payments

If you expect to qualify for the earned income credit in 2003, you can choose to receive advance payments of part of the credit in your regular paycheck.

You can request advance payments of the credit for 2003 by completing a 2003 Form W–5. See Publication 596 or the instructions for Form W–5 for more information on the advance earned income credit.

CAUTION *You must file a 2002 return to report what you already received as an advance payment in 2002 and to get any additional earned income credit.*

TIP *You must have at least one qualifying child and qualify for the earned income credit to get the advance payment of the credit in your pay.*

6.

Estimated Tax

Estimated tax is a method used to pay tax on income that is not subject to withholding. This income includes self-employment income, interest, dividends, alimony, rent, gains from the sale of assets, prizes, and awards.

Income tax generally is withheld from pensions and annuity payments you receive. However, if the tax withheld is not enough, you may have to pay estimated tax. If you do not pay enough tax through withholding, by making estimated tax payments, or both, you may be charged a penalty.

Who Must Make Estimated Tax Payments

If you had a tax liability for 2002, you may have to pay estimated tax for 2003. Generally, you must make estimated tax payments for 2003 if you expect to owe at least $1,000 in tax for 2003 after subtracting your withholding and credits, and you expect your withholding and credits to be less than the smaller of:

- 90% of the tax to be shown on your 2003 tax return, or
- 100% of the tax shown on your 2002 tax return. The 2002 tax return must cover all 12 months.

If all of your income will be subject to income tax withholding, you probably do not need to make estimated tax payments.

For more information on estimated tax, see Publication 505.

7.

How To Get Tax Help

You can get help with unresolved tax issues, order free publications and forms, ask tax questions, and get more information from the IRS in several ways. By selecting the method that is best for you, you will have quick and easy access to tax help.

Contacting Your Taxpayer Advocate. If you have attempted to deal with an IRS problem unsuccessfully, you should contact your Taxpayer Advocate.

The Taxpayer Advocate represents your interests and concerns within the IRS by protecting your rights and resolving problems that have not been fixed through normal channels. While Taxpayer Advocates cannot change the tax law or make a technical tax decision, they can clear up problems that resulted from previous contacts and ensure that your case is given a complete and impartial review.

To contact your Taxpayer Advocate:

- Call the Taxpayer Advocate at **1–877–777–4778.**
- Call, write, or fax the Taxpayer Advocate office in your area.
- Call **1–800–829–4059** if you are a TTY/TDD user.

For more information, see Publication 1546, *The Taxpayer Advocate Service of the IRS.*

Free tax services. To find out what services are available, get Publication 910, *Guide to Free Tax Services.* It contains a list of free tax publications and an index of tax topics. It also describes other free tax information services, including tax education and assistance programs and a list of TeleTax topics.

Personal computer. With your personal computer and modem, you can access the IRS on the Internet at **www.irs.gov**. While visiting our web site, you can:

- See answers to frequently asked tax questions or request help by e-mail.
- Download forms and publications or search for forms and publications by topic or keyword.
- Order IRS products on-line.
- View forms that may be filled in electronically, print the completed form, and then save the form for recordkeeping.
- View Internal Revenue Bulletins published in the last few years.
- Search regulations and the Internal Revenue Code.
- Receive our electronic newsletters on hot tax issues and news.
- Learn about the benefits of filing electronically (IRS e-file).
- Get information on starting and operating a small business.

You can also reach us with your computer using File Transfer Protocol at **ftp.irs.gov.**

TaxFax Service. Using the phone attached to your fax machine, you can receive forms and instructions by calling **703–368–9694.** Follow the directions from the prompts. When you order forms, enter the catalog number for the form you need. The items you request will be faxed to you.

For help with transmission problems, call the FedWorld Help Desk at **703–487–4608.**

Phone. Many services are available by phone.

- *Ordering forms, instructions, and publications.* Call **1–800–829–3676** to order current and prior year forms, instructions, and publications.
- *Asking tax questions.* Call the IRS with your tax questions at **1–800–829–1040.**
- *Solving problems.* Take advantage of Everyday Tax Solutions service by calling your local IRS office to set up an in-person appointment at your convenience. Check your local directory assistance or **www.irs.gov** for the numbers.
- *TTY/TDD equipment.* If you have access to TTY/TDD equipment, call **1–800–829–4059** to ask tax questions or to order forms and publications.
- *TeleTax topics.* Call **1–800–829–4477** to listen to pre-recorded messages covering various tax topics.

Evaluating the quality of our telephone services. To ensure that IRS representatives give accurate, courteous, and professional answers, we use several methods to evaluate the quality of our telephone services. One method is for a second IRS representative to sometimes listen in on or record telephone calls. Another is to ask some callers to complete a short survey at the end of the call.

Walk-in. Many products and services are available on a walk-in basis.

- *Products.* You can walk in to many post offices, libraries, and IRS offices to pick up certain forms, instructions, and publications. Some IRS offices, libraries, grocery stores, copy centers, city and county governments, credit unions, and office supply stores have an extensive collection of products available to print from a CD-ROM or photocopy from reproducible proofs. Also, some IRS offices and libraries have the Internal Revenue Code, regulations, Internal Revenue Bulletins, and Cumulative Bulletins available for research purposes.
- *Services.* You can walk in to your local IRS office to ask tax questions or get help with a tax problem. Now you can set up an appointment by calling your local IRS office number and, at the prompt, leaving a message requesting Everyday Tax Solutions help. A representative will call you back within 2 business days to schedule an in-person appointment at your convenience.

Mail. You can send your order for forms, instructions, and publications to the Distribution Center nearest to you and receive a response within 10 workdays after your request is received. Find the address that applies to your part of the country.

- **Western part of U.S.:**
  Western Area Distribution Center
  Rancho Cordova, CA 95743–0001
- **Central part of U.S.:**
  Central Area Distribution Center
  P.O. Box 8903
  Bloomington, IL 61702–8903
- **Eastern part of U.S. and foreign addresses:**
  Eastern Area Distribution Center
  P.O. Box 85074
  Richmond, VA 23261–5074

CD-ROM for tax products. You can order IRS Publication 1796, *Federal Tax Products on CD-ROM,* and obtain:

- Current tax forms, instructions, and publications.
- Prior-year tax forms and instructions.
- Popular tax forms that may be filled in electronically, printed out for submission, and saved for record-keeping.
- Internal Revenue Bulletins.

The CD-ROM can be purchased from National Technical Information Service (NTIS) by calling **1–877–233–6767** or on the Internet at **http://www.irs.gov/cdorders.** The first release is available in early January and the final release is available in late February.

CD-ROM for small businesses. IRS Publication 3207, *Small Business Resource Guide,* is a must for every small business owner or any taxpayer about to start a business. This handy, interactive CD contains all the business tax forms, instructions and publications needed to successfully manage a business. In addition, the CD provides an abundance of other helpful information, such as how to prepare a business plan, finding financing for your business, and much more. The design of the CD makes finding information easy and quick and incorporates file formats and browsers that can be run on virtually any desktop or laptop computer.

It is available in March. You can get a free copy by calling **1–800–829–3676** or by visiting the website at **www.irs.gov/smallbiz.**

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To help us develop a more useful index, please let us know if you have ideas for index entries. See “Comments and Suggestions” in the “Introduction” for the ways you can reach us.

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