Department of the Treasury
Internal Revenue Service

Publication 554
Cat. No. 15102R

Older Americans' Tax Guide

For use in preparing

1999 Returns

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Contents

Important Changes for 1999

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) $26,928 and have one qualifying child living with you,
2) $30,580 and have more than one qualifying child living with you, or
3) $10,200, do not have a qualifying child, and are at least 25 years old and under 65.

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

Stop-smoking programs. You can now include in medical expenses amounts you pay for a program to stop smoking. If you paid for a stop-smoking program in 1997 or 1998, you may be able to file an amended return on Form 1040X to include in medical expenses the amounts you paid for that stop-smoking program. However, you cannot include in medical expenses amounts you pay for drugs that do not require a prescription, such as nicotine gum or patches, that are designed to help you stop smoking.

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.

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.

Employment tax withholding. Your wages are subject to withholding for income tax, social security, and Medicare 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.*

Introduction

In general, the federal income tax laws apply equally to all taxpayers regardless of age. However, certain provisions give special treatment to older Americans.

While some items are discussed in this publication because of their interest to older Americans, they apply to taxpayers generally and are explained in detail in other publications of the Internal Revenue Service (IRS). References to these free publications are included for the convenience of readers who need more information on specific subjects.

Specific tax benefits for older Americans. Specific tax benefits are available to older Americans and are listed here.

1) **Higher gross income threshold for filing.** You must be age 65 or older to get this benefit. (You are considered 65 on the day before your 65th birthday.) If you are required to file, you must file Form 1040 or 1040A to claim the benefit.

2) **Other benefits.** Taxpayers who qualify and who meet the age requirements may benefit from the:
   a) Increased standard deduction, or
   b) Credit for the elderly or the disabled.

Ordering publications and forms. To order free publications and forms, see *How To Get More Information,* near the end of this publication.

Large print tax forms. For easier reading and to practice preparing your return, you may order large print tax forms. Call 1-800–829–3676 and order:

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

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

Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE). These programs help older, disabled, low-income, and non-English-speaking people fill in their returns. Call the telephone number listed in the forms instructions for your city or state for the location of the volunteer assistance site near you.

For the location of an American Association of Retired Persons (AARP) Tax-Aide site in your community, simply call 1–888–227–7669 and enter, when prompted, your 5-digit zip code or visit their Internet site at *www.aarp.org/taxaide/home.html.*

1999 Filing Requirements

If income tax was withheld from your pay, or if you can take the earned income credit, you should file a return 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.* Instructions for Form 1040, 1040A, or 1040EZ and Publication 501, *Exemptions, Standard Deduction, and Filing Information,* contain more detailed 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 employed, gross income includes your total salary or wages. If you own rental property, it includes the total rent you receive before you deduct any rental expenses. If you are self-employed, it includes the total gross profit (gross receipts minus cost of goods sold) from your trade or business.

Gross income does not include nontaxable income, such as welfare benefits or nontaxable social security benefits.

Table 1. **1999 Filing Requirements Chart for Most Taxpayers**

To use this chart, first find your filing status. Then, read across to find your age at the end of 1999. You must file a return if your **gross income**** was at least the amount shown in the last column.

Filing status	Age*	Gross income**
Single	under 65	$ 7,050
	65 or older	$ 8,100
Head of household	under 65	$ 9,100
	65 or older	$10,150
Married, filing jointly***	under 65 (both spouses)	$12,700
	65 or older (one spouse)	$13,550
	65 or older (both spouses)	$14,400
Married, filing separately	any age	$ 2,750
Qualifying widow(er) with dependent child	under 65	$ 9,950
	65 or older	$10,800

**If you turned age 65 on January 1, 2000, you are considered to be age 65 at the end of 1999.*

******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 1999.*

****If you didn't live with your spouse at the end of 1999 (or on the date your spouse died) and your gross income was at least $2,750, you must file a return regardless of your age.*

For more information on what income is taxable, see *Taxable and Nontaxable Income,* later.

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

Decedents

A personal representative of an 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 the 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. For more information, see Publication 559, *Survivors, Executors, and Administrators.*

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." See Publication 559 for other important information.

TIP *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. If you remarry before the end of the year in which the decedent died, a final joint return with the deceased spouse cannot be filed. You can, however, file a joint return with your new spouse. The filing status of your deceased spouse 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 1999, the year of death.*

For more information on filing requirements, see Publication 501.

Taxable and Nontaxable Income

Generally, all income is taxable unless it is specifically exempted by law. Your taxable income may include compensation for services, interest, dividends, rents, royalties, income from partnerships, estate and 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 section.

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.

You must include in your income all unemployment compensation you receive. See Publication 525, *Taxable and Nontaxable Income,* for more detailed information on specific types of income.

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)

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) (Including Roth IRAs and Education IRAs),* or Publication 575, *Pension and Annuity Income.*

Individual Retirement Arrangements (IRAs)

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

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

For more information on IRAs, see Publication 590.

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

After age 59½ and before age 70½. After you reach age 59½, you can withdraw assets from your traditional IRA without having to pay the 10% additional tax. Even though you can make withdrawals, you do not have to withdraw any assets from your IRA until you reach age 70½.

Required distributions. If you are the owner of a traditional IRA, you must withdraw 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 contributed to your pension or annuity plan, 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.

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 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 receive a payment from the plan or the date on which the plan's obligation becomes fixed.

Generally, the amount of your contributions to the plan may be shown in box 9b of Form 1099-R.

Foreign employment contributions. If you worked in a foreign country before 1963, the amount your employer paid into your retirement plan may be considered part of your cost. For details, see *Foreign employment contributions* in Publication 575.

Withholding. The payer of 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 for 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:

1) A nonqualified plan (such as a private annuity, a purchased commercial annuity, or a nonqualified employee plan), or
2) A qualified plan if you are age 75 or older on your annuity starting date and your annuity payments are guaranteed for at least 5 years.

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 fewer 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 1999. 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. Bill Kirkland, age 65, began receiving retirement benefits in January 1999, under a joint and survivor annuity. Bill's annuity starting date is January 1, 1999. The benefits are to be paid for the joint lives of Bill and his wife, Kathy, age 65. Bill had contributed $31,000 to a qualified plan and had received no distributions before the annuity starting date. Bill is to receive a retirement benefit of $1,200 a month, and Kathy is to receive a monthly survivor benefit of $600 upon Bill's death.

Bill must use the Simplified Method to figure his taxable annuity because his payments are from a qualified plan and he is under age 75. His completed Simplified Method Worksheet from Publication 575 is illustrated on the next page.

Because his annuity is payable over the lives of more than one annuitant, Bill uses his and Kathy's combined ages and Table 2 at the bottom of the worksheet in completing line 3 of the worksheet. Bill's tax-free monthly amount is $100 ($31,000 ÷ 310 as shown on line 4 of the worksheet). Upon Bill's death, if Bill 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 Bill 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.

Bill's completed worksheet appears on this page.

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 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 1999 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 on line 16b, Form 1040.

If you file Form 1040A, report your total annuity on line 11a, and the taxable part on line 11b. If your pension or annuity is fully taxable, enter it on line 11b. Do not make an entry on line 11a.

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 11a, Form 1040A, and report the taxable part on line 16b, Form 1040, or line 11b, Form 1040A.

Form 1099-R. You should receive a Form 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.,* for your pension or annuity. Form 1099-R shows your pension or annuity for the year and any income tax withheld.

Simplified Method Worksheet
(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 11a . . $ 14,400

2. Enter your cost in the plan (contract) at annuity starting date 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 below. **But** if your annuity starting date was **after** 1997 **and** the payments are for your life and that of your beneficiary, enter the appropriate number from Table 2 below 310

4. Divide line 2 by line 3 100

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 1,200

6. Enter any amounts previously recovered tax free in years after 1986 -0-

7. Subtract line 6 from line 2 31,000

8. Enter the lesser of line 5 or line 7 . . 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 11b . . . $ 13,200

Note: *If your Form 1099-R shows a larger taxable amount, use the amount on line 9 instead.*

10. Add lines 6 and 8 1,200

11. Balance of cost to be recovered. Subtract line 10 from line 2 . . . . $ 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 older	120	160

Table 2 for Line 3 Above

Combined ages at annuity starting date	Enter on line 3
110 and under	410
111–120	360
121–130	310
131–140	260
141 and over	210

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 retirement plan (a qualified employee plan or qualified employee annuity), 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 for capital gain treatment. 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 5- or 10-year tax option to figure tax on the ordinary income part.

You can use these tax options to figure your tax on a lump-sum distribution only if the plan participant was born before 1936. However, you may be able to use the 5-year tax option even if the plan participant was born after 1935, but only if the distribution was made on or after the date the participant reached age 59½.

CAUTION *For tax years beginning after 1999, the 5-year tax option is repealed. However, you can continue to choose the 10-year tax option or the capital gain treatment for a lump-sum distribution that qualifies for the special tax treatment.*

Form 1099-R. If you receive a total distribution from a plan, you should receive a Form 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.* 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.

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 59½ 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 for employees of public schools or tax-exempt organizations, or

4) An IRA (other than an education IRA).

25% rate on certain early distributions from SIMPLE IRA plans. An early withdrawal from a SIMPLE IRA is generally subject to an additional tax of 10%. However, if the distribution is made within the first two years of participation in the SIMPLE plan, the additional tax is 25%. Your Form 1099-R should show distribution code S in box 7 if the 25% rate applies.

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 beneficiary (but, if from a qualified retirement plan other than an IRA, only if the payments begin after your 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 (other than an IRA) after your separation from service in or after the year you reached age 55,
- From a qualified retirement plan (other than an IRA) 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 IRAs. The tax does not apply to distributions that are:

- From an IRA for health insurance premiums if you are unemployed,
- From an IRA to the extent of your higher education expenses,
- From an IRA for first home purchases.

For detailed information about the exceptions that apply only to IRAs, see *When Can I Withdraw or Use IRA Assets* in Publication 590.

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 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 53 of Form 1040. Write "No" on the dotted line. You do not have to file **Form 5329,** *Additional Taxes Attributable to IRAs, Other Qualified Retirement Plans, Annuities, Modified Endowment Contracts, and MSAs.*

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 (e.g., 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 must begin no later than your ***required beginning date*** unless the rule for 5% owners and IRAs applies. This is April 1 of the year that follows the **later of**:

1) The calendar year in which you reach age 70½, or
2) The calendar year in which you retire.

The additional tax applies to qualified employee plans, qualified employee annuity plans, deferred compensation plans under section 457, tax-sheltered annuity programs (for benefits accruing after 1986), and IRAs (other than education IRAs and Roth IRAs).

5% owners and IRAs. If you own more than 5% of the company maintaining the plan, you must begin to receive distributions by April 1 of the year after the calendar year in which you reach age 70½, regardless of when you retire.

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.

Purchased Annuities

If you bought an annuity contract directly from the issuer rather than through an employee plan, you must treat the contract as a nonqualified plan. This means that you must use the General Rule to figure the tax-free part of annuity payments you receive. (For information about the General Rule, see Publication 939.) If you withdraw funds from the annuity contract or receive other nonperiodic distributions, you must use the rules for nonqualified plans to figure the tax-free part, if any. See *Taxation of Nonperiodic Payments* in Publication 575 for information about those rules. Also see *Variable Annuities* in Publication 575 if the contract provides payments that vary in amount based on investment results or other factors.

Sale of annuity. Gain on the sale of an annuity contract before its maturity date is ordinary income to the extent that the gain is due to interest accumulated on the contract. You do not recognize gain or loss on an exchange of an annuity contract solely for another annuity contract if the insured or annuitant remains the same. See *Transfers of Annuity Contracts* in Publication 575 for more information about exchanges of annuity contracts.

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 called 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 benefits, vested dual benefits, and supplemental annuity benefits. This category of benefits is treated as an amount received from a qualified employer plan. This allows for the tax-free 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.

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 gross income as a pension on lines 16a and 16b of Form 1040 or on lines 11a and 11b 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 are generally not taxable.

Veterans' benefits and insurance are discussed in Publication 525.

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).

Note. 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.

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.

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.

Benefits you receive under an accident or health insurance policy. Benefits on which either you paid the premiums or your employer paid the premiums but you had to include them in your gross income are not taxable.

Long-term care insurance contracts. Long-term care insurance contracts are generally 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. Long-term care insurance contracts are discussed in more detail in Publication 525.

Compensation you receive for permanent loss or loss of use of a part or function of your body, or for your permanent disfigurement are 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 1999, 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 or 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 gross income in the year you receive it.

Workers' compensation. If part of your disability pension is workers' compensation, that part is exempt from tax. If you die, the part of your survivor's benefit that is a continuation of the workers' compensation is exempt from tax.

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 11a and 11b 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 gross 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 a 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. Report these amounts on lines 16a and 16b of Form 1040, or lines 11a and 11b 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 any amount of the lump-sum payment over 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.

Survivor benefits. Generally, payments made by or for an employer because of an employee's death must be included in income.

Accelerated Death Benefits

Certain payments received under a life insurance contract on the life of a terminally or chronically ill individual before the individual's death (an accelerated death benefit) can be excluded from income. 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 is also 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, *Medical Savings Accounts 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 can reasonably 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 by a licensed health care practitioner as meeting either of the following conditions.

1) 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.

2) 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.

Additional information. For more information on life insurance proceeds, see Publication 525. For more information on annuities, see Publication 575.

Other Nontaxable Items

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

Gifts, bequests, 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 the property, that income is taxable to you.

Veterans' benefits. Veterans' benefits under any law, regulation, or administrative practice administered by the Department of Veterans Affairs (VA), are not included in gross income. 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 gross 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 are also eligible for food benefits.

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 payments (SSI) 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 are commonly called the social security equivalent benefit (SSEB) portion of tier 1 benefits.

If you received these benefits during 1999, 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) showing the amount.

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 with the total of:

1) One-half of your benefits, plus

2) All your other income, including tax-exempt interest.

Exclusions. When making this comparison, do not reduce your income by any exclusions for:

1) Interest from qualified U.S. savings bonds,

2) Employer-provided adoption benefits,

3) Foreign earned income or foreign housing, or

4) 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 later in this discussion to figure this total income. If the total is more than your base amount, part of your benefits is taxable.

TIP *If the only income you received during 1999 was your social security or the 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.*

If you are married and file a joint return for 1999, 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.

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 1999,
- $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 1999.

Worksheet. You can use the following worksheet 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.

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 1999, for 1999 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, 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 (such as the qualified U.S. Savings Bond interest exclusion) .... 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 need to complete* Worksheet 1 *in Publication 915 to find out if they may be taxable.*

Repayment of Benefits

Any repayment of benefits you made during 1999 must be subtracted from the gross benefits you received in 1999. It does not matter whether the repayment was for a benefit you received in 1999 or in an earlier year. If you repaid more than the gross benefits you received in 1999, 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 1999 (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 benefits. If you choose to do this, you must complete a Form W-4V, *Voluntary Withholding Request.* You can choose withholding at 7%, 15%, 28%, or 31% of your total benefit payment.

CAUTION *If part of your benefits is taxable, 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.*

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 1999, also enter "D" to the left of 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 13a and the taxable part on line 13b. If you are married filing separately and you lived apart from your spouse for all of 1999, enter "D" to the right of the word "benefits" on line 13a.

Benefits not taxable. If none of your benefits are taxable, do not report any of them on your tax return. But if you are married filing separately and you lived apart from your spouse for all of 1999, make the following entries. On Form 1040, enter "D" to the left of line 20a and "–0–" on line 20b. On Form 1040A, enter "D" to the right of the word "benefits" on line 13a and "–0–" on line 13b.

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

1) 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).

2) You are married filing separately and ***lived with your spouse*** at any time during 1999.

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.

See *Lump-Sum Election* next.

Lump-Sum Election

You must include the taxable part of a lump-sum (retroactive) payment of benefits received in 1999 in your 1999 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 1999 income to figure the taxable part of the total benefits received in 1999. 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 amount 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 and is claimed on line 22 of 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.

Sale of Home

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

Amount of Exclusion

You can exclude the gain on the sale of your main home up to:

1) $250,000, or

2) $500,000 if all of the following are true.

   a) You are married and file a joint return for the year.

   b) Either you or your spouse meets the ownership test.

   c) Both you and your spouse meet the use test.

   d) 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 (not counting any sales before May 7, 1997).

Ownership and Use Tests

You can claim the exclusion if, during the ***5-year period*** ending on the date of the sale, you 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 may be able to claim a reduced exclusion. 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. (But see *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:

1) You owned it, and

2) 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 for business use 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 1999 sale of your main home on your tax return unless:

- You have a gain and do not qualify to exclude all of it,
- You have a gain and choose not to exclude it, or
- You made the choice described next and have a taxable gain.

If you have any taxable gain on the sale of your main home that cannot be excluded, see Publication 523 for information on how to report the gain.

Adjustments to Income

You may be able to subtract amounts from your gross income (Form 1040, line 22 or Form 1040A, line 14) to get your adjusted gross income (Form 1040, line 33 or Form 1040A, line 18). Some adjustments to income follow:

1) Contributions to your individual retirement arrangement (IRA), (Form 1040, line 23, or Form 1040A, line 15) explained later in this publication.
2) Certain moving expenses (Form 1040, line 26) if you changed job locations or started a new job in 1999. See Publication 521, *Moving Expenses,* or get Form 3903, *Moving Expenses,* and its instructions.
3) Some health insurance costs (Form 1040, line 28) if you were self-employed and had a net profit for the year, or if you received wages in 1999 from an S corporation in which you were a more than 2% shareholder. For more details get Publication 535, *Business Expenses.*
4) Payments to your Keogh and self-employed SEP plans (Form 1040, line 29). For more information, including limits on how much you can deduct, see Publication 560, *Retirement Plans for Small Business.*
5) Penalties paid on early withdrawal of savings. See the instructions for line 30 in your Form 1040 instructions.
6) Alimony payments (Form 1040, line 31a). 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) Deduction

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

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

1) You may be able to deduct your contributions in whole or in part, depending on the type of IRA and your circumstances, and
2) Generally, amounts in your IRA, including earnings and gains, are not taxed until distributed, or, in some cases, are not taxed at all if distributed according to the rules.

CAUTION *Although interest earned from your IRA is generally 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 smaller*** of the following amounts:

1) Your compensation that you must include in income for the year, or
2) $2,000.

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 were 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.

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

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.

Contributions to spousal IRAs. In the case of a married couple filing a joint return, up to $2,000 can be contributed to IRAs (other than SIMPLE or education IRAs) on behalf of each spouse, even if one spouse has little or no compensation. This means that the total combined contributions that can be made on behalf of a married couple can be as much as $4,000 for the year. For more detailed information, get Publication 590.

Roth IRA. Regardless of your age, you may be able to establish and make nondeductible individual retirement plan contributions 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.

Standard Deduction

Most taxpayers have a choice of either taking a standard deduction or itemizing their deductions. The ***standard deduction*** is a dollar amount that reduces the income on which you are taxed. It is a benefit that eliminates the need for many taxpayers to itemize their actual deductions. The standard deduction is higher for taxpayers who are 65 or older or blind. If you have a choice, you should use the method that gives you the lower tax.

You benefit from the standard deduction if your standard deduction is more than the total of your allowable itemized deductions.

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

1) You are married and filing a separate return, and your spouse itemizes deductions,
2) You are filing a tax return for a short tax year because of a change in your annual accounting period, or
3) 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. 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 on the day before your 65th birthday. Therefore, you can take the higher standard deduction for 1999 if your 65th birthday was on or before January 1, 2000.

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 3* in this publication. 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, you can avoid having to get a new certified statement each year by having the examining eye physician include this fact in the certification. You should keep the certification 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 the 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, 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.*

If you are under age 65 and not blind, use *Table 2* in this publication to figure the standard deduction amount you are entitled to.

If you are 65 or older or blind, use *Table 3* in this publication to figure the standard deduction amount you are entitled to.

CAUTION *If an exemption for you can be claimed on another person's return, your standard deduction may be limited. See* Standard Deduction for Dependents, *later in this section.*

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

If you decide to take the standard deduction. You may find your standard deduction amount by referring to the *1999 Standard Deduction Tables,* later, that fit your circumstances.

Example 1. Larry, 66, and Donna, 67, are filing a joint return for 1999. Neither is blind. They decide not to itemize their deductions. They use *Table 3*. Their standard deduction is $8,900.

Example 2. Assume the same facts as in *Example 1* except that Larry is blind at the end of 1999. They use *Table 3.* Larry and Donna's standard deduction is $9,750.

Example 3. Susan, 67, who is blind, qualifies as head of household in 1999. She has no itemized deductions. She uses *Table 3.* Her standard deduction is $8,450.

Standard Deduction for Dependents

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

- $700, or
- The individual's earned income for the year plus $250 (but not more than the regular standard deduction amount, generally $4,300).

However, if you are 65 or older or blind, your standard deduction may be higher. Use *Table 4* to determine your standard deduction.

1999 Standard Deduction Tables

Table 2. **Standard Deduction Chart for People Under Age 65***

If Your Filing Status is:	Your Standard Deduction is:
Single	$4,300
Married filing joint return or Qualifying widow(er) with dependent child	7,200
Married filing separate return	3,600
Head of household	6,350

*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 3 or 4 instead.

Table 3. **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	$5,350 6,400
Married filing joint return or Qualifying widow(er) with dependent child	1 2 3 4	8,050 8,900 9,750 10,600
Married filing separate return	1 2 3 4	4,450 5,300 6,150 7,000
Head of household	1 2	7,400 8,450

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

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. **Standard Deduction Worksheet for Dependents***

If you were 65 or older or blind, check 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 amount	**4.** $700
5. Enter the **larger** of line 3 or line 4.	**5.** ______
6. Enter the amount shown below for your filing status. • Single, enter $4,300 • Married filing separate return, enter $3,600 • Married filing jointly or Qualifying widow(er) with dependent child, enter $7,200 • Head of household, enter $6,350	**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 $1,050 ($850 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 1999.	**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).

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 $126,600 ($63,300 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 5 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 34, Form 1040.*

What to include. You can include only the medical and dental expenses you paid during 1999, 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, or
- Membership in an association that gives cooperative or so-called "free-choice" medical service, or group hospitalization and clinical care.

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 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 voluntarily enroll in Medicare A. In this situation the premiums paid in 1999 for Medicare A can be included as a medical expense.

Table 5. **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 and care of guide dogs or other animals aiding the blind, deaf, and disabled • Cost of lead-based paint removal (see Publication 502) • Expenses of an organ donor • Hospital services fees (lab work, therapy, nursing services, surgery, etc.) • Legal abortion • Legal operation to prevent having children • Long-term care contracts, qualified • 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,* below) • Special items (artificial limbs, false teeth, eye-glasses, 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)	• Bottled water • 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 —Weight loss program • 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 • Toothpaste, toiletries, cosmetics, etc.

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.

Medical savings account. You may be able to make deductible contributions to a medical savings account (MSA) if you are an employee of a small business (fewer than 50 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.

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

1) Payable in equal yearly installments, or more often, and

2) Payable for at least 10 years, or until you reach age 65 (but not for less than 5 years).

Medical and Dental Expenses

You can include in medical expenses the following medical and dental expenses.

- Medicines and drugs that are prescribed, and insulin.
- Medical services by physicians, surgeons, specialists, or any other medical practitioner.
- Hospital services, therapy and nursing services (including part of the cost of all nurses' meals you pay for), ambulance hire, and laboratory, surgical, diagnostic, dental, and X-ray fees.
- Qualified long-term care insurance and services. See Publication 502.
- Life-care fee or a founder's fee paid either monthly or as a lump sum under an agreement with a ***retirement home***. The part of the payment you include is the amount properly allocable to medical care. The agreement must require that you pay a specific fee as a condition for the home's promise to provide lifetime care that includes medical care.
- Wages and other amounts you pay for nursing services. Services need not be performed by a nurse as long as the services are of a kind generally performed by a nurse. This includes services connected with caring for the patient's condition, such as giving medication or changing dressings, as well as bathing and grooming the patient.

  Only the amount spent for nursing services is a medical expense. If the attendant also provides personal and household services, these amounts must be divided between the time spent in performing household and personal services and time spent for nursing services. However, certain expenses for household services or for the care of a qualifying individual incurred to allow you to work may qualify for the child and dependent care credit. See Publication 503, *Child and Dependent Care Expenses.*
- Social Security tax, FUTA, and Medicare tax, and state employment taxes for a worker who provided medical care. For information on employment tax responsibilities of household employers, see Publication 926, *Household Employer's Tax Guide.*
- Treatment at a therapeutic center for drug or alcohol addiction, including meals and lodging provided by the center during treatment.

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 cannot be more than $50 per night for each person. Lodging is included for a person for whom transportation expenses are a medical expense because that person is 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 deductible.)

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.

Medical trip. You cannot deduct the cost of your meals and lodging while you are away from home for medical treatment if you do not receive the treatment at a medical facility or if the lodging is not primarily for or essential to the medical care.

Special Items and Equipment

Include the following payments.

- False teeth, artificial limbs, contact lenses, eyeglasses, hearing aids and batteries to operate it, and crutches.
- The cost and care of a guide dog or other animal to be used by a visually or hearing impaired person. You can also include the cost and care of a dog or other animal trained to assist persons with other physical disabilities. Amounts you pay for the care of these specially trained animals are also medical expenses.
- The cost and repair of special telephone equipment that lets a hearing-impaired person communicate over a regular telephone.
- The extra cost of a specially equipped television set and the cost of an adapter for a regular set that provides subtitles for a hearing-impaired person.
- The part of the cost of braille books and magazines for use by a visually-impaired person that is more than the price for regular printed editions.
- A plan that keeps your medical information so that it can be retrieved from a computer data bank for your medical care.
- Oxygen and oxygen equipment to relieve breathing problems caused by a medical condition.
- Legal fees you paid that are necessary to authorize treatment for mental illness. You cannot include in medical expenses fees for the management of a guardianship estate, fees for conducting the affairs of the person being treated, or other fees that are not necessary to the medical care.
- Special hand controls and other special equipment installed in a car for the use of a person with a disability. Include the amount by which the cost of a car specially designed to hold a wheelchair is more than the cost of a regular car.
- An autoette or a wheelchair used mainly for the relief of sickness or disability, and not just to provide transportation to and from work. The cost of operating and keeping up an autoette or wheelchair is also a medical expense.

Do not include the cost of operating a specially equipped car, except as discussed next.

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,
- 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 ***10 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 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 work chart, 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.

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. The maximum credit available is $1,125. You may be able to take this credit if you are age 65 or older, or if you are retired on permanent and total disability.

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, *Credit for the Elderly or the Disabled.* If you want the IRS to figure your tax, see Publication 967, *The IRS Will Figure Your Tax.*

Can You Take the Credit?

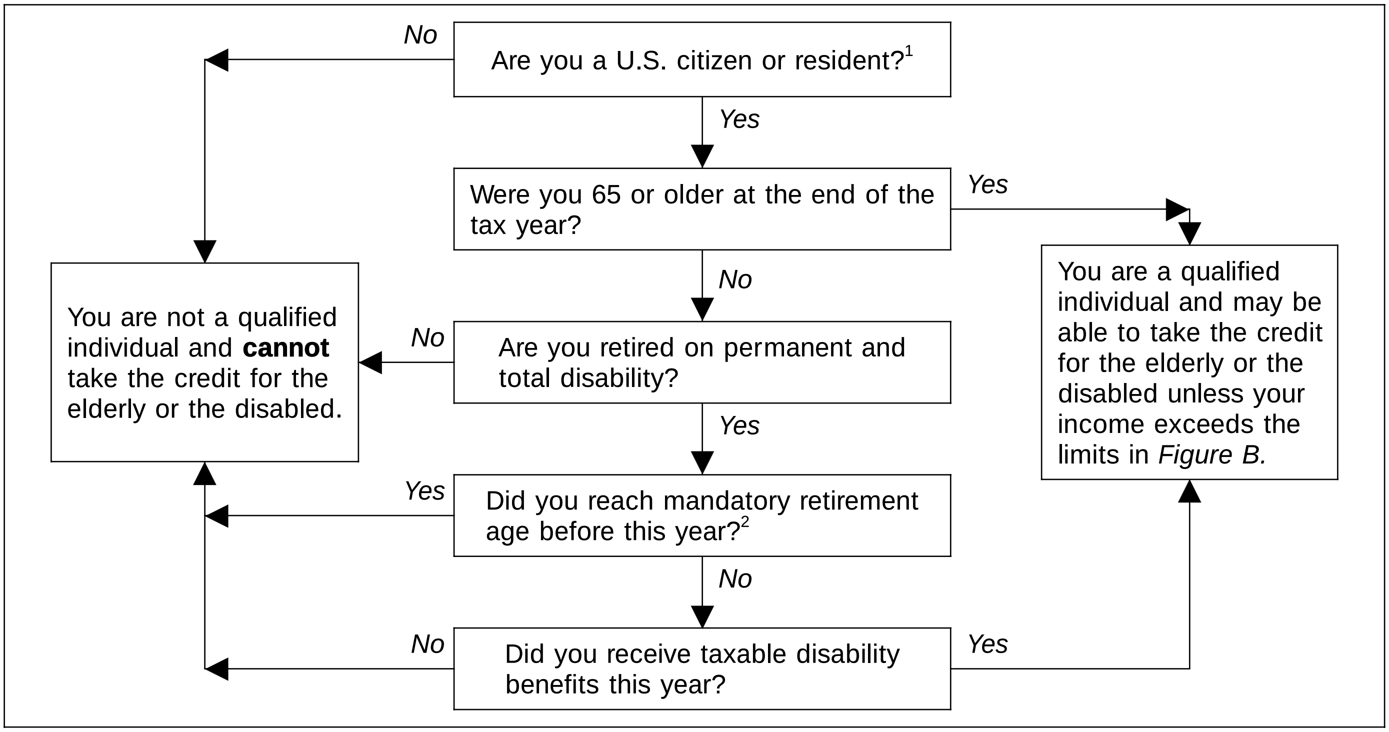
You can take the credit for the elderly or the disabled if:

1) You are a ***qualified individual***, and

2) Your income is not more than certain limits.

See *Figures A and B,* next.

Figure 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 B. **Income Limits**

If your filing status is . . .	**THEN even if you qualify (see *Figure 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 A*	$25,000	$7,500
Married filing a joint return **and** only one spouse qualifies in *Figure 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 19, or Form 1040, line 34

Qualified Individual

You are a qualified individual for this credit if you are a U.S. citizen or resident at the end of the tax year, and you are:

1) Age 65 or older, or
2) Under 65, retired on permanent and total disability, and
   a) Received taxable disability income, and
   b) Did not reach mandatory retirement age (defined later under *Disability income)* before the tax year.

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 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.

Exception. 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.

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:

1) You were permanently and totally disabled when you retired, and
2) 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.

The following examples illustrate the tests of substantial gainful activity.

Example 1. Trisha, a sales clerk, retired on disability. She is 53 years old and now works as a full-time baby-sitter for minimum wage. Even though Trisha is doing different work, she is able to do the duties of her new job in a full-time competitive work situation for the minimum wage. She cannot take the credit because she is able to engage in substantial gainful activity.

Example 2. Tom, a bookkeeper, retired on disability. He is 59 years old and now drives a truck for a charitable organization. He sets his own hours and is not paid. Duties of this nature generally are performed for pay or profit. Some weeks he works 10 hours and some weeks he works 40 hours. Over the year he averages 20 hours a week. The kind of work and his average hours a week conclusively show that Tom is able to engage in substantial gainful activity. This is true even though Tom is not paid and he sets his own hours. He cannot take the credit.

Example 3. John, who retired on disability, took a job with a former employer on a trial basis. The purpose of the job was to see if John could do the work. The trial period lasted for 6 months during which John was paid the minimum wage. Because of John's disability, he was assigned only light duties of a nonproductive “make-work” nature. The activity was gainful because John was paid at least the minimum wage. But the activity was not substantial because his duties were nonproductive. These facts do not, by themselves, show that John is able to engage in substantial gainful activity.

Example 4. Joan, who retired on disability from employment as a bookkeeper, lives with her sister who manages several motel units. Joan assists her sister for 1 or 2 hours a day by performing duties such as washing dishes, answering phones, registering guests, and bookkeeping. Joan can select the time during the day when she feels most fit to perform the tasks undertaken. Work of this nature, performed off and on during the day at Joan's convenience, is not activity of a “substantial and gainful” nature even if she is paid for the work. The performance of these duties does not, of itself, show that Joan is able to engage in substantial gainful activity.

Sheltered employment. Certain work offered at qualified locations to physically or mentally impaired persons is considered sheltered employment. These qualified locations are in sheltered workshops, hospitals and similar institutions, homebound programs, and Department of Veterans Affairs (VA) sponsored homes.

Compared to commercial employment, pay is lower for sheltered employment. Therefore, one usually does not look for sheltered employment if he or she can get other employment. The fact that one has accepted sheltered employment is not proof of the person's ability to engage in substantial gainful activity.

Physician's statement. If you are under 65, you must have your physician complete a statement certifying that you are 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 1999, you may not need to get another physician's statement for 1999. For a detailed explanation of the conditions you must meet, see the instructions for Part II of Schedule R (Form 1040) or 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 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:

1) The income must be paid under your employer's accident or health plan or pension plan, and

2) 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.

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.

Income Limits

To determine if you can claim the credit, you must consider two income limits. The first limit is the amount of your adjusted gross income (AGI). The second limit is the amount of nontaxable social security or other nontaxable pensions you received. The limits are shown in *Figure B.*

If the amount of your AGI and nontaxable pensions are less than their income limits, you may be able to claim the credit.

CAUTION *If the amount of your AGI or nontaxable pensions is equal to or more than the income limits, you cannot take the credit.*

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.

There are four steps in Part III to determine the amount of your credit.

1) Determine your ***initial amount*** (lines 10–12).

2) Total any ***nontaxable social security*** and certain other nontaxable pensions and disability benefits you received (lines 13a, 13b, and 13c).

3) Determine your ***excess adjusted gross income***, (lines 14–17).

4) Determine your credit (lines 18–20).

For more information on these steps, get Publication 524.

Limits on Credit

The amount of your credit may be limited if:

1) The amount of your credit is more than your tax liability, or

2) You file Form 2441, *Child and Dependent Care Expenses.*

Be sure to read your form instructions before claiming your credit.

Child and Dependent Care Credit

You may be able to claim the 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.

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 must also 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 a qualifying child and to persons 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 can also find information in the instructions for Form 1040 (lines 59a and 59b), Form 1040A (lines 37a and 37b), or Form 1040EZ (lines 8a and 8b).

Investment income more than $2,350. You cannot claim the earned income credit if your investment income is more than $2,350. For most people, **investment income** is taxable interest (line 8a of Form 1040 or 1040A), tax-exempt interest (line 8b of Form 1040 or 1040A), dividend income (line 9 of Form 1040 or 1040A), and capital gain net income (line 13 of Form 1040, if more than zero). If you have net rent and royalty income (if greater than zero) and net passive income (if greater than zero) that is not self-employment income or are reporting a gain on Form 4797, see Publication 596 for more information. Rents and royalties received in a trade or business are not investment income.

Modified AGI (adjusted gross income). Generally, you must know your earned income and modified AGI to figure the amount of your earned income credit. In many cases, your modified AGI will be the same as your AGI.

Modified AGI for most people is the amount on line 33 (Form 1040), line 18 (Form 1040A), and line 4 (Form 1040EZ). But if you are filing Schedule C, C-EZ, D, E, or F or you are claiming a loss from the rental of personal property not used in a trade or business or you received a distribution from a pension, annuity, or IRA that is not fully taxable, get Publication 596.

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

- Temporary assistance for needy families,
- Medicaid and supplemental security income (SSI),
- Food Stamps and low-income housing.

Workfare payments. Nontaxable workfare payments are not earned income for the EIC. These are cash payments certain families receive from a state or local agency that administers public assistance programs funded under the Federal Temporary Assistance for Needy Families program in return for certain work activities such as (1) work experience activities (including remodeling or repairing public housing) if sufficient private sector employment is not available, or (2) community service program activities.

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.

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 correctly fill out 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 you are entitled to.

Who Can Claim the Credit?

The earned income credit is available to persons with a qualifying child and to persons 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 (the whole year for an eligible foster child).
2) You must have earned income during the year.
3) Your earned income and modified AGI must each be less than:
   a) $26,928 if you have one qualifying child, or
   b) $30,580 if you have more than one qualifying child.
4) Your investment income cannot be more than $2,350.
5) Your filing status can be any filing status except married filing a separate return.

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 the qualifying child of another person whose modified AGI is more than yours.

8) You usually must claim a qualifying child who is married as a dependent.

9) 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:

1) Son, daughter, or adopted child (or a descendant of your son, daughter, or adopted child — for example, your grandchild),

2) Stepson or stepdaughter, or

3) Eligible foster child (including a niece, nephew, brother, sister, cousin). See Publication 596 for an explanation of an eligible foster child.

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

1) You must have a child who lived with you for more than half the year (the whole year if your child is an eligible foster child).

2) The home must be in the United States (one of the 50 states or the District of Columbia). United States 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:

1) Under age 19 at the end of the year,

2) A full-time student under age 24 at the end of the year, or

3) 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.

1) You must have earned income during the year.

2) Your earned income and modified AGI must each be less than $10,200.

3) Your investment income must be $2,350 or less.

4) Your filing status can be any filing status except married filing a separate return.

5) 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.

6) You (or your spouse if filing a joint return) must be at least age 25 but ***under age 65*** at the end of your tax year (usually December 31).

7) 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.

8) Your main home (and your spouse's if filing a joint return) must be in the United States for more than half the year.

9) 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 2000, 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 2000 by completing a 2000 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 1999 return to report what you already received as an advance payment in 1999 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.*

Estimated Tax

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

Income tax is generally 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 and/or by making estimated tax payments, you may be charged a penalty.

Who Must Make Estimated Tax Payments

If you had a tax liability for 1999, you may have to pay estimated tax for 2000. Generally, you must make estimated tax payments for 2000 if you expect to owe at least $1,000 in tax for 2000 after subtracting your withholding and credits, and you expect your withholding and credits to be less than the smaller of:

1) 90% of the tax to be shown on your 2000 tax return, or

2) 100% of the tax shown on your 1999 tax return. The 1999 tax return must cover all 12 months.

If all of your 2000 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.

How To Get More Information

You can 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.

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 select:

- *Frequently Asked Tax Questions* (located under *Taxpayer Help & Ed)* to find answers to questions you may have.
- *Forms & Pubs* to download forms and publications or search for forms and publications by topic or keyword.
- *Fill-in Forms* (located under *Forms & Pubs)* to enter information while the form is displayed and then print the completed form.
- *Tax Info For You* to view Internal Revenue Bulletins published in the last few years.
- *Tax Regs in English* to search regulations and the Internal Revenue Code (under *United States Code (USC)).*
- *Digital Dispatch* and *IRS Local News Net* (both located under *Tax Info For Business)* to receive our electronic newsletters on hot tax issues and news.
- *Small Business Corner* (located under *Tax Info For Business)* to 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.

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**.
- *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 evaluate the quality of our telephone services in several ways.

- A second IRS representative sometimes monitors live telephone calls. That person only evaluates the IRS assistor and does not keep a record of any taxpayer's name or tax identification number.
- We sometimes record telephone calls to evaluate IRS assistors objectively. We hold these recordings no longer than one week and use them only to measure the quality of assistance.
- We value our customers' opinions. Throughout this year, we will be surveying our customers for their opinions on our service.

Walk-in. You can walk into many post offices, libraries, and IRS offices to pick up certain forms, instructions, and publications. Also, some libraries and IRS offices have:

- An extensive collection of products available to print from a CD-ROM or photocopy from reproducible proofs.
- The Internal Revenue Code, regulations, Internal Revenue Bulletins, and Cumulative Bulletins available for research purposes.

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

- Current tax forms, instructions, and publications.
- Prior-year tax forms, instructions, and publications.
- Popular tax forms which may be filled in electronically, printed out for submission, and saved for recordkeeping.
- 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 **www.irs.gov/cdorders.** The first release is available in mid-December and the final release is available in late January.

IRS Publication 3207, *Small Business Resource Guide,* is an interactive CD-ROM that contains information important to small businesses. It is available in mid-February. You can get one free copy by calling **1–800–829–3676.**

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