

STUDENT TEXT
For Use in Preparing Tax Year 2002 Returns

VOLUNTEER ASSISTOR'S GUIDE



FOR USE IN IRS VOLUNTEER PROGRAMS

VITA Volunteer Income Tax Assistance

TCE Tax Counseling for the Elderly

To get the most up to date tax products and information visit our World Wide Web site at: www.irs.gov



IRS

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IRS VOLUNTEERS

The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.



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As always, please make sure that you have the **latest tax forms instructions, forms, schedules, charts, and worksheets**, when assisting taxpayers.

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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.



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

WAGE AND INVESTMENT DIVISION

WELCOME, VOLUNTEERS!

Through the assistance of trained volunteers from the Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) programs, the Internal Revenue Service is able to offer free tax help to low to moderate-income taxpayers. As a volunteer, you will help prepare tax returns for a taxpayer segment which often includes seniors, disabled, and non-English speaking people and others who cannot afford professional tax assistance.

This publication will help you to acquire the skills to prepare basic tax returns. There are two tracks to certification – the Wage Earner and the Pension Earner. The Wage Earner track covers issues working individuals and families customarily face. The Pension Earner track contains more complex issues, those generally encountered by retired people and senior citizens. These tracks allow instructors to train volunteers in specific tax issues encountered at the volunteer sites. For instance, a TCE class might certify their volunteers on the Pension Earner track that does not include training on the Earned Income Tax Credit (EITC). If the instructor or the site coordinator anticipates that taxpayers coming into the site will be eligible for the EITC, he/she can also teach, test, and certify volunteers on the EITC chapter, a portion of the Wage Earner track.

IRS e-file. After completing this class on basic tax law, I urge you to learn how to electronically file (*e-file*) the returns you prepare. Electronic filing (*e-filing*) uses automation to quickly check for errors or missing information. Consequently, *e-filed* returns have a higher accuracy rate than paper prepared returns. Taxpayers who have their returns filed electronically receive their refunds in less than half the time paper filers do and, with Direct Deposit, in as few as 10 days. Ask your instructor or site coordinator for information on our electronic filing classes.

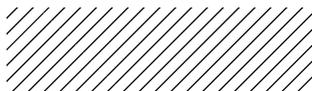
Comments and recommendations. I welcome your comments and recommendations about our training material. Your instructor or site coordinator can take your suggestions or you can write to us at the following address:

Internal Revenue Service
Stakeholder Partnerships, Education and Communication
W:CAR:SPEC:PPD:E, Stop 45-WI
401 W. Peachtree Street, NW
Atlanta, GA 30308

I thank you in advance for your willingness to volunteer your own time to provide this much needed service to your neighbors and your community.

Sincerely,

Mark E. Pursley
Director, Stakeholder Partnerships,
Education and Communication



Important Changes and Reminders for 2002

Exemption amount increased. The amount you can deduct for each exemption has increased from \$2,900 to \$3,000.

Standard deduction amount increased. Your standard deduction if you do not itemize deductions on Schedule A (Form 1040) is higher in 2002 than it was in 2001. The amount depends on your filing status.

Student loan interest deduction increased. The maximum amount of interest you can deduct on a qualified student loan is \$2,500.

Standard mileage rate. The standard mileage rate for the cost of operating a car is 36.5 cents a mile for all business miles driven.

Kidnapped children. Parents of a child who has been kidnapped by someone who is not a family member may be able to take the child into account in determining

- Head of household or qualifying widow(er) with dependent child filing status,
- An exemption for the child,
- The child tax credit, and
- The earned income credit.

For more information, see Publication 501, *Exemptions, Standard Deduction, and Filing Information*.

Restitution payments to holocaust victims exempt from income. Holocaust victims, their heirs or estates can exclude from income certain restitution payments received on or after January 1, 2000.

Education IRAs renamed Coverdell ESAs. Education individual retirement accounts (education IRAs) have been renamed Coverdell education savings accounts.

Tuition and fees. Beginning in 2002, taxpayers can deduct an amount equal to the qualified tuition and related expenses paid during the tax year as an adjustment to income. The adjustment is reported on Form 1040, line 26 or Form 1040A, line 19.

Educator expenses. Eligible educators can deduct as an adjustment to income up to \$250 in qualified expenses. These expenses are deductible even if he or she does not itemize deductions on Schedule A (Form 1040). This adjustment is for expenses paid or incurred in the years beginning during 2002 or 2003. Previously these expenses were deductible only as a miscellaneous itemized deduction subject to the 2% of adjusted gross income limit. The adjustment is reported on Form 1040A line 16 or Form 1040 line 23.

Earned income credit. Beginning in tax year 2002, some of the rules and qualifications for EIC changed. New rules and/or qualifications apply to earned income, modified adjusted gross income, taxpayers with the same qualifying child and a new definition of foster child.

The **tie breaking rules** for purposes of the earned income credit provided that if the parents do not file a joint return together, the child will be the qualifying child of the parent the child lived with for the longest period of time during the year, or if the child lived with both parents for an equal amount of time during the year, that child is the qualifying child or the parent with the highest adjusted gross income.

Retirement savings contributions credit. Beginning in 2002, if the taxpayer contributes to a retirement plan or an IRA, he or she may be eligible for the saver's credit. This is a nonrefundable credit. The taxpayer's filing status adjusted gross income, credit rate and the qualified contributions determine the amount of the credit. IRA deductions increase from \$2,500 to \$3,000 (to \$3,500 if 55 or older).

Medical expenses. Certain weight loss programs to treat diseases diagnosed by physicians including obesity are deductible as an itemized deduction reportable on Schedule A. Additionally, the costs of purchasing diet food items are also considered allowable medical expenses.

Coverdell ESAs. Beginning in 2002, taxpayers can receive tax-free distributions from Coverdell ESAs to pay for postsecondary education and public, private and religious elementary and secondary schools.

IMPORTANT NOTE

Bring your **Social Security Card(s)** with you next year.

The Internal Revenue Service verifies all of the names and social security numbers listed on your return with records from the Social Security Administration. If the name and the number that you list on your return do not match the Social Security Administration records, your return may be delayed. Allowing us to view the **social security card** helps us ensure that the name and number entered on your return are correct. If you do not have a social security card, please request one from the Social Security Administration before seeking assistance with your taxes.



INTRODUCTION AND ADMINISTRATIVE GUIDELINES

VOLUNTEER TRAINING

Welcome to the Internal Revenue Service's (IRS) Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) programs! These volunteer programs are very important to the IRS. As an IRS volunteer you provide a tremendous service to the American public and to your community. You are about to embark on a very challenging and rewarding task as an important player in tax administration.

Every year thousands of volunteers assist millions of taxpayers with their federal return. The people receiving your assistance need it the most. They are those with limited incomes, individuals with disabilities, non-English speaking, and the seniors. Thank you for your hard work and dedication!

This section highlights important changes to the VITA and TCE programs.

VITA/TCE overprint: As of October 1, 2002, you no longer have the responsibilities of reporting statistics using Form 6522. We will capture all of our statistics from internal reports. Each paper or electronically filed return should be identified with the appropriate "VITA or TCE" acronym. This will ensure that all volunteer prepared returns are correctly counted once received by the Internal Revenue Service.

Social Security Cards: One of the primary reasons for the rejection of a return or a delay in processing a return is an incorrect SSN. It is important, therefore, that you check the accuracy of each SSN, as well as the spelling of the name associated with the number.

e-file: Each year the IRS contracts with a software developer to provide tax return preparation software. All returns prepared using the software should be electronically filed. The only exception is when a return is filed electronically with the IRS and you experience unworkable rejects.

SCOPE AND SEQUENCE

We have re-organized this training manual. The new organization will help to better train you to assist the taxpayers you see day to day. Most taxpayers are either wage earners or pension earners. Therefore, we have organized this training material in three modules: basic, wage earner, and pension earner. There

are instances where a site serves both wage earners and pension earners. Your instructor has worked closely with the coordinator(s) at the site where you will assist taxpayers to determine which lessons you should learn.

Basic Module

All volunteers must complete the following lessons:

Lesson 1—Introduction

Lesson 2—Getting Started

Lesson 3—Income

Lesson 4—Adjustments

Lesson 5—Standard Deduction and Itemized Deductions

Lesson 6—Credit for Qualified Retirement Savings

Contributions, Mortgage Interest, and Foreign Tax Credit.

Lesson 7—Finishing the Return

Wage Earner Module

Volunteers who will be assisting wage earners need to complete the following lessons:

Lesson 8—Credit for Child and Dependent Care

Lesson 9—Education Credits

Lesson 10—Earned Income Tax Credit

Lesson 11— Child Tax Credit

Pension Earner Module

Volunteers who will be assisting pension earners are required to complete the following lessons.

Lesson 12—Sale of Stock

Lesson 13—Sale of Home

Lesson 14—Pensions

Lesson 15—Credit for Elderly or Disabled

Those who are taking this training with the expectation of becoming instructors themselves must learn all lessons.

The sequence of lessons generally follows the order of topics on the tax returns which you will complete at the volunteer site. In a few instances, this does not parallel the order of the tax form itself. For example, while the entity section (taxpayer's name, address, and social security number) appears first on the form, it is covered in the lesson on finishing the return since it is one of the last things to do when completing the return. (Have you ever tried to peel off one of the stick-on labels after you have found an error on the return?)

It is very important for you to assist only with returns and supporting schedules and forms for which you have been trained. If you go beyond your training, you risk making errors and

causing difficulties for those you wish to help. Refer taxpayers with difficult returns, or with portions of returns that are beyond the scope of your training to a paid professional tax preparer.

There are separate training materials available for the following categories of taxpayers:

Publication 678FS—Foreign Students and Scholars
Publication 678IN—U.S. Citizens and Residents Abroad
Publication 678M—Military Issues
Publication 678PR—Tax Issues for Puerto Rico

As a volunteer, you are not allowed to charge for your services. This includes taxpayer return preparation advice and return preparation. You may at times need to remind taxpayers that the assistance that you are providing is **FREE**. Do not solicit or accept donations on behalf of the VITA or TCE sponsor, or any other individual or organization, while providing assistance in this program.

Assisting taxpayers includes helping to make sure they are aware of their rights. Publication 1, *Your Rights as a Taxpayer*, is available free, from the IRS. Taxpayers can help ensure that they receive fair treatment in tax matters when they are aware of their rights.

Testing

All volunteers must take the applicable test to show that they can complete returns accurately. You may use this text and all reference materials to complete the test. Volunteers who do not pass the test may take the appropriate retest. Instructions on taking and grading the test are in the Test and Retest Booklets.

Proof Copies of Forms

Forms imprinted with “draft” were current as of the date this publication was sent to print. Final forms may have supplemental changes. **Be sure to compare the final forms with those in this publication and *The Tax Forms Booklet Appendix*, which was part of the Publication 678 Package, before helping taxpayers with their returns.**

Exercises and Exhibits

It is important that you take the time to complete the exercises to achieve the objectives in each lesson. Studies have shown that long-term retention of information increases dramatically if you put pencil to paper in responding to questions and problems. The Volunteer Assistor’s Guide is your learning tool and you may mark it up in any way you wish.

Each exercise is separated from the rest of the text by a border design. Write out your answer to each exercise, and then check it immediately against the answer provided. If your answer is different, work the problem again. If you need additional reinforcement, review any parts of the text that apply.

The exercises are designed to give you practice, to emphasize what we think is important, and to help you complete your training successfully.

The coursebook contains a large number of exhibits of the various tax forms and schedules. These exhibits are numbered starting at the beginning of each lesson. Many of the exercises contain exhibits of blank forms, or part of the form, that you must complete.

Lesson Features

Introduction

There is a brief **Introduction** to each lesson. This will give you an overview of the topic to be covered, as well as an idea of how you will most likely be asked to apply the information when helping taxpayers.

Objectives

At the start of each lesson, there is a list of **Objectives** that clearly define the key points for mastery of the topic. They not only help you focus your reading, but also help you check for understanding.

“Summing Up This Lesson”

This boxed feature appears at the end of each lesson. It provides you with a summary of the main points covered in the lesson. Used together, the lesson summaries provide a comprehensive overview of the course content.

Sidebar Features

Sidebar features appear in the outer margins (left and right) of the text. These boxed features emphasize important points presented in the lesson, or provide additional, related information. **Person-to-Person** highlights opportunities for taxpayers. **Tax Tips** provide special tax information, such as exceptions to rules, infrequent but important considerations, or special tax cases. **Potential Pitfalls** point out commonly made errors and indicate ways to avoid these errors. **Common Queries** identify questions and issues that taxpayers often have, and help you respond to their concerns. **Special Populations** provides information pertaining to certain types of taxpayers, such as seniors, the non-English speaking, or the military. **Alert!** identifies pending legislation, tax law changes, or tax forms changes that were expected, but not enacted or in final form when this publication went to print. As a volunteer please confirm that you have the latest information on the tax law and forms before assisting your clients.

CONFIDENTIALITY AND INTEGRITY

Taxpayers come to you for help. To provide appropriate assistance, you will be asking very personal questions about the taxpayers and their families, their sources of income, and their expenses. Taxpayers will give this information only if they trust and have confidence in you. **To maintain the taxpayer's trust and confidence, DO NOT disclose any personal tax information you learn as a result of the assistance you provide.**

Taxpayers can be amazingly frank about their personal lives. When taxpayers share extremely personal information with you, this creates a responsibility for you not to discuss the information with other taxpayers or fellow volunteers. Never use a taxpayer's name in the presence of other taxpayers.

However, volunteers may discuss tax situations with other taxpayers and volunteers. For example, a volunteer may refer to a situation (not a taxpayer) and ask or give advice about the appropriate tax treatment for that specific situation.

The VITA and TCE Programs offer free tax assistance. You cannot accept payment nor any type of gratuity for preparing a federal tax return or for other tax-related assistance that you provide. If you accept payment for preparing a tax return, you are considered a "paid preparer." Paid preparers are legally liable under federal law for the returns they prepare; volunteers are not.

An important aspect of integrity for volunteer assistors is declining to prepare a tax return when there is a question about the validity of the information supplied by a taxpayer. Some individuals may attempt to defraud the government by filing false tax returns.

Volunteers who are not comfortable with the information provided by a taxpayer because of any reason, should discuss their concerns with their Site Coordinator or other individual in charge of the site.

QUALITY SERVICE

The goal of the TCE and VITA Programs is to provide high quality service. The following list suggests some ways to ensure that each return is prepared correctly:

- Use a calculator to check your math.
- Refer to your Publication 17, other IRS publications and job aids for help with complicated topics.
- Use the checklists and worksheets provided.
- Consult with other, more experienced, volunteers.
- Call the Volunteer Hotline (described later in this lesson).

COMMON QUERIES

Ask your instructor or IRS Territory Manager for the dates of operation and schedule of hours for the hotline.

Volunteer Hotline

There is a toll-free hotline available for VITA and TCE volunteer use only. This hotline is a source of tax information for volunteers. When you use the hotline, identify yourself as a VITA or TCE volunteer.

The hotline number is 1-800-829-8482 (829-VITA). **Do not give this number to taxpayers.** This service is generally available between February 1 and April 15th.

Do not use this hotline to order forms or schedules. Instead, contact your IRS Territory Manager.

EFFECTIVE INTERVIEWING

To complete accurate returns, you must ask certain questions about the taxpayers and their families. It is important to set the appropriate climate to obtain this information.

It is also important to be sensitive to the needs of all taxpayers you assist, especially those with disabilities. All references to taxpayers with disabilities should reflect the individuality, equality and dignity of the person.

Refrain from using such terms as “handicapped, physically or mentally challenged, differently challenged”. It would be better to use:

Person(s) with a disability;
Persons who are blind; persons who are visually impaired;
Persons who are deaf; persons who are hearing impaired or hard of hearing;
Persons who use a wheelchair;
Persons who are physically disabled; or, persons with mental retardation.

Steps to Effective Interviewing:

1. Make necessary introductions and engage in small talk.
2. Preface what will take place during the interview.
3. Share your intentions and any hopeful results/benefits for the taxpayer.
4. Allow the taxpayer to share any expectations, needs, and/or concerns.
5. Respond with active listening skills.
 - A. Create a “safe” climate.
 - B. Remember your nonverbal listening clues.
 - C. Listen, then respond by:
 1. restating,

- 2. paraphrasing, (and/or)
 - 3. encouraging.
6. Ask the first key tax question, creating an awareness about why the tax information is needed.
 - A. Make no assumptions.
 - B. Ask no leading questions.
 - C. Ask, “What have you brought with you today?”
 7. Continue to ask questions. Define any terms that may be unfamiliar to the taxpayer.
 8. Check your own comfort level.
 9. Respond to any misunderstandings.
 10. Continue with effective questioning and active listening.
 11. Overcome any communication barriers.
 - A. Stay on track. (“I hear you.”/repeat question)
 - B. Allow adequate response time.
 - C. Avoid making assumptions.
 - D. Deal with taxpayers.
 1. Silent (“Tell me more about . . .”)
 2. Upset (paraphrase)
 - E. Concentrate.
 12. Indicate the taxpayer’s next steps. Educate the taxpayer about the VITA/TCE Programs and stress the benefits of accurate recordkeeping.
 - A. Express confidence in having completed an accurate tax return.
 - B. Part cordially.

WHAT IF . . . ?

Use these questions and answers to provide quick and accurate information to taxpayers who have administrative questions.

1. What is the CHIP Program?

The Children’s Health Insurance Program (CHIP) is designed to help millions of children of working families obtain affordable and much-needed health insurance. CHIP informational materials are available at IRS Tax Assistance Centers and Volunteer Income Tax Assistance (VITA) sites. CHIP information (i.e. brochures, flyers) should be provided to VITA sites prior to the filing season. Volunteers at VITA site locations are not expected to answer any questions pertaining to this program, just to make information available to taxpayers visiting their sites.

2. How can I direct someone to their closest AARP sponsored Tax-Aide Site?

AARP Tax-Aide operates a toll-free nationwide number to help people find their closest Tax-Aide Site. The number is 1-888-227-7669. The information is also available on the AARP web page. The address is www.aarp.org/taxaide.

3. What if a taxpayer or dependent does not have a social security number?

Social security numbers are required for all taxpayers and dependents. Taxpayers who do not have a social security number must apply for one by using Form SS-5, *Application for a Social Security Card*. This form is available from the Social Security Administration and U.S. Citizens must show proof of age, identity, and citizenship when they apply for a social security number. Individuals who are age 18 or older must apply at the Social Security Administration office in person rather than by mail.

4. What if the taxpayer needs an IRS form or publication?

Most IRS offices and many post offices and libraries have IRS forms that taxpayers may take or photocopy. They also have the instruction booklets for specific forms and publications. Remind the taxpayer that forms can also be ordered by calling the IRS on 1-800-829-3676 (1-800-TAX FORM) or from a fax machine dial (703) 487-4160.

IRS offers tax products and information on the Internet. The IRS Internet site provides instant access to federal income tax forms, instructions, publications, and information on free tax assistance programs, electronic tax filing, and more 24 hours a day. Current and prior year federal tax products and information are available for downloading.

By Internet:

1. World Wide Web – www.irs.gov
2. FTP – [ftp.irs.ustreas.gov](ftp://ftp.irs.ustreas.gov)
3. Telnet – [iris.irs.ustreas.gov](telnet://iris.irs.ustreas.gov)

5. What if the taxpayers move?

Taxpayers should use Form 8822, *Change of Address*, to notify the IRS of any change of address. If the taxpayers plan to move after sending the return and before a refund is received, they should notify their old post office and the IRS of their new address. (See item #4 for information on how to order Form 8822.)

6. Which address should taxpayers use, their street address or their post office box?

If the post office delivers mail to the post office box rather than to a street address, enter the P.O. box number on the line for the present home address.

7. What if the taxpayer needs a copy of a prior-year return?

To obtain a copy of a prior-year return, taxpayers should complete Form 4506, *Request for Copy or Transcript of Tax Form*, and mail it, with the required fee, to the Internal Revenue service center where the return was filed. As an alternative, a transcript of a prior-year return may be obtained, also using Form 4506. There is no charge for the transcript. A transcript shows most line items from the original return, including accompanying forms and schedules.

8. What if the taxpayer wants to make a voluntary contribution to reduce the public debt?

Voluntary contributions to reduce the public debt should be made payable to “Bureau of the Public Debt.” The contribution may be sent in the tax return envelope. If the taxpayer is making a payment of tax due, as well as a contribution, there should be two checks or money orders in the tax-return envelope—one to pay the tax due and one to make the voluntary contribution. Voluntary contributions to reduce the public debt are considered charitable contributions and may be entered as an itemized deduction on Schedule A of Form 1040 in the year paid.

9. How long should taxpayers keep their tax returns?

Taxpayers should keep a copy of the tax return, worksheets used, and records of all items appearing on it (such as 1099 forms) until the statute of limitations runs out for that return. Usually, this is 3 years from the date the return was due or filed, or 2 years from the date the tax was paid, whichever is later. They should keep forms W-2 until the Social Security Administration has recorded the earnings reflected on the forms. Keep property records (including those on a home) as long as they are needed to figure the basis of the original or replacement property. Closing statements for a home should be kept until the home is sold. Brokerage statements showing the purchase price of stock should be kept until the stock is sold. Also, contributions to nondeductible IRAs should be kept until all IRA funds are withdrawn. Calculations determining the non-taxable portion of pension income should be kept until all of the pension income is taxable. For additional recordkeeping information, see Publication 552, *Recordkeeping for Individuals*.

10. What is On-Line filing?

On-line filing allows a taxpayer to file their tax return from home through an Internet Web site or third-party transmitter. Information about filing from home is included in many commercial tax preparation software packages. Also, many software companies offer tax preparation and electronic filing software

that can be downloaded from the Web; or they provide the option for individuals to prepare their returns while logged on to the Internet.

All that is needed is a personal computer (PC), software and a modem to send the return data. On-line filing accommodates the same basic forms and schedules as electronic filing. The taxpayer is responsible for sending their signature document (Form 8453-OL) accompanying paper documents to IRS after they receive notification from the Internet on-line provider or transmitter that their return has been accepted by IRS. If IRS rejects the return, the taxpayer will either have to correct the information and retransmit the return or print it and send it as a paper return to IRS. Credit card and direct debit payment options are available for balance due returns.

11. Are there any publications or forms that can assist a taxpayer that owes prior year taxes or previously had their refund offset to satisfy another's debt?

IRS offers various publications and forms that are specific to these issues.

The IRS Collection Process, Publication 594, explains a taxpayer's right and responsibility regarding payment of federal taxes. **Installment Agreement Request**, Form 9465, gives the taxpayer the option to pay a balance due through monthly installment payments.

Innocent Spouse Relief, Publication 971, addresses how one spouse may request relief from past taxes due solely based on the other spouse's debt. **Request for Innocent Spouse Relief**, Form 8857, explains various forms of relief and who may qualify.

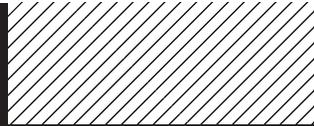
Injured Spouse Claim and Allocation, Form 8379, allows a taxpayer to request relief from their spouse's past due federal debts including back child support and past due taxes. An injured spouse can get a refund for his or her share of the overpayment that would be used to pay the past due amount.

Additional information on these topics can be obtained by contacting the IRS at 1-800-829-1040, accessing their web page at www.irs.gov, or by visiting a Tax Assistance Center in your area.

WHERE IS THE TOPIC?

The following pages show forms 1040EZ, 1040A, and 1040. For a discussion about what to put on a line, turn to the lesson in this text that is shown in the circle.

FORM 1040EZ



Form
1040EZ

Department of the Treasury—Internal Revenue Service
**Income Tax Return for Single and
Joint Filers With No Dependents (99) 2002**

OMB No. 1545-0675

Label
(See page 12.)
Use the IRS label.
Otherwise, please print or type.

L A B E L H E R E

Your first name and initial	Last name	(7)
If a joint return, spouse's first name and initial	Last name	
Home address (number and street). If you have a P.O. box, see page 12.		Apt. no.
City, town or post office, state, and ZIP code. If you have a foreign address, see page 12.		

Your social security number
: : :
Spouse's social security number
: : :

▲ Important! ▲
You **must** enter your SSN(s) above.

Presidential Election Campaign
(page 12) ▶

Note. Checking "Yes" will not change your tax or reduce your refund.
Do you, or your spouse if a joint return, want \$3 to go to this fund? ▶

You Yes No Spouse Yes No

Income
Attach Form(s) W-2 here.
Enclose, but do not attach, any payment.

1 Total wages, salaries, and tips. This should be shown in box 1 of your W-2 form(s). Attach your W-2 form(s).	1	(3)
2 Taxable interest. If the total is over \$400, you cannot use Form 1040EZ.	2	(3)
3 Unemployment compensation and Alaska Permanent Fund dividends (see page 14).	3	(3)
4 Add lines 1, 2, and 3. This is your adjusted gross income .	4	
5 Can your parents (or someone else) claim you on their return? Yes. Enter amount from worksheet on back. <input type="checkbox"/> No. If single , enter \$7,700. If married , enter \$13,850. See back for explanation. <input type="checkbox"/>	5	(5)
6 Subtract line 5 from line 4. If line 5 is larger than line 4, enter -0-. This is your taxable income .	▶ 6	

Note. You **must** check Yes or No.

Payments and tax

7 Federal income tax withheld from box 2 of your W-2 form(s).	7	(7)
8 Earned income credit (EIC).	8	(10)
9 Add lines 7 and 8. These are your total payments .	▶ 9	(7)
10 Tax. Use the amount on line 6 above to find your tax in the tax table on pages 24–28 of the booklet. Then, enter the tax from the table on this line.	10	(5)

Refund

11a If line 9 is larger than line 10, subtract line 10 from line 9. This is your **refund**. ▶ **11a** (7)

▶ **b** Routing number ▶ **c** Type: Checking Savings

▶ **d** Account number (7)

Amount you owe

12 If line 10 is larger than line 9, subtract line 9 from line 10. This is the **amount you owe**. For details on how to pay, see page 21. ▶ **12**

Third party designee

Do you want to allow another person to discuss this return with the IRS (see page 22)? **Yes.** Complete the following. **No**

Designee's name ▶ Phone no. () ▶ Personal identification number (PIN) ▶

Sign here

Under penalties of perjury, I declare that I have examined this return, and to the best of my knowledge and belief, it is true, correct, and accurately lists all amounts and sources of income I received during the tax year. Declaration of preparer (other than the taxpayer) is based on all information of which the preparer has any knowledge.

Your signature	(7)	Date	Your occupation	Daytime phone number
Spouse's signature. If a joint return, both must sign.		Date	Spouse's occupation	

Paid preparer's use only

Preparer's signature	(7)	Date	Check if self-employed <input type="checkbox"/>	Preparer's SSN or PTIN
Firm's name (or yours if self-employed), address, and ZIP code	EIN		Phone no. ()	

FORM 1040EZ

Use this form if

- Your filing status is single or married filing jointly.
- You (and your spouse if married) were under 65 on January 1, 2003, and not blind at the end of 2002.
- You do not claim any dependents.
- Your taxable income (line 6) is less than \$50,000.
- You do not claim a deduction for educator expenses, student loan interest deduction, or tuition and fees deduction (see page 8).
- You do not claim an education credit.
- You had **only** wages, salaries, tips, taxable scholarship or fellowship grants, unemployment compensation, or Alaska Permanent Fund dividends, and your taxable interest was not over \$400. **But** if you earned tips, including allocated tips, that are not included in box 5 and box 7 of your W-2, you may not be able to use Form 1040EZ. See page 13. If you are planning to use Form 1040EZ for a child who received Alaska Permanent Fund dividends, see page 14.
- You did not receive any advance earned income credit payments.

If you are not sure about your filing status, see page 11. If you have questions about dependents, use TeleTax topic 354 (see page 6). If you **cannot use this form**, use TeleTax topic 352 (see page 6).

Filling in your return

For tips on how to avoid common mistakes, see page 30.

If you received a scholarship or fellowship grant or tax-exempt interest income, such as on municipal bonds, see the booklet before filling in the form. Also, see the booklet if you received a Form 1099-INT showing Federal income tax withheld or if Federal income tax was withheld from your unemployment compensation or Alaska Permanent Fund dividends.

Remember, you must report all wages, salaries, and tips even if you do not get a W-2 form from your employer. You must also report all your taxable interest, including interest from banks, savings and loans, credit unions, etc., even if you do not get a Form 1099-INT.

Worksheet for dependents who checked "Yes" on line 5

(keep a copy for your records)

Use this worksheet to figure the amount to enter on line 5 if someone can claim you (or your spouse if married) as a dependent, even if that person chooses not to do so. To find out if someone can claim you as a dependent, use TeleTax topic 354 (see page 6).

A. Amount, if any, from line 1 on front	_____				
	+ 250.00	Enter total ▶	A.	_____	
B. Minimum standard deduction			B.	750.00	
C. Enter the larger of line A or line B here			C.	_____	
D. Maximum standard deduction. If single , enter \$4,700; if married , enter \$7,850			D.	_____	
E. Enter the smaller of line C or line D here. This is your standard deduction			E.	_____	
F. Exemption amount.			}	F.	_____
● If single, enter -0-.					
● If married and— —both you and your spouse can be claimed as dependents, enter -0-. —only one of you can be claimed as a dependent, enter \$3,000.					
G. Add lines E and F. Enter the total here and on line 5 on the front			G.	_____	

If you checked "No" on line 5 because no one can claim you (or your spouse if married) as a dependent, enter on line 5 the amount shown below that applies to you.

- Single, enter \$7,700. This is the total of your standard deduction (\$4,700) and your exemption (\$3,000).
- Married, enter \$13,850. This is the total of your standard deduction (\$7,850), your exemption (\$3,000), and your spouse's exemption (\$3,000).

Mailing return

Mail your return by **April 15, 2003**. Use the envelope that came with your booklet. If you do not have that envelope or if you moved during the year, see the back cover for the address to use.



FORM 1040A

Form **1040A** Department of the Treasury—Internal Revenue Service **U.S. Individual Income Tax Return** (99) **2002** IRS Use Only—Do not write or staple in this space.

Label
(See page 19.)

Use the IRS label.
Otherwise, please print or type.

L A B E L H E R E	Your first name and initial	Last name
	If a joint return, spouse's first name and initial	Last name
	Home address (number and street). If you have a P.O. box, see page 20.	
	City, town or post office, state, and ZIP code. If you have a foreign address, see page 20.	

OMB No. 1545-0085

Your social security number

Spouse's social security number

▲ Important! ▲
You **must** enter your SSN(s) above.

Presidential Election Campaign
(See page 20.)

Note. Checking "Yes" will not change your tax or reduce your refund.
Do you, or your spouse if filing a joint return, want \$3 to go to this fund? Yes No Yes No

Filing status
(2)

Check only one box.

- 1 Single
- 2 Married filing jointly (even if only one had income)
- 3 Married filing separately. Enter spouse's SSN above and full name here. ▶
- 4 Head of household (with qualifying person). (See page 21.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶
- 5 Qualifying widow(er) with dependent child (year spouse died ▶). (See page 22.)

Exemptions
(2)

If more than six dependents, see page 22.

6a **Yourself.** If your parent (or someone else) can claim you as a dependent on his or her tax return, **do not** check box 6a.

b **Spouse**

c **Dependents:**

(1) First name	Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) <input checked="" type="checkbox"/> if qualifying child for child tax credit (see page 23)
				<input type="checkbox"/>

d Total number of exemptions claimed.

No. of boxes checked on 6a and 6b _____

No. of children on 6c who:

- lived with you _____
- did not live with you due to divorce or separation (see page 24) _____

Dependents on 6c not entered above _____

Add numbers on lines above

Income

Attach Form(s) W-2 here. Also attach Form(s) 1099-R if tax was withheld.

If you did not get a W-2, see page 25.

Enclose, but do not attach, any payment.

7 Wages, salaries, tips, etc. Attach Form(s) W-2.	(3) 7
8a Taxable interest. Attach Schedule 1 if required.	(3) 8a
b Tax-exempt interest. Do not include on line 8a.	(3) 8b
9 Ordinary dividends. Attach Schedule 1 if required.	(3) 9
10 Capital gain distributions (see page 25).	(3) 10
11a IRA distributions.	(14) 11a
11b Taxable amount (see page 25).	11b
12a Pensions and annuities.	(14) 12a
12b Taxable amount (see page 26).	12b
13 Unemployment compensation and Alaska Permanent Fund dividends.	(3) 13
14a Social security benefits.	(14) 14a
14b Taxable amount (see page 28).	14b
15 Add lines 7 through 14b (far right column). This is your total income .	▶ 15
16 Educator expenses (see page XX).	16
17 IRA deduction (see page 28).	17
18 Student loan interest deduction (see page 31).	18
19 Tuition and fees deduction (see page XX).	19
20 Add lines 16 through 19. These are your total adjustments .	20
21 Subtract line 20 from line 15. This is your adjusted gross income .	▶ 21

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see page 53. Cat. No. 11327A Form **1040A** (2002)

FORM 1040A

Form 1040A (2002)

Page 2

Tax, credits, and payments	22	Enter the amount from line 21 (adjusted gross income).	22	
Standard Deduction for— • People who checked any box on line 23a or 23b or who can be claimed as a dependent, see page 33. • All others: Single, \$4,700 Head of household, \$6,900 Married filing jointly or Qualifying widow(er), \$7,850 Married filing separately, \$3,925	23a	Check <input type="checkbox"/> You were 65 or older <input type="checkbox"/> Blind <input type="checkbox"/> Spouse was 65 or older <input type="checkbox"/> Blind } Enter number of boxes checked ▶ 23a <input type="checkbox"/> (5)		
	b	If you are married filing separately and your spouse itemizes deductions, see page 32 and check here ▶ 23b <input type="checkbox"/>		
	24	Enter your standard deduction (see left margin).	24	
	25	Subtract line 24 from line 22. If line 24 is more than line 22, enter -0-.	25	
	26	Multiply \$3,000 by the total number of exemptions claimed on line 6d.	26	
	27	Subtract line 26 from line 25. If line 26 is more than line 25, enter -0-. This is your taxable income .	27	
	28	Tax, including any alternative minimum tax (see page 33).	28	(5)
	29	Credit for child and dependent care expenses. Attach Schedule 2.	29	(8)
	30	Credit for the elderly or the disabled. Attach Schedule 3.	30	(15)
	31	Education credits. Attach Form 8863.	31	(9)
32	Retirement savings contributions credit. Attach Form 8880.	32	(6)	
33	Child tax credit (see page 36).	33	(11)	
34	Adoption credit. Attach Form 8839.	34	(6)	
35	Add lines 29 through 34. These are your total credits .	35		
36	Subtract line 35 from line 28. If line 35 is more than line 28, enter -0-.	36		
37	Advance earned income credit payments from Form(s) W-2.	37	(10)	
38	Add lines 36 and 37. This is your total tax .	38		
39	Federal income tax withheld from Forms W-2 and 1099.	39	(7)	
40	2002 estimated tax payments and amount applied from 2001 return.	40	(7)	
41	Earned income credit (EIC) .	41	(10)	
42	Additional child tax credit. Attach Form 8812.	42	(11)	
43	Add lines 39 through 42. These are your total payments .	43	(7)	
Refund	44	If line 43 is more than line 38, subtract line 38 from line 43. This is the amount you overpaid .	44	(7)
Direct deposit? See page 47 and fill in 45b, 45c, and 45d.	45a	Amount of line 44 you want refunded to you .	45a	(7)
	b	Routing number <input type="text"/> ▶ c Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings		
	d	Account number <input type="text"/> ▶		(7)
	46	Amount of line 44 you want applied to your 2003 estimated tax .	46	(7)
Amount you owe	47	Amount you owe. Subtract line 43 from line 38. For details on how to pay, see page 48.	47	(7)
	48	Estimated tax penalty (see page 48).	48	

Third party designee Do you want to allow another person to discuss this return with the IRS (see page 49)? **Yes.** Complete the following. **No**

Designee's name ▶	Phone no. ▶ ()	Personal identification number (PIN) ▶ <input type="text"/>
-------------------	-----------------	---

Sign here Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and accurately list all amounts and sources of income I received during the tax year. Declaration of preparer (other than the taxpayer) is based on all information of which the preparer has any knowledge.

Your signature (7)	Date	Your occupation	Daytime phone number ()
Spouse's signature. If a joint return, both must sign.	Date	Spouse's occupation	

Paid preparer's use only

Preparer's signature (7)	Date	Check if self-employed <input type="checkbox"/>	Preparer's SSN or PTIN
Firm's name (or yours if self-employed), address, and ZIP code ▶	EIN	Phone no. ()	

FORM 1040

Form **1040**

Department of the Treasury—Internal Revenue Service
U.S. Individual Income Tax Return 2002

(99) IRS Use Only—Do not write or staple in this space.

Label

(See instructions on page 19.)

Use the IRS label. Otherwise, please print or type.

LABEL HERE

For the year Jan. 1–Dec. 31, 2002, or other tax year beginning _____, 2002, ending _____, 20

Your first name and initial _____ Last name **7**

If a joint return, spouse's first name and initial _____ Last name _____

Home address (number and street). If you have a P.O. box, see page 19. _____ Apt. no. _____

City, town or post office, state, and ZIP code. If you have a foreign address, see page 19. _____

OMB No. 1545-0074

Your social security number _____

Spouse's social security number _____

▲ Important! ▲
You must enter your SSN(s) above.

Presidential Election Campaign
(See page 19.)

Note. Checking "Yes" will not change your tax or reduce your refund.
Do you, or your spouse if filing a joint return, want \$3 to go to this fund? Yes No Yes No

Filing Status

Check only one box. **2**

- 1 Single
- 2 Married filing jointly (even if only one had income)
- 3 Married filing separately. Enter spouse's SSN above and full name here. ▶ _____
- 4 Head of household (with qualifying person). (See page 19.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶ _____
- 5 Qualifying widow(er) with dependent child (year spouse died ▶ _____). (See page 19.)

Exemptions

If more than five dependents, see page 20.

6a **Yourself.** If your parent (or someone else) can claim you as a dependent on his or her tax return, **do not** check box 6a

b **Spouse**

c Dependents:

(1) First name	Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) <input checked="" type="checkbox"/> if qualifying child for child tax credit (see page 20)
				<input type="checkbox"/>

d Total number of exemptions claimed

No. of boxes checked on 6a and 6b _____

No. of children on 6c who:

- lived with you _____
- did not live with you due to divorce or separation (see page 20) _____

Dependents on 6c not entered above _____

Add numbers on lines above ▶

Income

Attach Forms W-2 and W-2G here. Also attach Form(s) 1099-R if tax was withheld.

If you did not get a W-2, see page 21.

Enclose, but do not attach, any payment. Also, please use **Form 1040-V.**

7 Wages, salaries, tips, etc. Attach Form(s) W-2	3	3	7
8a Taxable interest. Attach Schedule B if required	3	3	8a
b Tax-exempt interest. Do not include on line 8a	3	3	8b
9 Ordinary dividends. Attach Schedule B if required	3	3	9
10 Taxable refunds, credits, or offsets of state and local income taxes (see page 22)	3	3	10 3
11 Alimony received	3	3	11
12 Business income or (loss). Attach Schedule C or C-EZ	3	3	12
13 Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ <input type="checkbox"/>			13
14 Other gains or (losses). Attach Form 4797			14
15a IRA distributions 14 15a _____ b Taxable amount (see page 23)			15b
16a Pensions and annuities 16a _____ b Taxable amount (see page 23)			16b
17 Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E			17
18 Farm income or (loss). Attach Schedule F			18
19 Unemployment compensation	3	3	19
20a Social security benefits 20a 14 _____ b Taxable amount (see page 25)			20b
21 Other income. List type and amount (see page 27)			21 3
22 Add the amounts in the far right column for lines 7 through 21. This is your total income ▶			22

Adjusted Gross Income

23 Educator expenses (see page xx)	4	4	23
24 IRA deduction (see page 27)	4	4	24
25 Student loan interest deduction (see page 28)	4	4	25
26 Tuition and fees deduction (see page XX)			26
27 Archer MSA deduction. Attach Form 8853			27
28 Moving expenses. Attach Form 3903	4	4	28
29 One-half of self-employment tax. Attach Schedule SE			29
30 Self-employed health insurance deduction (see page 30)			30
31 Self-employed SEP, SIMPLE, and qualified plans			31
32 Penalty on early withdrawal of savings			32
33a Alimony paid b Recipient's SSN ▶ _____			33a
34 Add lines 23 through 33a			34
35 Subtract line 34 from line 22. This is your adjusted gross income ▶			35

FORM 1040

Tax and Credits

Standard Deduction for—

- People who checked any box on line 37a or 37b or who can be claimed as a dependent, see page 31.
- All others:
 - Single, \$4,700
 - Head of household, \$6,900
 - Married filing jointly or Qualifying widow(er), \$7,850
 - Married filing separately, \$3,925

36	Amount from line 35 (adjusted gross income)	36	
37a	Check if: <input type="checkbox"/> You were 65 or older, <input type="checkbox"/> Blind; <input type="checkbox"/> Spouse was 65 or older, <input type="checkbox"/> Blind. Add the number of boxes checked above and enter the total here	37a	
b	If you are married filing separately and your spouse itemizes deductions, or you were a dual-status alien, see page 31 and check here	37b	
38	Itemized deductions (from Schedule A) or your standard deduction (see left margin)	38	
39	Subtract line 38 from line 36	39	
40	If line 36 is \$103,000 or less, multiply \$3,000 by the total number of exemptions claimed on line 6d. If line 36 is over \$103,000, see the worksheet on page 32	40	
41	Taxable income. Subtract line 40 from line 39. If line 40 is more than line 39, enter -0-	41	
42	Tax (see page 33). Check if any tax is from a <input type="checkbox"/> Form(s) 8814 b <input type="checkbox"/> Form 4972	42	
43	Alternative minimum tax (see page 34). Attach Form 6251	43	
44	Add lines 42 and 43	44	
45	Foreign tax credit. Attach Form 1116 if required	45	
46	Credit for child and dependent care expenses. Attach Form 2441	46	
47	Credit for the elderly or the disabled. Attach Schedule R	47	
48	Education credits. Attach Form 8863	48	
49	Retirement savings contributions credit. Attach Form 8880	49	
50	Child tax credit (see page XX)	50	
51	Adoption credit. Attach Form 8839	51	
52	Credits from: a <input type="checkbox"/> Form 8396 b <input type="checkbox"/> Form 8859	52	
53	Other credits. Check applicable box(es): a <input type="checkbox"/> Form 3800 b <input type="checkbox"/> Form 8801 c <input type="checkbox"/> Specify _____	53	
54	Add lines 45 through 53. These are your total credits	54	
55	Subtract line 54 from line 44. If line 54 is more than line 44, enter -0-	55	

Other Taxes

56	Self-employment tax. Attach Schedule SE	56	
57	Social security and Medicare tax on tip income not reported to employer. Attach Form 4137	57	
58	Tax on qualified plans, including IRAs, and other tax-favored accounts. Attach Form 5329 if required	58	
59	Advance earned income credit payments from Form(s) W-2	59	
60	Household employment taxes. Attach Schedule H	60	
61	Add lines 55 through 60. This is your total tax	61	

Payments

If you have a qualifying child, attach Schedule EIC.

62	Federal income tax withheld from Forms W-2 and 1099	62	
63	2002 estimated tax payments and amount applied from 2001 return	63	
64	Earned income credit (EIC)	64	
65	Excess social security and tier 1 RRTA tax withheld (see page 51)	65	
66	Additional child tax credit. Attach Form 8812	66	
67	Amount paid with request for extension to file (see page 51)	67	
68	Other payments from: a <input type="checkbox"/> Form 2439 b <input type="checkbox"/> Form 4136	68	
69	Add lines 62 through 68. These are your total payments	69	

Refund

Direct deposit? See page 51 and fill in 71b, 71c, and 71d.

70	If line 69 is more than line 61, subtract line 61 from line 69. This is the amount you overpaid	70	
71a	Amount of line 70 you want refunded to you	71a	
b	Routing number	c	Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings
d	Account number	72	Amount of line 70 you want applied to your 2003 estimated tax

Amount You Owe

73	Amount you owe. Subtract line 69 from line 61. For details on how to pay, see page 52	73	
74	Estimated tax penalty (see page 52)	74	

Third Party Designee

Do you want to allow another person to discuss this return with the IRS (see page 53)? **Yes.** Complete the following. **No**

Designee's name	Phone no.	Personal identification number (PIN)
-----------------	-----------	--------------------------------------

Sign Here

Joint return? See page 19. Keep a copy for your records.

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Your signature	Date	Your occupation	Daytime phone number
Spouse's signature. If a joint return, both must sign.	Date	Spouse's occupation	

Paid Preparer's Use Only

Preparer's signature	Date	Check if self-employed <input type="checkbox"/>	Preparer's SSN or PTIN
Firm's name (or yours if self-employed), address, and ZIP code	EIN	Phone no.	

TaxWise Hints

Each year the Internal Revenue Service contracts with a tax preparation software vendor to provide free software to our volunteers. This year you will find TaxWise hints integrated throughout the text. They will be at the end of each lesson just before “Summing Up This Lesson” or “Summing Up This Section”.

▶▶ SUMMING UP THIS LESSON ◀◀

- ▶ Remember that the information used to prepare an individual’s income tax return must be treated as confidential.
- ▶ Use the steps for effective interviewing.

STUDENT NOTES

Lined writing area for student notes.

OBJECTIVES

In this lesson you will learn what you need to know when you begin to prepare an individual's federal income tax return. Please note that two of the objectives concern the importance of insuring that the taxpayer's (or dependent's) name and social security number match our records.

After completing this lesson you should be able to:

- Explain the importance of requiring a social security card for the tax preparation.
- Identify the documents that could be used in-lieu-of a social security card.
- List the 5 tests for a qualifying dependent.
- List the requirements for each of the five filing statuses.
- Select the correct filing status.
- Determine Who Must File.
- Determine Who Should File.
- Select the appropriate tax form to use.

SOCIAL SECURITY NUMBER

Each year hundreds of thousands of returns are delayed in processing or credit/deductions disallowed because names and social security numbers do not match Social Security Administration (SSA) records. To prevent processing delays in paper returns and rejected electronically filed returns, volunteers must check the accuracy of each Social Security number, as well as the spelling of the name associated with the number.

To do this volunteers should ask for one of the following documents for each individual on the return.

- Social Security Card (original or copy)
- SSA 1099 benefit statements
- SSA letter

TAX TIPS

★★★★★★★★★

The exemption amount is indexed for inflation and generally changes every year.

Note: Driver's licenses and passport may not depict the name or number as it appears on SSA records.

PERSONAL AND DEPENDENCY EXEMPTIONS

After completing this section, you will be able to:

- Define *personal exemption*.
- Define *dependency exemption*.
- Use the five tests to determine a qualifying dependent.

There are two kinds of exemptions: personal and dependency. While both exemptions are worth the same amount, different rules apply to each type.

Personal exemptions are allowed to the taxpayer and to the taxpayer's spouse.

Dependency exemptions are allowed to the taxpayer for qualifying dependents who meet five specific tests.

The taxpayer can usually deduct the **exemption amount** (\$3,000 for 2002) when figuring taxable income.

POTENTIAL PITFALLS



A common-law marriage is recognized for federal tax purposes if the marriage is recognized by the state where the taxpayers now live or in the state in which the common-law marriage was entered. Legal advice may be required to determine if a common-law marriage exists.

PERSONAL EXEMPTIONS

The Taxpayer

The taxpayer can claim a personal exemption for himself or herself unless the taxpayer is eligible to be claimed as a dependent on another person's return. If this is true, the taxpayer cannot claim an exemption for himself or herself, even if the other taxpayer does not actually claim the dependency exemption.

The Spouse

Generally, if the taxpayer's spouse is claimed as a dependent on another person's return, the taxpayer cannot claim the spouse's exemption on his or her return. (One spouse is never considered the dependent of the other.)

To claim an exemption for a spouse, the taxpayers must be married by December 31, the last day of the year. If the taxpayer files a separate return, he or she can claim the exemption for his or her spouse only if his or her spouse had no gross income (defined later) and was not the dependent of another taxpayer. This is true even if the other taxpayer does not actually claim the taxpayer's spouse's exemption. If a taxpayer is divorced or legally separated at the end of the tax year, he or she cannot claim his or her (former) spouse's exemption.

If the taxpayer's spouse died during the year and the taxpayer did not remarry by December 31, the taxpayer can generally claim the personal exemption for the deceased spouse. This exemption can be claimed only if the taxpayer was not divorced or legally separated from his or her spouse on the date of the death and would have been able to claim the exemption under regular circumstances.

DEPENDENCY EXEMPTIONS

A **dependent** is a person, other than the taxpayer or spouse, who entitles the taxpayer to claim a dependency exemption. A taxpayer can claim a dependency exemption only if **all five** of the following dependency tests are met.

1. Member of Household or Relationship Test.
2. Citizen or Resident Test.
3. Joint Return Test.
4. Gross Income Test.
5. Support Test.

1. The Member of Household or Relationship Test

To meet this test, the person must either:

- A. Live with the taxpayer for the entire year as a member of his or her household, or
- B. Be related to the taxpayer in one of the ways listed later, under *Relatives who do not have to live with the taxpayer*.

Note.

A person away on temporary absences is considered to live and be a member of the household the entire year. Temporary absences include attending school, taking vacations, hospital stays due to illness, and military service. In addition, the relationship must not violate local law.

Relatives who do not have to live with the taxpayer

A person related to the taxpayer in any of the following ways does not have to live with the taxpayer the entire year as a member of his or her household to meet this test.

- Child, grandchild, great grandchild, etc. (A legally adopted child is considered the taxpayer's child.)
- Stepchild.
- Brother, sister, half brother, half sister, stepbrother, stepsister.
- Parent, grandparent, or other direct ancestor, but not foster parent.

COMMON QUERIES

A relationship established by marriage, such as "mother-in-law," does not end with divorce or the death of one of the spouses.

ALERT



Parents of children who are presumed to have been kidnapped by someone who is not a family member may be able to take the child into account in determining their eligibility for the head of household or qualifying widow(er) filing status, deduction for dependents, child tax credit, and the earned income credit (EIC). For details, see Publication 501, *Exemptions, Standard Deductions, and Filing Information* or Publication 596, *Earned Income Credit*.

TAX TIPS

★★★★★★★★★
Foreign exchange students generally cannot be claimed as dependents.

- Stepmother or stepfather.
- Brother or sister of your father or mother.
- Son or daughter of your brother or sister.
- Father-in-law, mother-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law.

If a child was born alive during the year and meets the dependency tests, the taxpayer can take the exemption, even if the child lived only for a moment. No exemption is allowed for a stillborn child. State or local laws determine if a child was born alive or stillborn.

A legally adopted child is considered to be the taxpayer's child. If an adoption is finalized and the child begins living with the taxpayer on or before December 31, member of the household test is met.

If a foster child has lived with the taxpayer for the entire year (except for temporary absences) and the taxpayer cares for the child as his or her own, the child is treated as the taxpayer's own child.

A person who died during the year and was a member of the taxpayer's household until death meets the member of household test.

A cousin must live with the taxpayer for the entire year (except for temporary absences) to meet the member of household test. A cousin *does not* meet the relationship test.

2. Citizen or Resident Test

To meet this test, a person must be for some part of the year:

- a U.S. citizen or resident, or
- a resident of Canada or Mexico.

Children usually are citizens or residents of the country of their parents. A child born in a foreign country can be recognized as a U.S. citizen for tax purposes if either parent is a U.S. citizen.

If a taxpayer (who is a U.S. citizen) legally adopts a child who is not a U.S. citizen or resident, and the other dependency tests are met, the taxpayer can take the exemption if the taxpayer's home is the child's main home and the child is a member of the household for the entire tax year.

3. Joint Return Test

To meet this test, generally, the taxpayer's dependent cannot file a joint return. However, the joint return test does not apply if a joint return is filed by the dependent and his or her spouse *merely as a claim for refund* and no tax liability would exist for either spouse on separate returns.

4. The Gross Income Test

A taxpayer cannot take an exemption for a person whose gross income equals or exceeds the **exemption amount**. The exemption amount for 2002 is \$3,000.

Gross income is all *taxable* income in the form of money, goods, property, and services. It includes all unemployment compensation and certain scholarships. It does not include welfare benefits or nontaxable social security benefits.

There are two exceptions to the gross income test. The gross income test does not apply if:

- The taxpayer's child is under 19 years of age at the end of the year, or
- The taxpayer's child is under 24 years of age at the end of the year and is a full-time student.

To be considered a student, the taxpayer's child must attend school full-time for some part of each of five calendar months of the year. The five months need not be consecutive in order to qualify. School generally does not include night schools, on-the-job training courses, or correspondence schools.

5. The Support Test

The support test requires that the taxpayer provide more than half of a person's total support for the entire year in order to claim that person as a dependent.

There are two exceptions to the support test:

- Multiple support, and
- Children of divorced or separated parents.

(Both of these exceptions will be covered later in this section.)

To determine if the taxpayer provided more than half of the dependent's support, compare the amount that the taxpayer contributed to the person's support with the entire amount of support the person received from all sources. (Exhibit 1 provides a worksheet for figuring whether the taxpayer provided more than half of a dependent's support.)

State benefit payments like welfare, food stamps, and housing are considered support provided by the state, not by the parent, regardless of how the parent actually spends the funds.

Support provided for the dependent includes support paid from these sources: amounts withdrawn from savings; borrowed amounts, such as student loans and car loans; and tax-exempt income, including social security benefits, life insurance proceeds, nontaxable pensions, gifts, and tax-exempt interest.

Only the amount of a dependent's own funds that is actually spent on support is counted. Scholarships received by full-time students are not included in total support.

TAX TIPS

★★★★★★★★★

The gross income test exceptions do not apply to a son-in-law or daughter-in-law. The exceptions only apply to the *children* of a taxpayer.

PERSON

TO

PERSON

You will be asking very personal questions when trying to determine if the support test is met. As always, it is a good idea to explain to the taxpayer why you need to ask such personal questions. If the taxpayer becomes uncomfortable, explain that the information is necessary to help determine the correct tax liability.

TAX TIPS

★★★★★★★★★

When determining who provides more than half of the support, it is the *dollar amount* of support provided, not the period of time the support was provided, that counts.

TAX TIPS

★★★★★★★★★

The amount used to decide whether a person meets the support test is different from that used for the gross income test. The gross income test considers the dependent's taxable income only. The support test considers *all* income of the dependent, both taxable and nontaxable.

TAX TIPS

★★★★★★★★★

Remind taxpayers that they must maintain good records in order to prove the amount of support provided.

Do not include in support any amounts that are:

- paid from a dependent's own funds for income and social security taxes,
- paid as life insurance premiums, or
- not spent, but saved or invested.

Total support items include food, clothing, shelter at fair rental value, education, medical and dental care, recreation, and transportation. Some support items, like food and rent, benefit more than one member of a household. Divide the value of these support items among the number of household members that benefit. Capital items like furniture, appliances, or autos should be included in support if the items are solely for the dependent's own use or benefit.

Example 1

Robin, age 20, lived all year with her parents and younger sister in an apartment. Robin earned \$4,000 from her part-time job. She saved \$1,000 for college and \$500 was withheld for income and social security taxes. Robin spent the remaining \$2,500 on clothing, transportation, and recreation.

Robin provided \$2,500 of her own support. The college savings will not be counted as support until the money is spent. The funds used to pay income and social security tax are not considered to be support.

In order for Robin's parents to claim her as a dependent, they must provide additional support of more than \$2,500. Included in support items are one-fourth of the family's rent, utilities, grocery bills, and any additional amounts paid for Robin's medical expenses and education.

Funds Belonging to the Person You Supported	
1) Total funds belonging to the person you supported, including income received (taxable and nontaxable) and amounts borrowed during the year, plus the amount in savings and other accounts at the beginning of the year	\$
2) Amount used for support	\$
3) Amount used for other purposes	\$
4) Amount in savings and other accounts at end of the year	\$
(The total of lines 2, 3, and 4 should equal line 1)	\$
Expenses for Entire Household (where the person you supported lived)	
5) Lodging (Complete item a or b)	
a) Rent paid	\$
b) If not rented, show fair rental value of home. If the person you supported owned the home, include this amount in line 19.	\$
6) Food	\$
7) Utilities (heat, light, water, etc. not included in line 5a or 5b)	\$
8) Repairs (not included in line 5a or 5b)	\$
9) Other. Do not include expenses of maintaining home, such as mortgage interest, real estate taxes, and insurance.	\$
10) Total household expenses (Add lines 5 through 9)	\$
11) Total number of persons who lived in household	
Expenses for the Person You Supported	
12) Each person's part of household expenses (line 10 divided by line 11)	\$
13) Clothing	\$
14) Education	\$
15) Medical, dental	\$
16) Travel, recreation	\$
17) Other (specify)	\$
18) Total cost of support for the year (Add lines 12 through 17)	\$
Did You Provide More Than Half?	
19) Amount the person provided for own support (line 2, plus line 5b if the person you supported owned the home)	\$
20) Amount others provided for the person's support. Include amounts provided by state, local, and other welfare societies or agencies. Do not include any amounts included on line 1.	\$
21) Amount you provided for the person's support (line 18 minus lines 19 and 20)	\$
22) 50% of line 18	\$
Is line 21 more than line 22? Yes. You meet the support test for the person. If the other exemption tests are met, you may claim an exemption for the person. No. You do not meet the support test for the person. You cannot claim an exemption for the person unless you can do so under a multiple support agreement. See <i>Multiple Support</i> , later.	

TAX TIPS

★★★★★★★★★
The taxpayers decide among themselves which one takes the exemption for the year. As a volunteer, you do not decide.

Multiple Support

Sometimes, no one person provides more than half of an individual's support, but two or more persons together do. In this situation, anyone who separately provides over 10 percent of the person's total support and meets the other tests can claim the exemption for the dependent. Nonetheless, only one person can claim the exemption. All other persons who provided more than 10 percent of the support and who meet the other tests must sign a written statement agreeing not to claim the exemption for that year. **Form 2120, Multiple Support Declaration**, is used for that purpose. The person who claims the exemption attaches Form(s) 2120 to his or her current year's tax return.

Example 2

Henry E. and Harold S. Rowan each provide more than 10 percent of the total support of their mother Margaret S. Rowan, but neither provides more than 50 percent. Together, Henry and Harold provide more than 50 percent. They decide that Henry will claim the exemption this year. Exhibit 2 shows the completed Form 2120 that Henry will attach to his return.

Exhibit 2

Henry's Form 2120

Form 2120 (Rev. October 2002) Department of the Treasury Internal Revenue Service	Multiple Support Declaration ▶ Attach to Form 1040 or Form 1040A.	OMB No. 1545-0071 Attachment Sequence No. 114
Name(s) shown on return Henry E. Rowan		Your social security number 000 00 4877
During the calendar year <u>2002</u> , the eligible persons listed below each paid over 10% of the support of: <u>Margaret S. Rowan</u> Name of person supported		
I have a signed statement from each eligible person waiving his or her right to claim this person as a dependent for any tax year that began in the above calendar year.		
<u>Harold S. Rowan</u> Eligible person's name		000 00 2780 Social security number
<u>123 Main Street, Springfield, VA 22140</u> Address (number, street, apt. no., city, state, and ZIP code)		
Eligible person's name		Social security number
Address (number, street, apt. no., city, state, and ZIP code)		
Eligible person's name		Social security number
Address (number, street, apt. no., city, state, and ZIP code)		
Eligible person's name		Social security number
Address (number, street, apt. no., city, state, and ZIP code)		

Children of Divorced or Separated Parents

The parent who has custody of the child for the greater part of the year (the custodial parent) will generally be considered as having provided over half of the child's support ***if all of the following conditions are met.***

- The child received over half of his or her total support from one or both parents.
- The parents are divorced, legally separated, separated under a written separation agreement, or have lived apart at all times during the last six months of the calendar year.
- The child was in the custody of one or both parents for more than half of the calendar year.

The custodial parent ***will not*** be considered as having provided over half of the child's support if any of the following conditions exist.

- Over half of the support of the child is considered to have been received from a third party, such as a relative or friend.
- The custodial parent signed Form 8332, *Release of Claim to Exemption for Child of Divorced or Separated Parents*, or a similar statement, that allows the noncustodial parent to claim the exemption (this statement must be attached to the noncustodial parent's return).
- A decree or agreement that went into effect after 1984 unconditionally states that the noncustodial parent can claim the child as a dependent.
- A qualified pre-1985 agreement provides that the noncustodial parent shall be entitled to the exemption for the child and the noncustodial parent contributed at least \$600 toward the child's support during the tax year, unless the pre-1985 agreement is modified after 1984 to specify that this provision will not apply.

TAX TIPS

★★★★★★★★★
A copy of Forms 2120 and 8332 can be found in the Tax Forms Booklet Appendix, which is part of your package.

Example 3

Ellen M. and Richard A. Stone are divorced. Under the terms of the 1984 divorce, Richard has custody of their two children, Alan R. and Mary E. The divorce decree specifies that Ellen can claim the dependency exemptions. Ellen provided \$1,500 of support for each child. Assuming all other tests are met, Ellen can claim both children as dependents.

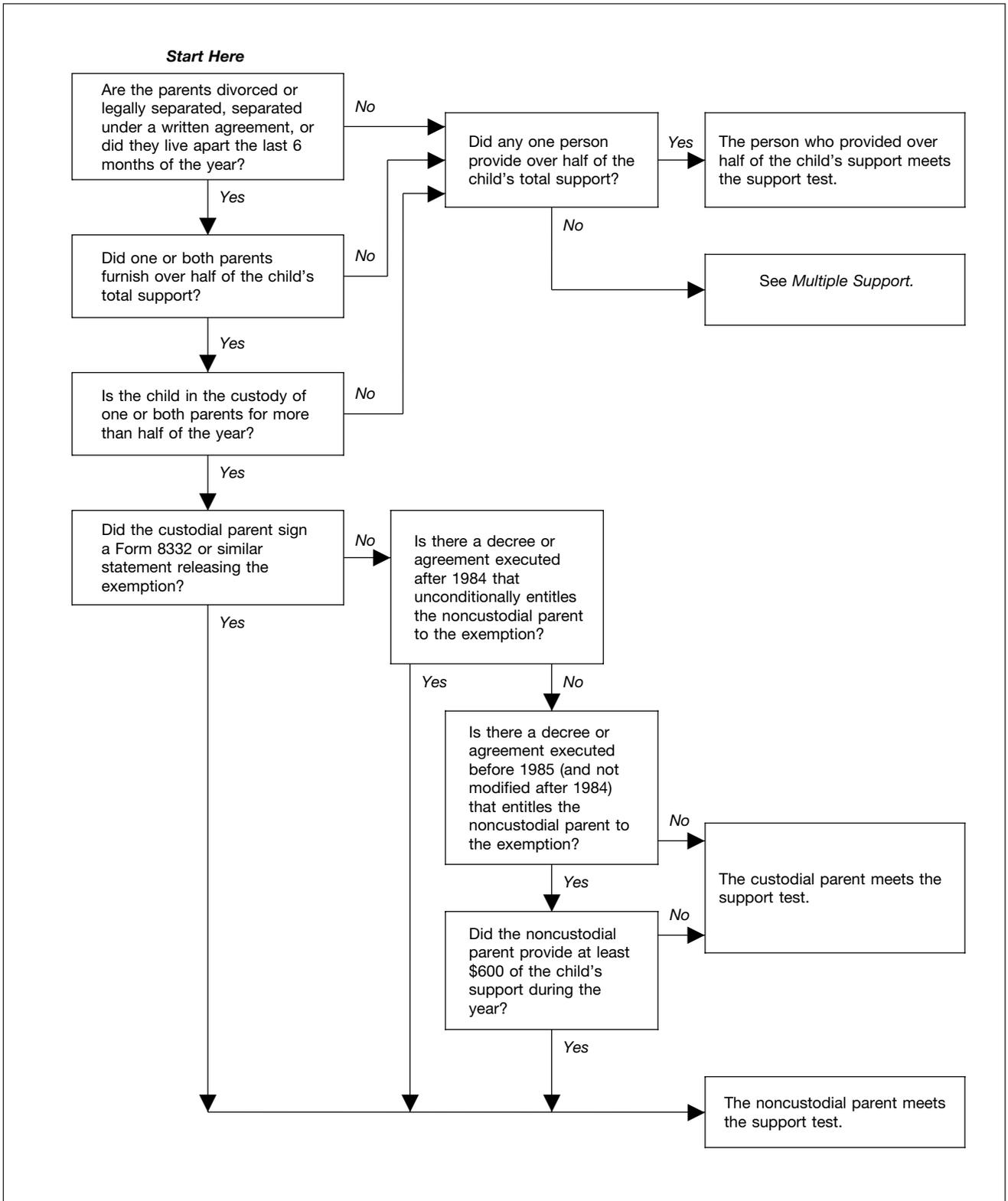
If Ellen had provided only \$500 of support for each child, she could not claim dependency exemptions for the two children. To claim the exemptions, she must provide at least \$600 of support for each child.

If the divorce occurred after 1984 and Richard and Ellen had agreed that Ellen would claim the dependency exemptions for the children, Ellen would attach Form 8332 or a similar statement to her tax return. Exhibit 3 shows a completed Form 8332 for Ellen.

Exhibit 3

Ellen's Form 8332

Form 8332 (Rev. December 2000) Department of the Treasury Internal Revenue Service	Release of Claim to Exemption for Child of Divorced or Separated Parents ▶ Attach to noncustodial parent's return each year exemption is claimed. Caution: Do not use this form if you were never married.	OMB No. 1545-0915 Attachment Sequence No. 115
Name of noncustodial parent claiming exemption <u>Ellen M. Stone</u>		Noncustodial parent's social security number (SSN) ▶ <u>000:00:2338</u>
Part I Release of Claim to Exemption for Current Year		
I agree not to claim an exemption for <u>Alan R. Stone and Mary E. Stone</u> <small style="margin-left: 300px;">Name(s) of child (or children)</small>		
for the tax year 20 <u>02</u> .		
<u>Richard A. Stone</u> <small>Signature of custodial parent releasing claim to exemption</small>	<u>000:00:3823</u> <small>Custodial parent's SSN</small>	<u>3/26/2003</u> <small>Date</small>
Note: If you choose not to claim an exemption for this child (or children) for future tax years, also complete Part II.		



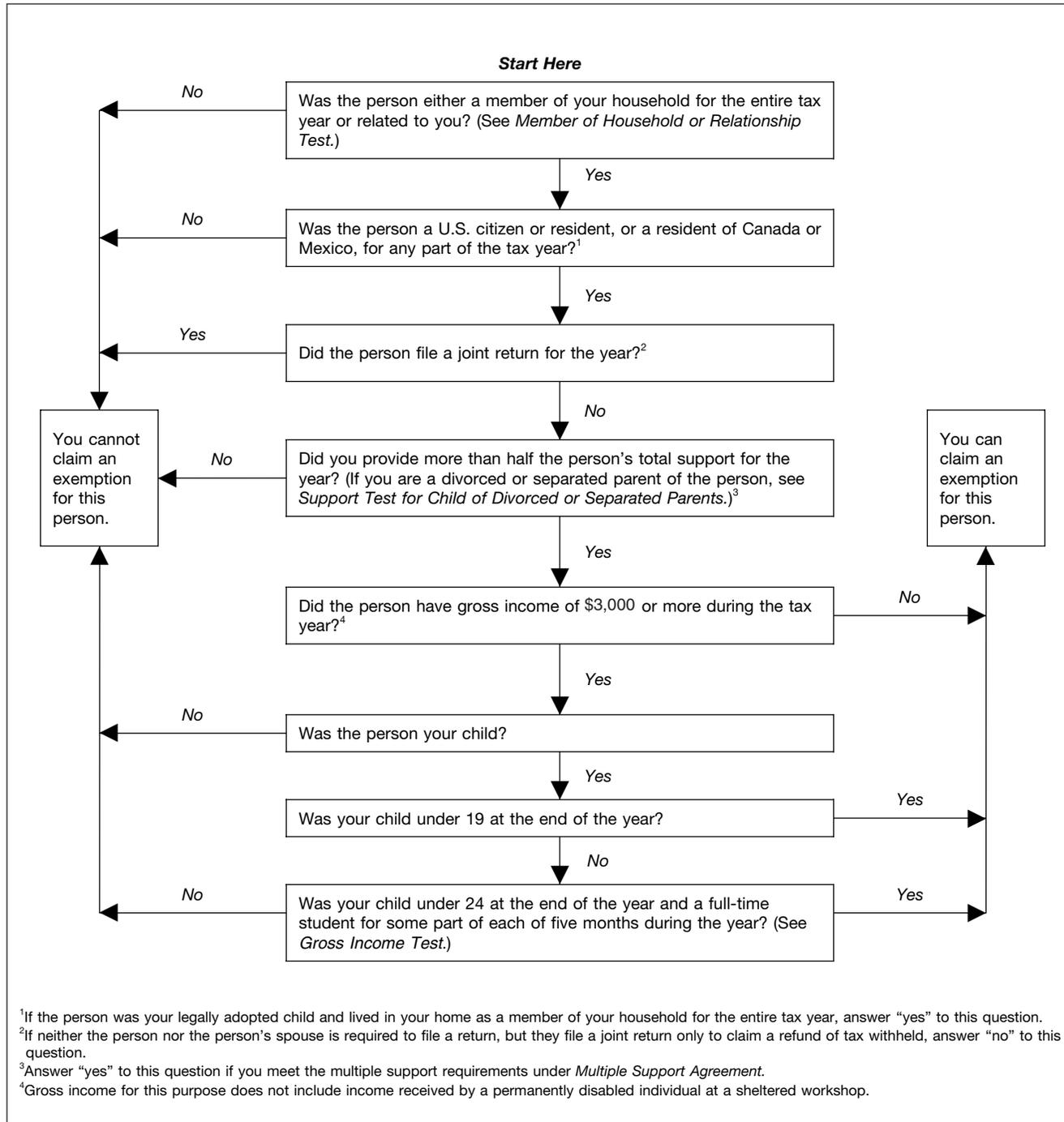
DETERMINING THE NUMBER OF EXEMPTIONS TO CLAIM

When determining the number of exemptions to claim, first look at the personal exemptions and then review each of the tests for dependency exemptions. There are many factors to consider as well as several major exceptions.

REMEMBER: Do not claim an exemption for a person who can be claimed on another return.

Exhibit 5

Can You Claim an Exemption for a Dependent?



¹If the person was your legally adopted child and lived in your home as a member of your household for the entire tax year, answer "yes" to this question.
²If neither the person nor the person's spouse is required to file a return, but they file a joint return only to claim a refund of tax withheld, answer "no" to this question.
³Answer "yes" to this question if you meet the multiple support requirements under *Multiple Support Agreement*.
⁴Gross income for this purpose does not include income received by a permanently disabled individual at a sheltered workshop.

COMPLETING THE EXEMPTION SECTION OF FORMS 1040A AND 1040

Exemptions are claimed on lines 6a through 6d. The taxpayer's personal exemption is claimed on line 6a. The personal exemption for the taxpayer's spouse is claimed on line 6b. The total of lines 6a and 6b is entered on the line in the right-hand margin. The dependency exemptions are claimed on line 6c. The columns on line 6c are self explanatory. In column 3, enter the specific relationship for each dependent: son, daughter, grandson, granddaughter, etc. Column 4 is checked if the taxpayer's dependent is also a qualifying child for the child tax credit (see lesson 11). The line 6c exemptions are totaled on the three right-hand-margin lines that relate to:

- Children who lived with the taxpayer,
- Children who did not live with the taxpayer due to divorce or separation, and
- Other dependents not entered on the lines above.

Line 6d shows the total number of exemptions (See Exhibit 6).

TAX TIPS

★★★★★★★★★

It is possible to claim "0" exemptions if another person can claim the taxpayer as a dependent.

Exemptions If more than six dependents, see page 22.	6a <input checked="" type="checkbox"/> Yourself. If your parent (or someone else) can claim you as a dependent on his or her tax return, do not check box 6a.				No. of boxes checked on 6a and 6b	2
	b <input checked="" type="checkbox"/> Spouse				No. of children on 6c who:	
	c Dependents:				• lived with you	
	(1) First name Last name				1	
	(2) Dependent's social security number				• did not live with you due to divorce or separation (see page 24)	
	(3) Dependent's relationship to you				Dependents on 6c not entered above	
(4) <input checked="" type="checkbox"/> if qualifying child for child tax credit (see page 23)				Add numbers on lines above		
d Total number of exemptions claimed.				3		

TAX TIPS
 ★★★★★★★★★★
 Be sure to use the words "son," "daughter," "grandson," and "granddaughter" on line 6c, column 3. If you use the word "child," there may be a delay in processing the return.

TAXWISE HINTS

Tax law help is available at any point of tax preparation by pressing F1 for tax assistance.

When entering the information for each child click on the DC (Dependent Care) and the EIC (Earned Income Credit) boxes, if applicable, even if you are not sure if the taxpayer will qualify. The program will automatically determine the CTC (Child Tax Credit) based on data you put in the system. EIC will be correctly computed if the taxpayer qualifies.

TAX TIPS
 ★★★★★★★★★★
 Social Security numbers are generally required for all dependents. Failure to enter the correct social security number may cause the return to be processed without the benefit of the dependency exemption. This may result in increased tax or decreased refund.

▶▶ SUMMING UP THIS SECTION ◀◀

There are two types of exemptions: personal and dependency. Each exemption reduces taxable income by \$3,000 in 2002.

A personal exemption can be claimed for a taxpayer and spouse if neither the taxpayer nor the spouse can be claimed on another taxpayer's return.

To claim a dependency exemption, the dependent must meet all of 5 tests.

1. The Member of Household or Relationship Test.
2. The Citizen or Resident Test.
3. The Joint Return Test.
4. The Gross Income Test.
5. The Support Test.

There are two exceptions to the gross income test.

- ▶ Taxpayers' children under age 19.
- ▶ Taxpayers' children under age 24 who are full-time students.

There are two exceptions to the support test.

- ▶ The multiple-support agreement.
- ▶ Children of divorced or separated parents.

Exercises

1. Janice is 18 years old and a full-time student. She can be claimed as a dependent on her parents' tax return. Janice will file Form 1040EZ to report income from her summer job. How many personal exemptions can Janice claim on her return? _____
2. Tom Brown supports his wife's uncle Jim (her mother's brother), who lives in another city. The Browns file a joint return. Can the Browns claim Jim as a dependent if all other tests are met? _____
3. Ruth filed a joint return with her husband whom she married in November. They claimed two personal exemptions on their return. Ruth had no income; her husband had \$10,600 income. Can Ruth's father, who supported her and paid for the wedding, claim her as a dependent on his return? _____
4. Joe is 65 years old and lives with his son and daughter-in-law. In 2002, Joe's taxable pension income was \$4,700. Can Joe's son and daughter-in-law claim a dependency exemption for Joe if all other tests are met? _____
5. Randy's son, Paul, earned \$4,300 last year. Paul is 18 years old and started college in September 2002. Is the gross income test met? _____
6. Traci's mother received \$3,500 in social security payments and \$600 in interest. Traci paid \$1,500 for her food and \$500 for her medical bills. Her mother paid \$2,400 for lodging, \$300 for recreation, \$150 for clothes, \$100 for transportation, \$400 for life insurance premiums, and \$200 for a television set.
 - A. What is the total support for Traci's mother? _____
 - B. How much did Traci contribute toward her mother's support? _____
 - C. How much did Traci's mother contribute toward her support? _____
 - D. Can Traci claim a dependency exemption for her mother? _____

7. Mrs. Wood has three children, Mark, Tim, and Mary. Each child contributes toward Mrs. Wood's support. Mark provides 45 percent, Tim, 35 percent, and Mary, 10 percent.
- A. Which, if any, of her children can claim a dependency exemption for Mrs. Wood under a multiple-support agreement? _____
- B. If Mark is to claim the dependency exemption, who must sign a statement waiving his/her right to claim Mrs. Chase as a dependent? _____
8. Under the terms of Peter's pre-1985 divorce decree, his former wife has custody of their child. The decree states that Peter can claim the exemption. He provided \$700 toward the child's support. Can he claim the exemption? _____

Exercise 1

0

Exercise 2

Yes; Jim is related by blood to Mrs. Brown.

Exercise 3

No, the husband has a filing requirement

Exercise 4

No; His gross income equals or exceeds the exemption amount of \$3,000.

Exercise 5

Yes; Paul is under the age of 19.

Exercise 6

- A. \$5,150 ($\$1,500 + \$500 + \$2,400 + \$300 + \$150 + \$100 + \200)
Note that life insurance premiums are not considered support.
- B. \$2,000 ($\$1,500 + \500)
- C. \$3,150 ($\$2,400 + \$300 + \$150 + \$100 + \200)
Note that life insurance premiums are not considered support.
- D. No; he did not provide more than half of her support.

Exercise 7

- A. Mark or Tim are eligible to claim the exemption. Both provide more than 10 percent of Mrs. Wood's support. Mary is not eligible since she does not provide more than 10 percent of the support.
- B. Only Tim must sign. Mary is not eligible to take the exemption. Therefore, she does not have to sign a waiver.

Exercise 8

Yes; Peter provided at least \$600 in support.

TAX TIPS

★★★★★★★★★
The *Filing Status* section of Form 1040A and the *Filing Status* section of Form 1040 are identical.

TAX TIPS

★★★★★★★★★
Remember that to file Form 1040EZ, the taxpayer (and spouse), must be under age 65 on 1/1/2003 and not blind at the end of 2002.

TAX TIPS

★★★★★★★★★
If more than one filing status applies to the taxpayer, choose the one that will give the lowest tax.

SINGLE

A taxpayer is considered **single** if, on the last day of the year, either of the following is true.

- The taxpayer was never married.
- The taxpayer was legally separated, according to state law, under a decree of divorce or separate maintenance.

A taxpayer can also be considered **single** if the taxpayer was widowed before January 1, 2002, and did not remarry in 2002. However, the taxpayer may be able to use another filing status that will give a lower tax. See *Head of Household* and *Qualifying Widow(er) with Dependent Child*, later.

MARRIED FILING A JOINT RETURN

Taxpayers may use the **married filing jointly** status if they are married. They are considered married if, on the last day of the year, one of the following applies:

- They are married and live together as husband and wife.
- They live together in a common-law marriage recognized in the state where they now live or in the state where the common-law marriage began.
- They are married and live apart but are not legally separated under a decree of divorce or separate maintenance.
- They are separated under an interlocutory (not final) divorce decree.
- The taxpayer's spouse died during the year and the taxpayer has not remarried.

If taxpayers file a joint return, combine the husband's and wife's tax items (for example, income) on the same return. Both the husband and wife must sign the return and both are responsible for any tax owed on that return. Taxpayers can choose the married filing joint status even if only one spouse has income.

Taxpayers filing a joint return generally have a lower tax than their combined tax for any other filing status.

MARRIED FILING A SEPARATE RETURN

Taxpayers who are married may choose to file separately. The husband and wife report their own incomes and deductions on separate returns. Taxpayers may choose the **married filing separately** status even if one spouse had no income.

If the taxpayers live in a community property state, they must follow state law to determine their separate income. For more information, see Publication 555, *Community Property*.

If a married couple files separately and one spouse itemizes deductions, the other spouse must also itemize deductions because he or she cannot take the standard deduction. See Lesson 5 for more information on itemized deductions.

Taxpayers filing separate returns generally have a higher tax than when filing jointly. Occasionally, however, separate returns may result in a lower tax. If you think this might be the case, compute the tax liability for (a) married filing jointly and (b) married filing separately. Choose the filing status that results in the lower tax.

When a married taxpayer files separately, the taxpayer must show his or her spouse's name and social security number on the return.

HEAD OF HOUSEHOLD

In general, the **head of household** status is for unmarried taxpayers (or those considered unmarried) who pay more than half the cost of keeping up a home for a qualified relative during the year.

Generally, taxpayers who file under the **head of household** filing status have a lower tax than if they file as single. If they qualify, taxpayers should use the head of household status instead of the single status.

Head of Household Qualifications

1. The taxpayer must be unmarried (single, divorced, or legally separated) on the last day of the year

OR

The taxpayer must meet the tests for married persons living apart with dependent children (explained later in this lesson)

AND

2. The taxpayer must have paid more than half the cost of keeping up a home that was the main home for more than half the year (except for temporary absences) of any of the following:

TAX TIPS

★★★★★★★★★

If a taxpayer is married, with a dependent child, and lived apart from the spouse during the last six months of the year, the taxpayer may be able to file as head of household. See the head of household requirements later in this lesson.

TAX TIPS

★★★★★★★★★

Some married couples do not want to file married filing jointly, even though it results in the lowest total tax. For example, one spouse may not want to be responsible for the other spouse's amount of tax owed. In such a case, the taxpayers may use the married filing separately filing status.

ALERT



For information on innocent spouse relief, see Publication 971, *Innocent Spouse Relief*.

TAX TIPS

★★★★★★★★★

The head of household filing status may be confusing. Many filing status errors involve the head of household status. Be sure that ALL of the qualifications are met before selecting the head of household status.

- A. The taxpayer's unmarried child—who must have lived with the taxpayer but does not have to have been the taxpayer's dependent,
- B. The taxpayer's foster child—who must have lived with the taxpayer and must have been the taxpayer's dependent (To qualify as a dependent, a foster child must live with the taxpayer for the entire tax year.), or
- C. Certain relatives (see the list at the end of this discussion) who lived with the taxpayer and who were the taxpayer's dependents.

EXCEPTION: The taxpayer may claim head of household filing status if the taxpayer's parent is claimed as a dependent, even if the parent does not live with the taxpayer. However, the taxpayer must pay more than half the cost of maintaining the parent's home for the entire year.

- D. The taxpayer's married child—who must have lived with the taxpayer and who must have been the taxpayer's dependent unless:
 - The child is not a dependent because the taxpayer signed a written declaration allowing the noncustodial parent to claim the child as a dependent, or
 - The child is not a dependent because the noncustodial parent provides at least \$600 of support for the child and claims the child as a dependent under a pre-1985 divorce decree or agreement.

“Child” includes:

- Grandchild; stepchild; adopted child

“Relative” includes:

- Parent; grandparent
- Brother; sister; stepbrother; stepsister
- Half brother; half sister
- Stepmother; stepfather
- Mother-in-law; father-in-law
- Brother-in-law; sister-in-law
- Son-in-law; daughter-in-law

AND (if related by blood)

- Uncle or aunt; nephew or niece

“Relative” does not include cousins and more distant relatives.

Keeping Up the Home

The taxpayer must pay more than half the cost of keeping up the home. The cost of keeping up a home includes: rent, mortgage interest, real estate taxes, insurance on the home, repairs, utilities, domestic help, and food eaten in the home. Welfare payments are not considered amounts that the taxpayer furnishes to keep up a home.

The home must have been the main home for more than half the year, except for temporary absences. Temporary absences include those for school, vacation, illness, business, or military service.

The following chart may help you decide who is eligible to claim head of household filing status.

Exhibit 7

Qualifying Relations for Head of Household		
Relationship to Taxpayer	Must Live with Taxpayer?	Must be Taxpayer's Dependent?
1. Unmarried child, grandchild, or stepchild	Yes	No
2. Married child, grandchild, or stepchild	Yes	Yes*
3. Foster child	Yes***	Yes
4. Mother or father	No	Yes
5. Other relatives**	Yes	Yes

Exceptions:

*The married child does not have to be the taxpayer's dependent if a noncustodial parent claims the child as a dependent under the rules for children of divorced or separated parents.

**Cousins and more distant relatives do not qualify as "relatives" in determining head of household status.

NOTE: The taxpayer's home must be the main home of the relative for more than half the year. The relative cannot be a person who files a joint return.

***The foster child must live with the taxpayer for the entire year.

TAX TIPS

★★★★★★★★★
Taxpayers cannot claim the head of household status if they can only claim a dependent under a multiple support agreement.

TAX TIPS

★★★★★★★★★
Some married taxpayers qualify as head of household and do not know it. They think they must use the married filing separately filing status. You can be a big help to these taxpayers by advising them to use the head of household filing status to get the lower tax.

TAX TIPS

★★★★★★★★★★

The IRS cannot process a head of household return unless a dependent's name is entered in the exemptions section or a nondependent's name is entered on the line next to the Head of Household filing the taxpayer's return.

ALERT



Parents of children who are presumed to have been kidnapped by someone who is not a family member may be able to take the child into account in determining their eligibility for the head of household or qualifying widow(er) filing status, deduction for dependents, child tax credit, and the earned income credit (EIC). For details, see Publication 501, *Exemptions, Standard Deductions, and Filing Information* or Publication 596, *Earned Income Credit*.

Married Persons Living Apart With Dependent Children

Some married taxpayers who live apart from their spouses may be considered unmarried for tax purposes. If so, these taxpayers are permitted to file as head of household and receive the benefit of lower tax amounts.

A married taxpayer can file as head of household if:

1. The taxpayer files a separate return,
2. The taxpayer paid more than half the cost of keeping up his or her home for the year,
3. The taxpayer's spouse did not live in the home during the last six months of the year,
4. The taxpayer's home was the main home of the taxpayer's child, stepchild, or adopted child for more than half of the year or of the taxpayer's foster child for the entire year, and
5. The taxpayer claims the child, stepchild, adopted child, or foster child as a dependent, unless one of the following exceptions for divorced or separated parents applies:
 - the taxpayer signed a statement allowing the noncustodial parent to claim the child as a dependent, or
 - the noncustodial parent provided at least \$600 for the child's support and can claim the dependent under a pre-1985 agreement.

Reporting Head of Household Filing Status

Taxpayers must enter the name of the person who qualifies them for the head of household status. If the person is a dependent, enter the dependent's name on line 6c of the exemption section of the tax return. If the qualifying person is not a dependent, enter the name of the nondependent person on line 4 in the filing status section of the tax return.

Example 4

Samantha is divorced and provided over half the cost of keeping up a home. Her five-year-old daughter, Pam, lived with her for seven months last year. Samantha does not claim Pam as a dependent; her ex-husband does.

Samantha may use head of household status. Samantha must write Pam's name in the space on Form 1040 or 1040A, on line 4.

Exhibit 8

Samantha's Form 1040A, page 1

Filing status	1 <input type="checkbox"/> Single	4 <input checked="" type="checkbox"/> Head of household (with qualifying person). (See page 21.)
	2 <input type="checkbox"/> Married filing jointly (even if only one had income)	If the qualifying person is a child but not your dependent, enter this child's name here. ► <u>Pam</u>
	3 <input type="checkbox"/> Married filing separately. Enter spouse's SSN above and full name here. ► _____	5 <input type="checkbox"/> Qualifying widow(er) with dependent child (year spouse died ► _____). (See page 22.)
	Check only one box.	

QUALIFYING WIDOW(ER) WITH DEPENDENT CHILD

A widow or widower, with one or more dependent children, may be able to use the **qualifying widow(er)** with dependent child filing status. This filing status yields the lowest tax (the same tax for married filing jointly).

If the taxpayer's spouse died during 2000 or 2001 and the taxpayer did not remarry before the end of 2002, the taxpayer may be able to file as a qualifying widow(er) with dependent child. To qualify, the taxpayer must:

- Have been entitled to file a joint return for the year the spouse died (It does not matter whether or not a joint return was actually filed.),
- AND
- Have a child, foster child, adopted child, or stepchild who qualifies as the taxpayer's dependent for the year,
- AND
- Have furnished over half the cost of keeping up a home that was the main home of the child for the entire year.

An "adopted child" includes a child placed with the taxpayer by an authorized placement agency for legal adoption.

Social Security survivor benefits received on behalf of the child are considered to be amounts furnished by the child, not by the parent.

In the year a taxpayer's spouse dies, if the taxpayer does not remarry, he or she can use the married filing jointly filing status or married filing separately filing status and can claim an exemption for the deceased spouse. For two years after the year of death, the taxpayer may file as a qualifying widow(er) with dependent child, but may not claim an exemption for the deceased spouse. After the second year following the year of death, the taxpayer can no longer use the qualifying widow(er) filing status. The taxpayer may use either the head of household or single filing status depending on his or her situation then.

The following chart may help you decide which filing status to use for a taxpayer with a qualifying dependent if the spouse is deceased and the taxpayer has not remarried.

PERSON

TO

PERSON

When seeking detailed information, be sensitive to the taxpayer's feelings. For example, talking about a deceased spouse may be very upsetting for a taxpayer regardless of how much time has passed since the death of his or her spouse.

Exhibit 9

Filing Status After Death of Spouse		
Tax Year	Filing Status	Exemption for Deceased Spouse?
1. Year of death	Married (joint)	Yes
	OR Married (separate)	Yes
2. First year after death	Qualifying widow(er)*	No
3. Second year after death	Qualifying widow(er)*	No
4. After the second year after death	Head of household**	No
	OR Single	No

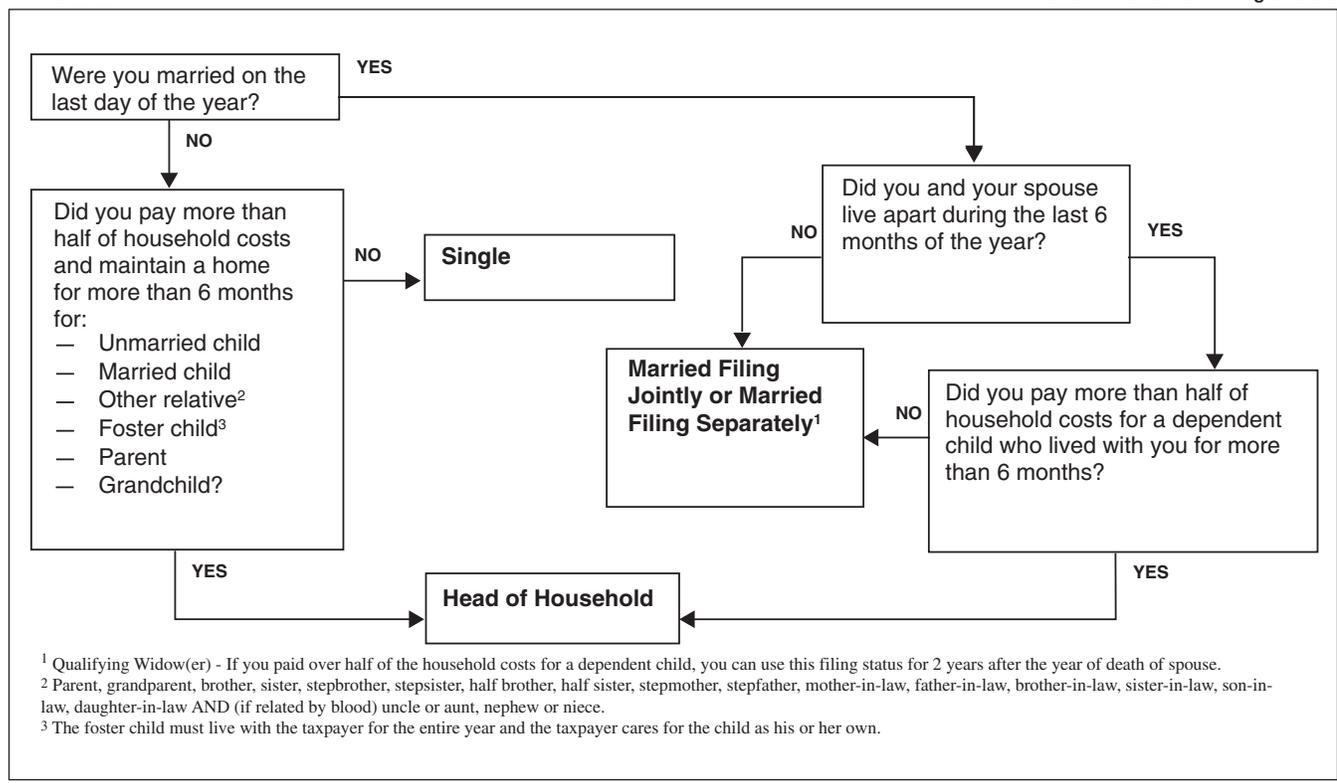
*With a qualifying dependent.
**With a qualifying relative.

Taxpayers who use the qualifying widow(er) status must list the year of the spouse’s death on line 5 of Form 1040A or 1040.

You may find the following flowchart helpful in determining the correct filing status.

Exhibit 10

Determination of Filing Status



TaxWise HINTS

When using TaxWise to prepare a tax return, you will need to have the Social Security Number of anyone who qualifies the taxpayer for Head of Household filing status and is not the taxpayer's dependent.

For Qualifying Widow(er) filing status, you must enter the year of death of the deceased spouse.

For Married Filing Separate status, you will need the spouse's full name and Social Security number.

▶▶ SUMMING UP THIS SECTION ◀◀

When completing their tax returns, taxpayers can use one of five filing statuses:

Tax Status

(from lowest tax to highest tax)

1. Married filing jointly*
2. Qualifying widow(er) with dependent child*
3. Head of household
4. Single
5. Married filing separately

* Numbers 1 and 2 yield the same (lowest) tax.

Filing status is indicated on lines 1 through 5 of Forms 1040A and 1040. Selecting the correct filing status is one of the most important aspects of completing a tax return because the filing status factors in how much tax will be due. Remember that filing status requirements do not change, regardless of the tax form used. If a taxpayer is qualified to use more than one filing status, choose the one that will result in the lowest tax.

Exercises

9. Carol and Roger were married in 2001. They are not divorced, but lived apart all of 2002. They are not legally separated under a decree of divorce or separate maintenance. They have no children. Can they use the married filing jointly status? _____
10. Martin does not know which filing status to use. You ask if he is married. He answers that he got divorced in December but supported his wife all year and has not remarried. Can Martin and his ex-wife file a joint return? _____
11. Ginger is single and paid more than half the cost of keeping up her home. Her grandmother lived with her all year. Ginger claims her grandmother as a dependent. What is Ginger's filing status? _____
12. Bill is single and lives alone. He paid over half the cost of maintaining a home for his father for the entire year. He claims his father as a dependent. What is Bill's filing status? _____
13. Franklin is single and lives alone. He paid over half the cost of maintaining a separate home for his father. He does not claim his father as a dependent. What is Franklin's filing status? _____
14. Mrs. Carmine tells you that she is divorced and that her 21-year-old unmarried son lived with her all year. She paid for their rent and food and provided over half of her son's total support. She cannot claim her son as a dependent because he earned \$4,000 and is not a student. Her son used his earnings to pay for his car, clothing, and entertainment. Can Mrs. Carmine file as head of household? _____
15. Kathy lived with her unemployed roommate, Sandra, for the entire year. Kathy had to pay more than half of the cost of keeping up their apartment. Can Kathy file as head of household? _____

16. Jack has lived apart from his wife for several years. Their children live with his wife but Jack pays over half the children's support. What filing status can Jack use?

17. Lily left her husband in August 2002. She took her children with her. She supported the children during all of 2002 and will claim them as dependents. Lily will not file a joint return with her husband. Which filing status should Lily use in 2002? _____
18. Rose and her husband separated in October 2002, but were still married on December 31, 2002. What filing status can she use? _____
19. Dick's wife died in 2000. Dick has not remarried. Dick provides all of the support for his two dependent children. What will be Dick's filing status for 2003? _____



Exercise 9

Yes

Exercise 10

No

Exercise 11

Head of household

Exercise 12

Head of household

Exercise 13

Single

Exercise 14

Yes

Exercise 15

No; Sandra is not a qualifying relative.

Exercise 16

Married filing jointly or married filing separately.

Exercise 17

Married filing separately; she lived with her husband during part of the last six months of 2002.

Exercise 18

Either married filing jointly or married filing separately.

Exercise 19

Head of household; he could claim qualifying widower for 2001 and 2002 only.

WHO MUST FILE—WHO SHOULD FILE

WHO MUST FILE?

To decide who must file a tax return, you will need to know the individual's:

- filing status,
- age,
- gross income,

and if:

- special taxes might be owed on different types of income,
- some of the income is excludable or exempt,
- the individual can be claimed as a dependent on another's tax return,
- the individual is blind, or
- the individual received advance earned income credit payments.

You may not be familiar with some of the terms used on the list. These terms will be explained in later lessons. For now, concentrate on learning how to use the charts and checklists.

How to Use the Charts and Flowcharts

You will use a set of charts to determine who must file. An individual who cannot be claimed as a dependent on another taxpayer's return will use *Chart A—For Most People*. Based on the individual's circumstances, a person who can be claimed as a dependent on another taxpayer's return will use one of the other charts. *Chart C—Other Situations When You Must File* should be reviewed for every individual.

COMMON QUERIES

In the instructions to Forms 1040EZ, 1040A, and 1040, you will find charts that help determine who must file and who should file.

POTENTIAL PITFALLS



If a checklist or chart indicates that a person must file a return, he or she should do so even if no tax is owed. If a minor child must file a return but cannot do so, the child's parent or guardian must complete and sign a return for the child.

Exhibit 11

Chart A—For Most People

If your filing status is...	AND at the end of 2002 you were*	THEN file a return if your gross income** was at least...
Single	Under 65 65 or older	\$ 7,700 8,850
Married filing jointly***	under 65 (both spouses) 65 or older (one spouse) 65 or older (both spouses)	\$13,850 14,750 15,650
Married filing separately	Any age	\$ 3,000***
Head of household (see page 19)	Under 65 65 or older	\$ 9,900 11,050
Qualifying Widow(er) with dependent child (see page 19)	Under 65 65 or older	\$10,850 11,750
<p>*If you turned age 65 on January 1, 2003, you are considered to be age 65 at the end of 2002.</p> <p>**Gross income means all income you received in the form of money, goods, property, and services that are not exempt from tax including any income from sources outside the United States (even if you may exclude part or all of it). Do not include social security benefits unless you are married filing a separate return and you lived with your spouse at any time in 2002.</p> <p>***If you did not live with your spouse at the end of 2002 (or on the date your spouse died) and your gross income was at least \$3,000, you must file a return regardless of your age.</p>		

Chart B—For Children and Other Dependents

If your parent (or someone else) can claim you as a dependent, use this chart to see if you must file a return.

In this chart, **unearned income** includes taxable interest and dividends. **Earned income** includes wages, tips, and taxable scholarship and fellowship grants.

*If your gross income was \$3,000 or more, you usually cannot be claimed as a dependent unless you were under age 19 or a student under age 24. For details, see **Pub. 501, Exemptions, Standard Deduction, and Filing Information.***

Single dependents. Were you **either** age 65 or older **or** blind?

- No.** You must file a return if **any** of the following apply.
 - Your **unearned income** was over \$750.
 - Your **earned income** was over \$4,700.
 - The total of your unearned and earned income was more than the larger of—
 - \$750, **or**
 - Your earned income (up to \$4,450) plus \$250.
- Yes.** You must file a return if **any** of the following apply.
 - Your earned income was over \$5,850 (\$7,000 if 65 or older **and** blind).
 - Your unearned income was over \$1,900 (\$3,050 if 65 or older **and** blind).
 - Your gross income was more than—

<u>The larger of:</u>	PLUS	<u>This amount:</u>
<ul style="list-style-type: none"> • \$750, or • Your earned income (up to \$4,450) plus \$250 	}	\$1,150 (\$2,300 if 65 or older and blind)

Married dependents. Were you **either** age 65 or older **or** blind?

- No.** You must file a return if **any** of the following apply.
 - Your gross income was at least \$5 and your spouse files a separate return and itemizes deductions.
 - Your unearned income was over \$750.
 - Your earned income was over \$3,925.
 - The total of your unearned and earned income was more than the larger of—
 - \$750, or
 - Your earned income (up to \$3,675) plus \$250.
- Yes.** You must file a return if **any** of the following apply.
 - Your earned income was over \$4,825 (\$5,725 if 65 or older **and** blind).
 - Your unearned income was over \$1,650 (\$2,550 if 65 or older **and** blind).
 - Your gross income was at least \$5 and your spouse files a separate return and itemizes deductions.
 - Your gross income was more than—

<u>The larger of:</u>	PLUS	<u>This amount:</u>
<ul style="list-style-type: none"> • \$750, or • Your earned income (up to \$3,675) plus \$250 	}	\$900 (\$1,800 if 65 or older and blind)

DEPENDENTS WHO MUST OR SHOULD FILE A RETURN—CHECKLIST

The dependents listed in the following checklist must or should file a return.

Exhibit 13

Checklist—Children and Other Dependents

- A married dependent with at least \$5 of income whose spouse itemizes deductions on a separate return on Form 1040 must file a return.
- A dependent with at least \$400 of net self-employment income must file a return. (**Self-employment income** is earned income from a trade, business, farming or profession that is not paid by an employer. For example, seamstresses and lawncare workers who work for themselves (and not for someone else) are considered self-employed.)
- A dependent who is not required to file but had income tax withheld should file a return to get a refund.
- A dependent who has to pay a tax, such as the alternative minimum tax, must file a return.

OTHER SITUATIONS

Remember to review the *Chart C—Other Situations When You Must File* chart after you use the other charts.

Chart C—Other Situations When You Must File
If any of the conditions below applied to you for 2002, you must file a return.
<p>1. You owe any special taxes, such as:</p> <ul style="list-style-type: none"> • Social security and Medicare tax on tips you did not report to your employer, • Uncollected social security and Medicare or RRTA tax on tips you reported to your employer or on group-term life insurance, • Alternative minimum tax, • Tax on a qualified retirement plan, including an individual retirement arrangement (IRA), or on an Archer medical savings account (Archer MSA), or • Recapture taxes. (See instructions for line 61 in the <i>Form 1040 Instructions</i> booklet).
<p>2. You received any advance earned income credit (EIC) payment from your employer. These payments should be shown in box 9 of your W-2 form.</p>
<p>3. You had net earnings from self-employment of at least \$400.</p>
<p>4. You had wages of \$108.28 or more from a church or qualified church-controlled organization that is exempt from employer social security and Medicare taxes.</p>
<p>5. You had any gains from the sale of stock or bonds.</p>

TAX TIPS
 ★★★★★★★★★★
 Do not become discouraged if you do not understand all of the terms used in the *Other Situations When You Must File* chart. Some of the situations will be explained in later lessons. Generally, *Other Situations* go beyond the scope of the VITA/TCE Program.

WHO SHOULD FILE A RETURN?

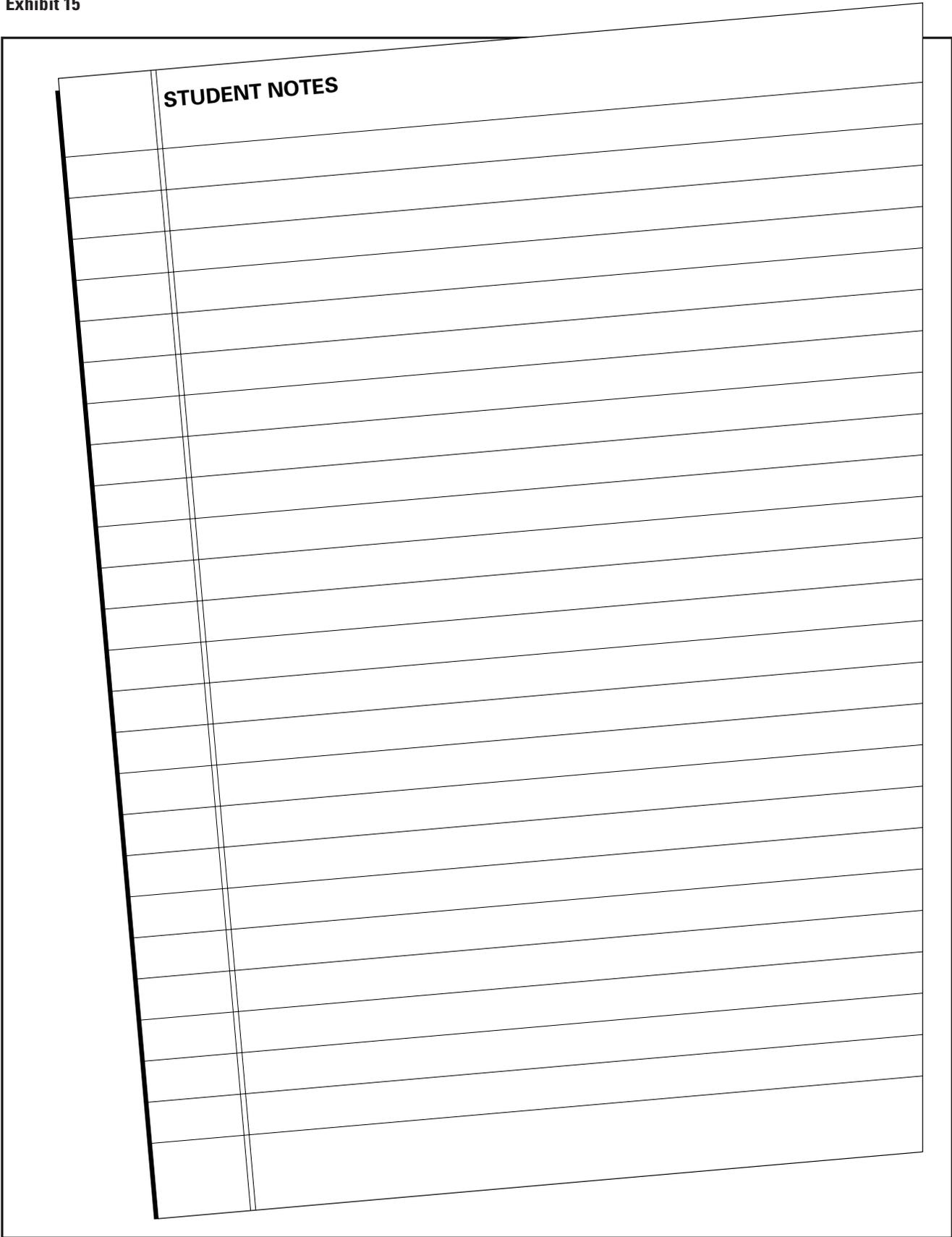
The charts, noted previously in this lesson, may indicate that an individual does not have to file a tax return. However, in three instances, individuals *should* file a return:

- to claim a refund of withheld taxes,
- to claim the earned income credit, and
- to claim the additional child tax credit.

HELPING THOSE WHO DON'T NEED TO FILE

The Reduce Unnecessary Filing Program (RUF) is intended to help certain individuals determine their need to file a federal income tax return. Use Form 9452, *Filing Assistance Program Worksheet*, to help potential unnecessary filers determine whether or not they need to file.

Thank you for helping to save time and effort for your VITA and TCE clients and for helping to reduce the cost to all taxpayers of processing unnecessary returns by helping your clients with Form 9452 and related materials, as needed.



▶▶ **SUMMING UP THIS SECTION** ◀◀

Use the charts provided in this section to determine who *must* and who *should* file a tax return.

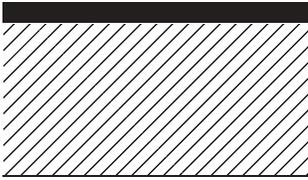
Exercises

20. Emily is married and has one dependent child. She has not lived with her husband since May and is head of household. She is under 65 and not blind. Her gross income from wages is \$15,000. Is she required to file a tax return? _____
21. Larry and Zelda are married but will not file a joint return. Both are under 65 and not blind. Larry's gross income from wages is \$30,150. Zelda's gross income is \$3,500.
- A. Is Larry required to file? _____
- B. Is Zelda required to file? _____

TAX TIPS

★★★★★★★★★★

If a taxpayer is not required to file a federal income tax return but still has federal income tax withheld, you should assist the taxpayer with completing a revised Form W-4, *Employee's Withholding Allowance Certificate*, or Form W-4P, *Withholding Certificate for Pension or Annuity Payments*.



WHO MUST FILE WHO SHOULD FILE

ANSWERS TO EXERCISES

Exercise 20

Yes

Exercise 21

A. Yes

B. Yes

WHICH FORM TO USE?

FORM 1040EZ

Form 1040EZ is for single and joint filers with no dependents. The form is no longer designed to be read by an optical scanning machine. The form instructions booklet has a worksheet for taxpayers who can be claimed as dependents.

TAX TIPS

★★★★★★★★★
Forms 1040EZ, 1040A, and 1040 are included in the *Tax Forms Booklet Appendix*.

FORM 1040A

Form 1040A is a two-page form. Page 1 of the form shows the filing status, exemptions, income, and adjusted gross income. Page 2 of the form shows the standard deduction, exemption amount, taxable income, tax, credits, payments, amount owed or refund, and signature. Form 1040A may have four schedules. Use **Schedule 1** to report interest and/or dividend income that is more than \$400. Use **Schedule 2** to report child and dependent care expenses and to figure the credit. Claim the credit for the elderly or the disabled on **Schedule 3**. This credit is explained in Lesson 15. If the taxpayer can take the earned income credit and has a qualifying child, use **Schedule EIC** to give information about that child. Schedule EIC is discussed and illustrated in Lesson 10.

TAX TIPS

★★★★★★★★★
Copies of many of these forms and schedules can be found in the *Tax Forms Booklet Appendix*, which is part of your *Publication 678 package*.

FORM 1040

Form 1040 is a two-page form. Page 1 of the form shows the filing status, exemptions, income, and adjusted gross income. Page 2 shows the standard deduction or itemized deductions, the exemption amount, taxable income, tax, credits, other taxes, payments, and the amount owed or refund due.

TAX TIPS

★★★★★★★★★
If there is no entry for a line, leave it blank. You do not have to enter zero on lines that are not used.



IRS *e-file* offers quick and easy options to traditional paper returns. These options include filing electronically through an authorized tax practitioner, over the telephone, and by personal computer. For those expecting a refund, these options all offer Direct Deposit to a bank account. For those with a balance due, paying is made easier with the option of payment by credit card or a direct debit to their bank account.

Why *e-file*? Because IRS *e-file* makes filing faster and more accurate and gets the taxpayer their refund in half the usual time....even faster with Direct Deposit!

As a volunteer, you should become familiar with these options as there will be occasions when you are called upon to answer questions from taxpayers regarding one or more of them. You may even have the opportunity to volunteer at a VITA or TCE site that has been set up to offer electronic tax filing. If so, you will receive additional specialized training on using return preparation software and on other procedures unique to this type of site.

TeleFile

Eligible 1040EZ filers, single or married filing jointly, who receive a TeleFile tax booklet and have the same address as the previous year, can file their federal income taxes by using a touch tone telephone and dialing a toll-free telephone number found in the tax booklet. (Note: Taxpayers in Georgia, Indiana, Kentucky, Maryland, Oklahoma, Oregon, or West Virginia have the option to TeleFile both their federal **and** state tax returns in the same toll-free telephone call.)

Here's how it works: the taxpayer completes the TeleFile Tax Record found in the booklet before making the call. The call, which prompts the taxpayer through recorded instructions, takes less than ten minutes. The TeleFile system calculates the tax and refund (or balance due) and then files the tax return. If the taxpayer requests Direct Deposit, a refund can be issued in as little as 10 days. **TeleFile is completely paperless; no forms are mailed to IRS, not even W-2s!** The taxpayer "signs" the return with a special Customer Service Number (CSN) provided in the booklet.

TeleFile is available 24 hours a day, seven days a week, through August 15. It is also available to users of TDD/TTY equipment. Credit card and direct debit payment options are available for balance due returns.

Because TeleFile is so easy to use, and because it is completely paperless, its use should be encouraged at every VITA and TCE site that encounters an eligible taxpayer with a TeleFile tax booklet. Even if there is no touch tone telephone available at the site, you should do everything possible to convince the taxpayer to file from home, or wherever a touch tone phone is available.

INTRODUCTION AND OBJECTIVES

In this lesson you will learn to distinguish between taxable and nontaxable income. You will also learn where to report the different types of income. In addition, you will learn to make income entries of Forms 1040EZ, 1040A, and 1040.

This lesson will help you achieve the following objectives.

- Calculate and properly report taxable income.
- Determine where capital gain distributions are reported.
- Determine who can use Schedule C-EZ.
- Accurately complete Schedule C-EZ and Schedule SE.

TAXABLE AND NONTAXABLE INCOME

Taxable income is any income that is subject to tax. It must be reported on a tax return, unless the amount is so small that the individual is not required to file a return.

The following types of income are taxable:

- Wages, salaries, bonuses, and commissions
- Certain fringe benefits
- Tips and other compensation for personal services
- Interest*
- Dividends
- Refunds of state and local taxes**
- Alimony received or separate maintenance payments received
- Business income
- Hobby income (a hobby loss is not deductible)
- Capital gains
- Gain from the sale of property
- Pensions and annuities (part may be nontaxable)
- IRA distributions (part or all may be nontaxable)
- Rents received
- Royalties
- Estate or trust income

POTENTIAL PITFALLS



Reimbursements for medical care are generally not taxable, but the reimbursement may reduce your medical expense deduction.

Likewise, you can get money tax free from your Archer medical savings account (Archer MSA) as long as you use the money to pay for qualified medical expenses. For more information see Publication 969, *Medical Savings Accounts (MSAs)* and Publication 502, *Medical and Dental Expenses*.

See also Lessons 4 and 5, later.

SPECIAL POPULATIONS



The Temporary Assistance for Needy Families program (TANF), replaced the Aid to Families with Dependent Children program (AFDC).

- Supplemental unemployment benefits
- Unemployment compensation
- Railroad retirement benefits (part may be taxable)
- Social security benefits (part may be taxable)
- Jury duty pay
- Executors' fees
- Gambling winnings (including lotteries, contests, raffles, etc.)
- Nonqualifying scholarships and fellowships
- Payments for punitive damages and damages not attributable to physical injuries or sickness
- Certain long-term care benefits. If the taxpayer received copy B of Form 1099-LTC, refer him or her to a paid professional preparer because some of the benefits may be taxable.

*Some interest is not taxable (for example, state and local bonds and qualified Series EE and Series I savings bonds used to pay for higher education expenses).

**Refunds of state and local taxes are taxable only if the taxpayer itemized deductions in the year the taxes were paid and the individual's tax liability was REDUCED because of the deduction.

Nontaxable income is income that is exempt from tax. If a return must be filed, some types of nontaxable income will be shown on the return but will not be added into the amount of income subject to tax.

The following types of income are nontaxable:

- Child support
- Federal income tax refunds
- Certain dividends on life insurance
- Gifts, bequests, and inheritances (may be subject to other taxes)
- Insurance and certain other payments for physical injury and sickness
- Interest on certain Series EE and Series I savings bonds redeemed to pay for qualified higher education expenses
- Interest on certain state and local obligations (municipal bonds)
- Most life insurance proceeds paid upon death (and certain accelerated death benefits or payments received under a life insurance contract on the life of a terminally or chronically ill individual before the individual's death)
- Public assistance payments (certain TANF payments)
- Certain railroad retirement benefits (part may be exempt)
- Social security benefits (part may be exempt)
- Veterans' disability benefits
- Workers' compensation
- Qualified scholarships and fellowships
- Certain dependent care services provided by employer
- Interest on insurance dividends left with VA
- Certain employer-provided educational benefits (up to \$5,250)
- Employer-provided assistance for qualifying adoption expenses. (Refer taxpayers with adoption expenses to a paid professional tax preparer and to Publication 968, *Tax Benefits for Adoption*)

- Restitution payments and excludable interest received by Holocaust victims, their heirs, or their estates, for persecutions are not taxable.
- Certain long-term care benefits. If the taxpayer received copy C of Form 1099-LTC, he or she is not the policyholder. The form is for information only and should be disregarded because none of the benefits are taxable to him or her. If the taxpayer received copy B of Form 1099-LTC, refer him or her to a paid professional preparer because some of the benefits may be taxable.

Example 1

LaDonna received the following income: wages, interest, child support, alimony, inheritance, workers' compensation, and lottery winnings.

The wages, interest, alimony, and lottery winnings are taxable income and will appear on LaDonna's tax return.

Child support, inheritance, and workers' compensation are nontaxable income and will not appear on LaDonna's tax return.

POTENTIAL PITFALLS



Form 1099-R reports pension income, not earned income. Form 1099-R amounts are not included on line 7 of Form 1040. They are reported on Form 1040A, lines 12a and 12b or Form 1040, lines 12a and 12b. You will learn how to report pensions in Lesson 14, *Pensions*.

Exercise 1

Indicate whether the income listed is taxable or nontaxable.

Type of Income	Nontaxable	Taxable
1. Wages	_____	_____
2. Dividends from stock	_____	_____
3. Veterans' disability benefits	_____	_____
4. Interest from savings account	_____	_____
5. Credit union dividends	_____	_____
6. Cash bonuses	_____	_____
7. Inheritances	_____	_____
8. Tips	_____	_____
9. Workers' compensation	_____	_____
10. Veterans' life insurance dividends	_____	_____

POTENTIAL PITFALLS



Volunteers should be alert to the following possible indications of fraudulent activity:

- Forms W-2 that are typed, handwritten or have noticeable corrections
- Form W-2 from a firm in the area that is different from other W-2s issued by the same firm
- Suspicious person accompanying the taxpayer and observed on other occasions
- Multiple refunds directed to the same address or P.O. Box
- Employment or earnings, that are a basis for refundable credits, that are not well documented
- Similar returns (e.g. same amount of refund, or same number of dependents, or same number of W-2s)

WHERE TO REPORT INCOME

Taxpayers can report only wages, salaries, tips, unemployment compensation, qualified state tuition program payments, Alaska Permanent Fund dividends, taxable scholarship and fellowship grants, and interest income of \$400 or less on Form 1040EZ.

In addition to the types of income that can be reported on Form 1040EZ, ordinary dividends, capital gains distribution interest income greater than \$400, IRA distributions, pension and annuity income, and taxable social security and equivalent railroad retirement benefits can be reported on Form 1040A.

These and all other types of income can be reported on Form 1040.

EARNED INCOME

Wages and Salaries

Total of wages, salaries, tips, and taxable scholarships and fellowships are reported on Form 1040EZ, line 1, Form 1040A or Form 1040, line 7.

Wages, salaries, and tips are primary examples of earned income received for services performed. Wages and salaries are compensation received. Tips are money and goods received as a gratuity by food servers, maids, porters, etc.

Form W-2. Form W-2, *Wages and Tax Statement*, reports the employee's earned income for the year. Employers should issue Form W-2 to every employee and a copy to the Social Security Administration. Box 1, *Wages, tips, and other compensation*, shows the amount of payments received in cash, goods and services, bonuses, supplemental unemployment benefits, awards, and taxable employee benefits. This amount should be included on the return.

An individual taxpayer or a couple filing jointly might have one or more W-2s from various employers. When the taxpayer and/or spouse receive W-2s from their employers, add the amounts from Box 1 of each W-2 and report the total amount on the return.

Generally, if a **household employee** earned less than \$1,300 a year while working in the employer's home, the employer is not required to provide the taxpayer with a Form W-2. However, a W-2 is required if the employer withheld federal income taxes.

If a taxpayer does not get a Form W-2, or if the one he or she gets is not correct, the taxpayer will have to contact his or her employer as soon as possible. Only an employer can **issue** a Form W-2 or a Form W-2c.

In the event that the employer prepared an incorrect W-2, a Form W2c, *Corrected Wage and Tax Statement*, should be issued. Use the W-2c amounts on the return. Be sure to attach the Form W-2c to the taxpayer's return.

All wage, salary, and tip income must be reported on the return, even if the employee did not receive a Form W-2.

If the taxpayer does not receive a Form W-2 by January 31, he or she should first contact the employer and find out if or when the Form W-2 was mailed. If after allowing a reasonable amount of time for the employer to issue or reissue the Form W-2, the Form W-2 still has not been received, he or she should contact the IRS for assistance at 1-800-829-1040, but not before February 15.

If after requesting a Form W-2 from the employer the taxpayer does not receive it by the due date of the return, he or she should file a Form 4852, *Substitute for Form W-2, Wage and Tax Statement or Form 1099-R, Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRA's, Insurance Contracts, Etc.*

The taxpayer should keep a copy of Form 4852 for his or her records and file a copy with the Social Security Administration to ensure proper social security credit.

Form 1099-MISC. Taxpayers with earnings reported on Form 1099-MISC may be considered self-employed. These amounts are reported on Schedule C-EZ or Schedule C. Net losses and profits are reported on line 12 of Form 1040. Self-employment income is discussed later in this lesson.

Tip Income

All tip income is taxable. Individuals who receive **\$20 or more per month in tips** while working one job must report their tip income to their employer. Tips that are reported to employers are included with wages on Form W-2, box 1. If the taxpayer received tip income of \$20 or more in a month and did not report all of those tips to the employer, he or she must report the social security and Medicare taxes on the unreported tips as additional tax on Form 1040. Form 4137, *Social Security and Medicare Tax on Unreported Tip Income*, should be used to compute and report the additional tax.

Individuals who receive **less than \$20 per month in tips** while working one job do not have to report their tip income to their employer. Additionally, noncash tips (for example, tickets or passes) do not have to be reported to the employer. Tips of less than \$20 per month or noncash tips are not subject to social security and Medicare taxes. However, this tip income is subject to federal income taxes and must be reported on line 7 of Form 1040 or Form 1040A, or line 1 of Form 1040EZ.

TAX TIPS

★★★★★★★★★★
Some employers misclassify workers as independent contractors and report their earnings on Form 1099-MISC. Taxpayers who believe that they have been misclassified should contact the IRS.

TAX TIPS

★★★★★★★★★★
If the taxpayer fails to report tip income as required to the employer, the taxpayer may be subject to a penalty equal to 50% of the social security and Medicare taxes owed on unreported tips.

POTENTIAL PITFALLS



The following individuals cannot file Form 1040EZ or 1040A; they must file Form 1040: (1) Individuals who received \$20 or more in tips in any month while working for one employer and who did not report the full amount to the employer. (These tips are subject to social security and Medicare tax.) (2) Taxpayers whose Form W-2 has an amount entered in box 8, *Allocated tips*, that they must report as income. For more information, see Publication 531, *Reporting Tip Income*.

Allocated tips are tips an employer assigns to an employee. They are in addition to the tips the employee reported to the employer. The taxpayer may have allocated tips if he or she worked in a restaurant, cocktail lounge, or similar business that must allocate tips to employees.

Allocated tips are shown separately in box 8 of Form W-2. They are not included in the amount in box 1. The taxpayer must report allocated tips on his or her tax return unless either of the following exceptions applies.

- 1) The taxpayer kept a daily tip record, or other evidence that is as credible and as reliable as a daily tip record, as required under rules explained earlier.
- 2) The taxpayer's tip record is incomplete, but it shows that his or her actual tips were more than the tips reported to his or her employer plus the allocated tips.

If either exception applies, report actual tips on the return. Do not report the allocated tips.

If the taxpayer is required to report allocated tips on the return, the amount on Form W-2, box 8, should be added to the amount in box 1. The total is reported on line 7 of Form 1040. Allocated tips cannot be reported on Form 1040EZ or 1040A, and are subject to social security and Medicare taxes.

Example 2

Fred works as a repairman during the week and as a barber on alternate Saturdays. His tips are less than \$20 in any month and he does not report them to his employer. The amounts from box 1 on his Forms W-2 show income of \$23,500 (repairman) and \$1,950 (barber). His unreported tip income was \$200.

Fred will report \$25,650 on Form 1040A, line 7. This is the total of his Form W-2, box 1 income and his unreported tip income (\$23,500 plus \$1,950 plus \$200).

If Fred reported his tip income to his employer, the tips would be included in box 1 of the Form W-2 that he received from the barbershop. The amount in box 1 of that Form W-2 would be \$2,150 (\$1,950 plus \$200). Fred would still enter \$25,650 on line 7 (\$23,500 plus \$2,150).

The taxpayer should keep a copy for his or her records and file a copy with the local Social Security Administration to ensure proper social security credit.

Scholarships and Fellowships

Some scholarships and fellowships may be partially taxable. If the taxpayer received a Form W-2 for the scholarship or fellowship, add the amount in box 1 to any other box 1 amounts. Enter the total on line 1, Form 1040EZ, or line 7, Form 1040A or 1040.

Even if the taxpayer did not receive a Form W-2 for the scholarship or fellowship, the taxable portion of the scholarship or fellowship must be reported. Add the taxable portion to other Form W-2, box 1 amounts and unreported tip income. Enter the total on line 7 (Form 1040 or 1040A) or line 1 (Form 1040EZ). Write "SCH" and the amount not reported on Form W-2 in the space to the left of line 7 or line 1, whichever applies.

COMMON QUERIES

To determine if any part of a scholarship or fellowship is taxable, see the instruction booklet for Form 1040A or Form 1040 and Publication 520 *Scholarships and Fellowships*.

Exercise 2

- A. Mandy worked two jobs. She was a quality inspector during the week and a bartender on the weekends. She reported all of her tip income (\$3,000) to her employer. Her Forms W-2, box 1, showed income of \$21,000 (quality inspector) and \$8,250 (bartender). What amount will Mandy report on her Form 1040A, line 7? _____
- B. Peter works as a food server in an expensive restaurant. He tells you that he did not report his tip income of \$18,100 to his employer. Can Peter file Form 1040A? _____
- C. Alex had several employers during the tax year. On February 3, 2003, he comes into the VITA site to have his return prepared. He tells you that he has not received the Form W-2 for XYZ Inc. What should you tell Alex?

INTEREST INCOME

Money earns interest when it:

- is deposited in accounts in banks, savings and loans, credit unions,
- is used to buy certificates of deposit or bonds, or
- is lent to another person or business.

Interest income is considered unearned income. Money, not a person, is working to earn the income.

POTENTIAL PITFALLS



Some savings and loans, credit unions, cooperative banks, and mutual savings banks call their distributions "dividends." These "dividends" are really interest and are reported as interest. True dividends are different and will be discussed later in this lesson.

TAXABLE INTEREST INCOME

Savings Accounts

Interest is reported in the year that it is credited to the taxpayer's account and is available for withdrawal by the taxpayer. The taxpayer should report all interest received during the year, even if the interest is not entered in the taxpayer's passbook.

U.S. Savings Bonds

Interest on U.S. savings bonds is earned in one of two ways.

- Some bonds are issued at a “discount” and the interest earned equals the increase in the bond's value over a period of time.
- Some bonds pay interest at stated intervals of time.

Series EE and Series I Bonds. Series EE bonds are the most common type. They are issued at a discount; this means that the purchase price is less than the face value (the amount shown on the bond). The interest is the difference between the purchase price and the amount received when the bonds are redeemed (cashed in).

Series I bonds were first offered in 1998. They are issued at face value with a maturity period of 30 years. Interest on these bonds is paid when the bond is redeemed.

Taxpayers can choose one of two ways to report interest income from these bonds.

- Report the increase in value when the bond is cashed in or when the bond matures, whichever is earlier.
- Report the increase in the bond's value each year.

Generally, taxpayers must use the same method for all Series EE and Series I bonds they own.

If a U.S. savings bond is issued in the names of co-owners, such as the taxpayer and child, or the taxpayer and spouse, interest on the bond is generally taxable to the co-owner who purchased the bond. To determine who is responsible for paying the tax on a bond see the table below.

Exhibit 1

Who Pays Tax on U.S. Savings Bond Interest	
IF...	THEN tax on the bond interest must be paid by...
You use your funds to buy a bond in your name and the name of another person as co-owners.	You.
You buy a bond in the name of another person, who is the sole owner of the bond.	The person for whom you bought the bond.
You and another person buy a bond as co-owners, each contributing part of the purchase price.	Both you and the other co-owner, in proportion to the amount each paid for the bond.
You and your spouse, who live in a community property state, buy a bond that is community property.	You and your spouse. If you file separate returns, both you and your spouse generally pay tax on one-half.

Example 3

Barbara owns a \$500 U.S. Series EE savings bond. She paid \$250 for the bond. When the bond matures, Barbara will receive \$500. At the end of the first year, the bond was worth \$265.

Barbara can report interest income in one of two ways.

- She can report \$250 of interest income when the bond matures. This is the difference between the \$500 value at maturity and the \$250 she paid for the bond. Barbara would report interest income only once, at maturity.
- She can report \$15 of interest income at the end of the first year. This is the increase in value at the end of the year (\$265 minus \$250). Barbara would report interest income each year until maturity.

Excludable Interest on U.S. Savings Bonds. Taxpayers may be able to exclude from income all or part of the interest received from certain qualified U.S. savings bonds. The taxpayer must have paid for qualified higher education expenses the same year the bonds are cashed. The bonds must be either Series EE bonds issued after 1989 or Series I bonds in the taxpayer's name or, if married, the taxpayer's name or spouse's name. The individual in whose name the bonds were issued must be 24 years of age or older before the bonds were issued. The taxpayer cannot file married filing separately.

POTENTIAL PITFALLS



For purposes of the savings bond interest exclusion, qualified higher education expenses do not include:

- those that the taxpayer used to claim the Hope or lifetime learning credits, or
- distributions from Coverdell ESAs that the taxpayer excluded from income.
- those paid with scholarships and fellowship distributions that were excluded from income.
- those paid with any nontaxable payments received (other than gifts, bequests, or inheritances) such as veterans' educational assistance benefits, benefits under a qualified state tuition program, or tax-free employer-provided educational assistance.

The Hope and lifetime learning credits are discussed in Lesson 9. The Coverdell ESA is discussed later in this lesson.

Qualified higher education expenses include tuition and fees paid to an eligible educational institution for the bond owner, the bond owner's spouse, or the bond owner's dependent for whom the bond owner claims an exemption. An eligible educational institution is any college, university, vocational school, or other postsecondary educational institution eligible to participate in a student aid program administered by the Department of Education.

Qualified expenses include any **contribution** to a qualified state tuition program or to a Coverdell ESA. (For more information, get Publication 970, *Tax Benefits for Higher Education*).

Use Form 8815, *Exclusion of Interest From Series EE and I U.S. Savings Bonds Issued After 1989 (For Filers with Qualified Higher Education Expenses)*, to report the exclusion of interest income. The excludable amount is transferred from Form 8815 to Part I, line 3 of Schedule 1 (Form 1040A) or to Schedule B (Form 1040).

Series HH Bonds. The interest on these bonds is paid twice a year. Report the interest on these bonds in the year in which it is received.

Other U.S. Obligations. Interest on other U.S. obligations, such as U.S. Treasury notes and bonds, is fully taxable when received.

Savings Certificates, Money Market Certificates, and Other Deferred Interest Accounts

Interest that is paid at fixed intervals of one year or less is included in taxable income when it is received or when the taxpayer could receive it (that is, when it is credited to the account, even if it is not withdrawn) without paying a substantial penalty. If an account matures in one year or less and provides a single interest payment at maturity, include the interest in taxable income when the account matures and the interest is received.

Example 4

Duane has a six-month certificate of deposit (CD) that matures in January 2003. He will receive \$75 in interest income.

Duane will report the interest income on the certificate of deposit on his 2003 tax return. It matures in one year or less with a single interest payment at maturity.

Certificates of Deposit with Maturities of Over One Year

If interest on a CD is deferred for more than one year, the taxpayer must include a part of the interest in income each year. The taxpayer should receive Form 1099-INT stating the amount to report.

Example 5

Deborah has a two-year CD that pays interest every three months. She bought the CD on March 1, 2002. It matures on February 29, 2004.

For 2002, Deborah reports the interest income earned from March through December. For 2003, she will report 12 months of interest. For 2004, she will report two months of interest.

Original Issue Discount. Long-term obligations that pay no interest before maturity are considered to be issued at a discount. **Original Issue Discount (OID)** is the amount by which the principal amount (redemption price at maturity) of a long-term debt instrument, such as a bond or note, exceeds its issue price. Taxpayers generally report a portion of the OID each year until the obligation matures.

Example 6

Roger purchased a \$1,000 U.S. Treasury Zero Coupon Bond for \$350. When the bond matures, Roger will receive \$1,000. He will receive no interest income until the bond matures many years later.

The difference between the redemption amount (\$1,000) and the issue price (\$350) is the OID (\$650). Each year until maturity, Roger must recognize part of the OID as taxable interest income.

Interest on Insurance Proceeds

Life insurance proceeds include interest. Taxpayers can receive life insurance policy benefits paid upon the death of the insured either in a lump sum or in installments. Generally, if the payments are received in installments, the portion that is interest must be included in the taxpayer's income. However, if the insured individual died before October 23, 1986, and was the taxpayer's spouse, the first \$1,000 of interest income received each year is not taxed if the payments are received in installments. This exclusion does not apply if proceeds are left on deposit with the insurance company and only interest is paid.

Life insurance dividends generally are not taxable. These dividends may be used to reduce life insurance premiums due, purchase additional paid-up insurance, or earn interest. In general, the interest earned on life insurance dividends is taxable when it is credited to the taxpayer's account.

Interest on insurance dividends that have been left on deposit with the Department of Veterans Affairs (VA) is **not** taxable. Do not include this interest in taxable income. Any open year return on which such interest was reported as taxable can be amended for a refund of the tax.

TAX TIPS

★★★★★★★★

A taxpayer can claim either the Hope credit or lifetime learning credit, in the same year you take a tax-free withdrawal from a Coverdell ESA, provided that the distribution from your Coverdell ESA are not used for the same expenses for which a credit is claimed. For additional information on the Hope credit or the lifetime learning credit, see Lesson 9, *Education Credits*.

COVERDELL ESA

Generally, an individual can establish a Coverdell ESA for a child who is under age 18. Contributions to a Coverdell ESA are not deductible. Amounts in the ESA grow tax free until they are distributed. No tax is due on distributions if the beneficiary had qualified education expenses (such as tuition, books, equipment, and certain other expenses needed to enroll at or attend an eligible educational institution), that were at least as much as the distributions during the year.

If Form 1099-R shows “M” in box 7, the taxpayer has received a distribution from a Coverdell ESA. Ask the taxpayer/beneficiary whether the distribution was more than the amount spent on:

- tuition, fees, books, supplies, and equipment needed to enroll at or attend a qualified educational institution,
- a qualified tuition program, or
- room and board if the beneficiary is at least a half-time student at the educational institution.

If the amount of the distribution was not more than the amount spent in these ways, the entire distribution is tax free. Report it on Form 1040A, line 11a, and leave line 11b blank; or report it on Form 1040, line 15a, and leave line 15b blank.

Refer the taxpayer/beneficiary to a paid professional tax preparer if the distribution was more than the amount spent for the purposes described above. Part or all of the distribution is taxable and must be computed.

TAX-EXEMPT INTEREST

Certain types of interest are exempt from federal income tax. Bonds issued by the following entities generally pay **tax-exempt interest**:

- State and political subdivisions (county or city),
- District of Columbia, and
- U.S. possessions and political subdivisions.

Examples of tax-exempt bonds are those issued by:

- Port authorities
- Toll-road commissions
- Utility service authorities
- Community redevelopment agencies
- Qualified volunteer fire departments
- Some mutual funds

Although tax-exempt interest is not taxable, the taxpayer must report all tax-exempt interest on Form 1040, 1040A or 1040EZ.

Form 1099-INT

Interest income is reported to the taxpayer on Form 1099-INT, *Interest Income*. A copy of Form 1099-INT is also sent to the IRS.

Box 1 shows taxable interest income from various institutions.

Some taxpayers withdraw funds from a time deposit before the maturity date of the account and, therefore, incur an interest penalty. The early withdrawal penalty is reported on Form 1099-INT in box 2. Report the total interest earned, shown in box 1 of Form 1099-INT, on line 8a of Form 1040. Do not subtract the penalty from the total interest. The early withdrawal penalty is an adjustment to income and is entered on line 32 of Form 1040.

Box 3 shows U.S. savings bond and Treasury obligations interest. Be sure to ask the taxpayer about this interest income. The amount shown on Form 1099-INT may be too high if the taxpayer was not the original owner of the bond or if the taxpayer has reported the interest income each year as it was earned.

Some Forms 1099-INT will have entries in box 4 indicating that federal income tax has been withheld from the interest paid. Be sure to include the amount shown in box 4 with other tax withheld on Form 1040A, line 39, or Form 1040, line 62.

Form 1099-OID

Form 1099-OID, *Original Issue Discount*, reports the amount of Original Issue Discount income that a taxpayer should report as income for the year. A copy of Form 1099-OID is also sent to the IRS.

Box 1 shows the amount of interest (OID) for the year if the taxpayer bought the obligation at its original issue and held the issue all year.

Box 2 shows regular interest paid on the obligation other than the OID income.

Reporting Interest Income

If the taxpayer is a **1040EZ** filer, taxable interest income is reported on line 2. 1040EZ filers should report tax-exempt interest by writing "TEI" and the amount of tax exempt interest on line 2 as shown in the example below. Do not include tax-exempt interest in the *Dollars/Cents* portion of line 2. If the taxpayer's interest income is more than \$1500, he or she cannot file a Form 1040EZ.

TAX TIPS

★★★★★★★★★★
A copy of a Form 1099-INT can be found in the *Tax Forms Booklet Appendix*, which is a part of your Publication 678 Package.

TAX TIPS

★★★★★★★★★★
Taxpayers must report the following types of interest income on Form 1040. These types of income cannot be reported on Form 1040EZ or 1040A: (1) Original Issue Discount (OID) that is different from the amount reported on Form 1099-OID; (2) accrued interest received or paid on securities transferred between payment dates, and (3) bond interest income reduced by amortizable bond premium.

TAX TIPS

★★★★★★★★★★
Some taxpayers will receive a mutual fund statement which shows tax-exempt interest. Be sure to include the tax-exempt interest on the return.

Example 7

Jennifer received taxable interest income of \$65 and tax-exempt interest income of \$23. She would report her interest income as shown in the exhibit below.

Exhibit 2

Jennifer's 1040EZ

Income Attach Form(s) W-2 here. Enclose, but do not attach, any payment. Note. You must check	1	Total wages, salaries, and tips. This should be shown in box 1 of your W-2 form(s). Attach your W-2 form(s).	1		
	2	Taxable interest. If the total is over \$400, you cannot use Form 1040EZ. TEI=\$23.00	2	65	00
	3	Unemployment compensation, qualified state tuition program earnings, and Alaska Permanent Fund dividends (see page 14).	3		
	4	Add lines 1, 2, and 3. This is your adjusted gross income .	4		
	5	Can your parents (or someone else) claim you on their return? Yes. Enter amount from No. If single , enter 7,450.00.			

TAX TIPS

★★★★★★★★★

Taxpayers should not have received a Form 1099-INT for tax-exempt interest. But if they do, they must report it on Form 1040A, Schedule 1, line 1, or Form 1040, Schedule B, line 1.

Taxpayers who file **Forms 1040A or 1040**, report taxable interest income on line 8a and tax-exempt interest on line 8b.

If the taxpayer files Forms 1040A or 1040 and:

- Has interest income of more than \$1500,
- Wants to claim an exclusion for savings bond interest in the same year that he or she paid for qualified higher education expenses, or
- Receives a Form 1099-INT for tax-exempt interest,

Schedule 1, Part I (1040A) or Schedule B, Part I (1040) must be completed, before making an entry on line 8a or 8b.

If the tax-exempt interest is shown on a Form 1099-INT, and a Schedule 1 or B must be filed, the taxpayer must include tax-exempt interest on Schedule 1 or B. It should be reported on line 1 but it should not be included in the total on line 2.

Instead, under the last entry on line 1, a subtotal of all interest listed should be made. Below the subtotal, the taxpayer should write "Tax-exempt interest" and show the amount. Subtract it from the subtotal and the result should be entered on line 2.

On Schedule 1 or Schedule B, Part I, list the interest payers' names and the various amounts received for each form, even if there are two or more forms from the same source.

TAX TIPS

★★★★★★★★★

Taxpayers must complete Schedule B, Part III if they:

- had over \$1500 of interest or ordinary dividends
- had a foreign account, or
- received a distribution from, or were a grantor of, or a transferor to, a foreign trust.

Exercise 3

- A. Randy and Ann have three Forms 1099-INT: Epping National Bank, \$62; Epping Credit Union, \$178; and Brenton Savings and Loan, \$760.
1. How much interest income will be reported on Schedule 1 (Form 1040A)? _____
 2. How much interest income will be reported on Form 1040A, line 8a? _____
- B. Catherine received \$398 interest income this year. She files Form 1040EZ. How much interest income is reported on her return, and where is it reported? _____
- _____
- C. Emily and Andrew file a joint return on Form 1040. They have the following interest income: City Savings and Loan (joint), \$320; Third National Bank (Andrew), \$100; U.S. Series HH Savings Bonds (joint), \$45; and Welder's Credit Union (Emily), \$30.
- How much interest is reported on their Form 1040, and where is it reported? _____

DIVIDEND INCOME AND OTHER CORPORATE DISTRIBUTIONS

Dividends are payments made by corporations to shareholders. Dividends can also be paid through partnerships, estates, or trusts.

There are several types of corporate distributions, including ordinary dividends, capital gain distributions, nontaxable distributions, stock dividends, and others. Most dividends are paid in cash. Some dividends, however, are paid in property, services, or additional shares of stock. Only **ordinary dividends** can be reported on Form 1040A. Any other dividends or distributions received are reported on Form 1040. Taxpayers with dividend income may not use Form 1040EZ. Other types of dividends and distributions include the following:

- **Dividend reinvestment** — Through **dividend reinvestment**, instead of receiving cash (a dividend check), some stockholders ask the corporation to use their dividends to purchase more shares of the corporation's stock. The shareholders "reinvest" their dividends. The dividend is taxable at the time it would be paid if it were in cash.

TAX TIPS

★ ★ ★ ★ ★ ★ ★ ★ ★ ★
Credit union dividends are reported as interest.

TAX TIPS

★ ★ ★ ★ ★ ★ ★ ★ ★ ★
A copy of a Form 1099-DIV is included in the *Tax Forms Booklet Appendix*, which is a part of your Publication 678 Package.

TAX TIPS

★ ★ ★ ★ ★ ★ ★ ★ ★ ★
Use ditto marks to save time when reporting more than one Form 1099-INT or Form 1099-DIV from the same financial institution or corporation.

- **Capital gain distributions** — Mutual funds (regulated investment companies) and real estate investment trusts (REITs) pass capital gains to their investors in the form of **capital gain distributions**. Capital gain distributions are treated as long-term capital gains, regardless of how long the taxpayer holds the shares. See Lesson 12, *Sale of Stock*, for more information on capital gains.
- **Return of capital** — A **return of capital** represents a return of part of the taxpayer's investment in the stock of the company. A return of capital reduces the basis of the stock and is not taxed until the taxpayer's basis in the stock is fully recovered. Any return of capital in excess of basis is treated as a capital gain and is reported on Schedule D, *Capital Gains and Losses*.
- **Stock dividends** — **Stock dividends** increase the taxpayer's number of shares in the company. Generally, stock dividends are not taxable.

Other types of nontaxable dividends are:

- Exempt-interest dividends paid by mutual funds (This interest is listed on Form 1040, line 8b.)
- Dividends on insurance policies, as long as they do not exceed the total of all net premiums paid by the taxpayer
- Dividends on veterans' insurance
- Certain patronage dividends

Reporting Dividends and Capital Gain Distributions

The payer reports dividends and certain other distributions on **Form 1099-DIV**, *Dividends and Distributions*.

Ordinary dividends are reported in box 1 of Form 1099-DIV. Add the amounts in box 1 from all the Forms 1099-DIV the taxpayer received. If the total is:

- \$1500 or less, enter the total on line 9 of Form 1040A or 1040.
- over \$1500, complete Schedule 1 (Form 1040A), Part II, or Schedule B (Form 1040), Part II. Transfer the result to line 9 of Form 1040A or 1040.

On Schedule 1 or Schedule B enter the payer's name and the amount received for each Form 1099-DIV even if the same corporation used separate forms to report more than one distribution. If the taxpayer has a substitute Form 1099-DIV from a brokerage firm, it may show a total for dividends received. Enter the brokerage firm as the payer of the dividends and enter the total dividend amount. Do not list the dividends individually.

Some taxpayers receive dividend income from shares that the husband and wife own jointly. If they file a joint return, enter the total dividend in the appropriate place on the return. If they file separate tax returns, divide the dividend by two. Report half on the husband's return and half on the wife's return.

Capital gain distributions occur when a mutual fund (regulated investment company) sells assets for more than their cost, and the realized capital gain is distributed to the fund's shareholders. This should not be confused with a capital gain that occurs when the owner of a mutual fund or a capital asset sells shares in the fund or the asset for more than the cost and realizes a capital gain. For more information on capital gains and losses, see Lesson 12, *Sale of Stock*.

Payers report capital gain distributions in box 2a of Form 1099-DIV. Taxpayers can report capital gain distributions directly on Form 1040A or Form 1040 if:

- The only amounts the taxpayer has to report on Schedule D are capital gain distributions (box 2a),
- The taxpayer does not have any 28% rate gain (box 2b), qualified 5-year gain (box 2c) unrecaptured section 1250 gain (box 2d), or section 1202 gain (box 2e), and
- If the taxpayer files Form 4952, *Investment Interest Expense Deduction*, the amount on line 4e of Form 4952 is not more than zero.

If the taxpayer does not meet the requirements to report the capital gain distribution directly on Form 1040A or Form 1040, a Schedule D, *Capital Gains and Losses* must be filed. If a Schedule D is not required, the capital gain distributions can be reported directly on line 13 of Form 1040, or line 10 of Form 1040A. Capital gain distributions are not reported on Form 1040EZ.

If capital gain distributions are reported directly on Form 1040 or Form 1040A:

- Check the box next to line 13, Form 1040 and
- Use the Capital Gain Tax Worksheet from either the Form 1040A or 1040 instruction booklet to compute tax.

TAX TIPS

★★★★★★★★★
If the taxpayer has unrecaptured section 1250 gain from mutual funds or real estate investment trusts, or has section 1202 gains, or must file Form 4952, advise the taxpayer to consult a paid professional tax preparer.

The volunteer should be careful not to ignore other boxes on the Form 1099-DIV.

- **Box 2c, *Qualified 5-year gain*.** If the taxpayer has an entry in box 2c, see Lesson 12 for the proper treatment of the gain.
- **Box 4, *Federal income tax withheld*.** Be sure to include this amount on line 39 of Form 1040A or line 62 of Form 1040.
- **Box 5, *Investment expenses*.** If the taxpayer files Form 1040 and itemizes deductions on Schedule A, report the amount from box 5 as a miscellaneous itemized deduction subject to the 2%-of-adjusted-gross-income limit. (See *Itemized Deductions* in Lesson 5.)
- **Box 6, *Foreign tax paid*.** If the taxpayer has an entry in box 6, see Lesson 6 for the proper treatment of the tax. The taxpayer may be able to claim the Foreign Tax Credit.

A capital gain distribution is reported on a Schedule D when the taxpayer has more than capital gain distributions to report, for example when boxes 2b, 2d, 2e, 3, 8, or 9 have entries, or when the taxpayer has sold a capital asset. Capital gain distributions are always treated as long-term capital gains, regardless of how long the taxpayer holds the shares, and are reported on line 13, column (f) of the Schedule D. If the taxpayer has an entry in box 2b, then that number is reported on line 13 column (g).

STATE AND LOCAL TAX REFUNDS

Taxpayers who receive a refund of state or local taxes may receive a Form 1099-G, *Certain Government Payments*. If the taxpayer claimed the standard deduction on the 2001 return and received a refund of 2001 state or local tax, the taxpayer does not have to include the refund in taxable income. However, if the taxpayer itemized deductions **and** received a state or local tax refund, the taxpayer may have to include part or all of the refund in taxable income. Use the *State and Local Income Tax Refund Worksheet—Line 10* in the Form 1040 instruction booklet to determine what part, if any, of the refund is taxable. Enter the taxable portion of state and local refunds on Form 1040, line 10.

POTENTIAL PITFALLS



If the state or local income tax refund reflects any deductions, credits, or payments for years other than 2001, refer the taxpayer to a paid professional tax preparer.

ALIMONY RECEIVED

Alimony or separate maintenance payments made under a court decree are taxable income to the person receiving them. They are reported on Form 1040, line 11. The person making the payments deducts them on Form 1040, line 33a, as an adjustment to gross income.

Child support payments are not alimony. The person making the payments cannot deduct them. The person receiving child support payments does not have to include them in income.

TAX TIPS

★★★★★★★★

An overpayment of taxes that is applied to the next year's estimated tax is considered a refund.

INCOME FROM BUSINESS (OPTIONAL TOPIC)

Business income or loss is reported first on Schedule C (Form 1040), *Profit or Loss From Business*, or Schedule C-EZ, *Net Profit From Business*, and then transferred to Form 1040, line 12. Taxpayers who must file a Schedule C should see a paid professional tax preparer.

Self-employed individuals who qualify to use Schedule C-EZ may be assisted by VITA and TCE volunteers who have received training on this topic, at the discretion of the site coordinator.

TAX TIPS

★★★★★★★★

Voluntary payments made that are not required by a divorce or separation instrument are not alimony.

TAX TIPS

★★★★★★★★★★
Schedule C-EZ is included in the *Tax Forms Booklet Appendix*, which is a part of your *Publication 678 package*.

POTENTIAL PITFALLS



Many taxpayers erroneously report amounts from Form 1099-MISC, *Miscellaneous Income*, with wages or other income. This income should instead be reported on Schedule C or C-EZ and on Schedule SE, *Self-Employment Tax*. If the income is reported incorrectly, IRS may later issue a notice of proposed tax increase for the self-employment income and tax.

TAX TIPS

★★★★★★★★★★
A copy of Form 1099-MISC and Instructions can be found in the *Tax Forms Booklet Appendix*, which is part of your *Publication 678 Package*.

Who Can Use Schedule C-EZ

A taxpayer can use Schedule C-EZ only if he or she:

- Had business expenses of \$2,500 or less,
- Uses the cash method of accounting,
- Did not have an inventory at any time during the year,
- Did not have a net loss from his or her business,
- Had only one business as a sole proprietor,
- Had no employees during the year,
- Is not required to file Form 4562, *Depreciation and Amortization*, for this business (See the instructions for Schedule C, line 13, to find out if the taxpayer must file.),
- Does not deduct expenses for business use of his or her home, and
- Does not have prior year unallowed passive activity losses from this business.

Completing Schedule C-EZ

Schedule C-EZ has three parts:

Part I: General Information

Part II: Figure Your Net Profit

Part III: Information on Your Vehicle

Part I: General Information

Part I is used to determine whether or not the taxpayer is eligible to use this form instead of Schedule C for reporting self-employment income. If all the criteria are met, the taxpayer then completes Part I.

Line B, Principal Business Code, is determined by looking at the code list in the *Instructions for Schedule C, Profit or Loss From Business*.

Line D, Employer ID Number, is a number which the Internal Revenue Service supplies to businesses and other professional activities. If the taxpayer does not have one, the space should be left blank.

Part II: Figure Your Net Profit

Gross receipts are all receipts from a trade or business including income reported on a Form 1099-MISC, *Miscellaneous Income*. All items of taxable income actually or constructively received during the year are included. Gross receipts are entered on line 1.

Total expenses include the total amount of all deductible business expenses actually paid during the year. Examples of these expenses include advertising, car and truck expenses, commissions, insurance, interest, legal and professional services and fees, office expense, rent or lease expense, repairs and mainte-

nance, supplies, taxes, travel, 50% of business meals and entertainment, and utilities (including telephone). Total expenses of \$2,500 or less are entered on line 2.

If the taxpayer uses his or her car or truck for business purposes, he or she can deduct expenses related to using the car or truck. To determine the amount of car and truck expenses that can be deducted, the taxpayer must use either the:

- Standard Mileage Rate, or
- Actual Car Expenses.

Standard Mileage Rate. If the taxpayer can and does choose to use the standard mileage rate, business miles are multiplied by the applicable mileage rate and added to the deductible parking and tolls. Car expenses using the standard mileage rate are computed as follows:

$$\begin{array}{r} \text{Business miles incurred during the year} \times 36.5\text{¢ per mile} \\ + \text{ Parking and tolls incurred while on business} \\ \hline \end{array}$$

Actual Car Expenses. If the taxpayer chooses to use the actual car expenses, only the business portion of the expenses are deductible. Deductible expenses under the actual method are computed as follows:

1. Compute the percentage of business use:

$$\frac{\text{Business miles}}{\text{Total miles}} = \% \text{ of business use}$$

2. Determine the deductible expenses:

$$(\% \text{ of business use} \times \text{total actual expenses})$$

$$+ \text{ Parking and tolls incurred while on business}$$

NOTE: If taxpayers depreciate their car or truck, or their total expenses are more than \$2,500, they cannot use Schedule C-EZ and should be referred to a paid professional tax preparer.

Net profit or loss is determined by subtracting line 2 from line 1 and entering the net amount on line 3.

If line 3 shows a profit, transfer this amount to Form 1040, line 12, and to Schedule SE, line 2 (except statutory employees). Attach Schedule C-EZ to Form 1040 in the correct sequence.

If line 3 is zero, show zero amount on Form 1040, line 12.

If line 3 shows a loss, the taxpayer cannot use Schedule C-EZ and should be referred to a paid professional tax preparer.

TAX TIPS

★★★★★★★★★
Generally, to use the standard mileage rate, a taxpayer must choose it in the first year the car is placed in service. In later years, the taxpayer can choose to use either the actual or standard rate. For more information on car and truck expenses, see Publication 463, *Travel, Entertainment, Gift, and Car Expenses*.

TAX TIPS

★★★★★★★★★
Schedule SE is included in the *Tax Forms Booklet Appendix*, which is a part of your Publication 678 Package.

Part III: Information on Your Vehicle

Part III should be completed if the taxpayer is claiming car and truck expenses in Part II.

Self-Employment Tax

Self-employment tax is a social security tax for persons who work for themselves. It is similar to the social security tax and Medicare tax withheld from employees' wages.

Special exemptions from self-employment tax may apply to members of the clergy, members of certain religious sects, and certain nonclergy church employees.

The tax is computed on Schedule SE and transferred to the Form 1040 to be added to other taxes owed. The Schedule SE is attached to the Form 1040.

Who Must File Schedule SE

A taxpayer must file Schedule SE if he or she has:

- Net earnings from self-employment of \$400 or more, other than church employee income (line 4 of Short Schedule SE),

OR

- Church employee income of \$108.28 or more (line 5a of Long Schedule SE).

Exception: If the only self-employment income was from earnings as a minister, member of a religious order, or Christian Science practitioner AND the taxpayer has filed Form 4361 and has received IRS approval not to be taxed on these earnings, he or she does not have to file Schedule SE. Instead, write "Exempt—Form 4361" on Form 1040, line 56.

Most taxpayers will need to complete only Section A of Schedule SE, also known as the Short Schedule SE. Follow the chart on the form to determine whether the taxpayer qualifies to file the short form. Anyone who does not qualify and who must file the long form should be referred to a paid professional tax preparer.

If the taxpayer qualifies for the short form, enter the net profit from Schedule C-EZ, line 3, on lines 2 and 3 of the Schedule SE.

POTENTIAL PITFALLS



Remember to transfer the following amounts from Form 1099-MISC to the return:

- Include any withheld income tax from Form 1099-MISC, box 4, on Form 1040A, line 39, or Form 1040, line 62.
- If the taxpayer itemizes deductions, include any withheld state or local tax from Form 1099-MISC, box 2, on Schedule A (Form 1040), *Itemized Deductions*, line 5.

Follow the instructions on the form to determine net earnings from self-employment on line 4 and the self-employment tax on line 5.

Enter the amount from line 5 on Form 1040, line 56.

Deduction of Self-Employment Tax

Self-employed people may claim an adjustment to income of one-half of the social security and Medicare taxes they pay.

Enter the amount from Schedule SE, line 6, on Form 1040, line 29, as an adjustment to income.

CAPITAL GAINS AND LOSSES

Both the sale of stock and the sale of a home are reported on Form 1040, line 13. The amount entered on Form 1040, line 13, is transferred from Schedule D (Form 1040), *Capital Gains and Losses*. See Lessons 12 and 13 for more information about these types of sales.

SALE OF BUSINESS PROPERTY

The sale or involuntary conversion of business property is reported on Form 1040, line 14. If taxpayers are reporting the sale of business property, they should be referred to a paid professional tax preparer.

PENSION AND ANNUITY INCOME

Generally, payers of pension and annuity income send Form 1099-R to the recipients. The total pension or annuity income is reported on Form 1040A, line 12a, or Form 1040, line 16a; the taxable portion is reported on line 12b (1040A) or 16b (1040). If all of the pension or annuity is taxable, make an entry on line 12b or 16b only.

For more information on pension and annuity income, see Lesson 14, *Pensions*.

RENTS, ROYALTIES, PARTNERSHIPS, ESTATES, AND TRUSTS

Income from rental property, royalties, partnerships, estates, and/or trusts is reported on Form 1040, line 17. Refer any taxpayer who receives income from these sources to a paid professional tax preparer.

POTENTIAL PITFALLS



Form 1099-R reports pension income, not earned income. Form 1099-R amounts are not included on line 7 of Form 1040. They are reported on Form 1040A, lines 12a and 12b or Form 1040, lines 16a and 16b. You will learn how to report pensions in Lesson 14, *Pensions*.

FARM INCOME

Farm income is reported on Form 1040, line 18. Advise taxpayers with farm income to see a paid professional tax preparer.

TAX TIPS

★★★★★★★★★★

Form 1099-G is included in the *Tax Forms Booklet Appendix*, which is a part of your *Publication 678 Package*.

UNEMPLOYMENT COMPENSATION

Unemployment compensation includes benefits to unemployed individuals that a state or the District of Columbia paid from the Federal Unemployment Trust Fund. It is reported to the recipient on Form 1099-G, *Certain Government Payments*. All unemployment compensation is taxable. Transfer the amount in box 1 of Form 1099-G to line 3 of Form 1040EZ, line 13 of Form 1040A, or line 19 of Form 1040.

Supplemental benefits provided from an employer's fund to which the employee did not contribute are sometimes thought of as unemployment benefits also. They are reported to the employee on Form W-2. Include them on line 7 of Form 1040A or 1040, or on line 1 of Form 1040EZ.

TAXWISE HINTS

When entering income for the taxpayer you have the following three choices:

Go to Line 7 and click F9 ([Link](#)),

Click the right mouse and select "Link" or

Click on add form and select "W-2".

All the information entered into TaxWise should be exactly what is on the W-2.

Note: TaxWise automatically rounds numbers.

When an entry is made for Alimony paid, TaxWise requires the Social Security Number of the spouse receiving the alimony.

▶▶ SUMMING UP THIS LESSON ◀◀

Form 1040EZ can be used to report only income from wages, salaries, tips, qualified tuition program earnings, Alaska Permanent Fund dividends, taxable scholarships and fellowship grants, interest of \$1500 or less, and unemployment compensation.

You can report several types of income on Form 1040A:

- ▶ Wages, salaries, tips, scholarships and fellowship grants, qualified tuition program payments, and Alaska Permanent Fund dividends
- ▶ Interest income
- ▶ Dividend income
- ▶ Capital gain distributions
- ▶ Unemployment compensation

Use Form 1040A, Schedule 1, or Form 1040, Schedule B, to report:

- ▶ Interest and/or dividend income over \$1500 and
- ▶ Interest from Series I and/or Series EE savings bonds, issued after 1989, that is excluded from taxable income.

Report any early withdrawal penalties on Form 1040, line 32, as an adjustment to income. Do not subtract penalties from interest income.

Report capital gain distributions directly on Form 1040, line 13 or Form 1040A, line 10, if the taxpayer is not required to file Schedule D.

State and local tax refunds are included in taxable income if:

- ▶ the taxpayer itemized deductions AND
- ▶ received a tax benefit by including the state and local tax in itemized deductions.

Alimony and separate maintenance payments are taxable income to the person receiving these payments. The person paying these payments can subtract them as an adjustment to income.

▶▶ **SUMMING UP THIS LESSON** ◀◀
(continued)

Business income or loss is generally beyond the scope of VITA or TCE. However, in some cases, trained volunteers may help self-employed taxpayers who qualify to use Schedule C-EZ.

Taxpayers with net self-employment income of \$400 or more must complete Schedule SE to compute self-employment tax.

Some nontaxable income is reported but is not included in taxable income:

- ▶ Tax-exempt interest
- ▶ Nontaxable portion of IRA distributions, including rollovers

Other income, such as prizes, awards, lottery winnings, and jury duty pay, is reported on line 21 of Form 1040, including the amount and description.

Volunteers should refer taxpayers with any of the following items to paid professional tax preparers:

- ▶ Sales of business property
- ▶ Income from rental property, royalties, partnerships, estates, or trusts
- ▶ Farm income

Exercise 1

1. Taxable
2. Taxable
3. Nontaxable
4. Taxable
5. Taxable
6. Taxable
7. Nontaxable
8. Taxable
9. Nontaxable
10. Nontaxable

Exercise 2

- (A) Mandy will report \$29,250 on line 7. The tip income is included in the \$8,250.
- (B) No; Peter must file Form 1040 to pay social security and Medicare tax on his tip income.
- (C) Alex should be advised to contact the employer and request that a Form W-2 be issued or reissued. If after waiting a reasonable amount of time, it still has not been received, Erik should contact the IRS.

Exercise 3

- (A) 1. None
2. \$1,000
- (B) \$398 is reported on line 2 of Form 1040EZ.
- (C) \$495 is reported on line 8a of Form 1040.

STUDENT NOTES

INTRODUCTION AND OBJECTIVES

In this lesson you will learn about adjustments to income. There are two new adjustments to income for tax year 2002. They are the Educator Expenses and Tuition and Fees Deduction. The other adjustments covered in this lesson are traditional IRA contributions, student loan interest payments, penalty on early withdrawal of savings, alimony payments, and jury duty pay. Lesson 3 discusses an additional adjustment to income covered in the VITA training — one-half of self-employment tax.

The remaining adjustments — Archer MSA deduction; moving expenses; self-employed health insurance deduction; and self-employed SEP, SIMPLE, and qualified plans — are not covered in VITA training. Taxpayers who need assistance with these adjustments should be referred to a paid professional tax preparer.

After completing this lesson you should be able to:

- Calculate and accurately report adjustments to income.
- Identify which IRA contributions are within the scope of the VITA/TCE program.
- Identify contribution limits for IRAs.
- Calculate and report non-deductible IRA contributions and carry-over on Form 8606.

TAX TIPS

★★★★★★★★

Some taxpayers can make tax deductible contributions to an Archer Medical Savings Account (Archer MSA), even if they do not itemize deductions.

Refer taxpayers with a medical savings account to a paid professional tax preparer. They can also get Publication 969, *Medical Savings Accounts (MSAs)*, for more information.

ADJUSTMENTS TO INCOME

Adjustments are subtractions from total income. Total income minus adjustments results in **adjusted gross income (AGI)**, an important number for tax purposes. Adjusted gross income is used to figure some limitations. In addition, it is used to figure income tax in some states.

Taxpayers cannot take any adjustments to income on Form 1040EZ. On Form 1040EZ total income and adjusted gross income are the same. Form 1040A filers can take adjustments for educator expenses, contributing to a traditional IRA, the student loan interest deduction, and tuition and fees payments. Form 1040 filers can take any of the adjustments (for which they are eligible).

DEDUCTION FOR EDUCATOR EXPENSES

If the taxpayer is an eligible educator, he or she can deduct as an adjustment to income up to \$250 in qualified expenses. The taxpayer can deduct these expenses even if he or she does not itemize deductions on Schedule A (Form 1040). This adjustment to income is for expenses paid or incurred in 2002. Previously, these expenses were deductible only as a miscellaneous itemized deduction subject to the 2% of adjusted gross income limit.

Eligible educator

The taxpayer is an eligible educator if, for the tax year, he or she is a kindergarten through grade 12 teacher, instructor, counselor, principal, or aide, and he or she works at least 900 hours during a school year in a school that provides elementary or secondary education as determined under state law.

Qualified expenses

Qualified expenses are the **unreimbursed expenses** paid or incurred for books, supplies, computer equipment (including related software and services), other equipment and supplementary materials that the taxpayer uses in his or her classroom. For courses in health and physical education, expenses for supplies are qualified expenses only if they are related to athletics.

To be deductible as an adjustment to income, the qualified expenses must be more than the following amounts for the tax year:

- The interest on qualified U.S. savings bonds that the taxpayer excluded from income because he or she paid qualified higher education expenses.
- Any distributions from a qualified tuition program that the taxpayer excluded from income, or
- Any tax-free withdrawals by the taxpayer from a Coverdell education savings account.

The educator expense can be claimed on Form 1040, line 23 or Form 1040A, line 16.

INDIVIDUAL RETIREMENT ARRANGEMENTS

An **Individual Retirement Arrangement (IRA)** is a tax-sheltered savings plan set up by the taxpayer, generally for retirement income. This lesson discusses only **traditional IRAs** (IRAs other than Roth IRAs, SIMPLE IRAs, or Coverdell education savings accounts (ESAs)). Contributions to the nontraditional IRAs are not deductible as adjustments to income.

For more information on nontraditional IRAs, see Publication 590, *Individual Retirement Arrangements (IRAs)*.

Contributions to a traditional IRA can be either deductible or nondeductible. Earnings and gains on the contributions are not taxed until withdrawn from the traditional IRA account.

Example 1

Anna contributed \$2,500 to her traditional IRA account at her local bank. During 2002 she earned \$140 of interest on her traditional IRA. All of the interest was added to her traditional IRA savings account.

Anna will not have to pay tax on the interest until she withdraws it from her traditional IRA account.

Contributions

Anyone under 70 1/2 years of age (at the end of the tax year) who has taxable compensation can contribute to a traditional IRA. **Compensation** includes wages, salaries, commissions, tips, bonuses, professional fees, and earnings from self-employment. Alimony or separate maintenance payments that are included in total income are also compensation for traditional IRA purposes. Compensation **does not include** interest, rents, dividends, pension and annuity income, deferred compensation received, certain partnership income, or income you can exclude.

General Limit

The most that can be contributed for any year to a traditional IRA is the lesser of:

- \$3,000 (\$3,500 if age 50 or older), or
- Compensation that is includible in income for the year.

If a taxpayer has more than one traditional IRA, the taxpayer must combine all of the traditional IRAs and treat them as one when figuring the amount that can be contributed for the year.

SPECIAL POPULATIONS



Persons who are 70 1/2 years of age or older before the end of the tax year cannot contribute to an IRA and must take required distributions from their IRAs.

SPECIAL POPULATIONS



Individuals serving in the U.S. Armed Forces or in support of the U.S. Armed Forces in designated "combat zones" have additional time to make a qualified retirement contribution to a traditional IRA. For more information on this extension, see Publication 3, *Armed Forces' Tax Guide*

TAX TIPS

★★★★★★★★★

Contributions to a traditional IRA reduce the limit for contributions to Roth IRAs.

Spousal IRA limit

If taxpayers file a joint return and one spouse's compensation is less than that of the other spouse's compensation, the spouse with the higher compensation may establish a traditional IRA for the other spouse. The most that can be contributed for that other spouse is the lesser of:

- 1) \$3,000 (\$3,500 if age 50 or older), or
- 2) The total compensation includible in the gross income of both spouses for the year, reduced by:
 - a) IRA contributions for the spouse with the greater compensation,
 - b) Nondeductible IRA contributions of the spouse with the greater compensation, and
 - c) Any contribution for the year to a Roth IRA for the spouse with the greater compensation.

The total combined contributions to both traditional IRAs cannot exceed the lesser of:

- \$6,000 (\$7,000 if both individuals are age 50 or older), or
- The total taxable compensation of both spouses.

Excess Contributions

Generally, an excess contribution is the amount contributed to a traditional IRA that is more than the lesser of the:

- 1) Taxable compensation for the year, or
- 2) \$3,000 (\$3,500 if age 50 or older).

This limit applies whether the contributions are deductible or nondeductible. Contributions made in the year the taxpayer reaches age 70 1/2 and any later year are also excess contributions.

In general, if the excess contribution for a year and any earnings on it are not withdrawn by the due date of the tax return (including extensions), the taxpayer is subject to an additional 6% tax. The additional 6% tax must be paid each year on the excess amounts that remain in the traditional IRA at the end of the tax year. The tax cannot be more than 6% of the value of the IRA as of the end of the tax year. The excise tax is figured on Form 5329, *Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts*.

A taxpayer who has taxable compensation, but can no longer contribute to a traditional IRA because of age (70 1/2 years or older) may continue to contribute to a spouse's traditional IRA until the year in which the spouse reaches 70 1/2.

Example 2

Eldridge is a single 73-year-old attorney. He earned \$12,000 during the year.

Eldridge had compensation for traditional IRA purposes but he cannot make an IRA contribution because he is 70 1/2 or older.

Example 3

Jane and Mike are married. Jane works in the home raising their two children. Mike works outside the home as an electrician and earned \$75,000 during the year.

If Jane and Mike file a joint return, a traditional IRA contribution can be made for Jane.

Exercise 1

- A. Liz receives alimony which is included in her total income. All of her other income is from interest and dividends. Can Liz make a traditional IRA contribution? Explain. _____

- B. David is 73 and works part time in a hardware store. David's wife, Mary, does not work outside of the home. Mary is 68. Can David make a traditional IRA contribution for Mary? Explain.

- C. Carla receives all her income from a rental property, interest income, and dividends. Can Carla make a traditional IRA contribution? Explain. _____

- D. Joy is 62 years old. Most of her income comes from a pension. However, Joy did earn \$1,250 doing consumer testing. How much can Joy contribute to a traditional IRA? Explain. _____

Deductible IRA Contributions

Generally, you can deduct the lesser of the contributions to your traditional IRA for the year or the general limit (or the spousal IRA limit, if it applies). A deduction for a traditional IRA depends on:

- Whether or not the taxpayer or taxpayer's spouse is covered by a retirement plan set up by an employer for any part of the year,
- The taxpayer's **modified adjusted gross income**, and
- The taxpayer's filing status.

COMMON QUERIES

If the Pension Plan box on Form W-2 has a check in it, the taxpayer is covered by an employer retirement plan.

Generally, **modified adjusted gross income** is the adjusted gross income without consideration of deductions for a traditional IRA or student loan interest, or any exclusion of Series EE or Series I bond interest shown on Form 8815, *Exclusion of Interest From Series EE and I U.S. Savings Bonds Issued After 1989*.

Not covered by an employer retirement plan.

A taxpayer whose filing status is single, head of household, or qualifying widow(er), and who is not covered by an employer retirement plan, can take a full traditional IRA deduction of either his or her taxable compensation or \$3,000 (whichever amount is smaller). The \$3,000 amount is increased to \$3,500 if the taxpayer is age 50 or older.

Example 4

Cyril is single and 40 years of age. His modified adjusted gross income is \$50,000. He is not covered by a retirement plan at work. Cyril's traditional IRA contribution of \$3,000 is deductible.

Married taxpayers who file separate returns for a taxable year and who live apart at all times during the taxable year are treated as single and can take a full IRA deduction, if not covered by an employer plan.

Married taxpayers who file jointly or separately may each be able to take the full IRA deduction of \$3,000 (\$3,500 if age 50 or older) or taxable compensation (whichever amount is smaller), if they had taxable compensation and were not covered by an employer retirement plan. The total deduction for a joint return cannot exceed \$6,000 (\$7,000 if both individuals are age 50 or older). ***When determining the allowable deduction each spouse figures the deduction separately.***

Covered by an employer retirement plan.

If the taxpayer is covered by a retirement plan at work, the traditional IRA deduction will be reduced or eliminated, as shown in **Table 1**, depending on filing status and modified AGI.

SPECIAL POPULATIONS



Reservists and volunteer firefighters should consult Publication 590 to determine if they are covered by an employer plan or not.

Table 1.
Traditional IRA Deduction Phaseout Chart
(If taxpayer is covered by an employer retirement plan)

Filing Status	Allowable traditional IRA deduction is...		
	reduced if modified AGI is:		zero when modified AGI is:
	at least	but less than	
Single or Head of household	\$34,000	\$44,000	\$44,000 or more
Married filing jointly or Qualifying widow(er)	\$54,000	\$64,000	\$64,000 or more
Married filing separately	\$0.01	\$10,000	\$10,000 or more

Example 5

Emily, 36 years old, is single. Her modified AGI was \$50,000. She is covered by a retirement plan at work. Emily's \$3,000 traditional IRA contribution is not deductible on her tax return because her modified adjusted gross income is at least \$44,000.

If either the taxpayer or the taxpayer's spouse is covered by an employer retirement plan, he or she may be entitled to only a partial deduction or no deduction at all, depending on filing status and modified adjusted gross income, as shown in **Table 2**, below.

Example 6

David and Ruth are filing a joint return. David earned \$65,000 and is covered by his employer's retirement plan. Ruth, age 32, is a homemaker, and has no compensation. David, age 36, contributed \$2,800 to his traditional IRA and \$3,000 to a traditional IRA for Ruth.

Because David is covered by his employer's retirement plan, the modified AGI limits apply (Table 1). Based on Table 1, David is not allowed a deduction for his traditional IRA contributions. Because David made traditional IRA contributions for Ruth, they can take a deduction on the tax return for her IRA contributions. Ruth is not covered by an employer's retirement plan. Their compensation for IRA purposes is \$65,000 and their modified AGI is not more than \$150,000 (see Table 2).

Table 2. Traditional IRA Deduction Phaseout Chart (If taxpayer is not covered, but the spouse is)			
Filing Status	<div style="border: 1px solid black; padding: 5px; text-align: center;"> Allowable traditional IRA deduction is... </div>		
	reduced if modified AGI is:		zero when modified AGI is:
	more than	but less than	
Married filing jointly or Qualifying widow(er)	\$150,000	\$160,000	\$160,000 or more
Married filing separately	\$0.01	\$10,000	\$10,000 or more

Example 7

Assume still that David earned \$65,000 and is covered by his employer’s retirement plan. Assume too that Ruth is employed; she earned \$66,000 and she is not covered by her employer’s retirement plan. David cannot deduct his traditional IRA contribution, but Ruth can deduct hers. The modified AGI limits that apply to David are shown in Table 1. Table 2 modified AGI limits apply to Ruth’s deduction. Her deduction would not be reduced unless the couple’s modified AGI was more than \$150,000. It would not be eliminated unless their modified AGI was \$160,000 or more.

Exercise 2

A. Angela and Joe are married and file a joint return. Joe, age 23, is covered by a retirement plan at work, but Angela, age 25, is not. Joe earned \$25,000 and Angela earned \$20,000; their modified AGI is \$45,000. Is any portion of Angela's traditional IRA contribution deductible, and why? _____

B. Annette, age 26, is single. She earned \$23,000, and her modified AGI is \$24,500. She made a \$500 contribution to a traditional IRA. Annette is covered by a retirement plan at work. Is any portion of her contribution deductible, and why?

C. Richard and Lynn are married and lived together during the year. They file separate returns. Richard is covered by a retirement plan at work. Lynn is not covered by a retirement plan at work. Richard, age 40, earned \$17,000 and contributed \$1,400 to a traditional IRA. Lynn, age 33, worked part-time and earned \$4,500. She contributed \$1,000 to a traditional IRA. Can Richard or Lynn deduct any of the IRA contributions, and why? _____

When to Deduct Traditional IRA Contributions

Individuals may deduct traditional IRA contributions on their 2002 tax return if the contributions are made in 2002 or by April 15, 2003. Taxpayers may not deduct on their 2002 tax return contributions made in 2002 which were deducted on the 2001 tax return. The contributions do not have to be made before the return is filed. If the taxpayer deducts traditional IRA contributions on the 2002 tax return but does not make the traditional IRA contributions by April 15, 2003, for the exact amount deducted, the taxpayer must file an amended tax return.

SPECIAL POPULATIONS



Taxpayers who receive Social Security Benefits should complete the worksheets in Appendix B of Publication 590 to determine the modified adjusted gross income and the allowable IRA deduction.

Using the Worksheet and Reporting the Deduction

Use the IRA Deduction Worksheet in the Form 1040A or Form 1040 instructions booklet to figure the traditional IRA deduction.

The traditional IRA deduction is reported on Form 1040A, line 17 or Form 1040, line 24. On joint returns when both spouses are making deductible traditional IRA contributions, enter the total contribution on line 17 or 24.

Example 8

Nick and Susan file a joint return. Both work, and Nick, age 27, was covered by a retirement plan, but Susan, age 25, was not. Nick earned \$12,300 and Susan earned \$10,990. Their total income, including interest, is \$23,400. Nick and Susan each contributed \$500 to a traditional IRA.

The completed worksheet and Form 1040, lines 22 through 35, for Nick and Susan are shown in Exhibits 1 and 2, respectively. The information for Nick is shown in the column for *Your IRA*. The information for Susan is shown in the column for *Spouse's IRA*.

IRA Deduction Worksheet—Line 24

Keep for Your Records

Before you begin:

- ✓ Complete Form 1040, lines 27 through 33a, if they apply to you.
- ✓ Figure any amount to be entered on the dotted line next to line 34 (see page 33).
- ✓ Be sure you have read the list on page 29.



	Your IRA	Spouse's IRA
1a. Were you covered by a retirement plan (see on page 31)?	1a. <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	
1b. If married filing jointly, was your spouse covered by a retirement plan?		1b. <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
Next. If you checked "No" on line 1a, and, if married filing jointly, "No" on line 1b, skip lines 2–6, enter \$3,000 (\$3,500 if age 50 or older at the end of 2002) on line 7a (and 7b if applicable), and go to line 8. Otherwise, go to line 2.		
2. Enter the amount shown below that applies to you.		
<ul style="list-style-type: none"> • Single, head of household, or married filing separately and you lived apart from your spouse for all of 2002, enter \$44,000 • Qualifying widow(er), enter \$64,000 • Married filing jointly, enter \$64,000 in both columns. But if you checked "No" on either line 1a or 1b, enter \$160,000 for the person who was not covered by a plan • Married filing separately and you lived with your spouse at any time in 2002, enter \$10,000 	2a. <u>64,000</u>	2b. <u>160,000</u>
3. Enter the amount from Form 1040, line 22 3.	<u>23,400</u>	
4. Add amounts on Form 1040, line 23, lines 27 through 33a, and any amount you entered on the dotted line next to line 34 4.	<u>0</u>	
5. Subtract line 4 from line 3. Enter the result in both columns 5a.	<u>23,400</u>	5b. <u>23,400</u>
6. Is the amount on line 5 less than the amount on line 2?		
<input type="checkbox"/> No. None of your IRA contributions are deductible. For details on nondeductible IRA contributions, see Form 8606.		
<input checked="" type="checkbox"/> Yes. Subtract line 5 from line 2 in each column. If the result is \$10,000 or more, enter \$3,000 (\$3,500 if age 50 or older at the end of 2002) on line 7 for that column and go to line 8 6a.	<u>40,600</u>	6b. <u>136,600</u>
7. Multiply line 6 by 30% (.30) (by 35% (.35) if age 50 or older at the end of 2002). If the result is not a multiple of \$10, increase it to the next multiple of \$10 (for example, increase \$490.30 to \$500). If the result is \$200 or more, enter the result. But if it is less than \$200, enter \$200 7a.	<u>3,000</u>	7b. <u>3,000</u>
8. Enter your wages, and your spouse's if filing jointly, and other earned income from Form 1040, minus any deductions on Form 1040, lines 29 and 31. Do not reduce wages by any loss from self-employment 8.	<u>23,290</u>	
CAUTION If married filing jointly and line 8 is less than \$6,000 (\$6,500 if one spouse is 50 or older at the end of 2002; \$7,000 if both spouses are 50 or older at the end of 2002), stop here and see Pub. 590 to figure your IRA deduction.		
9. Enter traditional IRA contributions made, or that will be made by April 15, 2003, for 2002 to your IRA on line 9a and to your spouse's IRA on line 9b 9a.	<u>500</u>	9b. <u>500</u>
10. On line 10a, enter the smallest of line 7a, 8, or 9a. On line 10b, enter the smallest of line 7b, 8, or 9b. This is the most you can deduct. Add the amounts on lines 10a and 10b and enter the total on Form 1040, line 24. Or, if you want, you may deduct a smaller amount and treat the rest as a nondeductible contribution (see Form 8606) 10a.	<u>500</u>	10b. <u>500</u>

Exhibit 2

Adjusted Gross Income	22	Add the amounts in the far right column for lines 7 through 21. This is your total income ▶	22	23,400
	23	Educator expenses (see page xx)	23	
	24	IRA deduction (see page 27)	24	1,000
	25	Student loan interest deduction (see page 28)	25	
	26	Tuition and fees deduction (see page XX)	26	
	27	Archer MSA deduction. Attach Form 8853	27	
	28	Moving expenses. Attach Form 3903	28	
	29	One-half of self-employment tax. Attach Schedule SE	29	
	30	Self-employed health insurance deduction (see page 30)	30	
	31	Self-employed SEP, SIMPLE, and qualified plans	31	
	32	Penalty on early withdrawal of savings	32	
	33a	Alimony paid b Recipient's SSN ▶	33a	
	34	Add lines 23 through 33a	34	1,000
	35	Subtract line 34 from line 22. This is your adjusted gross income ▶	35	22,400

COMMON QUERIES

A taxpayer does not have to make deductible IRA contributions. The entire IRA contribution may be treated as nondeductible.

Nondeductible IRA Contributions

Although the deductible amount of traditional IRA contributions can be reduced or eliminated because of the modified adjusted gross income limitation, a taxpayer can make nondeductible contributions to new or existing traditional IRAs. Earnings and gains on these contributions are not taxed until they are distributed to the taxpayer.

The total traditional IRA contribution, whether deductible or nondeductible, cannot be more than the taxpayer's taxable compensation or \$3,000 (\$3,500 if age 50 or older), whichever amount is smaller.

Taxpayers must complete Form 8606, *Nondeductible IRAs*, for each year that nondeductible contributions are made.

If taxpayers do not report nondeductible contributions, all of the contributions to a traditional IRA will be treated as deductible. This means all distributions will be taxed unless the taxpayer can show, with satisfactory evidence, that nondeductible contributions were made.

Example 9

Rachel, age 35, is single and wants to contribute the maximum amount possible to her traditional IRA. She is covered by her employer's retirement plan and her total income, Form 1040A Line 15, is \$39,000. Her total basis in traditional IRAs from line 14 of her 2002 Form 8606 is \$9,000. The completed IRA Deduction Worksheet and Form 8606 are shown in Exhibits 3 and 4.

IRA Deduction Worksheet—Line 17

Keep for Your Records

Before you begin: ✓ Be sure you have read the list that begins on page 30.



	Your IRA	Spouse's IRA
1a. Were you covered by a retirement plan (see this page)?	1a. <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	
1b. If married filing jointly, was your spouse covered by a retirement plan?		1b. <input type="checkbox"/> Yes <input type="checkbox"/> No
Next. If you checked "No" on line 1a, and, if married filing jointly, "No" on line 1b, skip lines 2–4, enter \$3,000 on line 5a (and 5b if applicable), and go to line 6. Otherwise, go to line 2.		
2. Enter the amount shown below that applies to you.		
<ul style="list-style-type: none"> • Single, head of household, or married filing separately and you lived apart from your spouse for all of 2002, enter \$44,000 • Qualifying widow(er), enter \$64,000 • Married filing jointly, enter \$64,000 in both columns. But if you checked "No" on either line 1a or 1b, enter \$160,000 for the person who was not covered by a plan • Married filing separately and you lived with your spouse at any time in 2002, enter \$10,000 	2a. <input style="width: 100px;" type="text" value="44,000"/>	2b. <input style="width: 100px;" type="text"/>
3. Enter the amount from Form 1040A, line 15	3. <input style="width: 100px;" type="text" value="39,000"/>	
4. Enter the amount, if any, from line 16	4. <input style="width: 100px;" type="text" value="0"/>	
5. Subtract line 4 from line 3. Enter the result in both columns	5a. <input style="width: 100px;" type="text" value="39,000"/>	5b. <input style="width: 100px;" type="text"/>
6. Is the amount on line 5 less than the amount on line 2?		
<input type="checkbox"/> No. None of your IRA contributions are deductible. For details on nondeductible IRA contributions, see Form 8606.		
<input checked="" type="checkbox"/> Yes. Subtract line 5 from line 2 in each column. If the result is \$10,000 or more, enter \$3,000 (\$3,500 if age 50 or older at the end of 2002) on line 7 for that column.	6a. <input style="width: 100px;" type="text" value="5,000"/>	6b. <input style="width: 100px;" type="text"/>
7. Multiply line 6 by 30% (.30) (by 35% (.35) if age 50 or older at the end of 2002). If the result is not a multiple of \$10, increase it to the next multiple of \$10 (for example, increase \$490.30 to \$500). If the result is \$200 or more, enter the result. But if it is less than \$200, enter \$200	7a. <input style="width: 100px;" type="text" value="1,500"/>	7b. <input style="width: 100px;" type="text"/>
8. Enter the amount from Form 1040A, line 7	8. <input style="width: 100px;" type="text" value="39,000"/>	
If married filing jointly and line 8 is less than \$6,000 (\$6,500 if one spouse is 50 or older at the end of 2002; \$7,000 if both spouses are 50 or older at the end of 2002), stop here and see Pub. 590 to figure your IRA deduction.		
9. Enter traditional IRA contributions made, or that will be made by April 15, 2003, for 2002 to your IRA on line 9a and to your spouse's IRA on line 9b	9a. <input style="width: 100px;" type="text" value="3,000"/>	9b. <input style="width: 100px;" type="text"/>
10. On line 10a, enter the smallest of line 7a, 8, or 9a. On line 10b, enter the smallest of line 7b, 8, or 9b. This is the most you can deduct. Add the amounts on lines 10a and 10b and enter the total on Form 1040A, line 17. Or, if you want, you may deduct a smaller amount and treat the rest as a nondeductible contribution (see Form 8606)	10a. <input style="width: 100px;" type="text" value="1,500"/>	10b. <input style="width: 100px;" type="text"/>

Part I Nondeductible Contributions to Traditional IRAs and Distributions From Traditional, SEP, and SIMPLE IRAs

Complete Part I only if:

- You made nondeductible contributions to a traditional IRA for 2002,
- You took distributions from a traditional, SEP, or SIMPLE IRA in 2002 (other than a rollover, conversion, recharacterization, or return of certain contributions) **and** you made nondeductible contributions to a traditional IRA in 2002 or an earlier year, **or**
- You converted part, but not all, of your traditional, SEP, and SIMPLE IRAs to Roth IRAs in 2002 (excluding any portion you recharacterized) **and** you made nondeductible contributions to a traditional IRA in 2002 or an earlier year.

1	Enter your nondeductible contributions to traditional IRAs for 2002, including those made for 2002 from January 1, 2003, through April 15, 2003 (see page 5 of the instructions)	1	1500	00
2	Enter your total basis in traditional IRAs for 2001 and earlier years (see page 5 of the instructions)	2	9000	00
3	Add lines 1 and 2	3	10,500	00

In 2002, did you take a distribution from traditional, SEP, or SIMPLE IRAs or make a Roth IRA conversion?

- No** → Enter the amount from line 3 on line 14. Do not complete the rest of Part I.
- Yes** → Go to line 4.

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13	Add lines 11 and 12. This is the nontaxable portion of all your distributions	13		
14	Subtract line 13 from line 3. This is your total basis in traditional IRAs for 2002 and earlier years	14	10,500	00
15	Taxable amount. Subtract line 12 from line 7. Also include this amount on Form 1040, line 15b; Form 1040A, line 11b; or Form 1040NR, line 16b.	15		

Note: You may be subject to an additional 10% tax on the amount on line 15 if you were under age 59½ at the time of the distribution (see page 6 of the instructions).

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Exercise 3

- A. Richard, who is single and 26 years old, wants to make the maximum traditional IRA contribution. He earned \$1,854 for giving private tennis lessons, \$2,000 interest income, and \$8,000 rental income. How much can Richard contribute to a traditional IRA? _____
- B. Mary is 55 and retired two years ago. She received an \$8,000 taxable pension and \$750 for baby sitting during the past year. How much can Mary contribute to a traditional IRA? _____
- C. Bill and Kathy are both employed and each earned \$15,000 in 2002. Both Bill and Kathy are age 32. Neither spouse was covered by an employer retirement plan for any part of the year. In July 2002, Bill contributed \$1,200 to his 2002 traditional IRA. In February 2003, he contributed \$800 to his 2002 traditional IRA. Kathy contributed \$400 to her 2002 traditional IRA. They file a joint return.
1. What is Bill's deductible traditional IRA contribution?

 2. What is Kathy's deductible traditional IRA contribution?

Additional Taxes and Penalties

Taxpayers are generally subject to additional taxes and penalties for:

- Contributing more to a traditional IRA than is allowed,
- Making traditional IRA withdrawals before age 59 1/2, and
- Not withdrawing enough traditional IRA funds after age 70 1/2.
- Investing in collectibles

There are penalties for overstating the amount of nondeductible contributions and for failure to file Form 8606, if required.

Saver's Credit

Refer to Lesson 6 to determine if a taxpayer is also eligible to receive the Saver's Credit based on their contributions to an IRA.

STUDENT LOAN INTEREST DEDUCTION

Taxpayers may be able to deduct interest due and paid in 2002 on a qualified student loan (even if they took out the loan before 2002). The deduction is reported on Form 1040A, line 18, or on Form 1040, line 25.

The student loan interest deduction for 2002 cannot be more than \$2,500 and is subject to the limit described later.

A taxpayer cannot claim the student loan interest deduction if another person can claim him or her as a dependent or if the taxpayer does not file a joint return with his or her spouse.

NOTE: Effective for 2002, student loan interest qualifies as an adjustment even if the required or voluntary payments began more than 60 months ago.

TAX TIPS

★★★★★★★★★
A taxpayer can deduct payments made in a later year when he or she is no longer claimed as a dependent.

Deduction Limit

The taxpayer's deduction may be limited, depending on the taxpayer's modified AGI. The following table explains when the limit applies.

Limit on Student Loan Interest Deduction		
If your filing status is...	AND your modified AGI is...	THEN...
Single, head of household, or qualifying widow(er)	\$50,000 or less	You can deduct all your interest, up to \$2,500.
	More than \$50,000, but less than \$65,000	Your deduction is limited.
	\$65,000 or more	You cannot claim this deduction.
Married filing jointly	\$100,000 or less	You can deduct all your interest up to \$2,500.
	More than \$100,000, but less than \$130,000	Your deduction is limited.
	\$130,000 or more	You cannot claim this deduction.

TAX TIPS

★★★★★★★★★
Interest is deductible on a qualified education loan if:
a) The loan is for the sole purpose of paying qualified higher education expenses; and
b) The individual claiming the interest is legally obligated to repay the loan.

Revolving lines of credit generally would not constitute qualified education loans unless the borrower agreed to use the line of credit to pay *only* qualifying education expenses.

Modified AGI

Modified AGI means AGI figured before taking the deduction for student loan interest payments and after adding back any of the following:

- Foreign earned income exclusion,
- Foreign housing exclusion or deduction,

- Exclusion of income for bona fide residents of Guam, Puerto Rico, American Samoa, or the Northern Mariana Islands.
- Qualified tuition and related expenses.

Figuring the limit

Taxpayers whose modified adjusted gross income is more than \$50,000 but less than \$65,000 (more than \$100,000 but less than \$130,000 for taxpayer's filing a joint return) figure their student loan interest deduction by completing the following two steps.

Step 1. Multiply the smaller of the actual interest paid on a qualified student loan, or \$2,500, by a fraction:

$$\frac{\text{Modified AGI} - \text{phaseout limit}}{\$15,000}$$

(\$30,000 if married filing a joint return)

Step 2. Subtract the result from step 1 from the smaller of the actual interest paid on a qualified student loan, or \$2,500.

Example 10

During 2002, Rick paid interest of \$1,500 on a qualified student loan. His modified AGI is \$115,000 and he is filing a joint return with Paula his wife. Rick's student loan deduction for 2002 is \$750, as figured below.

Step 1.

$$\frac{\$115,000 - \$100,000}{\$30,000} = .50$$

$$\$1,500 \times .50 = \$750$$

Step 2.

$$\$1,500 - \$750 = \$750$$

(Rick's student loan interest deduction)

Example 11

The facts are the same in Example 10, except that the actual interest paid on the qualified student loan is \$2,700. Because the interest Rick paid is greater than the maximum allowable student loan interest deduction (\$2,500), he will multiply his fraction by \$2,500.

Step 1.

$$\frac{\$115,000 - \$100,000}{\$30,000} = .50$$

$$\$2,500 \times .50 = \$1,250$$

Step 2.

$$\$2,500 - \$1,250 = \$1,250$$

(Rick's student loan interest deduction)

(In this case, Rick's deduction is based on the maximum amount allowable and not on the actual amount of interest he paid.)

Qualified Student Loan

A qualified student loan is a loan the taxpayer took out to pay qualified higher education expenses:

- For the taxpayer, the taxpayer's spouse, or the taxpayer's dependent (at the time that the taxpayer took out the loan),
- Paid or incurred within a reasonable time before or after the taxpayer took out the loan, and
- For education furnished during a period when the recipient was an eligible student.

Qualified Higher Education Expenses

These expenses are the costs of attending an eligible educational institution, including graduate school. Generally, these costs include tuition, fees, room and board, books, supplies, equipment, and other necessary expenses, such as transportation. You must reduce these costs by the following:

- Nontaxable employer-provided educational assistance benefits,
- Nontaxable distributions from a Coverdell ESA,
- U.S. savings bond interest that is nontaxable because you paid qualified higher educational expenses,
- Qualified scholarships that are nontaxable,
- Veterans' educational assistance benefits, and
- Any other nontaxable payments (other than gifts, bequests, or inheritances) received for educational expenses.

Eligible Educational Institution

Generally, an eligible educational institution means either:

- A college, university, vocational school, or other postsecondary educational institution eligible to participate in Department of Education student aid programs. This category includes virtually all accredited public, nonprofit, and proprietary postsecondary institutions, or
- An institution conducting an internship or residency program leading to a degree or certificate from an institution of higher education, a hospital, or a health care facility that offers postgraduate training.

Eligible Student

An eligible student is one who:

- Is enrolled in a degree, certificate, or other program (including a program of study abroad that is approved for credit by the institution at which the student is enrolled) leading to a recognized educational credential at an eligible educational institution, and
- Is carrying at least one-half the normal full-time work load for the course of study the student is pursuing.

Loan From Related Person

A taxpayer cannot deduct interest on a loan the taxpayer gets from a related person. Related persons include the taxpayer's

spouse, brother(s) and sister(s), half-brother(s) and half-sister(s), ancestors (parents, grandparents, etc.) and lineal descendants (children, grandchildren, etc.).

Refinanced Loan

If the taxpayer refinances a qualified student loan, the new loan can also be a qualified student loan.

TUITION AND FEES DEDUCTION

Prior to 2002 taxpayers could claim a deduction for education expenses on Form 1040, Schedule A as a miscellaneous expense limited to 2% of AGI.

Beginning in 2002, taxpayers can deduct an amount equal to the qualified tuition and related expenses paid during the tax year as an adjustment to income. The adjustment is reported on Form 1040, line 26, or Form 1040A, line 19.

To claim the deduction the taxpayer must have incurred *qualified expenses* for an *eligible student* to attend an *eligible educational institution* during the tax year.

Qualified Expenses

Qualified tuition and related expenses include tuition and fees required for enrollment or attendance at an eligible educational institution and generally include fees for:

- Course-related books, supplies and equipment, and
- Student activities.

The fees must be paid to the institution as a condition of enrollment or attendance.

Qualified tuition and related expenses do not include the cost of:

- Insurance,
- Medical expenses (including student health fees),
- Room and board,
- Transportation or similar personal, living or family expenses, even if the fees must be paid to the institution as a condition of enrollment or attendance.

Eligible Student

The deduction can be claimed for the taxpayer, the taxpayer's spouse (if filing a joint return) and any dependent (for whom the taxpayer claims a dependency exemption).

TAX TIPS

★★★★★★★★★
No deduction is allowed unless the taxpayer includes the name and taxpayer identification number of the eligible student on the tax return.

TAX TIPS

★★★★★★★★★
No deduction is allowed to a taxpayer if they are the dependent of another person.

Married taxpayers that file as married filing a separately return cannot take the deduction.

An individual who is the dependent of another taxpayer cannot claim the deduction.

Eligible Educational Institution

An eligible educational institution is generally any accredited public, nonprofit, or private postsecondary institution eligible to participate in the student aid programs administered by the Department of Education. Most universities and colleges, including community colleges, meet these requirements.

Deduction Amount

The deduction amount is determined by the taxpayer's filing status and adjusted gross income.

The total amount of qualified tuition and related expenses are reduced by:

- Distributions from qualified state tuition programs
- Distributions from Coverdell ESAs
- Interest from savings bonds used for higher education expenses

IF your filing status is...	AND your modified AGI is...	THEN...
Single, Head of Household, or Qualifying widow (er)	Equal to or less than \$65,000	You can deduct all of your qualified tuition and fees up to \$3,000.
	More than \$65,000	You cannot claim the credit.
Married filing jointly	Equal to or less than \$130,000	You can deduct all of your qualified tuition and fees up to \$3,000.
	More than \$130,000.	You cannot claim the credit.
Married filing separately	Any amount	You cannot claim the credit

Modified adjusted gross income for purposes of the deduction for qualified tuition and related fees is adjusted gross income before the deduction for qualified tuition and related fees and after adding back the following:

- Foreign earned income exclusion,
- Foreign housing exclusion or deduction,
- Exclusion of income for bona fide residents of Guam, Puerto Rico, American Samoa, or the Northern Mariana Islands.

Figuring the deduction

The taxpayer should use the worksheet in the instruction booklet for Form 1040 or Form 1040A to figure the allowable deduction for tuition and fees. In certain circumstances, the taxpayer may be required to use the worksheet in Publication 970 to figure the deduction.

Example 12

Luis and Priscilla file a joint return for 2002. Their 1040 line 22 total income is \$49,620. In 2002, Priscilla paid \$1,300 for classes taken at the local university. She had allowable IRA deductions of \$1,500. Their allowable tuition and fees deduction is \$1,300, shown in Exhibit 5.

Exhibit 5

Luis and Priscilla's Tuition and Fees deduction worksheet

Before you begin:	<ul style="list-style-type: none"> ✓ Complete Form 1040, lines 27 through 33a, if they apply to you. ✓ Figure any amount to be entered on the dotted line next to line 34 (see page xx). ✓ See the instructions for line 26 above. ✓ Be sure you have read the Exception above to see if you can use this worksheet instead of Pub. 970 to figure your deduction. 	
1. Enter the amount from Form 1040, line 22	1.	49,620
2. Enter the total of the amounts from Form 1040, lines 23 through 25, lines 27 through 33a, plus any amount you entered on the dotted line next to line 34	2.	1,500
3. Subtract line 2 from line 1	3.	48,120
<p>Note. If the amount on line 3 is more than \$65,000 (\$130,000 if married filing jointly), stop here. You cannot take the deduction for tuition and fees.</p>		
4. Tuition and fees deduction. Enter the total qualified tuition and fees (defined above) you paid in 2002. Do not enter more than \$3,000. Also, enter this amount on Form 1040, line 26	4.	1,300

No Double Benefits

A taxpayer cannot:

- Deduct higher education expenses on Schedule A and claim a deduction for the same expenses.
- Claim the Hope Credit or the lifetime learning credit for an individual in the same year as a deduction for qualified tuition and related expenses are claimed.
- Claim a credit based on expenses paid with a tax-free scholarship, grant, or an employer-provided educational assistance.

ONE-HALF OF SELF-EMPLOYMENT TAX

Report on Form 1040, line 29, the adjustment for one-half of self-employment tax from Schedule SE. This subject was covered in Lesson 3, for volunteers who will be helping self-employed taxpayers.

PENALTY ON EARLY WITHDRAWAL OF SAVINGS

Depositors may withdraw funds from ordinary savings accounts any time they wish. However, if they withdraw funds from a time deposit (such as a certificate of deposit) before the maturity date, a penalty is charged. Form 1099-INT reports the interest earned as well as any early withdrawal penalties.

As you learned in Lesson 3, taxpayers must report the total amount of interest earned. They cannot subtract the early withdrawal penalty from the interest earned and report the difference. The early withdrawal penalty can be claimed as an adjustment only on Form 1040, line 32. The entire penalty is deducted, even if it is greater than the interest income.

Example 13

Arlene has one Form W-2 and one Form 1099-INT and no other income. Her Form 1099-INT shows both interest income and an early withdrawal penalty. Arlene does not pay alimony, and she did not make a contribution to a traditional IRA. She will not itemize deductions, and she cannot claim any tax credits.

Arlene should file Form 1040 to claim the adjustment for the penalty on early withdrawal of savings.

ALIMONY PAID

As you learned in Lesson 3, alimony and separate maintenance payments are taxable to the person receiving these payments. The person paying the alimony or separate maintenance can claim it as an adjustment to income. This adjustment can be claimed only on Form 1040. The amount paid during the year and the recipient's social security number are entered on line 33a and 33b, respectively. Claim the adjustment only for amounts paid during the tax year.

Child support is not the same as alimony or separate maintenance payments. Child support is not taxable to the recipient and cannot be claimed as an adjustment by the payer.

JURY DUTY PAY GIVEN TO EMPLOYER

As you learned in Lesson 3, *Income*, jury duty pay received by taxpayers is included in other income on line 21 of Form 1040.

Some employees receive their regular wages from their employers when they are serving on a jury instead of working at their jobs. Often the jury duty pay the employees receive is turned over to their employers. The amount given to the employer may be claimed as an adjustment to income. On the dotted line next to line 34, write "jury pay" and the amount. Include jury duty pay with the adjustments claimed on lines 23 through 33a.

SPECIAL POPULATIONS



Divorced or separated individuals have tax questions that are unique to their situation. Some taxpayers may ask you complex questions like "How much of my payment represents alimony and how much is child support?" or "How do I report alimony received this year to make up for payments missed in previous years?" VITA/TCE materials prepare you to answer simple alimony questions; advise taxpayers with complex situations to seek paid professional tax assistance.

OTHER ADJUSTMENTS

The other adjustments that can be claimed on Form 1040 are beyond the scope of the VITA/TCE Program. Taxpayers who have adjustments that aren't discussed in this lesson should be advised to seek paid professional tax assistance.

TOTAL ADJUSTMENTS AND ADJUSTED GROSS INCOME

Add all adjustments and enter the total on Form 1040A, line 20, or Form 1040, line 34. Subtract the total adjustments from the total income on line 15 or 22. Enter the result on line 21 or 35. This is **adjusted gross income** and is often referred to as "**AGI.**" Adjusted gross income is used to compute some limitations, such as the medical and dental deduction on Schedule A and the credit for child and dependent care expenses.

▶▶ SUMMING UP THIS LESSON ◀◀

- An adjustment is an amount subtracted from total income.
The result is adjusted gross income.
- Adjustments covered in the VITA program are:
 - ▶ Educator expenses
 - ▶ Contributions to a traditional IRA
 - ▶ Student loan interest deduction
 - ▶ Tuition and fees paid
 - ▶ One-half of self-employment tax paid (volunteers trained to prepare Schedules C-EZ and SE can assist taxpayers claiming this adjustment)
 - ▶ Penalty on early withdrawal of savings
 - ▶ Alimony paid
 - ▶ Jury duty pay given to employer
- The adjustments for traditional IRA contributions, student loan interest deduction, tuition and fees deduction, and educator expenses deduction can be claimed either on Form 1040A or Form 1040. The other adjustments can be claimed on Form 1040.
- Persons 70 1/2 years of age or older by the end of the tax year cannot make traditional IRA contributions for that tax year.
- Traditional IRA contributions generally cannot be more than the taxpayer's taxable compensation or \$3,000 (\$3,500 if age 50 or older), whichever amount is smaller.
- Individuals who are not covered by retirement plans at work may make deductible IRA contributions regardless of their modified adjusted gross income. Taxpayers who are covered by retirement plans at work may deduct all, part, or none of their traditional IRA contributions depending on their modified adjusted gross income and filing status.
- Taxpayers may be subject to additional tax for contributing more to a traditional IRA than is allowed, making traditional IRA withdrawals before age 59 1/2, and not withdrawing enough traditional IRA funds after age 70 1/2.

Exercise 1

- (A) Yes; alimony is considered compensation for traditional IRA purposes.
- (B) Yes; Mary is under 70 1/2.
- (C) No; Carla has no compensation for traditional IRA purposes.
- (D) \$1,250; Because her total taxable compensation is less than \$3,500.

Exercise 2

- (A) Yes; all of her contribution up to \$3,000 is deductible because their combined modified adjusted gross income is not more than \$150,000.
- (B) Yes; all of it is deductible because her modified adjusted gross income is less than \$34,000.
- (C) Richard may not deduct any of his contribution because his modified adjusted gross income is at least \$10,000. Lynn will be able to deduct all of her IRA contribution because she is not covered by an employer-sponsored retirement plan.

Exercise 3

- (A) \$1,854
- (B) \$750
- (C) 1. \$2,000
2. \$400

STANDARD AND ITEMIZED DEDUCTIONS, AND TAX COMPUTATION

LESSON 5

INTRODUCTION AND OBJECTIVES

In this lesson you will learn about the standard deduction, itemized deductions and tax computations. You will learn which expenses can be included in itemized deductions. You will also learn when the taxpayer will use the tax tables and the Capital Gains Worksheet to compute their total tax.

After completing this lesson you should be able to:

- Select the correct standard deduction.
- Calculate and accurately report itemized deductions on Schedule A.
- Determine the miscellaneous deductions reported on Schedule A, line 27.
- Use the Capital Gain Tax Worksheet to calculate tax.
- Accurately calculate and report tax liability.

STANDARD DEDUCTION

The **standard deduction** depends on:

- the taxpayer's filing status,
- whether the taxpayer (or the taxpayer's spouse) is 65 or older and/or blind, and
- whether the taxpayer can be claimed as a dependent on another taxpayer's return.

Based on the taxpayer's situation, you will figure the standard deduction by using one of the following:

- Standard deduction amount for the appropriate filing status from the appropriate tax form,
- *Standard Deduction Chart for People Age 65 or Older or Blind*, or
- *Standard Deduction Worksheet for Dependents*.

TAX TIPS

★★★★★★★★★★

The charts showing the standard deduction amounts are included in the IRS Volunteer Quick Reference Guide, which is part of your Publication 678 Package.

- B.** Married, enter \$13,850. This is the total of the taxpayer's and spouse's standard deduction (\$7,850), exemption for the taxpayer (\$3,000), and exemption for the taxpayer's spouse (\$3,000).

Exercise 1

- A.** James is 37 years old. He has two children who live with him and he files as head of household. What is James' standard deduction? _____
- B.** Malcom is 37 years old. He was divorced in 2002. He is blind and has no dependent children. What is Malcom's standard deduction? _____
- C.** Carl is 67 years old and married to Sue, who is 59 years old. Neither is blind. If they file a joint return, what is their standard deduction? _____
- _____
- D.** If they are filing separate returns, what is Carl's standard deduction? _____
- E.** If they are filing separate returns, what is Sue's standard deduction? _____
- F.** Shirley is 15 years old and is claimed as a dependent on her parents' tax return. She earned \$1,500 during the summer and deposited it all into her savings account, where she earned \$40 in interest. What is her standard deduction? _____
- _____

POTENTIAL PITFALLS



Entering an incorrect standard deduction amount is a frequently made error on tax returns. Take care to report the correct standard deduction amount.

TAX TIPS

★★★★★★★★

A married taxpayer who files a separate return and whose spouse itemizes deductions will usually find it more beneficial to itemize deductions than to take the standard deduction of zero.

ITEMIZED DEDUCTIONS

Taxpayers can either claim the standard deduction or itemize their deductions. Both the standard deduction and itemized deductions reduce adjusted gross income. Most taxpayers choose the larger of their itemized deductions or their standard deduction. However, there are some exceptions:

- A married taxpayer filing a separate return cannot claim the standard deduction if the taxpayer's spouse itemizes deductions, and
- Nonresident aliens cannot claim the standard deduction.

For state tax purposes, it may be beneficial for some taxpayers to itemize deductions even if their total deductions are less than their standard deduction. If they do choose to itemize their deductions, enter "IE" (itemized elected) next to line 38 on Form 1040.

When itemizing, you should complete the taxpayer's return through line 36 of Form 1040. Then figure itemized deductions on Schedule A.

POTENTIAL PITFALLS



Explain to taxpayers that they can only deduct expenses in the year they are paid. They cannot deduct expenses that are owed but not paid.

PERSON

TO

PERSON

If you believe that a specific expense is not deductible, but a taxpayer insists that it is, politely refer the taxpayer to a paid professional tax preparer. The taxpayer may be correct. However, you should not deduct an expense unless you are absolutely sure that it qualifies as an itemized deduction.

Medical and Dental Expenses

Claim medical and dental expenses paid in 2002 on lines 1 through 4 of Schedule A. Include expenses incurred for:

- the taxpayer and spouse,
- dependents claimed on the return, and
- others who could have been claimed as dependents except that they had gross income of \$3,000 or more, or they filed a joint return.

If a child of divorced or separated parents is claimed as a dependent on either parent's return, each parent may deduct the medical expenses that he or she pays for the child.

Deductible expenses include:

- Prescription medicines and drugs (including insulin)
- Medical, dental, and nursing care, including amounts paid for unreimbursed qualified long-term care services
- Medical and hospital insurance premiums, including amounts paid for eligible long-term care (subject to certain limitations based on the insured person's age — see table later.)
- Prescription eyeglasses, hearing aids, crutches, wheelchairs, braces, and guide dogs
- Transportation for medical care at 13 cents a mile, or actual out-of-pocket expenses, plus parking fees and tolls
- Certain lodging expenses
- Certain home improvements made for medical care purposes or to make the home suitable for a disabled person
- Medicare A premiums for persons not enrolled in Social Security
- Medicare B
- Certain weight-loss programs to treat disease diagnosed by a physician, including obesity
- Unreimbursed costs of smoking-cessation programs, including the cost of prescription drugs designed to alleviate nicotine withdrawal
- Expenses for admission and transportation to a medical conference relating to the chronic disease of a dependent (if the costs are primarily for and essential to the medical care of the dependent).

Total medical and dental expenses must exceed 7.5 percent of a taxpayer's adjusted gross income (Form 1040, line 35) for Schedule A deduction.

Nondeductible expenses include:

- Medical expenses paid from a medical savings account (MSA). [Refer taxpayers with MSAs to Publication 969, *Medical Savings Accounts (MSAs)*, Publication 502, *Medical and Dental Expenses*, and a paid professional tax preparer.]
- Payroll tax paid for Medicare A
- Life insurance policy premiums
- Babysitting, child care, and nursing care for a healthy baby
- Illegal drugs
- Nonprescription drugs or medicines
- The cost of purchasing diet food items
- Nonprescription nicotine gum and patches designed to stop smoking
- Funeral, burial, or cremation costs
- Unnecessary cosmetic surgery (surgery that does not correct a congenital abnormality or an abnormality caused by injury or disease)
- Income protection policies, including nursing home policy premiums, if the policy ensures a maximum out-of-pocket expense per day
- Meals and lodging while attending a medical conference relating to the chronic disease of a dependent.

Eligible Long-Term Care Premiums

Attained age before the close of the taxable year:

40 years or less	\$ 240
More than 40, but not more than 50	\$ 450
More than 50, but not more than 60	\$ 900
More than 60, but not more than 70	\$2,390
More than 70	\$2,990

These figures should always be checked against the figures in the instructions for the Form 1040, Schedule A.

Exercise 2

Sam and Paula Fordham file a joint return. Sam's social security number is 000-00-8612. Their adjusted gross income is \$40,000. They paid the following medical bills:

Unreimbursed doctors' bills	\$ 500
Unreimbursed orthodontist bill for braces	1,200
Hospital insurance premiums	300
Life insurance premiums	500
Unreimbursed prescription medicines	100
Vitamins	70
Hospital bill (before deducting \$1,000 reimbursed by insurance company)	2,000
Smoking cessation program	150

Complete the *Medical and Dental Expenses* section of Schedule A for the Fordham family.

Exhibit 2

Schedule A

<p>SCHEDULES A&B (Form 1040)</p> <p>Department of the Treasury Internal Revenue Service (99)</p> <p>Name(s) shown on Form 1040</p>	<p>Schedule A-Itemized Deductions</p> <p>(Schedule B is on back)</p> <p>▶ Attach to Form 1040. ▶ See Instructions for Schedules A and B (Form 1040).</p>	<p>OMB No. 1545-0074</p> <p style="font-size: 2em; font-weight: bold;">2002</p> <p>Attachment Sequence No. 07</p> <p>Your social security number</p>										
<p>Medical and Dental Expenses</p>	<p>Caution. Do not include expenses reimbursed or paid by others.</p> <p>1 Medical and dental expenses (see page A-2)</p> <p>2 Enter amount from Form 1040, line 36</p> <p>3 Multiply line 2 above by 7.5% (.075)</p> <p>4 Subtract line 3 from line 1. If line 3 is more than line 1, enter -0-</p>	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 10%; text-align: center;">1</td> <td style="width: 10%; text-align: center;">2</td> <td style="width: 10%; text-align: center;">3</td> <td style="width: 10%; text-align: center;">4</td> <td style="width: 10%;"></td> </tr> </table>	1	2	3	4						
1	2	3	4									

Taxes

To be deductible, a tax must be imposed on and paid by the taxpayer. Taxpayers **cannot** deduct:

- a tax that they do not owe, but pay for someone else,
- a tax that they owe, but someone else pays, or
- a tax that was not paid in 2002.

Report deductible taxes on lines 5 through 9 of Schedule A.

State, Local, and Foreign Income Taxes—Taxpayers can deduct income taxes paid to a state or local government or to a foreign government or any of its subdivisions. These taxes include tax withheld, estimated payments, and tax paid for an earlier year.

Real Estate Taxes—State, local, or foreign taxes on real property, such as the taxpayer's house or land, are deductible. Real estate taxes are deductible when paid. If the taxes are paid with a mortgage payment and held in escrow, do not deduct the taxes until they are paid by the bank or mortgage lender.

Assessments to pave a street or install lighting or a sewer generally are not deductible.

Personal Property Tax—Taxes that state and local governments charge on the value of personal property are deductible. A portion of the cost of personal vehicle registration may fall in this category.

Nondeductible Taxes—Many federal, state, and local government taxes are not deductible. The following taxes are not deductible:

- General sales tax
- Federal taxes—income tax, social security (FICA), Medicare, railroad retirement tax, gift tax, and excise taxes or customs duties
- Hunting licenses and dog licenses
- Water and sewer taxes
- Taxes on alcoholic beverages, cigarettes, and tobacco
- State, local, and federal taxes on gasoline, diesel, and other motor fuels used in a nonbusiness vehicle
- Utility taxes—telephone, gas, electricity, etc.

Interest

Interest is the amount that is paid in order to borrow money. Only taxpayers who are legally liable for the debt can deduct the interest in the year it is paid or accrued. Interest expenses are reported on lines 10 through 14 of Schedule A.

Home Mortgage Interest—The amount of mortgage interest that a taxpayer can deduct depends on the:

- date of the loan,
- amount of the loan, and
- use of the proceeds of the loan.

If the mortgage debt was incurred on or before October 13, 1987, and was secured by a main or second home, the interest on that debt is fully deductible, regardless of the amount of the loan or the use of the loan proceeds.

If the mortgage debt was incurred after October 13, 1987, and was secured by a main or second home, the interest is fully deductible if:

- the loans plus any grandfathered debt do not exceed \$1 million (\$500,000 if married filing separate returns), and
- the proceeds were used to buy, build, or improve the home or homes.

SPECIAL POPULATIONS



Members of the clergy and military personnel can deduct real estate taxes even if they receive a housing allowance that is excluded from income. Also, they can deduct allowable mortgage interest even if the interest was paid from a nontaxable housing allowance.

In addition to loans used to buy, build, or improve a main or second home, taxpayers can deduct interest on other loans secured by a main or second home, regardless of the use of the proceeds, if:

- the total of these loans does not exceed \$100,000 (\$50,000 if married filing separate returns), and
- the total amount of the secured debt is not more than the home's fair market value minus any outstanding acquisition debt and any grandfathered debt on the home.

Points. Certain charges paid by a borrower and/or a seller to a lender to secure a loan are called points. They are also called loan origination fees (including VA and FHA loan origination fees), maximum loan charges, premium charges, loan discount, or discount points.

Points paid only for the use of money are considered prepaid interest. This interest, even if it qualifies as home mortgage interest, must be spread over the life of the mortgage and is considered paid and deductible over that period unless it meets the following exception.

Exception. A taxpayer may fully deduct points in the year he or she pays them only if all of the following conditions apply.

- The taxpayer itemizes deductions.
- The taxpayer's loan is secured by his or her main home. (The main home is the one the taxpayer lives in most of the time.)
- Paying points is an established business practice in the area where the loan was made.
- The points paid were not more than the points generally charged in that area.
- The taxpayer uses the cash method of accounting. (The cash method means that the taxpayer reports income in the year received and deducts expenses in the year paid.)
- The points were not paid in place of amounts that ordinarily are stated separately on the settlement statement, such as appraisal fees, inspection fees, title fees, attorney fees, and property taxes.
- The taxpayer uses his or her loan to buy or build his or her main home.
- The points were computed as a percentage of the principal amount of the mortgage.
- The amount is clearly shown on the settlement statement (such as Form HUD-1) as points charged for the mortgage. The points may be shown as paid from either the taxpayer's or the seller's funds.
- The funds the taxpayer provided at or before closing, plus any points the seller paid, were at least as much as the points charged. The funds the taxpayer provided do not have

TAX TIPS

★★★★★★★★★★

If the taxpayer does not meet the exception that allows him or her to deduct the full amount of points in the year paid, refer the taxpayer to a paid professional tax preparer.

TAX TIPS

★★★★★★★★★★

Taxpayers that meet the exception may choose to either fully deduct points in the year paid on a home mortgage or they may choose to amortize such points over the life of the loan, beginning in the year the loan was acquired. In either case, the points are deductible as interest on Schedule A (Form 1040).

to have been applied to the points. They can include a down payment, an escrow deposit, earnest money, and other funds the taxpayer paid at or before closing for any purpose. The taxpayer cannot have borrowed these funds from his or her lender or mortgage broker.

Charges by the lender for specific services, such as appraisal fees, preparation costs, VA funding fees, or notary fees, may be called points. However, these charges are not considered interest and are not deductible.

Points paid by the seller are deductible as interest by the buyer.

Points paid to refinance a mortgage are generally not deductible in full in the year the taxpayer paid them (unless they are paid in connection with the improvement of a main home and the first seven statements, discussed earlier under *Exception*, are true).

Points paid in excess of those generally charged in the area and points paid to refinance a mortgage can be deducted over the life of the mortgage. Deduct points reported to the taxpayer on Form 1098 on line 10 of Schedule A (Form 1040). Deduct points not reported to the taxpayer on Form 1098 on line 12 of Schedule A (Form 1040).

Investment Interest. Interest that is paid on money borrowed to buy or carry property held for investment is called **investment interest**. Taxpayers with investment interest expense that exceeds investment income (interest and ordinary dividend income) should see a paid professional tax preparer.

Interest that cannot be deducted. Interest that cannot be deducted includes:

- Interest on car loans where the car is used for personal use and other personal loans,
- Credit investigation fees,
- Loan fees; aid for services necessary to get a loan,
- Interest on a debt the taxpayer is not legally liable to pay, and
- Finance charges on credit card purchases of personal items.

POTENTIAL PITFALLS



Personal interest cannot be claimed as an itemized deduction. Personal interest includes interest on car loans, credit card balances, and installment-plan loans that are incurred for personal use or for personal expenses.

Exercise 3

John and Shannon file a joint return. During the year, they paid the bank \$2,180 of interest on their home mortgage that was re-reported to them on Form 1098 (all qualified), \$400 in credit card interest, \$300 on an installment loan, and \$2,000 on a car loan. Complete the *Interest You Paid* section of Schedule A for John and Shannon.

Exhibit 3

Schedule A

Interest You Paid (See page A-3.) Note. Personal interest is not deductible.	10	Home mortgage interest and points reported to you on Form 1098	10				
	11	Home mortgage interest not reported to you on Form 1098. If paid to the person from whom you bought the home, see page A-3 and show that person's name, identifying no., and address ▶					
	12	Points not reported to you on Form 1098. See page A-3 for special rules.	11				
	13	Investment interest. Attach Form 4952 if required. (See page A-3.)	12				
	14	Add lines 10 through 13	13				14

TAX TIPS

★★★★★★★★★
 Taxpayers can deduct contributions to a U.S. organization that transfers funds to a charitable foreign organization. This is true whether the U.S. organization controls the use of the funds or if the foreign organization is only an administrative arm of the U.S. organization.

Contributions

Taxpayers can deduct contributions to organizations that are:

- Organized and operated exclusively for religious, charitable, educational, scientific, or literary purposes,
- Organizations that work to prevent cruelty to children or animals, and
- Organizations that foster national or international amateur sports competition if they do not provide athletic facilities or equipment.

To be deductible, contributions must be made to an organization, not an individual. *Qualifying organizations* include:

- Churches, synagogues, temples, mosques, Salvation Army, Red Cross, CARE, United Way, Boy Scouts, Girl Scouts, World Wildlife Fund, etc.,
- Fraternal orders (if used for the purposes listed above),
- Nonprofit schools and hospitals,
- Nonprofit medical research organizations,
- Veterans' groups and certain cultural groups, and
- Federal, state, and local governments (if the gifts are exclusively for public purposes).

Nonqualifying organizations include:

- Business organizations, such as the Chamber of Commerce,
- Civic leagues and associations,
- Political organizations and candidates,

- Social clubs,
- Foreign organizations,
- Homeowners' associations, and
- Communist organizations.

Deductible items include:

- Money gifts,
- Dues, fees, and assessments paid to qualified organizations above the value of the benefits received (not country clubs or other social organizations),
- Fair market value of used clothing, furniture,
- Cost and upkeep of uniforms that have no general use but must be worn while performing donated services,
- Unreimbursed transportation expenses that relate directly to the services the taxpayer gave the qualified organization, including bus fare, parking fees, tolls, and either the actual cost of gas and oil or a standard mileage charge of 14 cents per mile, and
- The part of a contribution above the fair market value for items such as merchandise and tickets to charity balls or sporting events.

Nondeductible items include:

- Cost of raffle, bingo, or lottery tickets,
- Tuition,
- Value of a person's time or service,
- Blood donated to a blood bank or the Red Cross,
- Car depreciation, insurance, general repairs, or maintenance,
- Direct contributions to an individual,
- Sickness or burial expenses for members of a fraternal society, and
- The part of a contribution that personally benefits the taxpayer (such as the fair market value of the meal eaten at a charity dinner).

Report cash and check contributions on Schedule A, line 15. Contributions other than cash or check are entered on line 16. Taxpayers with noncash contributions exceeding \$500 should see a paid professional tax preparer.

The taxpayer must keep records to prove the amount of the cash and noncash contributions he or she makes during the year.

A taxpayer can claim a deduction for any single contribution of \$250 or more **only** if he or she has a written acknowledgment of the contribution from the qualifying organization. You do not have to see the written acknowledgement, but you should ask the taxpayer if they have one.

TAX TIPS

★★★★★★★★★
Taxpayers can also deduct contributions for disaster relief, for example, flood or hurricane relief, to a qualified organization. However, a taxpayer cannot deduct contributions for relief to a particular family or individual.

ALERT



If the taxpayer makes a contribution to a qualifying organization that is more than \$75 and is partly for goods or services, the qualifying organization must give the taxpayer a written statement. For more information, see Publication 526, *Charitable Contributions*.

Exercise 4

Rose contributed \$600 to St. Martin's Church (church gave letter verifying amount), \$32 to the Girl Scouts, and \$40 to a family whose house burned. She purchased \$50 worth of lottery tickets and spent \$100 playing bingo at her church. She donated used furniture with a fair market value of \$200 to Goodwill.

Complete the *Gifts to Charity* section of Schedule A for Rose.

Exhibit 4

Schedule A

Gifts to Charity	15	Gifts by cash or check. If you made any gift of \$250 or more, see page A-4	15					
If you made a gift and got a benefit for it, see page A-4.	16	Other than by cash or check. If any gift of \$250 or more, see page A-4. You must attach Form 8283 if over \$500	16					
	17	Carryover from prior year	17					
	18	Add lines 15 through 17				18		

TAX TIPS

★★★★★★★★★
Do not try to compute the deductible casualty or theft loss for taxpayers. This deduction is complex, with many rules and exceptions. Refer the taxpayer to a paid professional tax preparer.

Casualty and Theft Losses

A casualty occurs when property is damaged as a result of a sudden, unexpected, or unusual event such as fire, storm, shipwreck, flood, earthquake, or automobile accident. Theft is the unlawful taking and removing of money or property with the intent to deprive the owner of it. Theft does not include the mere disappearance of money or property.

A casualty or theft may result in a gain if the insurance proceeds or other reimbursements exceed the adjusted basis of destroyed or stolen property.

Usually, however, a casualty or theft results in a loss. Part of a casualty or theft loss may be deductible if the taxpayer can prove that the casualty or theft occurred to property that the taxpayer owned. The taxpayer must also prove the dollar amount of the loss.

Miscellaneous Itemized Deductions

Certain employee expenses, expenses of producing income, and other qualifying expenses are reported as miscellaneous itemized deductions on Schedule A. Miscellaneous itemized deductions that exceed 2% of adjusted gross income are deductible. There are some miscellaneous itemized deductions that are deductible, regardless of a taxpayer's adjusted gross income.

Examples of deductions that are subject to the 2% limit and that are reported on lines 20 through 26 of Schedule A are:

- Union dues and fees,
- Professional society dues,
- Uniforms not adaptable to general use,
- Small tools and supplies,
- Professional books, magazines, journals,

- Employment-related educational expenses,
- Expenses of looking for a new job,
- Investment counsel fees,
- Investment expenses,
- Tax counsel and assistance,
- Fees paid to an IRA custodian, and
- Safe deposit box rental for investment documents.

Examples of deductions that are not subject to the 2% limit and that are reported on line 27 of Schedule A are:

- Gambling losses to the extent of gambling winnings, and
- Work-related expenses for an individual with a disability, such as attendant-care services at the individual's place of work, that are necessary for the person to work.

Nondeductible expenses include:

- Burial or funeral expenses,
- Wedding expenses,
- Fees and licenses, such as car and marriage licenses and dog tags,
- Fines and penalties, such as parking tickets,
- Home repairs, insurance, and rent,
- Illegal bribes and kickbacks,
- Insurance premiums (except medical insurance premiums),
- Losses from the sale of a taxpayer's home, furniture, or personal car,
- Lost or misplaced cash or property,
- Personal legal expenses, and
- Commuting expenses to and from work.

Exercise 5

Roberts's adjusted gross income is \$20,000. He wants to deduct the following items on his tax return:

2002 income tax preparation fee	\$100
Safe deposit box rental (used to keep bonds)	75
Life insurance premiums	300
Investment expenses	70
Loss on sale of personal home	800
Investment journals and newsletters	250
Investment advisory fees	200
Attorney fees for preparation of will	100

Complete Robert's Schedule A, lines 20 through 26.

Exhibit 5

Schedule A

Job Expenses and Most Other Miscellaneous Deductions (See page A-5 for expenses to deduct here.)	20 Unreimbursed employee expenses—job travel, union dues, job education, etc. You must attach Form 2106 or 2106-EZ if required. (See page A-5.) ▶	20					
	21 Tax preparation fees.	21					
	22 Other expenses—investment, safe deposit box, etc. List type and amount ▶	22					
	23 Add lines 20 through 22	23					
	24 Enter amount from Form 1040, line 36 24	25					
	25 Multiply line 24 above by 2% (.02)	25					
	26 Subtract line 25 from line 23. If line 25 is more than line 23, enter -0-	26					

TAX TIPS
 ★★★★★★★★★★
 There is a limit on total itemized deductions for taxpayers with adjusted gross income greater than \$137,300 (\$68,650, if married filing separately.)

TOTAL ITEMIZED DEDUCTIONS

Schedule A, line 28, is *Total Itemized Deductions*. It is the sum of lines 4, 9, 14, 18, 19, 26, and 27.

Compare the amount on line 28 to the standard deduction, and enter the larger of the two on Form 1040, line 38.

Exercise 6

Seth A. and Karen Yale's adjusted gross income is \$28,000. Seth's social security number is 000-00-1039. They gave you a list of their itemized deductions. They received no insurance reimbursement for medical expenses. They purchased their home in 1989, and the mortgage is held by a commercial mortgage company. They have not refinanced the mortgage or increased the principal balance since they bought their home. They are both under age 65 and not blind. Neither can be claimed as a dependent by another taxpayer.

Medical expenses:

Medical insurance premiums	\$480
Hospital	600
Doctors and dentists	820
Vitamins	75
Prescription drugs	300
Insulin	120

Taxes:

State income tax	\$1,200
Federal income tax	2,400
Real estate tax	780

Interest:

Interest on mortgage (reported on Form 1098)	\$4,500
Car loan	900
Credit cards	102

Contributions:

Church (gave Yales' letter verifying this amount)	\$850
Bingo costs	60
American Cancer Society	130
Canned goods donated to a food drive	15
Fair market value of donated used clothing	60

Miscellaneous:

Union dues	\$90
IRA custodial fee	10
Traffic fine	70
Investment expenses	20

Complete Seth and Karen's Schedule A.

<p>SCHEDULES A&B (Form 1040)</p> <p>Department of the Treasury Internal Revenue Service (99)</p> <p>Name(s) shown on Form 1040</p>	<p>Schedule A—Itemized Deductions (Schedule B is on back)</p> <p>► Attach to Form 1040. ► See Instructions for Schedules A and B (Form 1040).</p>	<p>OMB No. 1545-0074</p> <p>2002 Attachment Sequence No. 07</p> <p>Your social security number</p>
<p>Medical and Dental Expenses</p> <p>Caution. Do not include expenses reimbursed or paid by others.</p>	<p>1 Medical and dental expenses (see page A-2)</p> <p>2 Enter amount from Form 1040, line 36</p> <p>3 Multiply line 2 above by 7.5% (.075)</p> <p>4 Subtract line 3 from line 1. If line 3 is more than line 1, enter -0-</p>	<p>1</p> <p>2</p> <p>3</p> <p>4</p>
<p>Taxes You Paid</p> <p>(See page A-2.)</p>	<p>5 State and local income taxes</p> <p>6 Real estate taxes (see page A-2)</p> <p>7 Personal property taxes.</p> <p>8 Other taxes. List type and amount ►</p> <p>9 Add lines 5 through 8</p>	<p>5</p> <p>6</p> <p>7</p> <p>8</p> <p>9</p>
<p>Interest You Paid</p> <p>(See page A-3.)</p> <p>Note. Personal interest is not deductible.</p>	<p>10 Home mortgage interest and points reported to you on Form 1098</p> <p>11 Home mortgage interest not reported to you on Form 1098. If paid to the person from whom you bought the home, see page A-3 and show that person's name, identifying no., and address ►</p> <p>12 Points not reported to you on Form 1098. See page A-3 for special rules</p> <p>13 Investment interest. Attach Form 4952 if required. (See page A-3.)</p> <p>14 Add lines 10 through 13</p>	<p>10</p> <p>11</p> <p>12</p> <p>13</p> <p>14</p>
<p>Gifts to Charity</p> <p>If you made a gift and got a benefit for it, see page A-4.</p>	<p>15 Gifts by cash or check. If you made any gift of \$250 or more, see page A-4</p> <p>16 Other than by cash or check. If any gift of \$250 or more, see page A-4. You must attach Form 8283 if over \$500</p> <p>17 Carryover from prior year</p> <p>18 Add lines 15 through 17</p>	<p>15</p> <p>16</p> <p>17</p> <p>18</p>
<p>Casualty and Theft Losses</p>	<p>19 Casualty or theft loss(es). Attach Form 4684. (See page A-5.)</p>	<p>19</p>
<p>Job Expenses and Most Other Miscellaneous Deductions</p> <p>(See page A-5 for expenses to deduct here.)</p>	<p>20 Unreimbursed employee expenses—job travel, union dues, job education, etc. You must attach Form 2106 or 2106-EZ if required. (See page A-5.) ►</p> <p>21 Tax preparation fees</p> <p>22 Other expenses—investment, safe deposit box, etc. List type and amount ►</p> <p>23 Add lines 20 through 22</p> <p>24 Enter amount from Form 1040, line 36</p> <p>25 Multiply line 24 above by 2% (.02)</p> <p>26 Subtract line 25 from line 23. If line 25 is more than line 23, enter -0-</p>	<p>20</p> <p>21</p> <p>22</p> <p>23</p> <p>24</p> <p>25</p> <p>26</p>
<p>Other Miscellaneous Deductions</p>	<p>27 Other—from list on page A-6. List type and amount ►</p>	<p>27</p>
<p>Total Itemized Deductions</p>	<p>28 Is Form 1040, line 36, over \$137,300 (over \$68,650 if married filing separately)?</p> <p><input type="checkbox"/> No. Your deduction is not limited. Add the amounts in the far right column for lines 4 through 27. Also, enter this amount on Form 1040, line 38.</p> <p><input type="checkbox"/> Yes. Your deduction may be limited. See page A-6 for the amount to enter.</p>	<p>28</p>
<p>For Paperwork Reduction Act Notice, see Form 1040 instructions.</p>		<p>Cat. No. 11330X</p> <p>Schedule A (Form 1040) 2002</p>

TAXABLE INCOME COMPUTATION

Once you have determined the standard deduction, compare it to the total itemized deductions. In most cases, you will enter the larger of the two amounts on Form 1040, line 38. Subtract line 38 from line 36 and enter the result on line 39. Then subtract the exemption deduction (line 40) to compute the taxable income.

If the taxpayer has capital gain distributions that are reported directly on Form 1040 or Form 1040A, the taxpayer should use the Capital Gain Tax Worksheet to determine if the tax is less. The taxpayer should:

- Check the box next to line 13, Form 1040 and
- Use the Capital Gain Tax Worksheet (Exhibit) from either the Form 1040A or 1040 instruction booklet to compute tax.

Example 8

Marjorie is a single taxpayer with taxable income of \$46,250. She files Form 1040 and does not have to file a Schedule D. In 2002, she received capital gain distributions of \$798 from XYZ Investments. Marjorie pays less tax by using Capital Gain Tax Worksheet (Exhibit 3).

Exhibit 7

Marjorie's Capital Gain Tax Worksheet

Capital Gain Tax Worksheet—Line 42		<i>Keep for Your Records</i>
Before you begin:		
✓	Be sure you do not have to file Schedule D (see the instructions for Form 1040, line 13, on page 23).	
✓	Be sure you checked the box on line 13 of Form 1040.	
1.	Enter the amount from Form 1040, line 41	1. <u>46,250</u>
2.	Enter the amount from Form 1040, line 13	2. <u>798</u>
3.	Subtract line 2 from line 1. If zero or less, enter -0-	3. <u>45,452</u>
4.	Figure the tax on the amount on line 3. Use the Tax Table or Tax Rate Schedules, whichever applies	4. <u>9,124</u>
5.	Enter the smaller of:	
	<ul style="list-style-type: none"> • The amount on line 1 or • \$27,950 if single; \$46,700 if married filing jointly or qualifying widow(er); \$23,350 if married filing separately; or \$37,450 if head of household. 	} 5. <u>27,950</u>
6.	Is the amount on line 3 equal to or more than the amount on line 5?	
	<input checked="" type="checkbox"/> Yes. Leave lines 6 through 8 blank; go to line 9 and check the "No" box.	
	<input type="checkbox"/> No. Enter the amount from line 3	6. <u> </u>
7.	Subtract line 6 from line 5	7. <u> </u>
8.	Multiply line 7 by 10% (.10)	8. <u> </u>
9.	Are the amounts on lines 2 and 7 the same?	
	<input type="checkbox"/> Yes. Leave lines 9 through 12 blank; go to line 13.	
	<input checked="" type="checkbox"/> No. Enter the smaller of line 1 or line 2	9. <u>798</u>
10.	Enter the amount, if any, from line 7	10. <u> </u>
11.	Subtract line 10 from line 9. If zero or less, enter -0-	11. <u>798</u>
12.	Multiply line 11 by 20% (.20)	12. <u>160</u>
13.	Add lines 4, 8, and 12	13. <u>9,284</u>
14.	Figure the tax on the amount on line 1. Use the Tax Table or Tax Rate Schedules, whichever applies	14. <u>9,344</u>
15.	Tax on all taxable income (including capital gain distributions). Enter the smaller of line 13 or line 14 here and on Form 1040, line 42	15. <u>9,284</u>

TAX TIPS

★ ★ ★ ★ ★ ★ ★ ★ ★ ★

The Tax Table for Form 1040 is included in the Tax Forms Booklet Appendix.

TAX TIPS

★ ★ ★ ★ ★ ★ ★ ★ ★ ★

To reduce errors when finding the amount of tax in the Tax Table, look up the tax a second time after completing the return.

TAX TIPS

★ ★ ★ ★ ★ ★ ★ ★ ★ ★

Always read the column heading before finding the tax in the Tax Tables.

FINDING THE TAX

Taxpayers with taxable income of less than \$100,000 use the Tax Table to find their tax. However, children under 14 years of age who have more than \$1,500 of investment income (interest, dividends, etc.) might not be able to use the Tax Table. Their income might have to be taxed at the parents' tax rate. These taxpayers should be referred to a paid professional tax preparer.

The Tax Table is in the instruction booklet for the tax forms. The tax is based on the person's filing status and taxable income. To find the tax, use the **taxable income** from the tax forms (1040EZ, line 6; 1040A, line 27; and 1040, line 41), and:

- locate the income bracket for the taxable income,
- read across that line until you reach the column for the appropriate filing status, and
- find the amount where the taxable income and filing status meet. This is the tax.

If the taxable income is the same as the ending amount in an income bracket, go to the next bracket to find the tax.

Qualifying widows(ers) use the married filing jointly column.

Enter the tax on Form 1040EZ, line 10, Form 1040A, line 28, or Form 1040, line 42.

Double check the amount entered. **Common errors** include:

- Using the wrong standard deduction,
- Incorrectly figuring the exemption amount,
- Using an amount other than taxable income to find the tax,
- Picking up the wrong number from the Tax Table, and
- Transposing the numbers when entering the tax amount.

▶▶ SUMMING UP THIS LESSON ◀◀

Both the standard deduction (or total itemized deductions, if greater) and exemption amounts are subtracted from adjusted gross income to arrive at taxable income.

The standard deduction depends upon:

- ▶ filing status,
- ▶ age, eyesight, and
- ▶ whether the taxpayer can be claimed as a dependent on another taxpayer's return.

Determine the standard deduction by using the:

- ▶ Standard Deduction amount for the appropriate filing status from the appropriate tax form,
- ▶ *Standard Deduction Chart for People Age 65 or Older or Blind*, or
- ▶ *Standard Deduction Worksheet for Dependents*.

Itemized deductions are specifically allowed by law. Claim itemized deductions on Schedule A (Form 1040).

Itemized deductions include:

- ▶ Medical and dental expenses
- ▶ Taxes paid
- ▶ Home mortgage and certain investment interest paid
- ▶ Charitable contributions
- ▶ Casualty and theft losses
- ▶ Miscellaneous itemized deductions.

Medical and dental expenses that exceed 7.5 percent of adjusted gross income are deductible.

To be deductible as a charitable contribution, a donation of \$250 or more must be acknowledged in writing by the charitable organization that received the donation.

Most miscellaneous itemized deductions that exceed 2% of adjusted gross income are deductible. However, there are certain miscellaneous itemized deductions that are fully deductible, regardless of adjusted gross income.

If deducted investment interest expense exceeds investment income, refer the taxpayer to a paid professional tax preparer.

If you are uncertain whether an expense qualifies as a deduction, do not guess. Refer the taxpayer to a paid professional tax preparer.

▶▶ **SUMMING UP THIS LESSON** ◀◀

(Continued)

Most taxpayers compare their total itemized deductions to their standard deduction and enter the larger amount on Form 1040, line 38.

Do not use the Tax Table for taxpayers with taxable income of \$100,000 or more.

Common errors include:

- ▶ Using the wrong standard deduction,
- ▶ Incorrectly figuring the exemption amount,
- ▶ Using an amount other than taxable income to find the tax,
- ▶ Picking up the wrong number from the Tax Table, and
- ▶ Transposing the numbers when entering the tax amount.

STANDARD AND ITEMIZED DEDUCTIONS AND TAX COMPUTATION

ANSWERS TO EXERCISES

Exercise 1

- (A) \$6,900
- (B) \$5,850
- (C) \$8,750
- (D) \$4,825
- (E) \$3,925
- (F) \$1,750

Exercise 2

Sam and Paula's Schedule A

SCHEDULES A&B (Form 1040) Department of the Treasury Internal Revenue Service (99)	Schedule A—Itemized Deductions (Schedule B is on back) ▶ Attach to Form 1040. ▶ See Instructions for Schedules A and B (Form 1040).	OMB No. 1545-0074 2002 Attachment Sequence No. 07																								
Name(s) shown on Form 1040 Sam and Paula Fordham		Your social security number 000 00 8612																								
Medical and Dental Expenses	Caution. Do not include expenses reimbursed or paid by others. 1 Medical and dental expenses (see page A-2) 2 Enter amount from Form 1040, line 36 2 <u>40,000</u> 3 Multiply line 2 above by 7.5% (.075) 4 Subtract line 3 from line 1. If line 3 is more than line 1, enter -0-	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 10%; text-align: center;">1</td> <td style="width: 10%; text-align: right;">3,250</td> <td style="width: 10%;"></td> </tr> <tr> <td style="text-align: center;">3</td> <td style="text-align: right;">3,000</td> <td></td> <td></td> <td></td> <td></td> <td></td> <td></td> </tr> <tr> <td style="text-align: center;">4</td> <td></td> <td></td> <td></td> <td></td> <td></td> <td style="text-align: right;">250</td> <td></td> </tr> </table>	1	3,250							3	3,000							4						250	
1	3,250																									
3	3,000																									
4						250																				

Exercise 3

John and Shannon's Schedule A

Interest You Paid (See page A-3.) Note. Personal interest is not deductible.	10 Home mortgage interest and points reported to you on Form 1098 11 Home mortgage interest not reported to you on Form 1098. If paid to the person from whom you bought the home, see page A-3 and show that person's name, identifying no., and address ▶ 12 Points not reported to you on Form 1098. See page A-3 for special rules 13 Investment interest. Attach Form 4952 if required. (See page A-3.) 14 Add lines 10 through 13	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 10%; text-align: center;">10</td> <td style="width: 10%; text-align: right;">2,180</td> <td style="width: 10%;"></td> </tr> <tr> <td style="text-align: center;">11</td> <td></td> <td></td> <td></td> <td></td> <td></td> <td></td> <td></td> </tr> <tr> <td style="text-align: center;">12</td> <td></td> <td></td> <td></td> <td></td> <td></td> <td></td> <td></td> </tr> <tr> <td style="text-align: center;">13</td> <td></td> <td></td> <td></td> <td></td> <td></td> <td></td> <td></td> </tr> <tr> <td style="text-align: center;">14</td> <td></td> <td></td> <td></td> <td></td> <td></td> <td style="text-align: right;">2,180</td> <td></td> </tr> </table>	10	2,180							11								12								13								14						2,180	
10	2,180																																									
11																																										
12																																										
13																																										
14						2,180																																				

Exercise 4

Line 15 \$632 Line 16 \$200 Line 18 \$832

Exercise 5

Robert's Schedule A

Job Expenses and Most Other Miscellaneous Deductions (See page A-5 for expenses to deduct here.)	20 Unreimbursed employee expenses—job travel, union dues, job education, etc. You must attach Form 2106 or 2106-EZ if required. (See page A-5.) ▶ 21 Tax preparation fees 22 Other expenses—investment, safe deposit box, etc. List type and amount ▶ safe deposit box \$75; investment \$520 23 Add lines 20 through 22 24 Enter amount from Form 1040, line 36 24 <u>20,000</u> 25 Multiply line 24 above by 2% (.02) 26 Subtract line 25 from line 23. If line 25 is more than line 23, enter -0-	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 10%; text-align: center;">20</td> <td style="width: 10%;"></td> </tr> <tr> <td style="text-align: center;">21</td> <td style="text-align: right;">100</td> <td></td> <td></td> <td></td> <td></td> <td></td> <td></td> </tr> <tr> <td style="text-align: center;">22</td> <td style="text-align: right;">595</td> <td></td> <td></td> <td></td> <td></td> <td></td> <td></td> </tr> <tr> <td style="text-align: center;">23</td> <td style="text-align: right;">695</td> <td></td> <td></td> <td></td> <td></td> <td></td> <td></td> </tr> <tr> <td style="text-align: center;">24</td> <td style="text-align: right;">20,000</td> <td></td> <td></td> <td></td> <td></td> <td></td> <td></td> </tr> <tr> <td style="text-align: center;">25</td> <td style="text-align: right;">400</td> <td></td> <td></td> <td></td> <td></td> <td></td> <td></td> </tr> <tr> <td style="text-align: center;">26</td> <td></td> <td></td> <td></td> <td></td> <td></td> <td style="text-align: right;">295</td> <td></td> </tr> </table>	20								21	100							22	595							23	695							24	20,000							25	400							26						295	
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STANDARD AND ITEMIZED DEDUCTIONS AND TAX COMPUTATION

LESSON 5

ANSWERS TO EXERCISES

Exercise 6

Schedule A

SCHEDULES A&B (Form 1040)		Schedule A—Itemized Deductions (Schedule B is on back)		OMB No. 1545-0074	
Department of the Treasury Internal Revenue Service (99)		▶ Attach to Form 1040. ▶ See Instructions for Schedules A and B (Form 1040).		2002 Attachment Sequence No. 07	
Name(s) shown on Form 1040 Seth and Karen Yale				Your social security number 000 00 1039	
Medical and Dental Expenses	1	Caution. Do not include expenses reimbursed or paid by others. Medical and dental expenses (see page A-2)	2,320		
	2	Enter amount from Form 1040, line 36	28,000		
	3	Multiply line 2 above by 7.5% (.075)	2,100		
	4	Subtract line 3 from line 1. If line 3 is more than line 1, enter -0-			220
Taxes You Paid (See page A-2.)	5	State and local income taxes	1,200		
	6	Real estate taxes (see page A-2)	780		
	7	Personal property taxes			
	8	Other taxes. List type and amount ▶			
	9	Add lines 5 through 8			1,980
Interest You Paid (See page A-3.)	10	Home mortgage interest and points reported to you on Form 1098	4,500		
	11	Home mortgage interest not reported to you on Form 1098. If paid to the person from whom you bought the home, see page A-3 and show that person's name, identifying no., and address ▶			
	12	Points not reported to you on Form 1098. See page A-3 for special rules			
	13	Investment interest. Attach Form 4952 if required. (See page A-3.)			
	14	Add lines 10 through 13			4,500
Gifts to Charity If you made a gift and got a benefit for it, see page A-4.	15	Gifts by cash or check. If you made any gift of \$250 or more, see page A-4	980		
	16	Other than by cash or check. If any gift of \$250 or more, see page A-4. You must attach Form 8283 if over \$500	75		
	17	Carryover from prior year			
	18	Add lines 15 through 17			1,055
Casualty and Theft Losses	19	Casualty or theft loss(es). Attach Form 4684. (See page A-5.)			
Job Expenses and Most Other Miscellaneous Deductions (See page A-5 for expenses to deduct here.)	20	Unreimbursed employee expenses—job travel, union dues, job education, etc. You must attach Form 2106 or 2106-EZ if required. (See page A-5.) ▶			
	21	Union dues \$90	90		
	22	Tax preparation fees			
	22	Other expenses—investment, safe deposit box, etc. List type and amount ▶ IRA custodial fee \$10; Investment \$20	30		
	23	Add lines 20 through 22	120		
	24	Enter amount from Form 1040, line 36	28,000		
25	Multiply line 24 above by 2% (.02)	560			
26	Subtract line 25 from line 23. If line 25 is more than line 23, enter -0-			0	
Other Miscellaneous Deductions	27	Other—from list on page A-6. List type and amount ▶			
Total Itemized Deductions	28	Is Form 1040, line 36, over \$137,300 (over \$68,650 if married filing separately)? <input checked="" type="checkbox"/> No. Your deduction is not limited. Add the amounts in the far right column for lines 4 through 27. Also, enter this amount on Form 1040, line 38. <input type="checkbox"/> Yes. Your deduction may be limited. See page A-6 for the amount to enter.			7,755

For Paperwork Reduction Act Notice, see Form 1040 instructions.

Cat. No. 11330X

Schedule A (Form 1040) 2002

CREDIT FOR QUALIFIED RETIREMENT SAVINGS CONTRIBUTIONS, MORTGAGE INTEREST, AND FOREIGN TAX CREDIT

LESSON 6

INTRODUCTION AND OBJECTIVES

In this lesson you will learn about three “miscellaneous credits”. The mortgage interest credit and the foreign tax credit are covered in this lesson. A new credit for qualified retirement savings has been added this year.

After completing this lesson you should be able to:

- Calculate the credit for qualified retirement savings contributions by using Form 8880.
- Accurately report the foreign tax credit if Form 1116 is not required.

CREDITS

A credit is a dollar-for-dollar reduction of the taxpayer’s tax liability. A **refundable** credit can be greater than the tax.

Taxpayers not only can have their tax reduced to zero; they can also receive a “refund” of excess credit. A **nonrefundable credit** can also be greater than the tax, but the nonrefundable credit can only reduce the tax to zero. Therefore, taxpayers will not receive a refund for any excess nonrefundable credit.

The Hope credit, the lifetime learning credit, the credit for child and dependent care expenses, the credit for the elderly or the disabled, the mortgage interest credit and the credit for qualified retirement savings contributions are nonrefundable credits.

The child tax credit is generally nonrefundable; but some taxpayers can qualify for the additional refundable child tax credit.

CREDIT FOR QUALIFIED RETIREMENT SAVINGS CONTRIBUTIONS

Beginning in 2002, if the taxpayer contributed to a retirement plan or an IRA, he or she may be eligible for the credit for qualified retirement savings contributions credit or saver's credit (a nonrefundable credit). The amount of the saver's credit is determined by the taxpayer's filing status, adjusted gross income, credit rate, and his or her qualified contributions.

The credit is reported on line 49 of Form 1040, or line 32 of Form 1040A.

To be eligible for the saver's credit, the taxpayer:

- Must be age 18 or older by the end of the tax year,
- Cannot be claimed on another person's tax return, and
- Cannot be a full-time student.

A **full-time student** is anyone who attends school full-time for some part of each of five calendar months of the year. The five months need not be consecutive. An individual is a full-time student if he or she is enrolled for the number of hours or courses the school considers as full-time attendance.

FIGURING THE CREDIT

The credit for qualified retirement savings contributions is figured by multiplying the **credit rate** by the lesser of the:

- Maximum allowable contribution (\$2,000), or
- Eligible contributions.

The credit rate is determined by using the following table.

IF your filing status is . . .	AND your adjusted gross income is . . .	THEN your credit rate is . . .
Married filing jointly	Less than \$30,001	50%
	Between \$30,001 and \$32,500	20%
	Between \$32,501 and \$50,000	10%
	Over \$50,000	0
Head of Household	Less than \$22,501	50%
	Between \$22,501 and \$24,375	20%
	Between \$24,376 and \$37,500	10%
	Over \$37,500	0
Single, Married filing separately, or qualifying widow(er)	Less than \$15,001	50%
	Between \$15,001 and \$16,250	20%
	Between \$16,251 and \$25,000	10%
	Over \$25,000	0

Adjusted gross income is determined without regards to:

- The foreign income exclusion
- The foreign housing exclusion or deduction
- Income from sources within Guam, American Samoa, and the Northern Mariana Islands
- Income from Puerto Rico

Eligible contributions are determined by reducing the taxpayer's **qualified retirement savings contributions** by the following distributions that were received during the **testing period**.

- Any distribution, that is included in the taxpayer's gross income, from a qualified retirement plan, or from an eligible deferred compensation plan.
- Any distribution from a Roth IRA that is not a qualified rollover contribution.

If the distributions received by the taxpayer are for loans or for excess IRA contributions returned before the due date of the return, they are not used to reduce the taxpayer's qualified retirement savings contributions.

Qualified retirement savings contributions are contributions made to a traditional or Roth IRA and salary reduction contributions to a 401(k) plan (including a SIMPLE 401(k)), a tax-sheltered annuity (403(b)) plan, an eligible deferred compensation plan of a state or local government (457(b)) plan, a SIMPLE IRA plan, or a salary reduction SEP.

Qualified retirement savings contributions also include voluntary after-tax employee contributions to a tax-qualified retirement plan or a tax-sheltered annuity (403(b)) plan. For purposes of the credit, an employee contribution will be voluntary as long as it is not required as a condition of employment.

The **testing period** includes:

- The tax year,
- The two preceding tax years, and
- The period between the end of the tax year and the due date of the return (including extensions).

Example 1

Terry contributes \$3,000 to a 401(k) plan during 2002. In 2001, Terry withdrew \$500 from his IRA. In 2002, he withdrew \$900 from his IRA. Neither of these withdrawals were rolled over. In 2002, Terry's adjusted gross income was \$23,000 and his filing status was head of household. Based on these facts, Terry would figure his saver's credit as follows:

(Qualified retirement contributions – withdrawals) x credit rate
(per table)

$$(\$3,000 - \$1,400) \times .20$$

$$\$1,600 \times .20 = \$320 \text{ saver's credit}$$

The saver's credit can be figured on **Form 8880**, *Credit for Qualified Retirement Savings Contributions*.

Married filing jointly. If the taxpayer is married filing a joint return, he or she and his or her spouse may both use the credit. Both the taxpayer and spouse are eligible for a credit of the maximum annual contribution amount of \$2,000.

If the taxpayers file a joint return, the qualified contribution is reduced by the taxable distributions received by the taxpayer or the taxpayer's spouse if the taxpayers filed jointly for both:

- the year a distribution was made, and
- the year the credit is claimed.

Exercise 1

Jason is 22 and earned \$30,000 in 2002. He is single and contributed \$3,000 to his 401(k) plan at work. Is Jason eligible for the credit for qualified retirement savings contributions?

Exercise 2

Sally Jones (000-00-0088) is 32 and files as Head of Household. Her only income is wages of \$26,819. This year, she was able to contribute \$1,000 to her employer's 401(k) plan. She did not put any money in an IRA. Use Exhibit 1 to complete Sally's Form 8880 through line 10.

TAX TIPS

★★★★★★★★★
A copy of Form 8396,
*Mortgage Interest
Credit* can be found
in the *Tax Forms
Booklet Appendix*,
which is part of your
Publication 678
Package.

Exhibit 1

Form **8880**
 Department of the Treasury
 Internal Revenue Service

Credit for Qualified Retirement Savings Contributions

OMB No. 1545-xxxx
2002
 Attachment
 Sequence No. **129**

▶ Attach to your tax return.

Name(s) shown on return

Your social security number

Caution. You cannot claim this credit if:

- Your adjusted gross income is over \$25,000 (\$37,500 if head of household; \$50,000 if married filing jointly);
- You were born after January 1, 1985;
- Someone else (such as your parent) claims you as a dependent for 2002; or
- You were a full-time student during 5 or more months in 2002.

	(a) You	(b) Your spouse																																				
1 Enter the amount contributed to traditional and Roth IRAs for 2002																																						
2 Enter the amount of salary reduction contributions to a 401(k) or other qualified employer plan for 2002, plus any voluntary contributions (see instructions)																																						
3 Add lines 1 and 2 in columns (a) and (b)																																						
4 Enter the total of all Roth IRA distributions, plus all taxable distributions from other qualified retirement plans, that were made after 1999 and before the due date (including extensions) of your 2002 tax return (see instructions)																																						
5 Subtract line 4 from line 3 in columns (a) and (b). If zero or less, enter -0-																																						
6 In each column, enter the smaller of line 5 or \$2,000																																						
7 Add the amounts on line 6. If zero, stop ; you cannot claim the credit																																						
8 Enter the amount from Form 1040, line 36 (or Form 1040A, line 22)* 8																																						
9 Enter the applicable decimal amount shown below for your filing status																																						
<table border="1"> <thead> <tr> <th>If line 8 is--</th> <th>Enter on line 9--</th> <th>Single, Married filing separate, or Qualifying widow(er)</th> </tr> <tr> <th>Over--</th> <th>But not over--</th> <th></th> </tr> </thead> <tbody> <tr> <td>---</td> <td>\$15,000</td> <td>.50</td> </tr> <tr> <td>\$15,000</td> <td>\$16,250</td> <td>.50</td> </tr> <tr> <td>\$16,250</td> <td>\$22,500</td> <td>.50</td> </tr> <tr> <td>\$22,500</td> <td>\$24,375</td> <td>.50</td> </tr> <tr> <td>\$24,375</td> <td>\$25,000</td> <td>.50</td> </tr> <tr> <td>\$25,000</td> <td>\$30,000</td> <td>.50</td> </tr> <tr> <td>\$30,000</td> <td>\$32,500</td> <td>.20</td> </tr> <tr> <td>\$32,500</td> <td>\$37,500</td> <td>.10</td> </tr> <tr> <td>\$37,500</td> <td>\$50,000</td> <td>.10</td> </tr> <tr> <td>\$50,000</td> <td>---</td> <td>.00</td> </tr> </tbody> </table>	If line 8 is--	Enter on line 9--	Single, Married filing separate, or Qualifying widow(er)	Over--	But not over--		---	\$15,000	.50	\$15,000	\$16,250	.50	\$16,250	\$22,500	.50	\$22,500	\$24,375	.50	\$24,375	\$25,000	.50	\$25,000	\$30,000	.50	\$30,000	\$32,500	.20	\$32,500	\$37,500	.10	\$37,500	\$50,000	.10	\$50,000	---	.00		
If line 8 is--	Enter on line 9--	Single, Married filing separate, or Qualifying widow(er)																																				
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---	\$15,000	.50																																				
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\$30,000	\$32,500	.20																																				
\$32,500	\$37,500	.10																																				
\$37,500	\$50,000	.10																																				
\$50,000	---	.00																																				
10 Multiply line 7 by line 9																																						
11 Enter the amount from Form 1040, line 44 (or Form 1040A, line 28) 11																																						
12 Enter the total of your credits from Form 1040, lines 45 through 48 (or Form 1040A, lines 29 through 31) 12																																						
13 Subtract line 12 from line 11. If line 12 is equal to or more than line 11, stop ; you cannot take the credit 13																																						
14 Credit for qualified retirement savings contributions. Enter the smaller of line 10 or line 13 here and on Form 1040, line 49 (or Form 1040A, line 32) 14																																						

Note: If line 9 is zero, **stop**; you cannot claim the credit.

*See Pub. 970 for the amount to enter if you are filing Form 2555, 2555-EZ, or 4563 or you are excluding income from Puerto Rico.

For Paperwork Reduction Act Notice, see page 4.

Cat. No. 333940

Form **8880** (2002)



TAX TIPS

★★★★★★★★★
A copy of Form 1116
can be found in the
*Tax Forms Booklet
Appendix*, which is
part of your
Publication 678
Package.

MORTGAGE INTEREST CREDIT

Taxpayers who hold qualified mortgage credit certificates under a qualified state or local government program may claim a credit for mortgage interest paid. The certificate must be for the taxpayer's main home. If the interest is paid to certain related parties (such as relatives), the credit cannot be claimed.

The credit is figured on Form 8396, *Mortgage Interest Credit*. Include the amount of the credit on Form 1040, line 52. Also, check box a on line 47 for Form 8396.

Any mortgage interest credit that the taxpayer cannot use in 2002 can be carried forward for up to three tax years. Figure the carryforward credit in Part II of Form 8396.

Reduce the mortgage interest deduction claimed on Schedule A, Form 1040, by the amount shown on line 3 of Form 8396.

Caution: If the taxpayer was issued (and used) a qualified mortgage credit certificate after 1990 for a home, the taxpayer may have to recapture (repay) all or part of the benefit if the taxpayer sells that home within 9 years. The recapture is figured on Form 8828, *Recapture of Federal Mortgage Subsidy*.

FOREIGN TAX CREDIT

If the taxpayer paid income, war profits, or excess profits taxes to any:

- Foreign country,
- U.S. possession, or
- Any political subdivision, or agency or instrumentality of the country or possession, he or she may be able to take a **Foreign Tax Credit** (FTC) for taxes paid.

To determine if the tax paid is eligible for the foreign tax credit, the taxpayer **may** need to consult a paid professional preparer.

Generally, to claim the FTC, a taxpayer is required to file Form 1116, *Foreign Tax Credit (Individual, Estate, Trust, or Nonresident Alien Individual)*; however, the taxpayer does not have to file Form 1116 to take the credit if he or she meets all of the following requirements.

- All of the taxpayer's gross foreign source income is from interest and dividends that are reported on Form 1099-INT, or Form 1099-DIV (or substitute statement)
- If the taxpayer has dividend income from shares of stock, he or she held those shares for at least 16 days.
- The taxpayer is not filing Form 4563, *Exclusion of Income for Bona Fide Residents of American Samoa*, or excluding income from sources within Puerto Rico.
- The total of the taxpayer's foreign taxes is less than or equal to \$300 (\$600 if married filing jointly).
- All of the taxpayer's foreign taxes were:
 - Legally owed and not eligible for a refund, and
 - Paid to countries that are recognized by the United States and do not support terrorism.

For additional information, see *the Instructions for Form 1116*.

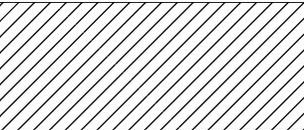
If the taxpayer meets all of the requirements listed above, enter the foreign tax credit on line 45 of Form 1040. Form 1116 is not required.

Example 2

Tabitha received a 1099-DIV that shows \$219 of foreign taxes (box 6) in 2002. According to Tabitha she paid no other foreign taxes. She can claim the \$219 on line 45 of Form 1040.

Exercise 3

Clyde comes to your site seeking help with his foreign tax credit. He is single and his 1099-DIVs show a total of \$423 of foreign tax. Does Clyde need Form 1116 to claim his credit?



CREDIT FOR QUALIFIED RETIREMENT SAVINGS CONTRIBUTIONS, MORTGAGE INTEREST, AND FOREIGN TAX CREDIT

LESSON 6

ANSWERS TO EXERCISES

Answers to Exercises

Exercise 1

No; Jason is not eligible for the credit because his income exceeds the threshold limit.

Exercise 2

See the completed Form 8880 on the next page.

Exercise 3

Yes, Clyde needs to complete a Form 1116 since his foreign taxes exceed \$300. Clyde will need to seek the assistance of a paid professional preparer.

Credit for Qualified Retirement Savings Contributions

▶ Attach to your tax return.

Name(s) shown on return

Sally Jones

Your social security number
 000 00 0088

Caution. You **cannot** claim this credit if:

- Your adjusted gross income is over \$25,000 (\$37,500 if head of household; \$50,000 if married filing jointly);
- You were born after January 1, 1985;
- Someone else (such as your parent) claims you as a dependent for 2002; **or**
- You were a full-time student during 5 or more months in 2002.

	(a) You	(b) Your spouse																																															
1 Enter the amount contributed to traditional and Roth IRAs for 2002	0																																																
2 Enter the amount of salary reduction contributions to a 401(k) or other qualified employer plan for 2002, plus any voluntary contributions (see instructions)	1,000																																																
3 Add lines 1 and 2 in columns (a) and (b)	1,000																																																
4 Enter the total of all Roth IRA distributions, plus all taxable distributions from other qualified retirement plans, that were made after 1999 and before the due date (including extensions) of your 2002 tax return (see instructions)	0																																																
5 Subtract line 4 from line 3 in columns (a) and (b). If zero or less, enter -0-	1,000																																																
6 In each column, enter the smaller of line 5 or \$2,000	1,000																																																
7 Add the amounts on line 6. If zero, stop ; you cannot claim the credit		1,000																																															
8 Enter the amount from Form 1040, line 36 (or Form 1040A, line 22)*	26,819																																																
9 Enter the applicable decimal amount shown below for your filing status																																																	
<table border="1"> <thead> <tr> <th rowspan="2">If line 8 is--</th> <th colspan="2">Enter on line 9--</th> <th rowspan="2">Single, Married filing separate, or Qualifying widow(er)</th> </tr> <tr> <th>Over--</th> <th>But not over--</th> <th>Married filing jointly</th> </tr> </thead> <tbody> <tr> <td>---</td> <td>\$15,000</td> <td></td> <td>.50</td> </tr> <tr> <td>\$15,000</td> <td>\$16,250</td> <td></td> <td>.50</td> </tr> <tr> <td>\$16,250</td> <td>\$22,500</td> <td></td> <td>.50</td> </tr> <tr> <td>\$22,500</td> <td>\$24,375</td> <td></td> <td>.50</td> </tr> <tr> <td>\$24,375</td> <td>\$25,000</td> <td></td> <td>.50</td> </tr> <tr> <td>\$25,000</td> <td>\$30,000</td> <td></td> <td>.50</td> </tr> <tr> <td>\$30,000</td> <td>\$32,500</td> <td></td> <td>.20</td> </tr> <tr> <td>\$32,500</td> <td>\$37,500</td> <td></td> <td>.10</td> </tr> <tr> <td>\$37,500</td> <td>\$50,000</td> <td></td> <td>.10</td> </tr> <tr> <td>\$50,000</td> <td>---</td> <td></td> <td>.00</td> </tr> </tbody> </table>			If line 8 is--	Enter on line 9--		Single, Married filing separate, or Qualifying widow(er)	Over--	But not over--	Married filing jointly	---	\$15,000		.50	\$15,000	\$16,250		.50	\$16,250	\$22,500		.50	\$22,500	\$24,375		.50	\$24,375	\$25,000		.50	\$25,000	\$30,000		.50	\$30,000	\$32,500		.20	\$32,500	\$37,500		.10	\$37,500	\$50,000		.10	\$50,000	---		.00
If line 8 is--	Enter on line 9--			Single, Married filing separate, or Qualifying widow(er)																																													
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\$50,000	---		.00																																														
10 Multiply line 7 by line 9		100																																															
11 Enter the amount from Form 1040, line 44 (or Form 1040A, line 28)																																																	
12 Enter the total of your credits from Form 1040, lines 45 through 48 (or Form 1040A, lines 29 through 31)																																																	
13 Subtract line 12 from line 11. If line 12 is equal to or more than line 11, stop ; you cannot take the credit																																																	
14 Credit for qualified retirement savings contributions. Enter the smaller of line 10 or line 13 here and on Form 1040, line 49 (or Form 1040A, line 32)																																																	

*See Pub. 970 for the amount to enter if you are filing Form 2555, 2555-EZ, or 4563 or you are excluding income from Puerto Rico.

For Paperwork Reduction Act Notice, see page 4.

Cat. No. 33394O

Form **8880** (2002)



STUDENT NOTES

INTRODUCTION AND OBJECTIVES

In this lesson you will learn how to report federal income tax payments and figure the overpayment or balance due. You will also learn how to determine if estimated taxes should be paid. Additionally, you will learn how to finish the return and have the taxpayer sign the return.

Please pay close attention to the section about identifying the returns that you work on. It is critical for you to mark VITA or TCE in the preparer's signature section of the return if you are not using the overprint forms.

After completing this lesson you should be able to:

- Calculate and report federal income tax withheld from all sources.
- Calculate and report estimated tax payments.
- Calculate the refund or amount due.
- Determine if estimated taxes should be paid.
- Determine if changes to the taxpayer's W-4 or W-4P should be suggested.

This lesson will provide detailed information on how to finish the tax return. The following checklist is provided as a quick reference of the steps needed to finish the return.

Checklist for Finishing the Return

- Add all Federal Income Tax Withholding from box 2 of Form W-2 and include on return.
- Add all Federal Income Tax Withholding from box 4 of Forms 1099R, 1099INT, 1099DIV and 1099G. Include in the payments section of the return.
- Include all estimated tax payments in the payment section.

POTENTIAL PITFALLS



Form W-2, box 4, shows social security tax withheld and box 6 shows Medicare tax withheld. These are not the same as federal income tax withheld. Do not report the amounts in box 4 and box 6 as federal income tax withheld.

POTENTIAL PITFALLS



When a taxpayer worked for more than one employer during the year, add up the amounts shown in box 4 of all Forms W-2. If the total in box 4 of all forms exceeds \$5,263.80 the taxpayer should claim a refund of excess social security tax withheld. Use the worksheet in Pub. 505, *Tax Withholding and Estimated Tax* to compute the refund.

- Include the amount of last year's refund that was applied to this year in the payment section. Note: If you need assistance with how to do this with TaxWise®, ask your site coordinator or computer specialist.
- Calculate all of the refundable credits (covered in later lessons) that the taxpayer is entitled to and include them in the payments section of the return. Using TaxWise® software will help you determine what credits that the taxpayer is entitled to.
- Add all payments together and enter them on the total payments line. TaxWise® will do this step for you.
- Subtract the total payments from the total tax. TaxWise® will also complete this step for you.
- Record the account number and the routing number for taxpayers who want their refund direct deposited. Note: TaxWise® will ask you for this information on the Main Information screen and on the tax form. This is to help ensure that you have keyed in the correct information. Complete the line to apply part of the refund to next year, if the taxpayer wishes to use this option.
- Explain the payment option (check, credit card, direct debit and installment agreement) to a taxpayer who owes money.
- Inform the taxpayer about the identifying information to include on payments made by check.
- Explain that interest and penalties continue to accrue on the unpaid balance even if the taxpayer has a valid installment agreement.
- Explain estimated taxes to taxpayers who expect to owe tax in 2003.
- Assist the taxpayer with completing form 1040ES for 2003. TaxWise® can do this for you. It will even print the vouchers for the payments.
- Provide the taxpayer with the mailing address for the estimated payments. (Some sites provide unstamped envelopes for the taxpayers.)
- Encourage taxpayers to consider adjusting their withholding (on Form W-4 or W-4P) if they have a large refund or owe more than \$1,000 on the return.
- Inform taxpayers about the Advanced Earned Income Credit, especially if they were eligible for EIC this year and have at least one qualifying child. Be prepared to give the taxpayer a Form W-5 if they request it.
- Complete the name and address section of the tax return. Use the taxpayer's label (if available) on a return prepared by hand. For computer generated returns, this section will be completed based on the information you entered in the Main Information section of the TaxWise® software.

- Make sure that you include the Taxpayer Identification Number for all taxpayers and dependents listed on the return. Note: If you are using TaxWise®, you will get an error when you run diagnostics if you have not included the identifying number. TaxWise® also has a diagnostic feature that helps you check the accuracy of the identifying number by comparing it to a database of information from the Social Security Administration. This does not guarantee that the name and social security number match. You should always try to look at the actual Social Security cards if possible.
- Mark the Presidential Election Campaign Box for the taxpayer. Note: If the taxpayer has a total tax of zero, the presidential campaign box should be marked no.
- Assemble the return. If filing a paper return for the taxpayer, forms should be in the order of the sequence number in the upper right corner. Procedures on assembling electronic returns may vary from site to site. Please ask your site coordinator for this information.
- Retain a copy of all electronic returns. Remember that you are not allowed to retain copies of the tax returns at your site past the end of the filing season. The retained copies should be forwarded to your local IRS territory office, where they will be retained until the end of the calendar year (as prescribed by the electronic filing regulations).
- Identify the return with the VITA or TCE designation in the preparer's signature section. Note: If you are using TaxWise®, you can set your initial forms so that this information is automatically included on every return you prepare.
- Submit the completed return to the quality reviewer at your site. Note: Not all sites have enough volunteers to have a designated quality reviewer. In this case, ask another volunteer to review the form you prepared. Using TaxWise® is not a substitute for quality review.
- Mark the area where the taxpayer should sign the return and/or Form 8453. Publication 3189 will contain additional information on how to use the PIN program to sign electronic returns.
- Complete the third party designation section of the return if the taxpayer wishes to allow someone else to discuss the return with the IRS. (You can't designate yourself.)
- Ask the taxpayer if they have any additional questions.
- Tell the taxpayer where to mail the return (if filing by paper). Some sites provide unstamped pre-addressed envelopes for their taxpayers. (You might be able to get the envelopes donated from a local office supply store. Your site receptionist could address the envelopes or you could print computer labels to use on them.)
- Keep track of the number of people you assist, using the method prescribed by your site coordinator.

PAYMENTS

The federal government has a pay-as-you-earn tax system. The information for the payments section of the return has three sources: federal income tax withholdings, estimated tax payments, and refundable credits.

Income tax withheld can appear on:

- Form W-2, *Wage and Tax Statement*, in box 2
- Form 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.*, in box 4
- Form 1099-INT, *Interest Income*, in box 4
- Form 1099-DIV, *Dividends and Distributions*, in box 4
- Form W-2G, *Certain Gambling Winnings*, in box 2
- Form 1099-G, *Certain Government and Qualified State Tuition Program Payments*, box 4
- SSA-1099 Social Security Benefits
- RRB-1099 Railroad Retirement Benefits Tier 1
- RRB-1099R Railroad Retirement Benefits Teir 2

Example 1

Susan has one Form W-2 (Exhibit 1).

The entry on line 7, Form 1040EZ, line 39, Form 1040A, or line 62, Form 1040, is \$988.

Exhibit 1

Susan's Form W-2

a Control number		OMB No. 1545-0008		Safe, accurate, FAST! Use Visit the IRS Web Site at www.irs.gov .	
b Employer identification number 10-0864213		1 Wages, tips, other compensation 12,350.00		2 Federal income tax withheld 988.00	
c Employer's name, address, and ZIP code XYZ Associates 2112 Third Street Tampa, FL 33621		3 Social security wages 12,350.00		4 Social security tax withheld 765.70	
		5 Medicare wages and tips 12,350.00		6 Medicare tax withheld 179.08	
		7 Social security tips		8 Allocated tips	
d Employee's social security number 000-00-2134		9 Advance EIC payment		10 Dependent care benefits	
e Employee's first name and initial Last name Susan A. Howard 134 Dawes Blvd. Tampa, FL 33621		11 Nonqualified plans		12a See instructions for box 12	
		13 Statutory employee Retirement plan Third-party sick pay <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>		12b	
		14 Other		12c	
				12d	
f Employee's address and ZIP code		15 State Employer's state ID number		16 State wages, tips, etc.	
		17 State income tax		18 Local wages, tips, etc.	
		19 Local income tax		20 Locality name	

Form **W-2** Wage and Tax Statement **2002** Department of the Treasury-Internal Revenue Service

Copy B To Be Filed with Employee's FEDERAL Tax Return. (Rev. February 2002)

This information is being furnished to the Internal Revenue Service.

Example 2

Albert has a Form 1099-INT (Exhibit 2), a Form 1099-R (Exhibit 3), and a Form 1099-DIV (Exhibit 4). His total income tax withheld is entered on line 39, Form 1040A. It is \$1,247.

Exhibit 2

Albert's Form 1099-INT

<input type="checkbox"/> CORRECTED (if checked)			
PAYER'S name, street address, city, state, ZIP code, and telephone no. Second Federal Bank 210 Miller Avenue Denver, CO 86011		Payer's RTN (optional)	OMB No. 1545-0112 2002 Form 1099-INT
PAYER'S Federal identification number 10-4213597	RECIPIENT'S identification number 000-00-4213	1 Interest income not included in box 3 \$ 935.00	
RECIPIENT'S name Albert B. George Street address (including apt. no.) 1360 Shannon Avenue City, state, and ZIP code Denver, CO 86011		2 Early withdrawal penalty \$	3 Interest on U.S. Savings Bonds and Treas. obligations \$
Account number (optional)		4 Federal income tax withheld \$ 187.00	5 Investment expenses \$
		6 Foreign tax paid \$	7 Foreign country or U.S. possession
Copy B For Recipient This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.			
Form 1099-INT		(keep for your records)	
Department of the Treasury - Internal Revenue Service			

Exhibit 3

Albert's Form 1099-R

<input type="checkbox"/> CORRECTED (if checked)			
PAYER'S name, street address, city, state, and ZIP code APEX Triangles 213 Hickory Meadows Denver, CO 86011		1 Gross distribution \$ 12,000.00	OMB No. 1545-0119 2002 Form 1099-R
		2a Taxable amount \$	Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.
		2b Taxable amount not determined <input type="checkbox"/>	
PAYER'S Federal identification number 10-9753124	RECIPIENT'S identification number 000-00-4213	3 Capital gain (included in box 2a) \$	4 Federal income tax withheld \$ 960.00
RECIPIENT'S name Albert B. George Street address (including apt. no.) 1360 Shannon Ave. City, state, and ZIP code Denver, CO 86011		5 Employee contributions or insurance premiums \$	6 Net unrealized appreciation in employer's securities \$
Account number (optional)		7 Distribution code IRA/SEP/SIMPLE <input type="checkbox"/>	8 Other \$ %
		9a Your percentage of total distribution %	9b Total employee contributions \$
		10 State tax withheld \$	11 State/Payer's state no. \$
		12 State distribution \$	This information is being furnished to the Internal Revenue Service.
		13 Local tax withheld \$	
		15 Local distribution \$	
Form 1099-R		Department of the Treasury - Internal Revenue Service	

<input type="checkbox"/> CORRECTED (if checked)				OMB No. 1545-0110 <div style="font-size: 2em; font-weight: bold; text-align: center;">2002</div> Form 1099-DIV	
PAYER'S name, street address, city, state, ZIP code, and telephone no. Denver Sheet Metal 214 16th Street Denver, CO 86013		1 Ordinary dividends \$ 500.00 2a Total capital gain distr. \$ 2b 28% rate gain \$	<div style="font-size: 1.5em; font-weight: bold;">Dividends and Distributions</div>		
PAYER'S Federal identification number 10-2846731	RECIPIENT'S identification number 000-00-4213	2c Qualified 5-year gain \$			
RECIPIENT'S name Albert B. George Street address (including apt. no.) 1360 Shannon Avenue City, state, and ZIP code Denver, CO 86011		2e Section 1202 gain \$	3 Nontaxable distributions \$	<div style="font-size: 1.2em; font-weight: bold;">Copy B For Recipient</div> This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.	
Account number (optional)		4 Federal income tax withheld \$ 100.00	5 Investment expenses \$		
Account number (optional)		6 Foreign tax paid \$	7 Foreign country or U.S. possession \$		
Account number (optional)		8 Cash liquidation distr. \$	9 Noncash liquidation distr. \$		
Form 1099-DIV		(keep for your records)		Department of the Treasury - Internal Revenue Service	

COMMON
QUERIES

Taxpayers use Form 1040-ES, Estimated Tax for Individuals, to make estimated tax payments.

TAX TIPS

★★★★★★★★★★

If the taxpayer does not pay the amount shown on line 12 of Form 1040EZ, line 47 of Form 1040A, or line 73 of Form 1040, he or she will be charged interest and a late payment penalty even if a request to pay in installment payments is granted. To limit the interest and penalty charges, the taxpayer should pay as much of the tax as possible with the return.

Estimated Tax Payments

Add all estimated tax payments made by the taxpayer for the year. Be sure to include:

- Payment made from last year's overpayment (see last year's tax return.)
- Quarterly payments made using the Form 1040ES, including the one made in January of the current tax year.

Record total estimated tax payments on Line 40 of Form 1040A or Line 63 of Form 1040.

Refundable Credits

Make sure that any refundable credits you have calculated are entered on the proper lines. The Earned Income Credit is reported on line 8 of the Form 1040 EZ, Line 41 of the Form 1040A, and Line 64 of the Form 1040. Any refundable Child Tax Credit is reported on Line 42 of the Form 1040A and Line 66 of the Form 1040. If excess Social Security deductions were made because of multiple employers, that amount is shown on Line 65 of the Form 1040.

Total Payments

Add the total of withholdings, estimated tax payments made, and refundable credits together. Enter this total on Line 9 of the Form 1040EZ, Line 43 of the Form 1040A, or Line 69 of the Form 1040.

FIGURING THE OVERPAYMENT OR THE TAX DUE

Overpayments

If there has been more tax payments made than the amount of tax liability (Line 10, Form 1040EZ, Line 38, Form 1040A, or Line 61, Form 1040), this is considered an overpayment. A taxpayer may wish to have a portion of the overpayment applied to next year's taxes. If so, then enter the amount to be applied to the following year on Line 46 of the Form 1040A or Line 72 of the Form 1040. Subtract this amount from the total overpayment and enter the remainder on Line 45a of the Form 1040A or Line 71a of the Form 1040.

Only a total refund can be entered on the Form 1040EZ, Line 12a. Any overpayment on Form 1040EZ must be refunded; it cannot be applied to next year's taxes.

Example 3

Exhibit 5 shows Form 1040A, lines 28 through 46, for Ron. His total tax is \$3,491. His total payments are \$5,000. Ron overpaid and wants \$900 to be applied to his 2003 estimated tax. Note that line 45a plus line 46 equals the amount on line 44.

Exhibit 5

Ron's 1040A, page 2

dependent, see page 33. • All others: Single, \$4,700 Head of household, \$6,900 Married filing jointly or Qualifying widow(er), \$7,850 Married filing separately, \$3,925	28	Tax, including any alternative minimum tax (see page 33).	28	3,491	00
	29	Credit for child and dependent care expenses. Attach Schedule 2.	29		
	30	Credit for the elderly or the disabled. Attach Schedule 3.	30		
	31	Education credits. Attach Form 8863.	31		
	32	Retirement savings contributions credit. Attach Form 8880.	32		
	33	Child tax credit (see page 36).	33		
	34	Adoption credit. Attach Form 8839.	34		
	35	Add lines 29 through 34. These are your total credits.	35		
	36	Subtract line 35 from line 28. If line 35 is more than line 28, enter -0-.	36	3,491	00
	37	Advance earned income credit payments from Form(s) W-2.	37		
	38	Add lines 36 and 37. This is your total tax.	38	3,491	00
	39	Federal income tax withheld from Forms W-2 and 1099.	39	2,600	00
	40	2002 estimated tax payments and amount applied from 2001 return.	40	2,400	00
If you have a qualifying child, attach Schedule EIC.	41	Earned income credit (EIC).	41		
	42	Additional child tax credit. Attach Form 8812.	42		
	43	Add lines 39 through 42. These are your total payments.	43	5,000	00
Refund	44	If line 43 is more than line 38, subtract line 38 from line 43. This is the amount you overpaid.	44	1,509	00
Direct deposit? See page 47 and fill in 45b, 45c, and 45d.	45a	Amount of line 44 you want refunded to you.	45a	609	00
	b	Routing number <input type="text"/>	c	Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings	
	d	Account number <input type="text"/>			
	46	Amount of line 44 you want applied to your 2003 estimated tax.	46	900	00

TAX TIPS

★★★★★★★★★★

If the taxpayer owes an estimated tax penalty (line 48, Form 1040A and line 74, Form 1040) the penalty should be added to the tax due on line 47 of the 1040A or line 73 of 1040.

Refunds

If the taxpayer wants any overpayment refunded, advise that a check should be mailed within 6-8 weeks after the return is filed. Remind the taxpayer of the availability to have the refund deposited directly into a financial account, such as a bank account.

Direct Deposit

Instead of getting a paper check, taxpayers may choose to have their refund deposited directly into their account at a bank or other financial institution such as a mutual fund, brokerage firm, or credit union.

Note. Taxpayers should check with their financial institution to make sure their direct deposit will be accepted and to get the correct routing and account number.

Exhibit 6 shows the general location of the routing and account number on a sample check. The routing number must be nine digits (the first two digits must begin with 01 through 12 or 21 through 32, otherwise the direct deposit will be rejected and a check sent instead). The account number can be up to 17 characters (both numbers and letters). It can include hyphens but not spaces or special symbols. The number should be entered from left to right with any unused boxes left blank.

Exhibit 6

The diagram shows a sample check with the following details:

- Payee: CHRIS MAPLE, LAURA MAPLE, 123 Main Street, Anyplace, CA 10000
- Amount: 20
- Bank: ANYPLACE BANK, Anyplace, NY 10000
- Routing number: 250250025 (line 71b)
- Account number: 202020 86 (line 71d)
- Check number: 1234
- Microprint MICR line: @250250025|@202020 86|1234

Annotations on the diagram:

- A circle around the routing number is labeled "Routing number (line 71b)".
- A circle around the account number is labeled "Account number (line 71d)".
- An oval around the check number "1234" is labeled "Do not include the check number".
- An arrow points from the check number "1234" to the MICR line.
- An arrow points from the MICR line to the routing and account numbers.
- A "SAMPLE" watermark is visible across the center of the check.

Exercise 1

- A. Helen paid \$500 in estimated tax to the United States Treasury. Where is this reported on Form 1040A? _____

- B. Shirley paid \$200, the amount owed on last year's income tax return. Is the \$200 an estimated tax payment for this year's income tax return? _____
- C. Elmer wants his refund deposited in his checking account. What information should you enter on line 45b of his 1040A form? _____
- D. Jennifer had tax withheld from her wages on Form W-2. She also had some withholding on her Form 1099-R. Can these items be combined and listed on one line on her tax return? _____

TAX TIPS

★★★★★★★★★
If the taxpayer does not pay the amount owed that is shown on his or her return, the taxpayer will still be charged interest and a late payment penalty even if his/her request to pay in installment payments is granted. To limit the interest and penalty charges, the taxpayer should pay as much of the tax as possible with his/her return.

TAX TIPS

★★★★★★★★★
Before requesting an installment agreement, the taxpayer should consider less costly alternatives, such as a bank loan.

ALERT

★★★★★★★★★
To pay by credit card, the taxpayer must call one of the service providers listed in the forms instructions and follow the instructions. A convenience fee will be charged by the service provider based on the amount paid by the taxpayer. Do *not* include the convenience fee as part of the tax payment. The taxpayer must enter the confirmation number given at the end of the call on Page 1 of his or her tax form in the upper left corner.

Tax Due

If there are less tax payments than the amount of tax liability, then there is tax due to be paid with the return. When this happens, remind the taxpayer to make the check or money order payable to the “United States Treasury.” Taxpayers can also pay by credit card or by authorizing a direct debit from their checking or savings account on the date they choose (anytime up to April 15, 2003). Encourage a 1040 filer to voluntarily send Form 1040-V, *Payment Voucher*, with his or her payment. The instructions for completing the voucher appear on the 1040-V. The taxpayer should write his or her name, address, social security number, daytime telephone number, and “2002 Form 1040 (or 1040A or 1040EZ, whichever applies)” on the check or money order. The payment and Form 1040-V should be enclosed, but not attached to the tax return. Taxpayers should not mail cash with their returns.

To help IRS process the payment, the taxpayer should enter the amount on the right side of the check like this: \$XXX.XX. Do not use dashes or lines (for example, do not enter “\$XXX—” or “\$XXX^{xx}/₁₀₀”).

Electronic Payment Options

If the taxpayer owes an amount on his or her return, he/she can make the payment electronically. To pay by credit card, the taxpayer must use one of the service providers listed in the instructions for Forms 1040, 1040A, or 1040EZ. The taxpayer can also pay by authorizing a direct debit out of his/her checking or savings account by April 15, 2003.

If the taxpayer cannot pay the full amount owed shown on his/her return, the taxpayer may ask permission to make monthly installment payments. To ask for an installment agreement, the taxpayer should file Form 9465, *Installment Agreement Request*, with the tax return.

Estimated Tax Penalty. If line 10, Form 1040EZ, line 47, Form 1040A, or line 73, Form 1040, is \$1,000 or more and it is more than 10 percent of the tax shown on the return, or if the taxpayer underpaid his or her 2002 estimated tax liability, the taxpayer can owe a penalty for underpayment of estimated tax. If so, report the penalty on line 48 for Form 1040A or line 74 of Form 1040. Line 47 or line 73 should include the amount owed with the return plus the penalty reported on line 48 of Form 1040A or line 74 of Form 1040, respectively.

Because the Form 2210, *Underpayment of Estimated Tax by Individuals, Estates, and Trusts*, used to compute estimated tax penalty is complicated, the IRS encourages taxpayers to let the IRS figure the penalty for them. The IRS will figure the penalty for underpayment of estimated tax and, if a penalty is owed, the taxpayer will be sent a bill. If taxpayers want the IRS to figure the penalty for them, the taxpayers should leave the penalty line on their return blank and **should not** complete Form 2210. As long as the taxpayer files the return by April 15, 2003, the IRS will not charge interest on the penalty if the bill is paid by the date specified on the bill.

PERSON
TO
PERSON

Remember to respect the taxpayer's privacy. Keep the taxpayer's personal and tax information confidential.

FIGURING ESTIMATED TAX FOR NEXT YEAR

Estimated tax is the amount a taxpayer expects to owe for the year, after deducting any tax credits or federal income tax withheld. In other words, it is the amount the taxpayer anticipates will be owed on his or her 2003 federal income tax return.

If a taxpayer is an employee, the taxpayer's employer generally must withhold income, Medicare, and social security taxes on the wages paid. Also, most payers of taxable pensions withhold income tax and pay it to the government. However, a taxpayer may receive many types of taxable income that are not subject to having tax withheld.

A taxpayer who receives interest, dividends, alimony, unemployment compensation, rent, gains from the sale of assets, prizes, or awards, generally will have no income tax withheld on the payments. As a result, the taxpayer may find that he or she owes estimated tax. Most self-employed taxpayers will also find they are required to pay estimated tax.

TAX TIPS

★★★★★★★★★
A taxpayer does not have to pay estimated tax if the 2002 return showed zero total tax or if no return was required.

Who Must Pay Estimated Tax

Estimated tax payments are required if certain conditions are met. Generally a taxpayer must make payments of estimated tax if:

1. He or she expects to owe \$1,000 or more in tax for 2003 after subtracting federal income tax withheld and credits from taxable income,

AND

2. He or she expects the 2003 tax withheld and credits to be less than the smaller of:
 - a) 90 percent of the tax to be shown on his or her 2003 tax return, or
 - b) 100 percent of the tax shown on his or her 2002 tax return. The return must cover all 12 months.

POTENTIAL PITFALLS



When figuring estimated tax, be sure to include all taxes, such as tax on lump-sum distributions and self-employment tax.

PERSON

TO

PERSON

Some taxpayers who begin making estimated tax payments late in the year may believe that they are entitled to divide the tax by the number of payment periods remaining and pay in equal installments. The payments are always figured on the basis of one fourth of the year's total. The later the taxpayer begins paying, the greater the number of payments that must be added together and paid as the first payment in order to bring the taxpayer up to date on the payment schedule.

COMMON QUERIES

Checks for payment of taxes or estimated taxes need to be made payable to the "United States Treasury".

Married taxpayers can pay estimated tax either separately or jointly. How they pay their estimated tax will not affect their choice of filing a joint return or separate returns for the year. Joint estimated tax payments may be divided between the spouses if they later choose to file separate returns.

Example 4

Alma is single and retired. She works part time as an usher in a movie theater. She estimates her 2003 income will be \$16,421, which includes \$3,500 of interest income from which there will be no tax withheld. Alma calculates that she expects to owe \$1,008 (after taking into account her expected tax withheld and credits). Alma meets condition 1 (mentioned earlier) and may have to pay estimated tax. Further checking tells Alma that her expected 2003 tax withheld will be less than 100 percent of the tax shown on her 2002 return and less than 90 percent of the tax she will show on her 2003 tax return. Since Alma also meets condition 2 (mentioned earlier), she is required to pay estimated tax.

Limit on the use of prior year's tax. Married taxpayers with joint AGI exceeding \$150,000 or \$75,000 if married filing separately cannot use 100% of their 2002 tax to figure their 2003 estimated tax payments.

For more information, see Publication 505, *Tax Withholding and Estimated Tax*.

How to Figure Estimated Tax

Estimated tax is paid by using Form 1040-ES, *Estimated Tax For Individuals*. Form 1040-ES also contains a worksheet that can be used in figuring a taxpayer's estimated tax. The taxpayer should keep the worksheet for his or her records.

To figure the estimated tax, the taxpayer must first figure his or her expected adjusted gross income, taxable income, taxes, and credits for 2003. All available facts that will affect those items during the year must be taken into account. Use the 2002 tax return as a starting point for estimating 2003 income, deductions, and credits. However, be careful to make adjustments both for anticipated changes in the taxpayer's situation and for recent changes in the tax law.

Form 1040-ES contains both the 2003 Tax Rate Schedules and the 2003 standard deduction and exemption amounts. Be sure to use the 2003 figures when figuring the estimated tax.

When to Pay Estimated Tax

For estimated tax purposes, the year is divided into four payment periods. Each period has a specific due date.

Date taxpayer receives income	Due date of first installment	No. of payments
January 1 – March 31	April 15, 2003	4
April 1 – May 31	June 16, 2003	3
June 1 – August 31	September 15, 2003	2
September 1 – December 31	January 15, 2004	1

Most of the taxpayers that you assist will pay their estimated tax in four equal installments. However, a taxpayer does not have to make estimated tax payments until he or she has income on which tax is owed. If a taxpayer receives income after one or more of the payment periods have passed, he or she will begin making payments during the period when the income is received.

The minimum payment due during the period when the income is received is one-fourth of the total estimated tax for the year, generally, plus an additional fourth of the yearly total for each period which has already passed. The balance of the estimated tax will be paid during the remaining periods (one-fourth of the yearly total for each remaining period).

The taxpayer also has the option of paying all the estimated tax at once. Instead of paying by installments, he or she may choose to pay the entire amount by the due date of the period during which the income is received.

Some taxpayers choose to pay all of their estimated tax with the first payment, April 15, 2003. It alleviates the need for them to remember to make the remaining payments.

Also, a taxpayer can apply all or part of an overpayment from his or her 2002 Form 1040 or Form 1040A to the estimated tax for 2003. The overpayment amount to be credited is entered on Form 1040, line 72, or Form 1040A, line 46. All of the credit can be applied to the first payment or it can be spread out among any or all of the payments.

If any due date falls on a Saturday, Sunday, or legal holiday, the payment is due on the next business day.

If a taxpayer files his or her 2003 Form 1040 or Form 1040A by January 31, 2004, and pays the entire amount of tax owed at that time, he or she is not required to make the estimated tax payment that would be due on January 15, 2004.

TAX TIPS

★★★★★★★★★★
Remember, estimated tax equals the amount the taxpayer expects to owe after credits and after tax is withheld.

POTENTIAL PITFALLS



Advise the taxpayer to use the pre-addressed envelopes that came with his or her Form 1040-ES package, or mail payment vouchers to the address shown in the Form 1040-ES instructions for the place where he or she lives. *Do not* use the address shown in the Form 1040 or Form 1040A instructions.

SPECIAL POPULATIONS

Farmers and fishermen can follow different rules for their estimated taxes.

TAX TIPS

★★★★★★★★★★

A taxpayer will not have to pay estimated tax if enough is paid through tax withholding to keep the 2003 amount owed under \$1000.

How Much Estimated Tax to Pay

The computed estimated tax is based on expected income and deductions and should take into account all facts known at the time the estimate is made. If the taxpayer is unsure about the accuracy of the estimate, he or she may want to pay more than the required minimum 90 percent of the 2002 estimated tax. Taxpayers who do not pay enough tax by the due date of each payment period may be charged a penalty, even if the filed 2003 return shows a refund. Generally, the simplest and safest procedure is to make sure that the total of tax withheld plus the amount of estimated tax for each payment period during 2003 is at least one-fourth of the tax shown on the 2002 return. For more information, see Publication 505.

How to Pay Estimated Tax

Estimated tax payments can be sent electronically to the IRS by direct debit payment from the taxpayer's checking or savings account, by credit card, or can be sent along with a payment voucher from Form 1040-ES. Each voucher is inscribed with its due date. Be sure to use the correct voucher for each payment. For more information on electronic filing and payments, see the Form 1040-ES instructions.

If the taxpayer paid estimated tax in 2002, he or she should have received a Form 1040-ES package containing pre-printed vouchers. These vouchers show the taxpayer's pre-printed name, address, and social security number. To use them, simply enter the amount of the payment on the appropriate line. If a taxpayer does not have the preprinted forms, use a set of blank vouchers from Form 1040-ES and enter the information on the appropriate lines. Advise the taxpayer to write his or her social security number and "2003 Form 1040-ES" on the check or money order (payable to the "United States Treasury") when paying estimated tax.

PERSON

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A taxpayer may become upset when you mention a penalty, especially if he or she made estimated tax payments. Stress that an estimate is inexact and that a change, for example, in income during the year can affect the original estimate.

FORM W-4 AND W-4P

An employer withholds tax based on wages paid and information the employee provides on Form W-4, *Employee's Withholding Allowance Certificate*. The employee uses his or her expected income, deductions, adjustments to income, and credits to figure the total withholding allowances to claim on Form W-4. In addition, an employee can claim extra allowances in certain situations.

A taxpayer who receives distributions from a pension, an annuity, an IRA, a stock bonus plan, or certain deferred compensation plans should use Form W-4P, *Withholding Certificate for Pension or Annuity Payments*, to notify the payer whether, and how much, income tax should be withheld.

Income, deductions, and credits should be estimated carefully. Taxpayers who do not have enough federal income tax withheld can be subject to interest and penalties. Taxpayers who have a very large refund or who owe should consider adjusting their withholding.

Some taxpayers want their withholding to be high enough to ensure that they receive a tax refund. They do not want to pay an additional amount when filing their tax return. If a taxpayer wishes, it is legal to claim fewer allowances than he or she is allowed. More tax than required will be withheld each pay period and, at the end of the year, the taxpayer should be eligible for a refund of overpaid taxes.

The Forms W-4 and W-4P also contain:

- Instructions
- *Personal Allowances Worksheet*
- *Deductions and Adjustments Worksheet*
- *Two-Earner / Two-Job, Multiple Pension / More Than One Income Worksheets*
- Tables

COMMON QUERIES

An employee can claim exemption from withholding only if all 2002 withholding was refunded because no tax was owed and no tax liability is expected in 2003.

TAX TIPS

★★★★★★★★★
Complete separate Form W-4 worksheets only if the taxpayer and his or her spouse will file separate returns.

The worksheets incorporate the number of allowances, adjustments, deductions, and credits that the employee expects on his or her 2003 income tax return. Some or all of these additional worksheets will then be used by the employee in completing the allowance certificate.

If an employee has a working spouse or income from two jobs, only one set of Form W-4 worksheets should be completed. Complete the Form W-4 worksheets using the combined expected income, adjustments, deductions, and exemptions. The number of total allowances from this Form W-4 can then be divided among all jobs. Withholding will usually be the most accurate when an employee claims zero allowances on all jobs except for the highest paying one.

Certain events can occur during the year that can change an employee's marital status, exemptions, allowances, deductions or credits. When this happens, the employee may have to change his or her withholding allowances by submitting a new Form W-4 to the employer. The original Form W-4 remains in effect until the employee changes it.

For more information on withholding, refer to Publication 919, *How Do I Adjust My Tax Withholding?*

W-5, Advance Earned Income Credit (AEIC)

At this time, you the preparer have the opportunity and the means to assist the taxpayer with the Form W-5, *Earned Income Credit Advance Payment Certificate*. The amount of the AEIC payments are based on wages by payroll cycle. Only persons with at least one qualifying child can get AEIC payments. If the taxpayer qualifies for the Earned Income Credit for 2002 refer them to Publication 596, *Earned Income Credit* or Form W-5 for additional information.

Completing and Assembling the Return

After all the decisions have been made regarding payments, overpayments, and estimated taxes, you should complete the taxpayer identification section, assemble the return, and submit it for quality review. When the review is completed, have the taxpayer sign the return and provide instructions on where and when to send it to the IRS. These steps are provided below.

Taxpayer Identification Section

This section is completed after the rest of the return. Often, this saves time because after you begin preparing Form 1040A, you may discover that Form 1040EZ or Form 1040 is more appropriate. If this happens, you will not have to complete the taxpayer identification section twice.

Taxpayers who filed returns last year probably received a forms package by mail this year. The package includes a pre-addressed label which shows the name and address of the taxpayer(s).

Peel the label off and place it in the address area of the return. Mark through any errors on the label, and print the correct information on the label. Be sure to enter the social security number(s) (or Taxpayer Identification Number (ITIN)) to the right of the label area.

If a taxpayer did not receive a forms package or does not have a pre-addressed label, PRINT the required information. Enter the taxpayer's name and social security number (or ITIN) on the first line. If married taxpayers are filing a joint return, enter one spouse's complete name and social security number (or ITIN) on the first line and the other spouse's complete name and social security number (or ITIN) on the second line. Be sure that each taxpayer's name and social security number (or ITIN) appear on one line, separate from the spouse's information. If you enter the husband's name and the wife's social security number (or ITIN) on the same line, there can be a considerable delay in processing the return.

Enter the address where any refund or notices should be sent. If the post office delivers mail to a post office box rather than to a street address, enter the P.O. box number on the line for the home address.

The Presidential Election Campaign Fund appears in the name and address area of Forms 1040EZ, 1040A, or 1040. Check *Yes* if the taxpayer wishes to have \$3 go to the Presidential Election Campaign Fund. Otherwise, check *No*. Checking *Yes* will not change the tax or reduce the refund. On a joint return, each taxpayer chooses whether or not \$3 should go to the fund.

POTENTIAL PITFALLS



Using the pre-addressed label reduces processing time. However, to protect the taxpayer's privacy, the peel-off label that he or she received in the mail with the tax return booklet does not have his or her SSN (or that of his or her spouse if filing a joint return) printed on it. Therefore, *be sure* the taxpayer's SSN (and spouse's, if applicable) is entered in the space provided on the tax form (1040, 1040A, or 1040EZ).

Further, if the taxpayer filed a joint return for 2001 and is filing a joint return for 2002 with the same spouse, *be sure* the taxpayer's and spouse's names and SSN's are entered in the same order as on the 2001 tax return.

TAX TIPS



Name change. Taxpayers who have changed their names because of marriage, divorce, etc., should be sure to report this to the Social Security Administration. This prevents delays in processing returns and issuing refunds and safeguards future social security benefits.

Assembling the Return

Make sure that all forms, schedules, and attachments show the taxpayer's name and social security number. List the names in the same order that they appear on the front of the return and use the first social security (or ITIN) number that appears on the front of the return.

Attach forms and schedules behind Form 1040 according to the attachment sequence number shown in the upper right corner of the form or schedule. Items without an attachment sequence number should be placed at the end. For Form 1040A, attach any forms or schedules in order by number with Schedule EIC last.

Attach Form(s) W-2 to the left margin of the return. If any Form 1099 shows federal income tax withheld, include that amount in the payments section of the return.

When any Form 1099 shows federal income tax withheld, attach a copy to the return, along with any Form(s) W-2.

IDENTIFYING RETURNS

Tax returns prepared by or with the assistance of TCE and VITA volunteers are identified on the tax form. This identification helps the IRS count the number of returns prepared by volunteers nationwide.

If taxpayers ask about the "TCE" or "VITA" designation at the bottom of the return, explain that this is done for statistical purposes. Inform the taxpayers that the designation does not affect the likelihood of an IRS examination (audit) of the return.

If you prepare over 50 percent of the tax return and you are reasonably sure that the return will be filed as you prepared it, enter the "VITA" or "TCE" designation at the bottom of the return. If the assistance you provide is limited to answering taxpayer questions, you do not need to enter the volunteer designation on the tax return. Do not enter volunteer designations on schedules and attachments.

Most sites will have forms preprinted with volunteer designations. For Form 1040A and Form 1040, the designation appears under the signature block on page two. For Form 1040EZ, the designation appears *at the bottom of page one*. Volunteers should circle the appropriate designation, "VITA" or "TCE."

If you do not have forms with the preprinted designation, print the appropriate designation in bold letters in the "Paid preparer's use only" block at the bottom of page two. On Form 1040A and 1040 and on the bottom of page one of Form 1040EZ.

Enter your site number on the line directly to the right of the "VITA/TCE" designation.

QUALITY SERVICE

The goal of the TCE and VITA Programs is to provide high quality service.

On-Site Quality Review Program

Every site should have a quality review program. Properly reviewed returns will help prevent taxpayers from receiving an error notice from the IRS. At larger sites, an experienced volunteer should be designated as the quality reviewer. At small sites, volunteers may review each other's work. A Quality Review Checklist, like the one shown below, may be used for this purpose.

OVERPRINT INSTRUCTIONS

Effective October 1, 2002, VITA/TCE volunteers no longer have the responsibility of reporting statistics using Form 6522. The Internal Revenue Service (IRS) will capture this information using the Individual Master File Report (IMF Report) and the Electronic Tax Administration (ETA) report. Based on this change, it is very important that **all returns** prepared by a volunteer tax preparation site be identified as VITA or TCE prepared. "VITA or TCE" should be marked, written or stamped on the form in the space provided for "Paid Preparer's Use Only" (see Exhibit)

The following procedures must be used when returns are prepared in a VITA or TCE site.

1. Paper Returns

- TCE Sites will circle TCE and VITA will circle VITA
- If you use a return without the overprint, you must mark VITA or TCE whichever applies in big bold letters in the "Paid Preparer's Use Only".

2. Electronically filed returns

- E-file administrators will set up computers to indicate VITA or TCE acronyms in the "non-paid preparer indicator" section.
- If the return rejects or does not qualify for electronic filing the return must be marked VITA or TCE in the "Paid Preparer's Use Only" section.

COMMON QUERIES

If the taxpayer moves, he or she should notify the IRS using Form 8822, *Change of Address*. The taxpayer should mail it to the same IRS service center where the last return was filed.

TAX TIPS

★★★★★★★★★
A resident or non-resident alien who does not have, or cannot get an SSN, should file a Form W-7 with the IRS to apply for an individual taxpayer identification number (ITIN).

The ITIN is entered on the return whenever the SSN is requested, and is used for tax purposes only.

TAX TIPS

★★★★★★★★★
Make sure the social security number is entered correctly in the designated area of the tax return. An incorrect number could delay the taxpayer's refund.

COMMON QUERIES

The IRS quality review does not make an examination (audit) more likely nor does it otherwise affect the taxpayer's return.

- Are the name, address, and **social security number** correct for each taxpayer on the return?
- Is the social security number(s) or ITIN(s) entered to the right of the label area?
- Is the Presidential Election Campaign Fund box(es) checked?
- Is the filing status correct? Is the box checked?
- Are the exemptions and dependents checked, listed, and added correctly?
- Are dependents' social security numbers or ITINs entered?
- Are income items correctly transferred from Form W-2, Form 1099-INT, Form 1099-DIV, Form 1099-G, Form 1099-R, and Form SSA-1099 (or RRB-1099), for example?
- Is tax-exempt interest income reported? Is "TEI" written to the left of line 2 on Form 1040EZ?
- Is the taxable portion of social security benefits, IRA distributions, pensions, and/or annuity income correctly figured?
- Are there IRA withdrawals to report?
- Is there any other income to report (lottery, fees, etc.)?
- If the taxpayer paid alimony, is the recipient's social security number entered?
- Are all appropriate boxes on line 37a, Form 1040 or line 23a, Form 1040A or line 5, Form 1040EZ checked?
- Is the standard deduction correct? Complete worksheet if taxpayer is someone else's dependent.
- Is the tax correct?
- Is the taxpayer eligible to claim the credit for child and dependent care expenses, child tax credit, education credits, adoption credit, or credit for the elderly or the disabled?
- Does the tax withheld agree with the total of amounts shown on all Forms W-2, 1099-INT, 1099-DIV, and 1099-R?
- Are the estimated tax payments correct?
- Is the taxpayer eligible to claim the earned income credit?
- Is the overpayment or the amount owed correct? Does the taxpayer want any part of the refund applied to next year's estimated tax? Does the taxpayer want the refund or any part directly deposited?
- Did you use a calculator to check your math?
- Are all Forms W-2 and 1099 (showing tax withheld), as well as schedules and forms, attached to the return?
- Is the appropriate volunteer site designation entered?
- Did the taxpayer(s) sign, date, and fill in his/her occupation on the return?
- Is the taxpayer eligible to claim the Earned income credit? Advanced earned income credit?

Signature section

Make sure the taxpayer signs and dates the return before mailing. An unsigned return cannot be processed and may be sent back to the taxpayer. On a joint return, both spouses must sign, even if only one spouse had income. Also, make sure the occupation(s) of the taxpayer (or of both spouses, if married filing jointly) is entered.

If a taxpayer died before filing a return for 2002, the taxpayer's spouse or personal representative may have to file and sign a return for that taxpayer. A personal representative can be an executor, administrator, or anyone who is in charge of the deceased taxpayer's property. If the deceased taxpayer did not have to file a return but had tax withheld, a return must be filed to get a refund. The person who files the return should enter "DECEASED," the deceased taxpayer's name, and the date of death across the top of the return.

If the taxpayer's spouse died in 2002 and the taxpayer did not remarry in 2002, the taxpayer can file a joint return. (The taxpayer can also file a joint return if his or her spouse dies in 2003 before filing a 2002 return.) A joint return should show the taxpayer's spouse's 2002 income before death and the taxpayer's income for all of 2002. The taxpayer should enter "Filing as surviving spouse" in the area where the taxpayer signs the return. If someone else is the personal representative, he or she must also sign.

The surviving spouse or personal representative should promptly notify all payers of income, including financial institutions, of the taxpayer's death. This will ensure the proper reporting of income earned by the taxpayer's estate or heirs. A deceased taxpayer's social security number should not be used for tax years after the year of death, except for estate tax return purposes.

Third-Party Designee

If the taxpayer wants to allow a friend, family member, or any other person he or she chooses to discuss his or her 2002 tax return with the IRS, the taxpayer should check the "Yes" box in the "Third party designee" area of the return. Also, the taxpayer should enter the designee's name, phone number, and any five numbers the designee chooses as his or her personal identification number (PIN).

If the taxpayer checks the "Yes" box, he or she, and his or her spouse if filing a joint return, is authorizing the IRS to call the designee to answer any questions that may arise during the processing of the return. The taxpayer is also authorizing the designee to:

- Give the IRS any information that is missing from the return,

- Call the IRS for information about the processing of the return or the status of the taxpayer's refund or payment(s), and
- Respond to certain IRS notices that the taxpayer has shared with the designee about math errors, offsets, and return preparation. The notices will not be sent to the designee.

The taxpayer is not authorizing the designee to receive any refund check, bind the taxpayer to anything (including any additional tax liability), or otherwise represent the taxpayer before the IRS. If the taxpayer wants to expand the designee's authorization, he or she should see Publication 947, *Practice Before the IRS and Power of Attorney*.

The authorization cannot be revoked. However, the authorization will automatically end no later than the due date (without regard to extensions) for filing the taxpayer's 2003 tax return. This is April 15, 2004, for most people.

As a volunteer preparer you should not be designated as a "Third Party Designee."

Ending the Interview

Make sure the taxpayer keeps a copy of all Forms W-2 and 1099 with a copy of the tax return. Advise the taxpayer to keep these copies for at least three years. As the volunteer assistant, you should not keep a copy of the return.

If an envelope has been provided for the taxpayer's records place the copies into it. Advise the taxpayer to bring the envelope back next year.

VOLUNTEER ASSISTANCE WORKSHEET

The Volunteer Assistance Worksheet is currently under revision and was not available at publication date. Your local Stakeholder Partnerships, Education and Communication office will provide you with the revised Volunteer Assistance Worksheet when you attend training along with the training module that explains the new worksheet and reporting requirements.

Exercise 2

Look at the completed Form 1040EZ shown in Exhibit 7 and identify at least 3 areas that have not been properly completed.

Department of the Treasury-Internal Revenue Service
Form 1040EZ **Income Tax Return for Single and Joint Filers With No Dependents** (99) **2002**

OMB No. 1545-0675

Label
 (See page 12.)
Use the IRS label.
 Otherwise, please print or type.

Presidential Election Campaign (page 12)

Your first name and initial Jorge	Last name Mendez
If a joint return, spouse's first name and initial Lucinda	Last name Mendez
Home address (number and street). If you have a P.O. box, see page 12. 1040 Main Street	
Apt. no. A	
City, town or post office, state, and ZIP code. If you have a foreign address, see page 12. Anywhere, USA 99999	

Your social security number
123 45 6789

Spouse's social security number
 :

▲ Important! ▲
 You **must** enter your SSN(s) above.

Note. Checking "Yes" will not change your tax or reduce your refund.
 Do you, or your spouse if a joint return, want \$3 to go to this fund? Yes No Yes No

Income
Attach Form(s) W-2 here.
 Enclose, but do not attach, any payment.

Note. You **must** check Yes or No.

1 Total wages, salaries, and tips. This should be shown in box 1 of your W-2 form(s). Attach your W-2 form(s).	1	14,900	00
2 Taxable interest. If the total is over \$400, you cannot use Form 1040EZ.	2	2	00
3 Unemployment compensation and Alaska Permanent Fund dividends (see page 14).	3		
4 Add lines 1, 2, and 3. This is your adjusted gross income .	4		
5 Can your parents (or someone else) claim you on their return? Yes. Enter amount from worksheet on back. <input type="checkbox"/> No. If single , enter \$7,700. If married , enter \$13,850. See back for explanation. <input type="checkbox"/>	5		
6 Subtract line 5 from line 4. If line 5 is larger than line 4, enter -0-. This is your taxable income .	6	14,900	00

Payments and tax

7 Federal income tax withheld from box 2 of your W-2 form(s).	7	1,700	00
8 Earned income credit (EIC).	8		
9 Add lines 7 and 8. These are your total payments .	9	1,700	00
10 Tax. Use the amount on line 6 above to find your tax in the tax table on pages 24-28 of the booklet. Then, enter the tax from the table on this line.	10	1,490	00

Refund

Have it directly deposited! See page 20 and fill in 11b, 11c, and 11d.

11a If line 9 is larger than line 10, subtract line 10 from line 9. This is your **refund**. **11a** 2 00

b Routing number **c** Type: Checking Savings

d Account number

Amount you owe

12 If line 10 is larger than line 9, subtract line 9 from line 10. This is the **amount you owe**. For details on how to pay, see page 21. **12**

Third party designee

Do you want to allow another person to discuss this return with the IRS (see page 22)? **Yes.** Complete the following. **No**

Designee's name Phone no. () Personal identification number (PIN)

Sign here

Joint return? See page 11. Keep a copy for your records.

Under penalties of perjury, I declare that I have examined this return, and to the best of my knowledge and belief, it is true, correct, and accurately lists all amounts and sources of income I received during the tax year. Declaration of preparer (other than the taxpayer) is based on all information of which the preparer has any knowledge.

Your signature Lucinda Mendez	Date 1/23/03	Your occupation	Daytime phone number ()
Spouse's signature. If a joint return, both must sign. Lucinda Mendez	Date 1/23/03	Spouse's occupation	

Paid preparer's use only

Preparer's signature Date Check if self-employed Preparer's SSN or PTIN

Firm's name (or yours if self-employed), address, and ZIP code EIN Phone no. ()

▶▶ SUMMING UP THIS LESSON ◀◀

The information for the payment section of the return comes from these sources:

- ▶ federal income tax withheld by the employer, and
- ▶ Forms 1099, and
- ▶ estimated tax payments paid by the taxpayer (not reported on Form 1040EZ), and
- ▶ refundable credits.

If the amount owed is \$1,000 or more, the taxpayer may have to pay an estimated tax penalty. If there is an overpayment, the taxpayer can take one of the following courses of action:

- ▶ receive a complete refund,
- ▶ apply the overpayment to the next year's estimated tax, or
- ▶ receive a partial refund and apply the remainder of the overpayment to the next year's estimated tax.

Estimated tax payments must be made if a taxpayer:

- ▶ Expects to owe \$1,000 or more in tax for 2003 after subtracting income tax withheld and credits,

AND

- ▶ Expects his or her 2003 tax withheld and credits to be less than the smaller of: 90 percent of the tax to be shown on his or her 2003 tax return or, generally, 100 percent of the tax shown on his or her 2002 tax return.

Withholding allowances for employees are reported on Form W-4. Allowances for pension or annuity recipients are reported on Form W-4P. They are figured by taking into account:

- ▶ Expected income
- ▶ Deductions
- ▶ Credits
- ▶ Adjustments to income

To finish the return:

- ▶ Consider the taxpayer's possible eligibility for Advance Earned Income Credit.
- ▶ Complete the taxpayer's identification section after you have finished the rest of the return.
- ▶ Enter the volunteer designation in the paid preparer's section.
- ▶ Assemble the return correctly, attaching any Forms W-2 and any Forms 1099 showing federal income tax withholding.
- ▶ Check each return for completeness and accuracy.
- ▶ Submit each return for on-site quality review.
- ▶ Have the taxpayer(s) sign and date the return.

Answers to Exercise 1

- (A) Line 40
- (B) No.
- (C) The routing number for his bank account, and type of account
- (D) Yes.

Answers to Exercise 2

- Wife's SSN is missing
- Presidential Election Campaign is not marked
- Husband's signature is missing
- VITA designation and site number is missing
- Line 4 is blank
- Line 5 is blank
- Line 6 is incorrect
- Line 11a is incorrect
- Occupations are missing

STUDENT NOTES

CREDIT FOR CHILD AND DEPENDENT CARE EXPENSES

LESSON 8

INTRODUCTION AND OBJECTIVES

In this lesson you will learn about the credit for child and dependent care expenses. This non-refundable credit is one of the most commonly used credits.

After completing this lesson you should be able to :

- Determine who is eligible for the child and dependent care credit.
- Calculate the credit and report on the correct form.

CREDITS

A credit is a dollar-for-dollar reduction of the taxpayer's tax liability. A **refundable** credit can be greater than the tax. Taxpayers not only can have their tax reduced to zero; they can also receive a "refund" of excess credit. A **nonrefundable credit** can also be greater than the tax, but the non-refundable credit can only reduce the tax to zero. Therefore, taxpayers will not receive a refund for any excess nonrefundable credit.

The Hope credit, the lifetime learning credit, the credit for child and dependent care expenses, the credit for the elderly or the disabled, the mortgage interest credit and the credit for qualified retirement savings contributions are nonrefundable credits.

The child tax credit is generally nonrefundable; but some taxpayers can qualify for the refundable additional child tax credit.

TAX TIPS

★★★★★★★★

Some taxpayers can take a nonrefundable adoption tax credit for qualifying expenses paid to adopt an eligible child. Refer taxpayers with adoption expenses to a paid professional tax preparer. They can also get Publication 968, *Tax Benefits for Adoption*, for more information.

CREDIT FOR CHILD AND DEPENDENT CARE EXPENSES

The credit for child and dependent care expenses is one of the most commonly used credits.

This credit can be claimed on either Form 1040A or Form 1040. The requirements for claiming the credit are the same, regardless of the form used. If the taxpayer files Form 1040A, the credit is figured on Schedule 2, *Child and Dependent Care Expenses for Form 1040A Filers*. If the taxpayer files Form 1040, the credit is figured on Form 2441, *Child and Dependent Care Expenses*. If the taxpayer claims the credit, attach Schedule 2 or Form 2441 to the tax return.

To qualify for the credit, a taxpayer must have:

- Incurred expenses for the care of a qualifying person,
- Incurred expenses in order to work or look for work,
- Earned income for work performed during the year (see first exception below),
- Filed a joint return if married (see second exception below),
- Maintained a home (paid over half the cost) that was also the home of a qualifying person,
- Paid the expenses to someone other than his or her child (under age 19) or a dependent claimed on the tax return,
- Identified the care provider on the tax return, and
- Excluded less than \$2,400 (\$4,800, if 2 or more qualifying persons) of dependent care assistance benefits.

There are two *exceptions*.

1. A spouse who is a full-time student for some part of each of five months of the year or who is incapable of self-care is considered to have earned income.
2. A married taxpayer does not have to file a joint return to receive the credit if legally separated or living apart from his or her spouse. A taxpayer is not considered married and is eligible to take the credit if *all* of the following apply.
 - The taxpayer files a separate return.
 - The taxpayer paid more than half the cost of keeping up a home for himself or herself and a qualifying person.
 - The qualifying person lived in the home for more than half the year.
 - The taxpayer's spouse did not live in the home during the last six months of the year.

TAX TIPS

★★★★★★★★★★

A copy of Form 2441 and Schedule 2 can be found in the *Tax Forms Booklet Appendix*, which is part of your Publication 678 Package.

Qualifying Person

The child and dependent care expenses must be for at least one qualifying person.

A **qualifying person** is:

- A child that is under the age of 13 when the care is provided and for whom a dependency exemption can be claimed. (Special rules apply, however, if the parents are divorced or separated.)
- A dependent (or person who could be claimed as a dependent if his or her gross income had been less than \$3,000) who is physically or mentally incapable of self-care.
- A spouse who is physically or mentally incapable of self-care.

Example 1

Jim paid someone to care for his wife, Janet. Janet is physically unable to care for herself. Jim also paid to have someone prepare meals for his 13-year-old daughter, Jill.

Janet is a qualifying person, but Jill is not because she is not under 13.

Example 2

Ronald is unable to care for himself. His parents cannot claim him as a dependent only because Ronald earned \$3,000 during the year.

Ronald is a qualifying person. He would be claimed as a dependent if the gross income test had been met.

Example 3

Amanda is divorced and her 8-year-old daughter, Carrie, lives with her. In order to work, Amanda pays child care expenses for Carrie. Carrie's father claims a dependency exemption for her.

Carrie is a qualifying person. Amanda, the parent Carrie lives with, can claim the credit for child and dependent care expenses if the exception to the dependency exemption requirement for children of divorced or separated parents applies. Carrie's father cannot claim the credit if the exception applies.

Expenses for Care of Qualifying Person

To be work related, the expenses must be for the care of a qualifying person to allow the taxpayer to work or to look for work. Expenses are for the care of a qualifying person who is incapable of self-care are allowable only if their main purpose is the person's well-being and protection. The care can be provided in the taxpayer's home or outside the home if the 8 hours in the taxpayer's home requirement is met.

TAX TIPS

★★★★★★★★

It is physical custody (who the child lives with), not legal custody, that determines whether or not a taxpayer is eligible to claim the child care credit. It is not uncommon for physical custody to differ from legal custody.

POTENTIAL PITFALLS



If the taxpayer paid cash wages of \$1,300 or more for the year to an employee working in the taxpayer's home, the taxpayer must pay the employment taxes on the employee's wages with Schedule H, attached to Form 1040. Taxpayers in this situation should seek paid professional tax assistance. This is beyond the scope of the VITA/TCE Program.

For more information, see Publication 926, *Household Employer's Tax Guide*.

TAX TIPS

★★★★★★★★★★

If the special rules for children of divorced or separated parents apply (discussed in Lesson 2), a child is a qualifying person of the custodial parent if a dependency exemption is not claimed because:

- The custodial parent signed Form 8332 to release claim to exemption, or
- The noncustodial parent provided at least \$600 under a pre-1985 divorce or separation agreement.

If the special rules apply, the child cannot be a qualifying child of the noncustodial parent.

The cost of care provided outside the taxpayer's home is counted if the care is for the taxpayer's dependent under the age of 13, or any other qualifying person who regularly spends at least 8 hours each day in the taxpayer's home.

Day-camp fees may be qualified expenses for this credit. Expenses for an overnight camp are not qualified expenses for this credit.

Expenses for care generally do not include amounts paid for food, clothing, entertainment or education. The total cost of sending a child to school can be counted only if:

- The child is in a grade level below the first grade, and
- The amount paid for food, and schooling is small and incidental to the child care and cannot be separated from the total cost of care.

If the child is in the first grade or higher, and the cost of schooling can be separated from the total cost, the taxpayer can divide the total cost between the cost of schooling and the cost of care. Only the cost of care can be counted. If the cost of care cannot be separated, no costs can be counted.

Earned Income

Generally, to claim the child and dependent care credit, the taxpayer (and spouse, if married) must have earned income during the year. Earned income **includes**:

- Wages, salaries, tips and other employee compensation,
- Net earnings from self-employment,
- Military basic quarters and subsistence allowances (including in-kind quarters and subsistence),
- Strike benefits,
- Disability payments that are reported as wages,
- Parsonage allowances,
- Military pay earned in a combat zone,
- Meals and lodging furnished for the convenience of the employer, and
- Voluntary salary deferrals.

Earned income **does not include**:

- Pensions or annuities,
- Social security payments,
- Workers' compensation,
- Interest,
- Dividends,
- Unemployment compensation,
- Scholarships, or fellowship grants except for amounts paid (and reported on Form W-2) for teaching, research or other services.

Limit on Expenses

The amount of expenses eligible for the credit is limited to the lowest of the following amounts for the year.

- The lower paid spouse's earned income (in the case of married taxpayers).
- The single taxpayer's earned income.
- The actual expenses paid.
- The overall limit of \$2,400 for one qualifying person or \$4,800 for two or more qualifying persons.

Some taxpayers receive **dependent care benefits** from their employers. If so, the overall limit of \$2,400/\$4,800 is reduced, dollar for dollar, by any reimbursement excluded from the taxpayer's income. The amount of dependent care benefits received is shown in box 10 of Form W-2.

Example 4

Mark earned \$14,000. His wife, Evelyn, earned \$5,600. Day care expenses for their three-year-old daughter were \$2,200.

The maximum amount of qualifying child care expenses is \$2,200. This is the lowest of:

- The lower paid spouse's earnings (\$5,600),
- The amount actually paid (\$2,200), and
- The overall limit for one qualifying person (\$2,400).

Example 5

Geraldine has one dependent child, Donald. Geraldine can claim the child and dependent care credit for Donald. Box 10 of her Form W-2 shows that Geraldine received \$1,400 during the year from her employer's dependent care assistance program.

Geraldine's overall expense limit is \$1,000 (\$2,400 minus \$1,400).

Nonworking Spouse

Married taxpayers usually must both work in order to claim the credit. However, if a spouse is either a full-time student during any five months of the year, or is incapable of self-care for some period during the year, a credit can be claimed. To figure the credit, the earned income for each month the spouse is either a full-time student or disabled is considered to be at least:

- \$200 with one qualifying person in the home, or
- \$400 with two or more qualifying persons in the home.

Example 6

Janice worked full time. Her husband, Ken, was a full-time student from January through May. Their son, Jason, was in day-care while Ken attended school.

Ken was a full-time student because he attended school for part of each of five months during the year (the five months need not have been consecutive). Ken's earned income for the time he attended school is considered to be \$1,000 (5 months X \$200).

Exercise 1

For the following situations, determine if the taxpayer can claim the credit for child and dependent care expenses, and if possible, determine the maximum amount eligible for the credit.

- A. Karen earned \$18,000. She paid \$1,800 for child care expenses for her four-year-old daughter, Crystal. If Karen can claim the credit, what is the maximum amount of child care expenses eligible for the credit? _____
- B. Andrea is married to Bill. They have a seven-year-old son, Charles. Charles lived with Andrea for the entire year. Andrea paid all the expenses of keeping the home they shared. Andrea also paid for before-school and after-school child care. Her total support for the child was \$1,800. Bill left the area 18 months ago. He did not live with Andrea at all during the year, but he did send \$1,200 in child support. Andrea and Bill will file separate returns. Bill will claim the dependency exemption for Charles. Can Andrea claim the credit for child and dependent care expenses? _____
- C. Ellen is divorced. She has custody of her 12-year-old daughter, Terri. Terri takes care of herself after school. In the summer, Ellen spends \$2,000 to send Terri away to overnight camp. What portion, if any, of the camp fees is eligible for the child and dependent care expenses credit? _____

Figuring the Credit

The credit is a percentage of qualifying expenses. For taxpayers with adjusted gross incomes of \$10,000 or less, the credit is 30 percent of qualifying expenses. As adjusted gross income increases, the percentage decreases. The lowest percentage is 20 percent. The tables on Schedule 2 (Form 1040A) and on Form 2441 show the percentage for each adjusted gross income bracket.

Completing Schedule 2 of Form 1040A or Form 2441 of Form 1040

This credit can be claimed on either Schedule 2 (Form 1040A) or Form 2441 (Form 1040). Complete the forms found in the instructions for Forms 1040A or 1040.

- **Part I** – The taxpayer is required to identify all persons or organizations that provided care for the dependent or child. Enter the name, address, social security number (SSN) or employer identification number (EIN), and the amount paid to the person or organization that provided the care for the qualifying person during the year. (For taxpayers who received benefits under a dependent care benefits program, complete Part III before making any entries in Part II. Complete Part II for all taxpayers.)

If the care provider is not identified or the information is incomplete, the credit may be disallowed; but, if the taxpayer is able to show that he or she used due diligence in trying to furnish the necessary information, the taxpayer can still claim the credit.

Due diligence can be shown by getting and keeping the provider's completed Form W-10 or one of the following pieces of information.

- A copy of the provider's social security card.
 - If the care was provided in a state where the driver's license includes the social security number, a copy of the provider's driver's license.
 - A copy of the provider's completed Form W-4, if he or she is a household employee.
 - A copy of the statement furnished by the taxpayer's employer, if the employer's dependent care plan is the provider.
 - A letter or invoice from the provider if it shows the necessary information.
- **Part II** – The child care credit is figured in this section of Schedule 2 or Form 2441. Enter the qualifying person(s) name, SSN, and the amount of qualified expenses paid on line 2 of Schedule 2 or Form 2441. Transfer the amount from Schedule 2, line 11, to Form 1040A, line 29. Transfer the amount from Form 2441, line 11, to Form 1040, line 46.
 - **Part III** – Complete this part only for taxpayers who received benefits under a dependent care benefits program.

Example 7

David A. and Edith B. Worth are married and file a joint return. Last year, they paid \$2,800 for the care of their son, Jonathan (SSN 000-00-2194). The payment was made to Karen's Kiddie Care, 456 Chester Avenue, Berlin, MD 25789 (EIN 10-6789101). The \$2,800 payment includes a \$1,000 dependent care benefit Edith received from her employer. Edith earned \$18,500 and David earned \$20,200 last year, working full time. Their adjusted gross income is \$38,700 and their tax liability is \$2,681. David's social security number is 000-00-2916. Exhibits 1 and 2 show the completed Schedule 2 (Form 1040A) for David and Edith.

POTENTIAL PITFALLS



The taxpayer must complete Part I of Schedule 2 or Form 2441. If the provider refuses to give their identifying information, the taxpayer should provide whatever information is available, and explain that the information was requested but the provider refused to give it. Taxpayers can use Form W-10, *Dependent Care Provider's Identification and Certification*, to get the required information from the care provider.

tion is available, and explain that

POTENTIAL PITFALLS



Schedule 2 or Form 2441 must be filled out by all taxpayers with an entry in Box 10 of Form W-2, even if they do not claim the credit.

information from the care provider.

POTENTIAL PITFALLS



Schedule 2 or Form 2441 must be filled out by all taxpayers with an entry in Box 10 of Form W-2, even if they do not claim the credit.

Schedule 2
(Form 1040A)

Department of the Treasury—Internal Revenue Service

Child and Dependent Care Expenses for Form 1040A Filers (99) **2002**

OMB No. 1545-0085

Name(s) shown on Form 1040A

David A. and Edith B. Worth

Your social security number

000 : 00 : 2935

Before you begin: You need to understand the following terms. See **Definitions** on page 1 of the separate instructions.

• **Dependent Care Benefits** • **Qualifying Person(s)** • **Qualified Expenses** • **Earned Income**

Part I

Persons or organizations who provided the care

1	(a) Care provider's name	(b) Address (number, street, apt. no., city, state, and ZIP code)	(c) Identifying number (SSN or EIN)	(d) Amount paid (see instructions)
	Karen's Kiddie Care	456 Chester Avenue Berlin, MD 25789	10-6789101	2,800 00

(If you need more space, use the bottom of page 2.)

You must complete this part.

Did you receive dependent care benefits?	No	→ Complete only Part II below.
	Yes	→ Complete Part III on the back next.

Caution. If the care was provided in your home, you may owe employment taxes. If you do, you must use Form 1040. See **Schedule H** and its instructions for details.

Part II

Credit for child and dependent care expenses

2 Information about your **qualifying person(s)**. If you have more than two qualifying persons, see the instructions.

(a) Qualifying person's name		(b) Qualifying person's social security number	(c) Qualified expenses you incurred and paid in 2002 for the person listed in column (a)
First	Last		
Johnathan	Worth	000 : 00 : 2194	1,800 00

3 Add the amounts in column (c) of line 2. **Do not** enter more than \$2,400 for one qualifying person or \$4,800 for two or more persons. If you completed Part III, enter the amount from line 26.

3 1,400 00

4 Enter your **earned income**.

4 20,200 00

5 If married filing a joint return, enter your spouse's earned income (if your spouse was a student or was disabled, see the instructions); **all others**, enter the amount from line 4.

5 18,500 00

6 Enter the **smallest** of line 3, 4, or 5.

6 1,400 00

7 Enter the amount from Form 1040A, line 22.

7 38,700 00

8 Enter on line 8 the decimal amount shown below that applies to the amount on line 7.

If line 7 is:			If line 7 is:		
Over	But not over	Decimal amount is	Over	But not over	Decimal amount is
\$0—10,000		.30	\$20,000—22,000		.24
10,000—12,000		.29	22,000—24,000		.23
12,000—14,000		.28	24,000—26,000		.22
14,000—16,000		.27	26,000—28,000		.21
16,000—18,000		.26	28,000—No limit		.20
18,000—20,000		.25			

8 × .20

9 Multiply **line 6** by the decimal amount on line 8. If you paid 2001 expenses in 2002, see the instructions.

9 280 00

10 Enter the amount from Form 1040A, line 28.

10 2,681 00

11 **Credit for child and dependent care expenses.** Enter the **smaller** of line 9 or line 10 here and on Form 1040A, line 29.

11 280 00

For Paperwork Reduction Act Notice, see Form 1040A instructions.

Cat. No. 10749I

Schedule 2 (Form 1040A) 2002

Schedule 2 (Form 1040A) 2002		Page 2		
Part III Dependent care benefits	12 Enter the total amount of dependent care benefits you received for 2002. This amount should be shown in box 10 of your W-2 form(s). Do not include amounts that were reported to you as wages in box 1 of Form(s) W-2.	12	1,000 00	
	13 Enter the amount forfeited, if any. See the instructions.	13	0 00	
	14 Subtract line 13 from line 12.	14	1,000 00	
	15 Enter the total amount of qualified expenses incurred in 2002 for the care of the qualifying person(s).	15	2,800 00	
	16 Enter the smaller of line 14 or 15.	16	1,000 00	
	17 Enter your earned income .	17	20,200 00	
	18 If married filing a joint return, enter your spouse's earned income (if your spouse was a student or was disabled, see the instructions for line 5); if married filing a separate return, see the instructions for the amount to enter; all others , enter the amount from line 17.	18	18,500 00	
	19 Enter the smallest of line 16, 17, or 18.	19	1,000 00	
	20 Excluded benefits. Enter here the smaller of the following: <ul style="list-style-type: none"> • The amount from line 19 or • \$5,000 (\$2,500 if married filing a separate return and you were required to enter your spouse's earned income on line 18). 	20	1,000 00	
	21 Taxable benefits. Subtract line 20 from line 14. Also, include this amount on Form 1040A, line 7. In the space to the left of line 7, enter "DCB."	21	0 00	
	To claim the child and dependent care credit, complete lines 22–26 below.			
	22 Enter \$2,400 (\$4,800 if two or more qualifying persons).	22	2,400 00	
	23 Enter the amount from line 20.	23	1,000 00	
	24 Subtract line 23 from line 22. If zero or less, stop . You cannot take the credit. Exception. If you paid 2001 expenses in 2002, see the instructions for line 9.	24	1,400 00	
	25 Complete line 2 on the front of this schedule. Do not include in column (c) any benefits shown on line 20 above. Then, add the amounts in column (c) and enter the total here.	25	1,800 00	
	26 Enter the smaller of line 24 or 25. Also, enter this amount on line 3 on the front of this schedule and complete lines 4–11.	26	1,400 00	

Schedule 2 (Form 1040A) 2002

Exercise 2

Sam L. and Sue D. Rock are married and file a joint return. Sam's social security number is 000-00-9832. The Rocks file Form 1040 because they itemize deductions. Their adjusted gross income is \$27,321 and their line 44 tax is \$748. Their earned income is \$27,100. Sam earned \$10,000 and Sue earned \$17,100. They have two children, Doug (SSN 000-00-2387), age 7, and Pebbles (SSN 000-00-3278), age 4, who lived with them all year. The children stayed at The Learning Center day care after school until their parents picked them up after work. The Learning Center is located at 496 White Road, Rancho Cordova, CA 95744. The Learning Center's tax identification number is 10-4487965. During 2002, total child care expenses for the Rocks was \$3,211. The Rocks paid \$2,200. Sue's employer paid \$1,011 under a dependent care benefits program.

- A. Prepare the Form 2441 for the Rocks.
- B. What amount is entered on Form 1040, line 46?

Form 2441 Department of the Treasury Internal Revenue Service (99)	<h2 style="margin:0;">Child and Dependent Care Expenses</h2> <p style="margin:0;">▶ Attach to Form 1040. ▶ See separate instructions.</p>	OMB No. 1545-0068 <h1 style="margin:0;">2002</h1> Attachment Sequence No. 21																																									
Name(s) shown on Form 1040		Your social security number																																									
<p>Before you begin: You need to understand the following terms. See Definitions on page 1 of the instructions.</p> <p>• Dependent Care Benefits • Qualifying Person(s) • Qualified Expenses • Earned Income</p>																																											
<p>Part I Persons or Organizations Who Provided the Care—You must complete this part. (If you need more space, use the bottom of page 2.)</p>																																											
1	(a) Care provider's name	(b) Address (number, street, apt. no., city, state, and ZIP code)	(c) Identifying number (SSN or EIN)	(d) Amount paid (see instructions)																																							
<table border="1" style="margin: auto; border-collapse: collapse;"> <tr> <td style="padding: 5px;">Did you receive dependent care benefits?</td> <td style="padding: 5px; text-align: center;">No</td> <td style="padding: 5px;">→ Complete only Part II below.</td> </tr> <tr> <td style="padding: 5px;"></td> <td style="padding: 5px; text-align: center;">Yes</td> <td style="padding: 5px;">→ Complete Part III on the back next.</td> </tr> </table>					Did you receive dependent care benefits?	No	→ Complete only Part II below.		Yes	→ Complete Part III on the back next.																																	
Did you receive dependent care benefits?	No	→ Complete only Part II below.																																									
	Yes	→ Complete Part III on the back next.																																									
<p>Caution. If the care was provided in your home, you may owe employment taxes. See the instructions for Form 1040, line 60.</p>																																											
<p>Part II Credit for Child and Dependent Care Expenses</p>																																											
2 Information about your qualifying person(s) . If you have more than two qualifying persons, see the instructions.																																											
	(a) Qualifying person's name	(b) Qualifying person's social security number	(c) Qualified expenses you incurred and paid in 2002 for the person listed in column (a)																																								
	First Last																																										
3	Add the amounts in column (c) of line 2. Do not enter more than \$2,400 for one qualifying person or \$4,800 for two or more persons. If you completed Part III, enter the amount from line 26			3																																							
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5	If married filing a joint return, enter your spouse's earned income (if your spouse was a student or was disabled, see the instructions); all others , enter the amount from line 4			5																																							
6	Enter the smallest of line 3, 4, or 5			6																																							
7	Enter the amount from Form 1040, line 36			7																																							
8	Enter on line 8 the decimal amount shown below that applies to the amount on line 7			8																																							
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10	Enter the amount from Form 1040, line 44, minus any amount on Form 1040, line 45			10																																							
11	Credit for child and dependent care expenses. Enter the smaller of line 9 or line 10 here and on Form 1040, line 46			11																																							
<p>For Paperwork Reduction Act Notice, see page 3 of the instructions. Cat. No. 11862M Form 2441 (2002)</p>																																											

Part III Dependent Care Benefits

12	Enter the total amount of dependent care benefits you received for 2002. This amount should be shown in box 10 of your W-2 form(s). Do not include amounts that were reported to you as wages in box 1 of Form(s) W-2	12		
13	Enter the amount forfeited, if any (see the instructions).	13		
14	Subtract line 13 from line 12	14		
15	Enter the total amount of qualified expenses incurred in 2002 for the care of the qualifying person(s)	15		
16	Enter the smaller of line 14 or 15	16		
17	Enter your earned income	17		
18	If married filing a joint return, enter your spouse's earned income (if your spouse was a student or was disabled, see the instructions for line 5); if married filing a separate return, see the instructions for the amount to enter; all others , enter the amount from line 17	18		
19	Enter the smallest of line 16, 17, or 18	19		
20	Excluded benefits. Enter here the smaller of the following: <ul style="list-style-type: none"> • The amount from line 19 or • \$5,000 (\$2,500 if married filing a separate return and you were required to enter your spouse's earned income on line 18). 	20		
21	Taxable benefits. Subtract line 20 from line 14. Also, include this amount on Form 1040, line 7. On the dotted line next to line 7, enter "DCB"	21		

To claim the child and dependent care credit, complete lines 22–26 below.

22	Enter \$2,400 (\$4,800 if two or more qualifying persons)	22		
23	Enter the amount from line 20	23		
24	Subtract line 23 from line 22. If zero or less, stop . You cannot take the credit. Exception. If you paid 2001 expenses in 2002, see the instructions for line 9	24		
25	Complete line 2 on the front of this form. Do not include in column (c) any benefits shown on line 20 above. Then, add the amounts in column (c) and enter the total here	25		
26	Enter the smaller of line 24 or 25. Also, enter this amount on line 3 on the front of this form and complete lines 4–11	26		





CREDIT FOR CHILD AND DEPENDENT CARE EXPENSES ANSWERS TO EXERCISES

LESSON 8

Exercise 1

- (A) \$1,800, which is the lowest of: earned income (\$18,000); the amount actually paid (\$1,800); and the limit for one qualifying person (\$2,400).
- (B) Yes.
- (C) None.

CREDIT FOR CHILD AND DEPENDENT CARE EXPENSES

ANSWERS TO EXERCISES

LESSON 8

Exercise 2

The Rocks' Form 2441, page 1

Form **2441**

Child and Dependent Care Expenses

OMB No. 1545-0068

Department of the Treasury
Internal Revenue Service (99)

▶ Attach to Form 1040.
▶ See separate instructions.

2002
Attachment
Sequence No. **21**

Name(s) shown on Form 1040

Sam L. and Sue D. Rock

Your social security number

000 00 9832

Before you begin: You need to understand the following terms. See **Definitions** on page 1 of the instructions.

- **Dependent Care Benefits**
- **Qualifying Person(s)**
- **Qualified Expenses**
- **Earned Income**

Part I **Persons or Organizations Who Provided the Care**—You must complete this part.
(If you need more space, use the bottom of page 2.)

1	(a) Care provider's name	(b) Address (number, street, apt. no., city, state, and ZIP code)	(c) Identifying number (SSN or EIN)	(d) Amount paid (see instructions)
	The Learning Center	496 White Road Rancho Cordova, CA 95744	10-4487965	3,211 00

<div style="border: 1px solid black; padding: 2px; display: inline-block;"> Did you receive dependent care benefits? </div>	No Yes	No → Complete only Part II below. Yes → Complete Part III on the back next.
---	-----------	--

Caution. If the care was provided in your home, you may owe employment taxes. See the instructions for Form 1040, line 60.

Part II **Credit for Child and Dependent Care Expenses**

2 Information about your **qualifying person(s)**. If you have more than two qualifying persons, see the instructions.

(a) Qualifying person's name		(b) Qualifying person's social security number	(c) Qualified expenses you incurred and paid in 2002 for the person listed in column (a)
First	Last		
Doug	Rock	000 00 2387	1,100 00
Pebbles	Rock	000 00 3278	1,100 00

3 Add the amounts in column (c) of line 2. Do not enter more than \$2,400 for one qualifying person or \$4,800 for two or more persons. If you completed Part III, enter the amount from line 26	3	2,200 00
4 Enter your earned income	4	10,000 00
5 If married filing a joint return, enter your spouse's earned income (if your spouse was a student or was disabled, see the instructions); all others , enter the amount from line 4	5	17,100 00
6 Enter the smallest of line 3, 4, or 5	6	2,200 00

7 Enter the amount from Form 1040, line 36	7	27,321 00																																							
8 Enter on line 8 the decimal amount shown below that applies to the amount on line 7																																									
If line 7 is: <table style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 20%; text-align: left;">Over</th> <th style="width: 20%; text-align: left;">But not over</th> <th style="width: 20%; text-align: left;">Decimal amount is</th> </tr> </thead> <tbody> <tr><td>\$0—10,000</td><td></td><td style="text-align: center;">.30</td></tr> <tr><td>10,000—12,000</td><td></td><td style="text-align: center;">.29</td></tr> <tr><td>12,000—14,000</td><td></td><td style="text-align: center;">.28</td></tr> <tr><td>14,000—16,000</td><td></td><td style="text-align: center;">.27</td></tr> <tr><td>16,000—18,000</td><td></td><td style="text-align: center;">.26</td></tr> <tr><td>18,000—20,000</td><td></td><td style="text-align: center;">.25</td></tr> </tbody> </table>	Over	But not over	Decimal amount is	\$0—10,000		.30	10,000—12,000		.29	12,000—14,000		.28	14,000—16,000		.27	16,000—18,000		.26	18,000—20,000		.25	If line 7 is: <table style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 20%; text-align: left;">Over</th> <th style="width: 20%; text-align: left;">But not over</th> <th style="width: 20%; text-align: left;">Decimal amount is</th> </tr> </thead> <tbody> <tr><td>\$20,000—22,000</td><td></td><td style="text-align: center;">.24</td></tr> <tr><td>22,000—24,000</td><td></td><td style="text-align: center;">.23</td></tr> <tr><td>24,000—26,000</td><td></td><td style="text-align: center;">.22</td></tr> <tr><td>26,000—28,000</td><td></td><td style="text-align: center;">.21</td></tr> <tr><td>28,000—No limit</td><td></td><td style="text-align: center;">.20</td></tr> </tbody> </table>	Over	But not over	Decimal amount is	\$20,000—22,000		.24	22,000—24,000		.23	24,000—26,000		.22	26,000—28,000		.21	28,000—No limit		.20	
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	8	× .21																																							

9 Multiply line 6 by the decimal amount on line 8. If you paid 2001 expenses in 2002, see the instructions	9	462 00
10 Enter the amount from Form 1040, line 44, minus any amount on Form 1040, line 45	10	748 00
11 Credit for child and dependent care expenses. Enter the smaller of line 9 or line 10 here and on Form 1040, line 46	11	462 00

For Paperwork Reduction Act Notice, see page 3 of the instructions. Cat. No. 11862M Form **2441** (2002)

CREDIT FOR CHILD AND DEPENDENT CARE EXPENSES

ANSWERS TO EXERCISES

LESSON 8

Exercise 2

The Rocks' Form 2441, page 2

Form 2441 (2002)

Page **2**

Part III Dependent Care Benefits

<p>12 Enter the total amount of dependent care benefits you received for 2002. This amount should be shown in box 10 of your W-2 form(s). Do not include amounts that were reported to you as wages in box 1 of Form(s) W-2</p>	12	1,011	00
<p>13 Enter the amount forfeited, if any (see the instructions).</p>	13	0	00
<p>14 Subtract line 13 from line 12</p>	14	1,011	00
<p>15 Enter the total amount of qualified expenses incurred in 2002 for the care of the qualifying person(s)</p>	15	3,211	00
<p>16 Enter the smaller of line 14 or 15</p>	16	1,011	00
<p>17 Enter your earned income</p>	17	10,000	00
<p>18 If married filing a joint return, enter your spouse's earned income (if your spouse was a student or was disabled, see the instructions for line 5); if married filing a separate return, see the instructions for the amount to enter; all others, enter the amount from line 17</p>	18	17,100	00
<p>19 Enter the smallest of line 16, 17, or 18</p>	19	1,011	00
<p>20 Excluded benefits. Enter here the smaller of the following:</p> <ul style="list-style-type: none"> • The amount from line 19 or • \$5,000 (\$2,500 if married filing a separate return and you were required to enter your spouse's earned income on line 18). 	20	1,011	00
<p>21 Taxable benefits. Subtract line 20 from line 14. Also, include this amount on Form 1040, line 7. On the dotted line next to line 7, enter "DCB"</p>	21	0	00

To claim the child and dependent care credit, complete lines 22–26 below.

<p>22 Enter \$2,400 (\$4,800 if two or more qualifying persons)</p>	22	4,800	00
<p>23 Enter the amount from line 20</p>	23	1,011	00
<p>24 Subtract line 23 from line 22. If zero or less, stop. You cannot take the credit. Exception. If you paid 2001 expenses in 2002, see the instructions for line 9</p>	24	3,789	00
<p>25 Complete line 2 on the front of this form. Do not include in column (c) any benefits shown on line 20 above. Then, add the amounts in column (c) and enter the total here</p>	25	2,200	00
<p>26 Enter the smaller of line 24 or 25. Also, enter this amount on line 3 on the front of this form and complete lines 4–11</p>	26	2,200	00



Form **2441** (2002)

Exercise 2

(B) Form 1040, line 46: \$462.

INTRODUCTION AND OBJECTIVES

In this lesson you will learn about the education credits. The Hope scholarship credit and the Lifetime Learning Credit cannot both be claimed on the same student in a tax year.

After completing this lesson, you should be able to:

- Calculate the Hope Credit on Form 8863.
- Calculate the Lifetime Learning credit on Form 8863.

GENERAL REQUIREMENTS

Taxpayers can claim the **Hope Scholarship Credit** (Hope credit) and the **Lifetime Learning Credit** for higher education expenses paid in 2002 for an eligible student. Both credits are nonrefundable and can be claimed on either Form 1040 or Form 1040A. These two credits are also called *education credits*.

To claim either of the education credits the taxpayer must:

- Meet all of the general requirements,
- Meet all of the specific requirements for the individual credit, and
- Meet the income limits.

The general requirements provide that the taxpayer must have incurred *qualified expenses* for an *eligible student* to attend *an eligible educational institution* during the tax year. Additionally, the general requirements set limits on the modified adjusted gross income of the taxpayer.

POTENTIAL PITFALLS



If a student receives a tax-free distribution from a Coverdell education savings account for the tax year, he or she can claim an education credit, as long as the distribution is not used to pay the same expenses. For more information, see Publications 590 and 970.

TAX TIPS

★★★★★★★★★★

Taxpayers may not take the Tuition and Fees Deduction and the Hope or lifetime learning credit for the same student.

If a taxpayer has qualified tuition and fees, it is usually to the taxpayer's benefit to take the above the line deduction.

Qualified Expenses

The Hope credit and the lifetime learning credit are based on qualified tuition and related expenses the taxpayer pays for himself or herself, the taxpayer's spouse, or dependents the taxpayer claims on his or her tax return.

Qualified tuition and related expenses are tuition and fees required for enrollment or attendance at an eligible educational institution and generally **include fees for:**

- Course-related books, supplies and equipment, and
- Student activities.

The fees must be paid **to the institution** as a condition of enrollment or attendance.

Qualified tuition and related expenses **do not include** the cost of:

- Insurance,
- Medical expenses (including student health fees),
- Room and board,
- Transportation or similar personal, living, or family expenses, **even if** the fees must be paid to the institution as a condition of enrollment or attendance.

When considering qualified tuition and related expenses for the Hope credit, the cost of courses for athletics, sports, games, hobbies or noncredit courses are not used unless the course is part of the student's degree program. However, when computing the qualified tuition and related expenses for the lifetime learning credit, these types of expenses are includible if the course was taken to acquire or improve the job skills of the student.

If a taxpayer **prepaid** qualified tuition and related expenses for an academic period that begins in the first three months of the following year, he or she can use the prepaid amount in figuring the credit.

Example 1

Thomas pays \$1,500 in December 2002 for qualified tuition for the winter semester that begins in January 2003. He can use the \$1,500 paid in December of 2002 to compute his credit for 2002.

Payments with borrowed funds.

Taxpayers can claim the Hope credit and lifetime learning credit for qualified tuition and related expenses paid with the proceeds of a loan. Use the expenses to figure the credit for the year in which the expenses are paid, not the year in which the loan is repaid.

Eligible Student

The taxpayer, the taxpayer's spouse, or the taxpayer's dependent (for whom the taxpayer claims a dependency exemption) can be an eligible student.

In addition, for the Hope credit, the student must be:

- Enrolled in a program that leads to a degree, certificate or other recognized educational credential.
- Taking at least one-half of the normal full-time workload for his or her course of study for at least one academic period beginning during the calendar year.
- Enrolled for one of the first two years of his or her postsecondary education.
- Free of any felony conviction for possessing or distributing a controlled substance.

Eligible Educational Institution

An eligible educational institution is generally any accredited public, nonprofit, or proprietary (private) postsecondary institution eligible to participate in the student aid programs administered by the Department of Education. Most universities and colleges, including community colleges, meet these requirements.

An eligible educational institution (such as a college or university) that receives payment of qualified tuition and related expenses generally must issue **Form 1098-T**, *Tuition Payments Statement*, to each student by February 1, of each year. The information on Form 1098-T will help you determine whether the taxpayer can claim an education credit for 2002. The following information should be included on the 2002 form.

- The name, address, and taxpayer identification number of the educational institution.
- The name, address, and taxpayer identification number of the student.
- Whether the student was enrolled for at least half of the full-time academic workload, box 4.
- Whether the student was enrolled exclusively in a graduate-level program, box 5.

Income Requirements

The Hope credit and the lifetime learning credit are phased out (gradually reduced) if the taxpayer's modified AGI is over \$41,000 (over \$82,000 if married filing jointly). If a taxpayer's modified AGI is \$51,000 or more (\$102,000 or more if married filing jointly), no credit is allowed. Education credits are not allowed to persons who are married filing separately.

POTENTIAL PITFALLS



Prepaid expenses do not change the fact that only payments made during this tax year can be used to claim an education credit for this tax year.

Modified Adjusted Gross Income (MAGI)

For most taxpayers, modified adjusted gross income (MAGI) is adjusted gross income (AGI) as figured on their federal income tax return. MAGI when using Form 1040A is the AGI on line 21 of that form. MAGI when using Form 1040 is the AGI on line 35 of that form, modified by adding back any:

- 1) Foreign earned income exclusion
- 2) Foreign housing exclusion
- 3) Exclusion of income for bona fide residents of America Samoa, and
- 4) Exclusion of income from Puerto Rico.

HOPE CREDIT

A Hope credit can be claimed for *each* eligible student that is claimed on the taxpayer's return.

Credit Amounts

The Hope credit is figured on Form 8863, *Education Credits (Hope and Lifetime Learning Credits)*. The maximum Hope credit is \$1,500 *per student* for each of the first two taxable years of his or her postsecondary education. For each eligible student who qualifies for the Hope credit:

- If the expenses are \$1,000 or less, the credit is the amount of the expenses,
- If the expenses are \$2,000 or more, the credit is \$1,500, and
- If the expenses are between \$1,000 and \$2,000, the credit is \$1,000 plus one-half of the expenses over \$1,000. For example, if the expenses are \$1,500, the credit is \$1,250 (\$1,000 plus one-half of \$500).

Example 2

John and Mary Green have a dependent son, Jim, who is a freshman at the local university. They paid \$4,500 in qualified tuition expenses. They determined it would be more beneficial to them to take the Hope Credit rather than the Tuition and Fees Deduction. Their Form 8863 is shown in Exhibit 1.

Form **8863**
Department of the Treasury
Internal Revenue Service

Education Credits
(Hope and Lifetime Learning Credits)

OMB No. 1545-1618
2002
Attachment
Sequence No. **50**

▶ See instructions.

▶ Attach to Form 1040 or Form 1040A.

Name(s) shown on return

John and Mary Green

Your social security number

000 00 9876

Part I Hope Credit. Caution: The Hope credit may be claimed for no more than 2 tax years for the same student.

1	(a) Student's name (as shown on page 1 of your tax return) First name Last name	(b) Student's social security number (as shown on page 1 of your tax return)	(c) Qualified expenses (but do not enter more than \$2,000 for each student). See instructions	(d) Enter the smaller of the amount in column (c) or \$1,000	(e) Subtract column (d) from column (c)	(f) Enter one-half of the amount in column (e)
	Jim Green	000 00 4313	2,000 00	1,000 00	1,000 00	500 00
2	Add the amounts in columns (d) and (f)			2	1,000	500 00
3	Tentative Hope credit. Add the amounts on line 2, columns (d) and (f). If you are claiming the lifetime learning credit, go to Part II; otherwise, go to Part III			3	1,500	00

Part II Lifetime Learning Credit

4	(a) Student's name (as shown on page 1 of your tax return) First name Last name	(b) Student's social security number (as shown on page 1 of your tax return)	(c) Qualified expenses. See instructions
5	Add the amounts on line 4, column (c), and enter the total		5
6	Enter the smaller of line 5 or \$5,000		6
7	Tentative lifetime learning credit. Multiply line 6 by 20% (.20) and go to Part III		7

Part III Allowable Education Credits

8	Tentative education credits. Add lines 3 and 7		8	1,500	00
9	Enter: \$102,000 if married filing jointly; \$51,000 if single, head of household, or qualifying widow(er)		9	102,000	00
10	Enter the amount from Form 1040, line 36 (or Form 1040A, line 22)*		10	32,000	00
11	Subtract line 10 from line 9. If line 10 is equal to or more than line 9, stop; you cannot take any education credits		11	70,000	00
12	Enter: \$20,000 if married filing jointly; \$10,000 if single, head of household, or qualifying widow(er)		12	20,000	00
13	If line 11 is equal to or more than line 12, enter the amount from line 8 on line 14 and go to line 15. If line 11 is less than line 12, divide line 11 by line 12. Enter the result as a decimal (rounded to at least three places)		13	×	.
14	Multiply line 8 by line 13		14	1,500	00
15	Enter the amount from Form 1040, line 44 (or Form 1040A, line 28)		15	3,349	00
16	Enter the total, if any, of your credits from Form 1040, lines 45 through 47 (or from Form 1040A, lines 29 and 30)		16	0	00
17	Subtract line 16 from line 15. If line 16 is equal to or more than line 15, stop; you cannot take any education credits		17	3,349	00
18	Education credits. Enter the smaller of line 14 or line 17 here and on Form 1040, line 48 (or Form 1040A, line 31)		18	1,500	00

*See Pub. 970 for the amount to enter if you are filing Form 2555, 2555-EZ, or 4563 or you are excluding income from Puerto Rico.

For Paperwork Reduction Act Notice, see page 3.

Cat. No. 25379M

Form **8863** (2002)

LIFETIME LEARNING CREDIT

The lifetime learning credit is based on the total qualified education expenses paid by the taxpayer and not on the number of eligible students. Education expenses are qualified for the lifetime learning credit if they are:

- For courses taken as part of a postsecondary degree program, or
- For courses that are not part of a postsecondary degree program, but that are taken to improve or acquire job skills.

Example 3

Samantha, a professional photographer, enrolls in an advanced photography course at a local community college. Although the course is not part of a degree program, she enrolls in it to improve her job skills. The course fee paid by Samantha is considered qualified tuition for the purpose of claiming the lifetime learning credit.

Example 4

Cleve, an engineer, plans to vacation in Europe next year. In preparation for the trip, he enrolls in a noncredit photography class at a local community college. Because Cleve is not taking the course as part of a degree program or to acquire or improve his job skills, the cost of the course is not a qualifying expense for claiming the lifetime learning credit.

Credit amounts

The lifetime learning credit is also figured on Form 8863. The maximum amount of the credit is \$1,000 per taxpayer for all eligible students. The credit amount is figured by multiplying total qualified educational expenses, up to \$5,000, by 20%.

Example 5

Judy Green is single and took a course at the local college to recertify her to teach in public schools. Her qualified tuition expenses were \$500. She chooses to take the lifetime learning credit rather than the Tuition and Fees Deduction. Her completed Form 8863 is shown in Exhibit 2.

Form **8863**

**Education Credits
(Hope and Lifetime Learning Credits)**

OMB No. 1545-1618

2002

Department of the Treasury
Internal Revenue Service

▶ See instructions.

▶ Attach to Form 1040 or Form 1040A.

Attachment
Sequence No. **50**

Name(s) shown on return
Judy Green

Your social security number
000 : 00 : 7777

Part I Hope Credit. Caution: *The Hope credit may be claimed for no more than 2 tax years for the same student.*

1	(a) Student's name (as shown on page 1 of your tax return) First name Last name	(b) Student's social security number (as shown on page 1 of your tax return)	(c) Qualified expenses (but do not enter more than \$2,000 for each student). See instructions	(d) Enter the smaller of the amount in column (c) or \$1,000	(e) Subtract column (d) from column (c)	(f) Enter one-half of the amount in column (e)	
2	Add the amounts in columns (d) and (f)			2			
3	Tentative Hope credit. Add the amounts on line 2, columns (d) and (f). If you are claiming the lifetime learning credit, go to Part II; otherwise, go to Part III					3	

Part II Lifetime Learning Credit

4	(a) Student's name (as shown on page 1 of your tax return) First name Last name	(b) Student's social security number (as shown on page 1 of your tax return)	(c) Qualified expenses. See instructions
	Judy Green	000 : 00 : 7777	500 : 00
5	Add the amounts on line 4, column (c), and enter the total		5 500 : 00
6	Enter the smaller of line 5 or \$5,000		6 500 : 00
7	Tentative lifetime learning credit. Multiply line 6 by 20% (.20) and go to Part III		7 100 : 00

Part III Allowable Education Credits

8	Tentative education credits. Add lines 3 and 7	8	100 : 00
9	Enter: \$102,000 if married filing jointly; \$51,000 if single, head of household, or qualifying widow(er)	9	51,000 : 00
10	Enter the amount from Form 1040, line 36 (or Form 1040A, line 22)*	10	22,000 : 00
11	Subtract line 10 from line 9. If line 10 is equal to or more than line 9, stop ; you cannot take any education credits	11	29,000 : 00
12	Enter: \$20,000 if married filing jointly; \$10,000 if single, head of household, or qualifying widow(er)	12	10,000 : 00
13	If line 11 is equal to or more than line 12, enter the amount from line 8 on line 14 and go to line 15. If line 11 is less than line 12, divide line 11 by line 12. Enter the result as a decimal (rounded to at least three places)	13	×
14	Multiply line 8 by line 13	14	100 : 00
15	Enter the amount from Form 1040, line 44 (or Form 1040A, line 28)	15	1,849 : 00
16	Enter the total, if any, of your credits from Form 1040, lines 45 through 47 (or from Form 1040A, lines 29 and 30)	16	0 : 00
17	Subtract line 16 from line 15. If line 16 is equal to or more than line 15, stop ; you cannot take any education credits	17	1,849 : 00
18	Education credits. Enter the smaller of line 14 or line 17 here and on Form 1040, line 48 (or Form 1040A, line 31)	18	100 : 00

*See Pub. 970 for the amount to enter if you are filing Form 2555, 2555-EZ, or 4563 or you are excluding income from Puerto Rico.

No Double Benefits

A taxpayer cannot:

- Deduct higher education expenses and claim a credit based on those same expenses,
- Claim a Hope credit and a lifetime learning credit based on the same qualified education expenses, or
- Claim a credit based on expenses paid with tax-free scholarship, grant, employer-provided educational assistance or a distribution from a Coverdell ESA.

However, a taxpayer can claim a credit based on expenses paid with the eligible student's earnings, loans, gifts, inheritances, or personal savings.

An eligible student cannot claim an education credit if he or she is claimed as a dependent on another taxpayer's tax return. Any amounts paid by the student are considered paid by the taxpayer who claims the student as a dependent.

The following table summarizes the differences between the credits.

Table: Comparison of Education Credits

Lifetime Learning Credit	Hope Scholarship Credit
per taxpayer credit	per eligible student credit
\$1,000 limit per taxpayer	\$1,500 limit per eligible student
available for an unlimited number of years	available ONLY for the first two years of postsecondary education
credit available for courses taken as part of a postsecondary degree program or to acquire or improve job skills (including noncredit courses and graduate level work)	must be pursuing a degree or other educational credential
available for one or more courses	must take at least 1/2 of the normal full-time workload for one academic period
no other restrictions	felony drug conviction restriction

Exercise 1

Bruce and Toni are married and file a joint tax return. For 2002, their modified AGI (\$50,000) is the same as their AGI and their tax is \$4,826. Toni (SSN 000-00-6941) is attending the local community college (an eligible institution) part time to earn credits toward an associate's degree in nursing. She already has a bachelor's degree in history and wants to become a nurse. In August 2002, Toni paid \$4,000 for her fall 2002 semester. Bruce and Toni choose to take the lifetime learning credit. They claim no other credits. Complete their Form 8863.

TAXWISE HINTS

To input qualified tuition expenses and prepare a Form 8863 using TaxWise, select Form 8863, enter the student's name in either the Hope credit section or the lifetime learning credit section and complete all the entries annotated in red. TaxWise will automatically complete the form and carry the mathematical calculations to the Form 1040.

▶▶ SUMMING UP THIS LESSON ◀◀

The Hope and lifetime learning credits are nonrefundable credits that allow a taxpayer to claim all or a portion of qualified tuition and related expenses paid for post-secondary education.

Generally, a taxpayer can claim the Hope or lifetime learning credit if they pay qualified tuition and related expenses of higher education for an eligible student who is either the taxpayer, the taxpayer's spouse, or a dependent whom the taxpayer can claim an exemption on his or her tax return.

A taxpayer cannot:

- ▶ Deduct higher education expenses on his or her tax return and also claim a Hope or lifetime learning credit based on those same expenses,
- ▶ Claim a Hope credit and a lifetime learning credit based on the same qualified education expenses, or
- ▶ Claim a credit based on expenses paid with tax-free scholarship, grant, or employer-provided educational assistance.

The Hope and lifetime learning credits are claimed on Form 8863 which can be filed with either Form 1040 or Form 1040A.

Form **8863**

**Education Credits
(Hope and Lifetime Learning Credits)**

OMB No. 1545-1618

2002

Department of the Treasury
Internal Revenue Service

▶ See instructions.

▶ Attach to Form 1040 or Form 1040A.

Attachment
Sequence No. **50**

Name(s) shown on return
Bruce and Toni Green

Your social security number
000 : 00 : 9541

Part I Hope Credit. Caution: The Hope credit may be claimed for no more than 2 tax years for the same student.

1	(a) Student's name (as shown on page 1 of your tax return) First name Last name	(b) Student's social security number (as shown on page 1 of your tax return)	(c) Qualified expenses (but do not enter more than \$2,000 for each student). See instructions	(d) Enter the smaller of the amount in column (c) or \$1,000	(e) Subtract column (d) from column (c)	(f) Enter one-half of the amount in column (e)	
2	Add the amounts in columns (d) and (f)			2			
3	Tentative Hope credit. Add the amounts on line 2, columns (d) and (f). If you are claiming the lifetime learning credit, go to Part II; otherwise, go to Part III					3	

Part II Lifetime Learning Credit

4	(a) Student's name (as shown on page 1 of your tax return) First name Last name	(b) Student's social security number (as shown on page 1 of your tax return)	(c) Qualified expenses. See instructions
5	Add the amounts on line 4, column (c), and enter the total		5
6	Enter the smaller of line 5 or \$5,000		6
7	Tentative lifetime learning credit. Multiply line 6 by 20% (.20) and go to Part III		7

Part III Allowable Education Credits

8	Tentative education credits. Add lines 3 and 7	8	
9	Enter: \$102,000 if married filing jointly; \$51,000 if single, head of household, or qualifying widow(er)	9	
10	Enter the amount from Form 1040, line 36 (or Form 1040A, line 22)*	10	
11	Subtract line 10 from line 9. If line 10 is equal to or more than line 9, stop ; you cannot take any education credits	11	
12	Enter: \$20,000 if married filing jointly; \$10,000 if single, head of household, or qualifying widow(er)	12	
13	If line 11 is equal to or more than line 12, enter the amount from line 8 on line 14 and go to line 15. If line 11 is less than line 12, divide line 11 by line 12. Enter the result as a decimal (rounded to at least three places)	13	× .
14	Multiply line 8 by line 13	14	
15	Enter the amount from Form 1040, line 44 (or Form 1040A, line 28)	15	
16	Enter the total, if any, of your credits from Form 1040, lines 45 through 47 (or from Form 1040A, lines 29 and 30)	16	
17	Subtract line 16 from line 15. If line 16 is equal to or more than line 15, stop ; you cannot take any education credits	17	
18	Education credits. Enter the smaller of line 14 or line 17 here and on Form 1040, line 48 (or Form 1040A, line 31)	18	

*See Pub. 970 for the amount to enter if you are filing Form 2555, 2555-EZ, or 4563 or you are excluding income from Puerto Rico.

Form **8863**

**Education Credits
(Hope and Lifetime Learning Credits)**

OMB No. 1545-1618

2002

Department of the Treasury
Internal Revenue Service

▶ See instructions.

▶ Attach to Form 1040 or Form 1040A.

Attachment
Sequence No. **50**

Name(s) shown on return

Bruce and Toni Green

Your social security number

000 : 00 : 9541

Part I Hope Credit. Caution: The Hope credit may be claimed for no more than 2 tax years for the same student.

1	(a) Student's name (as shown on page 1 of your tax return) First name Last name	(b) Student's social security number (as shown on page 1 of your tax return)	(c) Qualified expenses (but do not enter more than \$2,000 for each student). See instructions	(d) Enter the smaller of the amount in column (c) or \$1,000	(e) Subtract column (d) from column (c)	(f) Enter one-half of the amount in column (e)
2	Add the amounts in columns (d) and (f)			2		
3	Tentative Hope credit. Add the amounts on line 2, columns (d) and (f). If you are claiming the lifetime learning credit, go to Part II; otherwise, go to Part III					3

Part II Lifetime Learning Credit

4	(a) Student's name (as shown on page 1 of your tax return) First name Last name	(b) Student's social security number (as shown on page 1 of your tax return)	(c) Qualified expenses. See instructions
	Toni Green	000 00 6941	4000 00
5	Add the amounts on line 4, column (c), and enter the total		5 4000 00
6	Enter the smaller of line 5 or \$5,000		6 4000 00
7	Tentative lifetime learning credit. Multiply line 6 by 20% (.20) and go to Part III		7 800 00

Part III Allowable Education Credits

8	Tentative education credits. Add lines 3 and 7		8 800 00
9	Enter: \$102,000 if married filing jointly; \$51,000 if single, head of household, or qualifying widow(er)	9 102,000 00	
10	Enter the amount from Form 1040, line 36 (or Form 1040A, line 22)*	10 50,000 00	
11	Subtract line 10 from line 9. If line 10 is equal to or more than line 9, stop ; you cannot take any education credits	11 52,000 00	
12	Enter: \$20,000 if married filing jointly; \$10,000 if single, head of household, or qualifying widow(er)	12 20,000 00	
13	If line 11 is equal to or more than line 12, enter the amount from line 8 on line 14 and go to line 15. If line 11 is less than line 12, divide line 11 by line 12. Enter the result as a decimal (rounded to at least three places)		13 × .
14	Multiply line 8 by line 13	14 800 00	
15	Enter the amount from Form 1040, line 44 (or Form 1040A, line 28)	15 4826 00	
16	Enter the total, if any, of your credits from Form 1040, lines 45 through 47 (or from Form 1040A, lines 29 and 30)	16 0 00	
17	Subtract line 16 from line 15. If line 16 is equal to or more than line 15, stop ; you cannot take any education credits	17 4826 00	
18	Education credits. Enter the smaller of line 14 or line 17 here and on Form 1040, line 48 (or Form 1040A, line 31)	18 800 00	

*See Pub. 970 for the amount to enter if you are filing Form 2555, 2555-EZ, or 4563 or you are excluding income from Puerto Rico.

STUDENT NOTES

INTRODUCTION AND OBJECTIVES

In this lesson you will learn about the earned income tax credit. This is a refundable credit, and taxpayers must file a tax return to receive the credit. Beginning in 2002, some of the rules and qualifications for earned income tax credit changed. New rules and/or qualifications apply to earned income, modified adjusted gross income, taxpayers with the same qualifying child, and a new definition of foster child.

After completing this lesson you should be able to:

- Use the new 2002 rules to determine which taxpayers are eligible for the earned income credit.
- Calculate and report the credit using the EIC worksheet.
- Explain the benefits of the Advanced Earned Income Credit (AEIC).
- Report the AEIC on the tax return.

GENERAL REQUIREMENTS

Some taxpayers are able to claim the earned income credit. This is a refundable credit, and eligible taxpayers can receive a refund of this credit even if they owe no tax and had no income tax withheld.

All taxpayers (and spouses, if filing a joint return) must meet the general requirements to claim the credit. Other requirements apply depending on whether or not the taxpayer has a qualifying child (defined later).

TAX TIPS

★★★★★★★★★
Taxpayers who are eligible to claim the earned income credit should file a tax return even if they are not otherwise required to file.

POTENTIAL PITFALLS



If the taxpayer's filing status is married filing separately, the taxpayer cannot claim the earned income credit.

Generally, to claim the earned income tax credit, a taxpayer must:

- Have earned income during the year,
- Not have investment income of more than \$2,550. Investment income includes taxable interest and dividends, tax exempt interest, capital gain net income, net income from rents and royalties not derived from a trade or business, and net income from passive activities,
- Use any filing status except married filing a separate return,
- Have a tax return that covers a 12-month period. This does not apply if a short period return is filed because of an individual's death,
- Show on the tax return the SSN of the taxpayer (and spouse if filing a joint return). See identification numbers, later.
- Not be the qualifying child of another person,
- Not exclude from gross income any income earned in foreign countries, or deduct or exclude a foreign housing amount (File Form 2555 or Form 2555-EZ), and
- Not be a nonresident alien. Nonresident aliens may qualify for the credit only if they are married to a U.S. citizen or resident *and* their filing status is married filing jointly.

Identification Numbers

To claim the EIC, the taxpayer (and spouse if filing a joint return) must have a valid Social Security number (SSN) issued by the Social Security Administration (SSA). Any qualifying child listed on Schedule EIC must also have a valid SSN. If a social security card has a legend that says ***“Not valid for employment”*** and the number was issued so that the taxpayer (or spouse or qualifying child) could receive a federally funded benefit, the taxpayer cannot claim the EIC. An example of a federally funded benefit is Medicaid.

Individual Taxpayer Identification Numbers (ITINs) and Adoption Taxpayer Identification Numbers (ATINs) cannot be used when claiming the EIC.

If a taxpayer has a social security card that contains the legend “valid for work only with INS authorization,” the taxpayer may claim the credit, assuming he or she meets the other requirements.

Taxpayers With One or More Qualifying Children

If the taxpayer has a qualifying child (defined later), the following additional requirements apply.

- The taxpayer's earned income and adjusted gross income must each be less than:
 - b) \$33,178 (\$34,178 if married filing jointly) if he or she has more than one qualifying child,
 - a) \$29,201 (\$30,201 if married filing jointly) if he or she has one qualifying child, or
- The taxpayer must show on Schedule EIC the name, age, and SSN for each qualifying child listed (see *Identification Numbers*, earlier).

Taxpayers With No Qualifying Child

If the taxpayer does not have a qualifying child, the following additional requirements apply.

- The taxpayer's earned income and adjusted gross income must each be less than \$11,060 (\$12,060 if married filing jointly).
- The taxpayer (or the taxpayer's spouse, if filing a joint return) must be at least age 25 but under age 65 at the end of the year.
- Neither the taxpayer (nor the taxpayer's spouse if filing jointly) can be eligible to be claimed as a dependent on another person's return.
- The principal place of abode of the taxpayer (and the taxpayer's spouse, if filing jointly) must be in the United States for more than half the year.

Earned Income

Earned income is wages, salaries, tips and other employee compensation, but only if the amounts are includible in gross income; plus net earnings from self-employment. Table 1 provides examples of what to include and not to include as earned income in computing the earned income credit.

Amounts received for work performed while an inmate in a penal institution are not considered earned income for purposes of the earned income credit. Enter "PRI" and the amount of the income earned while an inmate next to line 7 (Form 1040 or 1040A) or line 1 (Form 1040 EZ). This income is still considered taxable for purposes of determining the taxpayer's federal income tax.

If the taxpayer was a household employee who did not receive a Form W-2 because he or she was paid less than \$1,300, the income must still be included on line 7 (Form 1040A or 1040) or line 1 (Form 1040EZ). Enter "HSH" and the amount not reported on Form W-2 next to line 7 (Form 1040A or 1040) or Line 1 (Form 1040EZ).

Table 1. Examples of Earned Income for the Earned Income Credit

Earned Income	
Includes	Does not include
<p>Taxable wages, salaries, and tips</p> <p>Union strike benefits</p> <p>Taxable long-term disability benefits received prior to minimum retirement age</p> <p>Net earnings from self-employment</p> <p>Gross income of a statutory employee</p>	<p>Interest and dividends</p> <p>Social Security and railroad retirement benefits</p> <p>Welfare benefits</p> <p>Workfare payments</p> <p>Pensions or annuities</p> <p>Veteran's benefits (including VA rehabilitation payments)</p> <p>Workers' compensation benefits</p> <p>Alimony</p> <p>Child Support</p> <p>Nontaxable foster care payments</p> <p>Unemployment compensation</p> <p>Taxable scholarship or fellowship grants that are not reported on Form W-2</p> <p>Earnings for work performed while an inmate at a penal institution</p> <p>Salary deferrals (for example, under a 401(k) or 403(b) plan or the Federal Thrift Savings Plan)</p> <p>Combat zone excluded pay (box 12, code Q of Form W-2)</p> <p>Basic housing and subsistence allowances for the U.S. Military (box 12, code Q of Form W-2)</p> <p>The value of meals or lodging provided by an employer for the convenience of the employer</p> <p>Housing allowance or rental value of a parsonage for the clergy</p> <p>Excludable dependent care benefits (line 18 of either Form 2441, Form 1040, or Schedule 2, Form 1040A)</p> <p>Salary reductions such as under a cafeteria plan</p> <p>Excludable employer provided educational assistance benefits (may be shown in box 13 of Form W-2)</p> <p>Anything else of value received from someone for services performed, if it is not currently taxable</p>

TAX TIPS
 ★★★★★★★★★★
Nontaxable earned income is no longer considered for eligibility of EIC.

QUALIFYING CHILD

For purposes of the earned income credit, a taxpayer has a qualifying child, if the child meets three tests.

- Relationship Test
- Residency Test, and
- Age Test

Relationship Test

To meet the relationship test, the qualifying child must be the taxpayer's:

1. Son, daughter, stepson, stepdaughter or a descendant of the taxpayer's son, daughter, stepson, or stepdaughter.
2. Brother, sister, stepbrother, stepsister. The taxpayer must care for any of these children as his or her own child. A descendant must be lineal descendant.
3. Eligible foster child.

An **eligible foster child** is a child placed with the taxpayer by an authorized placement agency and whom the taxpayer cares for as his or her own child. An authorized placement agency is an agency of a state or political subdivision of a state, including a court, or tax-exempt organization licensed by the state.

An adopted child (and a child placed with the taxpayer for adoption) is treated as a child by blood.

Residency Test

To meet the residency test, the child must live with the taxpayer in the United States for more than half of the tax year. If a child fails to meet the residency test because the child was born or died during the year, the child is considered to meet the test if the child lived with the taxpayer while the child was alive.

Age Test

To meet the age test, the child must be:

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

A **married taxpayer** can be a qualifying child of the taxpayer if he or she can be claimed as a dependent by the taxpayer.

TAX TIPS

★★★★★★★★★★

The taxpayer does not need to have a home. It is sufficient if the taxpayer and child live together in a series of homeless shelters.

Qualifying Child of More Than One Taxpayer

Beginning with tax year 2002, if a child is a qualifying child of more than one taxpayer, the taxpayers may choose which of them will claim the credit on the basis of that child. If two or more children are qualifying children of the same taxpayers (not filing a joint return together), the taxpayers may agree that one will claim the credit on the basis of one child and the other will claim the credit on the basis of the other child.

Example 1

Jane (age 30) is unmarried. In 2002, Jane lived with her four children and her mother, Linda. Provided they each meet the eligibility and income requirements, Jane may claim the EIC based on one or two of the children, and Linda may claim the EIC based on any other children not claimed by Jane.

If two or more taxpayers actually claim the credit on the basis of the same qualifying child, the statute determines which of them is entitled to the credit on the basis of that child. This is the tie-breaker rule. The taxpayer who is entitled to the credit is –

- The parent, if one taxpayer is a parent of the child.
- The taxpayer with the higher AGI, if neither is a parent of the child.
- The parent the child lived with longest during the tax year, if both taxpayers are parents of the child and they do not file a joint return together.
- The parent with the higher AGI, if both taxpayers are parents of the child, the child lived with both parents for the same length of time during the tax year, and they do not file a joint return together.

Example 2

John (age 26) is unmarried. In 2002, John and his daughter, Lynn, lived with John's father, Paul. John's sole income was wages of \$19,000. Paul's sole income was wages of \$12,000.

Lynn is a qualifying child of both John and Paul. John and Paul agree that Paul will claim the EIC on the basis of Lynn, because Paul's credit would be more than John's. If John later decides to claim the credit, under the tie-breaker rule, Paul will lose the credit he claimed.

Example 3

Ralph is single and has two qualifying children. He earned \$23,247 in taxable wages and his adjusted gross income is \$26,928.

Ralph can claim the earned income credit because his earned income and adjusted gross income are each less than \$33,178.

Example 4

Maureen has \$23,050 in earned income; her adjusted gross income is \$23,175. Her filing status is single. Maureen's 20-year-old daughter, Angie, lived with her for eight months of the year. Angie is not married and is a full-time college student.

Maureen can claim the earned income credit because she has a qualifying child and her earned income and adjusted gross income are under \$29,201.

DISALLOWED EARNED INCOME CREDIT

If a taxpayer's earned income credit was disallowed in a prior year as a result of the deficiency procedures, he or she cannot claim the credit again unless *Form 8862, Information To Claim Earned Income Credit After Disallowance*, is attached to the return. If the credit is claimed without attaching Form 8862, it will be automatically denied, under the math error procedures.

A deficiency procedure occurs when the IRS questions the taxpayer's eligibility for the earned income credit for reasons other than a mathematical or clerical error. If the credit was disallowed in the earlier year because of a mathematical or clerical error, Form 8862 should not be completed. For more information on deficiency procedures, see Publication 596.

A taxpayer who is determined to have claimed the EIC due to reckless or intentional disregard of rules or regulations is ineligible to claim the EIC for a subsequent period of 2 years.

A taxpayer who is determined to have fraudulently claimed the EIC is ineligible to claim the EIC for a subsequent period of 10 years.

Exercise 1

Determine if the taxpayers in this exercise can claim the earned income credit. If they cannot, explain why.

- A.** Sharon has an eligible foster child, Eric. Eric is 12 years old and began living with Sharon in August 2002. Sharon's earned income and her adjusted gross income are \$14,275. Can Sharon claim the earned income credit? _____
- B.** Doug and Donna are married and live together. Their combined earned income is \$22,222. Doug reports adjusted gross income of \$10,728 on his separate tax return, and Donna reports adjusted gross income of \$11,514 on her separate return. Sam, their four-year-old son, lives with Doug and Donna. Can Doug and/or Donna claim the earned income credit? _____
- C.** Randy and Cara were married and lived together until August when they divorced. Randy and Cara have two children, Jimmy, age seven, and Anna, age five. The children lived with both of their parents until August, then they lived with their mother. Randy's earned income and adjusted gross income are \$19,251. Cara's earned income is \$14,751, and her adjusted gross income is \$15,362. Can Randy and/or Cara claim the earned income credit? _____
- D.** Benjamin, age 26, lives alone, is single, and earns \$8,250. His adjusted gross income is \$8,950. Can Benjamin claim the earned income credit? _____
- E.** Melanie is 18 years old and married. Melanie's husband is overseas, and she lives with her mother, Susan. Susan's earned income is \$18,431, and her adjusted gross income is \$18,453. Susan cannot claim Melanie as a dependent. Can Susan claim the earned income credit? _____
- F.** Circle the items that are considered earned income for earned income credit purposes.
1. Wages
 2. Housing allowance for a member of the clergy
 3. Social security benefits
 4. Interest income
 5. Unemployment compensation
 6. Tip income
 7. Dividend income
 8. Military subsistence allowances

THE EARNED INCOME CREDIT WORKSHEET AND SCHEDULE EIC

The earned income credit is computed on the Earned Income Credit (EIC) Worksheet. Before completing the EIC Worksheet, **you must** complete the steps in the EIC instructions line 64 of Form 1040; line 41 of Form 1040A; or line 8 of Form 1040EZ.

Completing the steps will help you determine whether or not the taxpayer is eligible to take the credit. If the taxpayer can claim the earned income credit, complete the EIC Worksheet. If the taxpayer is not eligible to claim the credit, write “No” next to line 8 of 1040EZ; line 41 of 1040A; or line 64 of 1040. **The steps and the EIC Worksheets are included in the Tax Forms Booklet Appendix, and the Forms 1040, 1040A, and 1040EZ instructions.**

There are two versions (A and B) of the EIC Worksheet for Form 1040 filers. (The sidebar on this page alerts you to when Version B applies). Complete the EIC Worksheet to determine the amount of the earned income credit the taxpayer can claim. The EIC Worksheet should not be attached to the return; the taxpayer should keep it with his or her tax records.

Using the Earned Income Credit Table

The Earned Income Credit (EIC) Table is used to determine the amount of the credit. The tables are found in the instructions for Forms 1040EZ, 1040A, or 1040.

When using the earned income credit table to determine the credit, read down the columns labeled *At least . . . But less than* and find the line that includes the amount you are instructed to look up from the EIC Worksheet. Read across to the column that includes the number of qualifying children of the taxpayer and filing status. Enter the earned income credit from that column on the EIC Worksheet.

Example 5

Roger’s filing status is head of household and he has two qualifying children. The amount shown on lines 1 and 3 of his Form 1040A EIC Worksheet is \$19,300.

Roger’s earned income credit from the EIC Table is \$2,917.

ALERT



The EIC Worksheet for Form 1040 has two versions, A and B. They are both included in the *Tax Forms Booklet Appendix*.

If the taxpayer was self-employed or reported income and expenses on Schedule C or C-EZ as a statutory employee, he or she must use the *EIC Worksheet B* to figure his or her credit amount.

TAX TIPS

★★★★★★★★★
The Earned Income Credit (EIC) Table is included in the *Tax Forms Booklet Appendix*.

POTENTIAL PITFALLS



Errors are easily made when using the earned income credit table. To ensure that you have entered the correct amount on the tax form, look up the credit twice—once before you enter the credit on the form and once after you have entered it on the form.

TAX TIPS

★★★★★★★★★
Schedule EIC is included in the Tax Forms Booklet Appendix.

Exercise 2

- A. Alex and Cheryl have two qualifying children. Their filing status is married filing jointly. The amount shown on lines 1 and 3 of their EIC Worksheet is \$19,866.

What is the earned income credit from the EIC Table? _____

- B. Roxanne is divorced. She lives with her infant daughter. The amount shown on lines 1 and 3 of her EIC Worksheet is \$17,750.

What is the earned income credit from the EIC Table? _____

Completing Schedule EIC

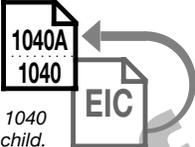
Qualifying Child Information

Schedule EIC, *Earned Income Credit*, contains only information about qualifying children. Only taxpayers who have a qualifying child must fill out the schedule and attach it to Form 1040A or Form 1040.

Example 6

Ronald Evans (SSN 000-00-9840) is single. His son, Harry (SSN 000-00-9849), was born in 1979. Harry lived with Ronald during all of 2002. Harry is a full-time student. Harry is not married and is a qualifying child of his father. He is not a qualifying child of his mother. However, Harry's mother claims him as a dependent on her tax return.

Exhibit 1 shows the Schedule EIC.

<p>SCHEDULE EIC (Form 1040A or 1040)</p> <p>Department of the Treasury Internal Revenue Service (99)</p> <p>Name(s) shown on return</p>	<p>Earned Income Credit Qualifying Child Information</p> <p>Complete and attach to Form 1040A or 1040 only if you have a qualifying child.</p>		<p>OMB No. 1545-0074</p> <p>2002</p> <p>Attachment Sequence No. 43</p>		
<p>Ronald Evans</p>		<p>Your social security number 000 00 9840</p>			
<p>Before you begin: See the instructions for Form 1040A, line 41, or Form 1040, line 64, to make sure that (a) you can take the EIC and (b) you have a qualifying child.</p>					
<div style="display: flex; align-items: flex-start;"> <div style="margin-right: 10px;">  </div> <ul style="list-style-type: none"> If you take the EIC even though you are not eligible, you may not be allowed to take the credit for up to 10 years. See back of schedule for details. It will take us longer to process your return and issue your refund if you do not fill in all lines that apply for each qualifying child. Be sure the child's name on line 1 and social security number (SSN) on line 2 agree with the child's social security card. Otherwise, at the time we process your return, we may reduce or disallow your EIC. If the name or SSN on the child's social security card is not correct, call the Social Security Administration at 1-800-772-1213. </div>					
<p>Qualifying Child Information</p>					
	Child 1		Child 2		
1 Child's name	First name	Last name	First name	Last name	
<p>If you have more than two qualifying children, you only have to list two to get the maximum credit.</p>	Harry Evans				
2 Child's SSN					
<p>The child must have an SSN as defined on page 42 of the Form 1040A instructions or page 44 of the Form 1040 instructions unless the child was born and died in 2002. If your child was born and died in 2002 and did not have an SSN, enter "Died" on this line and attach a copy of the child's birth certificate.</p>	000 00 9849				
3 Child's year of birth					
<p>If born after 1983, skip lines 4a and 4b; go to line 5.</p>	Year <u>1 9 7 9</u>		Year _____		
4 If the child was born before 1984—					
a Was the child under age 24 at the end of 2002 and a student?	<input checked="" type="checkbox"/> Yes. <input type="checkbox"/> No. <i>Go to line 5.</i> <i>Continue</i>		<input type="checkbox"/> Yes. <input type="checkbox"/> No. <i>Go to line 5.</i> <i>Continue</i>		
b Was the child permanently and totally disabled during any part of 2002?	<input type="checkbox"/> Yes. <input type="checkbox"/> No. <i>Continue</i> The child is not a qualifying child.		<input type="checkbox"/> Yes. <input type="checkbox"/> No. <i>Continue</i> The child is not a qualifying child.		
5 Child's relationship to you (for example, son, daughter, grandchild, foster child, etc.)	Son				
6 Number of months child lived with you in the United States during 2002					
<ul style="list-style-type: none"> If the child lived with you for more than half of 2002 but less than 7 months, enter "7". If the child was born or died in 2002 and your home was the child's home for the entire time he or she was alive during 2002, enter "12". 	<p style="text-align: center;"><u>12</u> months</p> <p style="text-align: center;"><i>Do not enter more than 12 months.</i></p>		<p style="text-align: center;">_____ months</p> <p style="text-align: center;"><i>Do not enter more than 12 months.</i></p>		
<div style="display: flex; align-items: center;"> <div style="margin-right: 10px;">  </div> <p>You may also be able to take the additional child tax credit if your child (a) was under age 17 at the end of 2002, (b) is claimed as your dependent on line 6c of Form 1040A or Form 1040, and (c) is a U.S. citizen or resident alien. For more details, see the instructions for line 42 of Form 1040A or line 66 of Form 1040.</p> </div>					
For Paperwork Reduction Act Notice, see Form 1040A or 1040 instructions.		Cat. No. 13339M		Schedule EIC (Form 1040A or 1040) 2002	

POTENTIAL PITFALLS



Remember that the amount of the earned income credit depends on the taxpayer's income, number of qualifying children, and filing status. Be sure to use the correct column from the EIC Table.

Exercise 3

Sam U. and Robin O. Bell are married and file a joint return. Sam's social security number is 000-00-4797 and Robin's is 000-00-4798. They have a child, Jennifer S. Bell (SSN 000-00-1987) who was born in 1996. Jennifer lived with her parents for the entire year. Form 1040, line 7 shows that the Bells had wages of \$21,211, line 8a shows \$39 of taxable interest income, and line 35 shows the Bells' adjusted gross income of \$21,250.

- A. Complete the Form 1040A, line 41 steps, the EIC Worksheet and Schedule EIC.
- B. Report the earned income credit on Form 1040A.

Earned Income Credit (EIC) Worksheet—Line 41

Keep for Your Records



Part 1
All Filers

1. Enter your earned income from Step 5, on page 43. 1

2. Look up the amount on line 1 above in the EIC Table on pages 46–51 to find the credit. Be sure you use the correct column for your filing status and the number of children you have. Enter the credit here. 2

If line 2 is zero, You cannot take the credit. Put "No" to the left of the entry space for line 41.

3. Enter the amount from Form 1040A, line 22. 3

4. Are the amounts on lines 3 and 1 the same?
 Yes. Skip line 5; enter the amount from line 2 on line 6.
 No. Go to line 5.

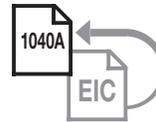
Part 2
Filers Who Answered "No" on Line 4

5. If you have:
 • No qualifying children, is the amount on line 3 less than \$6,150 (or \$7,150 if married filing jointly)?
 • 1 or more qualifying children, is the amount on line 3 less than \$13,520 (\$14,520 if married filing jointly)?
 Yes. Leave line 5 blank; enter the amount from line 2 on line 6.
 No. Look up the amount on line 3 in the EIC Table on pages 46–51 to find the credit. Be sure you use the correct column for your filing status and the number of children you have. Enter the credit here. 5
 Look at the amounts on lines 5 and 2. Then, enter the **smaller** amount on line 6.

Part 3
Your Earned Income Credit

6. **This is your earned income credit.** 6
 Enter this amount on Form 1040A, line 41.

Reminder—
 ✓ If you have a qualifying child, complete and attach Schedule EIC.



If your EIC for a year after 1996 was reduced or disallowed, see page 44 to find out if you must file Form 8862 to take the credit for 2002.

**Line 41—
Earned Income Credit (EIC)**

What Is the EIC?

The EIC is a credit for certain people who work. The credit may give you a refund even if you do not owe any tax.

To Take the EIC:

- Follow the steps below.
- Complete the worksheet that applies to you **or** let the IRS figure the credit for you.
- If you have a qualifying child, complete and attach Schedule EIC.



If you take the EIC even though you are not eligible and it is determined that your error is due to reckless or intentional disregard of the EIC rules, you will not be allowed to take the credit for 2 years even if you are otherwise eligible to do so. If you fraudulently take the EIC, you will not be allowed to take the credit for 10 years. You may also have to pay penalties.

Step 1 All Filers

1. If, in 2002:
 - 2 children lived with you, is the amount on Form 1040A, line 22, less than \$33,178 (or \$34,178 if married filing jointly)?
 - 1 child lived with you, is the amount on Form 1040A, line 22, less than \$29,201 (\$30,201 if married filing jointly)?
 - No children live with you, is the amount on Form 1040A, line 22, less than \$11,060 (or \$12,060 if married filing jointly)?

Yes. *Continue* → **No.** You cannot take the credit.
2. Do you, and your spouse if filing a joint return, have a social security number that allows you to work or is valid for EIC purposes (see page 44)?

Yes. *Continue* → **No.** You cannot take the credit.
Put "No" to the left of the entry space for line 41.
3. Is your filing status married filing separately?

Yes. You cannot take the credit. **No.** *Continue* →
4. Were you a nonresident alien for any part of 2002?

Yes. *See Nonresident Aliens on page 44.* **No.** *Go to Step 2.*

Step 2 Investment Income

1. Add the amounts from Form 1040A:

Line 8a	_____		
Line 8b	+	_____	
Line 9	+	_____	
Line 10	+	_____	
Investment Income			=

2. Is your investment income more than \$2,550?
- Yes.** You cannot take the credit. **No.** *Continue* →
3. Did a child live with you in 2002?
- Yes.** *Go to Step 3.* **No.** *Go to Step 4 on page 42.*

(Continued on page 42)

Continued from page 41

Step 3 Qualifying Child

A qualifying child is a child who is...

Your son, daughter, adopted child, stepchild, or grandchild

or

Your brother, sister, stepbrother, or stepsister, or a descendant of your brother, sister, etc. (for example, your niece or nephew), whom you cared for as your own child

or

A foster child (any child placed with you by an authorized placement agency whom you cared for as your own child)

If the child was married, see page 42.

AND

was at the end of 2002...

Under age 19

or

Under age 24 and a student (see page 44)

or

Any age and permanently and totally disabled (see page 44)

AND

who...

Lived with you in the United States for more than half of 2002. If the child did not live with you for the required time, see Exception to "Time Lived With You" Condition on page 44.

Note. If the child was married, see page 44.

1. Look at the qualifying child conditions above. Could you, or your spouse if filing a joint return, be a qualifying child of another person in 2002?

- Yes.**  You cannot take the credit. Put "No" to the left of the entry space for line 41.
- No.** *Continue* ↘

2. Do you have at least one child who meets the above conditions to be your qualifying child?

- Yes.** *Continue* ↘
- No.** *Skip question 3; go to Step 4, question 2.*

3. Does the child meet the conditions to be a qualifying child of any other person (other than your spouse if filing a joint return) for 2002?

- Yes.** *See Qualifying Child of More Than One Person on page 44.*
- No.** This child is your qualifying child. The child must have a social security number as defined on page 44 unless the child was born and died in 2002. *Skip Step 4; go to Step 5 on page 43.*

Step 4 Filers Without a Qualifying Child

1. Look at the qualifying child conditions in Step 3. Could you, or your spouse if filing a joint return, be a qualifying child of another person in 2002?

- Yes.**  You cannot take the credit. Put "No" to the left of the entry space for line 41.
- No.** *Continue* ↘

2. Can you, or your spouse if filing a joint return, be claimed as a dependent on someone else's 2002 tax return?

- Yes.**  You cannot take the credit.
- No.** *Continue* ↘

3. Were you, or your spouse if filing a joint return, at least age 25 but under age 65 at the end of 2002?

- Yes.** *Continue* ↘
- No.**  You cannot take the credit. Put "No" to the left of the entry space for line 41.

4. Was your home, and your spouse's if filing a joint return, in the United States for more than half of 2002? Members of the military stationed outside the United States, see page 44 before you answer.

- Yes.** *Go to Step 5 on page 43.*
- No.**  You cannot take the credit. Put "No" to the left of the entry space for line 41.

(Continued on page 41)

Continued from page 42

Step 5 Earned Income

1. Figure earned income:

Form 1040A, line 7 _____

Subtract, if included on line 7, any:

- Taxable scholarship or fellowship grant not reported on a W-2 form
- Amount paid to an inmate in a penal institution for work (put "PRI" and the amount subtracted to the left of the entry space for line 7 of Form 1040A)
- Amount received as a pension or annuity from a nonqualified deferred compensation plan or a nongovernmental section 457 plan (put "DFC" and the amount subtracted to the left of the entry space for line 7 of Form 1040A). This amount may be shown in box 11 of your W-2 form. If you received such an amount but box 11 is blank, contact your employer for the amount received as a pension or annuity.

Taxable Earned Income =

Go to Step 6.

2. If you have:

- 2 or more qualifying children, is your earned income less than \$33,178 (\$34,178 if married filing jointly)?
- 1 qualifying child, is your earned income less than \$29,201 (\$30,201 if married filing jointly)?
- No qualifying children, is your earned income less than \$11,060 (\$12,060 if married filing jointly)?

Yes. *Go to Step 6.* **No.** **You cannot take the credit.**

Step 6 How To Figure the Credit

1. Do you want the IRS to figure the credit for you?

Yes. *See Credit Figured by the IRS below.* **No.** *Go to the worksheet on page 44.*

Definitions and Special Rules
(listed in alphabetical order)

Adopted Child. Any child placed with you by an authorized placement agency for legal adoption. An authorized placement agency includes any person authorized by state law to place children for legal adoption. The adoption does not have to be final.

Credit Figured by the IRS. To have the IRS figure the credit for you:

1. Put "EIC" to the left of the entry space for line 41 of Form 1040A.
2. If you have a qualifying child, complete and attach Schedule EIC. If your EIC for a year after 1996 was reduced or disallowed, see Form 8862, Who Must File, on page 44.

Exception to "Time Lived With You" Condition. A child is considered to have lived with you for all of 2002 if the child was born or died in 2002 and your home was this child's home for the entire time he or she was alive in 2002. Temporary absences, such as for school, vacation, medical care, or detention in a juvenile facility, count as time lived at home. If your child is presumed to have been kidnapped by someone who is not a family member, see Pub. 596 to find out if that child is a qualifying child for the EIC. To get Pub. 596, see page 9. If you were in the military stationed outside the United States, see Members of the Military below.

Form 8862, Who Must File. You must file Form 8862 if your EIC for a year after 1996 was reduced or disallowed for any reason other than a math or clerical error. But do not file Form 8862 if, after your EIC was reduced or disallowed in an earlier year:

- You filed Form 8862 (or other documents) and your EIC was then allowed and
- Your EIC has not been reduced or disallowed again for any reason other than a math or clerical error.

Also, do not file Form 8862 or take the credit if it was determined that your error was due to reckless or intentional disregard of the EIC rules or fraud.

(Continued on page 44)

Form 1040A (2002)		Page 2
Tax, credits, and payments	22 Enter the amount from line 21 (adjusted gross income). 22	
Standard Deduction for—	23a Check <input type="checkbox"/> You were 65 or older <input type="checkbox"/> Blind } Enter number of boxes checked ▶ 23a <input style="width: 30px;" type="text"/> <input type="checkbox"/> Spouse was 65 or older <input type="checkbox"/> Blind }	
	b If you are married filing separately and your spouse itemizes deductions, see page 32 and check here ▶ 23b <input type="checkbox"/>	
<ul style="list-style-type: none"> • People who checked any box on line 23a or 23b or who can be claimed as a dependent, see page 33. • All others: <ul style="list-style-type: none"> Single, \$4,700 Head of household, \$6,900 Married filing jointly or Qualifying widow(er), \$7,850 Married filing separately, \$3,925 	24 Enter your standard deduction (see left margin). 24 25 Subtract line 24 from line 22. If line 24 is more than line 22, enter -0-. 25 26 Multiply \$3,000 by the total number of exemptions claimed on line 6d. 26 27 Subtract line 26 from line 25. If line 26 is more than line 25, enter -0-. This is your taxable income . ▶ 27 28 Tax , including any alternative minimum tax (see page 33). 28 29 Credit for child and dependent care expenses. Attach Schedule 2. 29 30 Credit for the elderly or the disabled. Attach Schedule 3. 30 31 Education credits. Attach Form 8863. 31 32 Retirement savings contributions credit. Attach Form 8880. 32 33 Child tax credit (see page 36). 33 34 Adoption credit. Attach Form 8839. 34 35 Add lines 29 through 34. These are your total credits . 35 36 Subtract line 35 from line 28. If line 35 is more than line 28, enter -0-. 36 37 Advance earned income credit payments from Form(s) W-2. 37 38 Add lines 36 and 37. This is your total tax . ▶ 38 39 Federal income tax withheld from Forms W-2 and 1099. 39 40 2002 estimated tax payments and amount applied from 2001 return. 40 41 Earned income credit (EIC) . 41 42 Additional child tax credit. Attach Form 8812. 42 43 Add lines 39 through 42. These are your total payments . ▶ 43	
Refund	44 If line 43 is more than line 38, subtract line 38 from line 43. This is the amount you overpaid . 44	
	45a Amount of line 44 you want refunded to you . ▶ 45a b Routing number <input style="width: 100px;" type="text"/> c Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings d Account number <input style="width: 100px;" type="text"/>	
Amount you owe	46 Amount of line 44 you want applied to your 2003 estimated tax . 46	
	47 Amount you owe . Subtract line 43 from line 38. For details on how to pay, see page 48. ▶ 47 48 Estimated tax penalty (see page 48). 48	
Third party designee	Do you want to allow another person to discuss this return with the IRS (see page 49)? <input type="checkbox"/> Yes . Complete the following. <input type="checkbox"/> No Designee's name ▶ _____ Phone no. () _____ Personal identification number (PIN) <input style="width: 40px;" type="text"/>	
Sign here	Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and accurately list all amounts and sources of income I received during the tax year. Declaration of preparer (other than the taxpayer) is based on all information of which the preparer has any knowledge.	
Joint return? See page 20. Keep a copy for your records.	Your signature _____ Date _____ Your occupation _____ Daytime phone number () _____	
	Spouse's signature. If a joint return, both must sign. _____ Date _____ Spouse's occupation _____	
Paid preparer's use only	Preparer's signature ▶ _____ Date _____ Check if self-employed <input type="checkbox"/> Preparer's SSN or PTIN _____	
	Firm's name (or yours if self-employed), address, and ZIP code ▶ _____ EIN _____ Phone no. () _____	



<p>SCHEDULE EIC (Form 1040A or 1040)</p> <p>Department of the Treasury Internal Revenue Service (99)</p>	<p>Earned Income Credit Qualifying Child Information</p> <p><i>Complete and attach to Form 1040A or 1040 only if you have a qualifying child.</i></p>		<p>OMB No. 1545-0074</p> <p>2002</p> <p>Attachment Sequence No. 43</p>
Name(s) shown on return _____		Your social security number _____	
<p>Before you begin: See the instructions for Form 1040A, line 41, or Form 1040, line 64, to make sure that (a) you can take the EIC and (b) you have a qualifying child.</p>			
<p> If you take the EIC even though you are not eligible, you may not be allowed to take the credit for up to 10 years. See back of schedule for details.</p> <p>It will take us longer to process your return and issue your refund if you do not fill in all lines that apply for each qualifying child.</p> <p>Be sure the child's name on line 1 and social security number (SSN) on line 2 agree with the child's social security card. Otherwise, at the time we process your return, we may reduce or disallow your EIC. If the name or SSN on the child's social security card is not correct, call the Social Security Administration at 1-800-772-1213.</p>			
<p>Qualifying Child Information</p>			
		Child 1	Child 2
1 Child's name	First name	Last name	First name Last name
<p>If you have more than two qualifying children, you only have to list two to get the maximum credit.</p>			
2 Child's SSN			
<p>The child must have an SSN as defined on page 42 of the Form 1040A instructions or page 44 of the Form 1040 instructions unless the child was born and died in 2002. If your child was born and died in 2002 and did not have an SSN, enter "Died" on this line and attach a copy of the child's birth certificate.</p>			
3 Child's year of birth	Year _____		Year _____
		<i>If born after 1983, skip lines 4a and 4b; go to line 5.</i>	<i>If born after 1983, skip lines 4a and 4b; go to line 5.</i>
4 If the child was born before 1984—			
a Was the child under age 24 at the end of 2002 and a student?	<input type="checkbox"/> Yes. <i>Go to line 5.</i>	<input type="checkbox"/> No. <i>Continue</i>	<input type="checkbox"/> Yes. <input type="checkbox"/> No. <i>Go to line 5. Continue</i>
b Was the child permanently and totally disabled during any part of 2002?	<input type="checkbox"/> Yes. <i>Continue</i>	<input type="checkbox"/> No. The child is not a qualifying child.	<input type="checkbox"/> Yes. <input type="checkbox"/> No. <i>Continue</i> The child is not a qualifying child.
5 Child's relationship to you (for example, son, daughter, grandchild, foster child, etc.)			
6 Number of months child lived with you in the United States during 2002			
<p>• If the child lived with you for more than half of 2002 but less than 7 months, enter "7".</p> <p>• If the child was born or died in 2002 and your home was the child's home for the entire time he or she was alive during 2002, enter "12".</p>			
		_____ months <i>Do not enter more than 12 months.</i>	_____ months <i>Do not enter more than 12 months.</i>
<p> You may also be able to take the additional child tax credit if your child (a) was under age 17 at the end of 2002, (b) is claimed as your dependent on line 6c of Form 1040A or Form 1040, and (c) is a U.S. citizen or resident alien. For more details, see the instructions for line 42 of Form 1040A or line 66 of Form 1040.</p>			
For Paperwork Reduction Act Notice, see Form 1040A or 1040 instructions.		Cat. No. 13339M	Schedule EIC (Form 1040A or 1040) 2002

ADVANCE EARNED INCOME CREDIT PAYMENTS

An employee who expects to qualify for the earned income credit (EIC) and to have at least one qualifying child for 2003 can choose to get a portion of the credit in advance throughout the year (based on one qualifying child) by giving a filled out Form W-5, *Earned Income Credit Advance Payment Certificate*, to his or her employer. Taxpayers receive only a portion of the credit through advance payments, so the eligibility questions and the EIC Worksheet must be completed when the tax return is prepared to determine the full amount of the credit the taxpayer is entitled to receive.

If the employee chooses to receive the EIC in advance, the employer will include advance payments of the credit in the employee's regular paychecks during the year. Employees who receive advance earned income credit payments **must** file a tax return even if they are not otherwise required to file.

Advance earned income credit payments are reported in box 9 of Form W-2. Enter this amount on Form 1040A, line 37, or Form 1040, line 59.

TAX TIPS

★★★★★★★★★★
Advance earned income credit payments are based on the taxpayer's wages for the payroll period. Only persons who expect to have at least one qualifying child can get the advance EIC payment.

Exercise 4

Kyle B. Evans is a single parent. He claims his daughter, Julie, as a dependent on his tax return. Kyle's social security number is 000-00-2442. Julie was born in November 2001. Her social security number is 000-00-4104. Kyle's earned income was \$18,751, and his total income and adjusted gross income were \$19,223. He received \$550 in advance earned income credit payments.

- A. Complete Kyle's eligibility questions and EIC Worksheet.
- B. What entries would you make on Schedule EIC?

Line 41— Earned Income Credit (EIC)

What Is the EIC?

The EIC is a credit for certain people who work. The credit may give you a refund even if you do not owe any tax.

To Take the EIC:

- Follow the steps below.
- Complete the worksheet that applies to you **or** let the IRS figure the credit for you.
- If you have a qualifying child, complete and attach Schedule EIC.



If you take the EIC even though you are not eligible and it is determined that your error is due to reckless or intentional disregard of the EIC rules, you will not be allowed to take the credit for 2 years, even if you are otherwise eligible to do so. If you fraudulently take the EIC, you will not be allowed to take the credit for 10 years. You may also have to pay penalties.

Step 1 All Filers

- If, in 2002:
 - 2 children lived with you, is the amount on Form 1040A, line 22, less than \$33,178 (or \$34,178 if married filing jointly)?
 - 1 child lived with you, is the amount on Form 1040A, line 22, less than \$29,201 (\$30,201 if married filing jointly)?
 - No children live with you, is the amount on Form 1040A, line 22, less than \$11,060 (or \$12,060 if married filing jointly)?

Yes. *Continue* ↘ **No.** You cannot take the credit.
- Do you, and your spouse if filing a joint return, have a social security number that allows you to work or is valid for EIC purposes (see page 44)?

Yes. *Continue* ↘ **No.** You cannot take the credit.
Put "No" to the left of the entry space for line 41.
- Is your filing status married filing separately?

Yes. You cannot take the credit. **No.** *Continue* ↘
- Were you a nonresident alien for any part of 2002?

Yes. *See Nonresident Aliens on page 44.* **No.** *Go to Step 2.*

Step 2 Investment Income

1. Add the amounts from Form 1040A:

Line 8a	+	
Line 8b	+	
Line 9	+	
Line 10	+	
Investment Income		

- Is your investment income more than \$2,550?

Yes. You cannot take the credit. **No.** *Continue* ↘
- Did a child live with you in 2002?

Yes. *Go to Step 3.* **No.** *Go to Step 4 on page 42.*

(Continued on page 42)

Continued from page 41

Step 3 Qualifying Child

A qualifying child is a child who is...

Your son, daughter, adopted child, stepchild, or grandchild

or

Your brother, sister, stepbrother, or stepsister, or a descendant of your brother, sister, etc. (for example, your niece or nephew), whom you cared for as your own child

or

A foster child (any child placed with you by an authorized placement agency whom you cared for as your own child)

If the child was married, see page 42.

AND

was at the end of 2002...

Under age 19

or

Under age 24 and a student (see page 44)

or

Any age and permanently and totally disabled (see page 44)

AND

who...

Lived with you in the United States for more than half of 2002. If the child did not live with you for the required time, see Exception to "Time Lived With You" Condition on page 44.

Note. If the child was married, see page 44.

1. Look at the qualifying child conditions above. Could you, or your spouse if filing a joint return, be a qualifying child of another person in 2002?

- Yes.**  You cannot take the credit. Put "No" to the left of the entry space for line 41.
- No.** Continue ↘

2. Do you have at least one child who meets the above conditions to be your qualifying child?

- Yes.** Continue ↘
- No.** Skip question 3; go to Step 4, question 2.

3. Does the child meet the conditions to be a qualifying child of any other person (other than your spouse if filing a joint return) for 2002?

- Yes.** See *Qualifying Child of More Than One Person* on page 44.
- No.** This child is your qualifying child. The child must have a social security number as defined on page 44 unless the child was born and died in 2002. Skip Step 4; go to Step 5 on page 43.

Step 4 Filers Without a Qualifying Child

1. Look at the qualifying child conditions in Step 3. Could you, or your spouse if filing a joint return, be a qualifying child of another person in 2002?

- Yes.**  You cannot take the credit. Put "No" to the left of the entry space for line 41.
- No.** Continue ↘

2. Can you, or your spouse if filing a joint return, be claimed as a dependent on someone else's 2002 tax return?

- Yes.**  You cannot take the credit.
- No.** Continue ↘

3. Were you, or your spouse if filing a joint return, at least age 25 but under age 65 at the end of 2002?

- Yes.** Continue ↘
- No.**  You cannot take the credit. Put "No" to the left of the entry space for line 41.

4. Was your home, and your spouse's if filing a joint return, in the United States for more than half of 2002? Members of the military stationed outside the United States, see page 44 before you answer.

- Yes.** Go to Step 5 on page 43.
- No.**  You cannot take the credit. Put "No" to the left of the entry space for line 41.

(Continued on page 41)

Continued from page 42

Step 5 Earned Income

1. Figure earned income:

Form 1040A, line 7 _____

Subtract, if included on line 7, any:

- Taxable scholarship or fellowship grant not reported on a W-2 form
- Amount paid to an inmate in a penal institution for work (put "PRI" and the amount subtracted to the left of the entry space for line 7 of Form 1040A)
- Amount received as a pension or annuity from a nonqualified deferred compensation plan or a nongovernmental section 457 plan (put "DFC" and the amount subtracted to the left of the entry space for line 7 of Form 1040A). This amount may be shown in box 11 of your W-2 form. If you received such an amount but box 11 is blank, contact your employer for the amount received as a pension or annuity.

Taxable Earned Income =

Go to Step 6.

2. If you have:

- 2 or more qualifying children, is your earned income less than \$33,178 (\$34,178 if married filing jointly)?
- 1 qualifying child, is your earned income less than \$29,201 (\$30,201 if married filing jointly)?
- No qualifying children, is your earned income less than \$11,060 (\$12,060 if married filing jointly)?

Yes. Go to Step 6. **No.**  You cannot take the credit.

Step 6 How To Figure the Credit

1. Do you want the IRS to figure the credit for you?

Yes. See Credit Figured by the IRS below. **No.** Go to the worksheet on page 44.

Definitions and Special Rules
(listed in alphabetical order)

Adopted Child. Any child placed with you by an authorized placement agency for legal adoption. An authorized placement agency includes any person authorized by state law to place children for legal adoption. The adoption does not have to be final.

Credit Figured by the IRS. To have the IRS figure the credit for you:

1. Put "EIC" to the left of the entry space for line 41 of Form 1040A.
2. If you have a qualifying child, complete and attach Schedule EIC. If your EIC for a year after 1996 was reduced or disallowed, see Form 8862, Who Must File, on page 44.

Exception to "Time Lived With You" Condition. A child is considered to have lived with you for all of 2002 if the child was born or died in 2002 and your home was this child's home for the entire time he or she was alive in 2002. Temporary absences, such as for school, vacation, medical care, or detention in a juvenile facility, count as time lived at home. If your child is presumed to have been kidnapped by someone who is not a family member, see Pub. 596 to find out if that child is a qualifying child for the EIC. To get Pub. 596, see page 9. If you were in the military stationed outside the United States, see Members of the Military below.

Form 8862, Who Must File. You must file Form 8862 if your EIC for a year after 1996 was reduced or disallowed for any reason other than a math or clerical error. But do not file Form 8862 if, after your EIC was reduced or disallowed in an earlier year:

- You filed Form 8862 (or other documents) and your EIC was then allowed and
- Your EIC has not been reduced or disallowed again for any reason other than a math or clerical error.

Also, do not file Form 8862 or take the credit if it was determined that your error was due to reckless or intentional disregard of the EIC rules or fraud.

(Continued on page 44)

Earned Income Credit (EIC) Worksheet—Line 41

Keep for Your Records



Part 1

All Filers

1. Enter your earned income from Step 5, on page 43. 1

2. Look up the amount on line 1 above in the EIC Table on pages 46–51 to find the credit. Be sure you use the correct column for your filing status and the number of children you have. Enter the credit here. 2

If line 2 is zero, You cannot take the credit. Put “No” to the left of the entry space for line 41.

3. Enter the amount from Form 1040A, line 22. 3

4. Are the amounts on lines 3 and 1 the same?
 Yes. Skip line 5; enter the amount from line 2 on line 6.
 No. Go to line 5.

Part 2

Filers Who Answered “No” on Line 4

5. If you have:
 • No qualifying children, is the amount on line 3 less than \$6,150 (or \$7,150 if married filing jointly)?
 • 1 or more qualifying children, is the amount on line 3 less than \$13,520 (\$14,520 if married filing jointly)?
 Yes. Leave line 5 blank; enter the amount from line 2 on line 6.
 No. Look up the amount on line 3 in the EIC Table on pages 46–51 to find the credit. Be sure you use the correct column for your filing status and the number of children you have. Enter the credit here. 5
 Look at the amounts on lines 5 and 2. Then, enter the **smaller** amount on line 6.

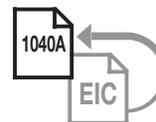
Part 3

Your Earned Income Credit

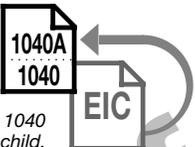
6. **This is your earned income credit.** 6
 Enter this amount on Form 1040A, line 41.

Reminder—

✓ If you have a qualifying child, complete and attach Schedule EIC.



If your EIC for a year after 1996 was reduced or disallowed, see page 44 to find out if you must file Form 8862 to take the credit for 2002.

<p>SCHEDULE EIC (Form 1040A or 1040)</p> <p>Department of the Treasury Internal Revenue Service (99)</p> <p>Name(s) shown on return</p>	<p>Earned Income Credit Qualifying Child Information</p> <p>Complete and attach to Form 1040A or 1040 only if you have a qualifying child.</p>		<p>OMB No. 1545-0074</p> <p>2002</p> <p>Attachment Sequence No. 43</p>
		Your social security number	
<p>Before you begin: See the instructions for Form 1040A, line 41, or Form 1040, line 64, to make sure that (a) you can take the EIC and (b) you have a qualifying child.</p>			
<p> If you take the EIC even though you are not eligible, you may not be allowed to take the credit for up to 10 years. See back of schedule for details.</p> <p>It will take us longer to process your return and issue your refund if you do not fill in all lines that apply for each qualifying child.</p> <p>Be sure the child's name on line 1 and social security number (SSN) on line 2 agree with the child's social security card. Otherwise, at the time we process your return, we may reduce or disallow your EIC. If the name or SSN on the child's social security card is not correct, call the Social Security Administration at 1-800-772-1213.</p>			
Qualifying Child Information			
		Child 1	Child 2
1 Child's name	First name	Last name	First name Last name
If you have more than two qualifying children, you only have to list two to get the maximum credit.			
2 Child's SSN			
The child must have an SSN as defined on page 42 of the Form 1040A instructions or page 44 of the Form 1040 instructions unless the child was born and died in 2002. If your child was born and died in 2002 and did not have an SSN, enter "Died" on this line and attach a copy of the child's birth certificate.		: : : : : : : : :	: : : : : : : : :
3 Child's year of birth	Year _____ <i>If born after 1983, skip lines 4a and 4b; go to line 5.</i>		Year _____ <i>If born after 1983, skip lines 4a and 4b; go to line 5.</i>
4 If the child was born before 1984—			
a Was the child under age 24 at the end of 2002 and a student?	<input type="checkbox"/> Yes. <i>Go to line 5.</i>	<input type="checkbox"/> No. <i>Continue</i>	<input type="checkbox"/> Yes. <i>Go to line 5.</i>
b Was the child permanently and totally disabled during any part of 2002?	<input type="checkbox"/> Yes. <i>Continue</i>	<input type="checkbox"/> No. The child is not a qualifying child.	<input type="checkbox"/> Yes. <i>Continue</i>
5 Child's relationship to you (for example, son, daughter, grandchild, foster child, etc.)			
6 Number of months child lived with you in the United States during 2002			
<ul style="list-style-type: none"> If the child lived with you for more than half of 2002 but less than 7 months, enter "7". If the child was born or died in 2002 and your home was the child's home for the entire time he or she was alive during 2002, enter "12". 	_____ months <i>Do not enter more than 12 months.</i>		_____ months <i>Do not enter more than 12 months.</i>
<p> You may also be able to take the additional child tax credit if your child (a) was under age 17 at the end of 2002, (b) is claimed as your dependent on line 6c of Form 1040A or Form 1040, and (c) is a U.S. citizen or resident alien. For more details, see the instructions for line 42 of Form 1040A or line 66 of Form 1040.</p>			
For Paperwork Reduction Act Notice, see Form 1040A or 1040 instructions.		Cat. No. 13339M	Schedule EIC (Form 1040A or 1040) 2002

Exercise 1

- (A) No; to be a qualifying child, the child must live with the tax-payer more than half of the year.
- (B) Neither Donna nor Doug can claim the credit; in order to claim the earned income credit, married taxpayers living together must file a joint return.
- (C) Jimmy and Anna are qualifying children of both Randy and Cara. Randy and Cara can choose which of them will claim the credit based on each child. One can claim the credit on the basis of two children, or each can claim the credit on the basis of one child. If both claim the credit on the basis of the same child or both children, Cara will be entitled to the credit because each child lived with her for the longer period of time during the year.
- (D) Yes. He is between 25 and 65; his earned income is less than \$11,060; he cannot be claimed as a dependent and he is not a qualifying child of another person.
- (E) No; to be a qualifying child, a married child must generally be eligible to be claimed as a dependent by the taxpayer.
- (F) Numbers 1 and 6 should be circled.

Exercise 2

- (A) \$3,012
- (B) \$1,826

EARNED INCOME CREDIT

ANSWERS TO EXERCISES

LESSON 10

Exercise 3

Bell's EIC Worksheet

Earned Income Credit (EIC) Worksheet—Line 41

Keep for Your Records



Part 1

All Filers

1. Enter your earned income from Step 5, on page 43.

1	21,211
---	--------

2. Look up the amount on line 1 above in the EIC Table on pages 46–51 to find the credit. Be sure you use the correct column for your filing status and the number of children you have. Enter the credit here.

2	1,434
---	-------

If line 2 is zero, You cannot take the credit. Put "No" to the left of the entry space for line 41.

3. Enter the amount from Form 1040A, line 22.

3	21,250
---	--------

4. Are the amounts on lines 3 and 1 the same?

Yes. Skip line 5; enter the amount from line 2 on line 6.

No. Go to line 5.

Part 2

Filers Who Answered "No" on Line 4

5. If you have:

- No qualifying children, is the amount on line 3 less than \$6,150 (or \$7,150 if married filing jointly)?
- 1 or more qualifying children, is the amount on line 3 less than \$13,520 (\$14,520 if married filing jointly)?

Yes. Leave line 5 blank; enter the amount from line 2 on line 6.

No. Look up the amount on line 3 in the EIC Table on pages 46–51 to find the credit. Be sure you use the correct column for your filing status and the number of children you have. Enter the credit here.

5	1,426
---	-------

Look at the amounts on lines 5 and 2. Then, enter the **smaller** amount on line 6.

Part 3

Your Earned Income Credit

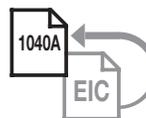
6. This is your earned income credit.

6	1,426
---	-------

Enter this amount on Form 1040A, line 41.

Reminder—

✓ If you have a qualifying child, complete and attach Schedule EIC.



If your EIC for a year after 1996 was reduced or disallowed, see page 44 to find out if you must file Form 8862 to take the credit for 2002.

Exercise 3

Bell's Eligibility Questions, page 1

Line 41— Earned Income Credit (EIC)

What Is the EIC?

The EIC is a credit for certain people who work. The credit may give you a refund even if you do not owe any tax.

To Take the EIC:

- Follow the steps below.
- Complete the worksheet that applies to you **or** let the IRS figure the credit for you.
- If you have a qualifying child, complete and attach Schedule EIC.



If you take the EIC even though you are not eligible and it is determined that your error is due to reckless or intentional disregard of the EIC rules, you will not be allowed to take the credit for 2 years even if you are otherwise eligible to do so. If you fraudulently take the EIC, you will not be allowed to take the credit for 10 years. You may also have to pay penalties.

Step 1 All Filers

- If, in 2002:
 - 2 children lived with you, is the amount on Form 1040A, line 22, less than \$33,178 (or \$34,178 if married filing jointly)?
 - 1 child lived with you, is the amount on Form 1040A, line 22, less than \$29,201 (\$30,201 if married filing jointly)?
 - No children live with you, is the amount on Form 1040A, line 22, less than \$11,060 (or \$12,060 if married filing jointly)?

Yes. *Continue* → **No.** You cannot take the credit.
- Do you, and your spouse if filing a joint return, have a social security number that allows you to work or is valid for EIC purposes (see page 44)?

Yes. *Continue* → **No.** You cannot take the credit.
Put "No" to the left of the entry space for line 41.
- Is your filing status married filing separately?

Yes. You cannot take the credit. **No.** *Continue* →
- Were you a nonresident alien for any part of 2002?

Yes. *See Nonresident Aliens on page 44.* **No.** *Go to Step 2.*

Step 2 Investment Income

1. Add the amounts from Form 1040A:	Line 8a	<u> \$39 </u>
	Line 8b +	<u> 0 </u>
	Line 9 +	<u> 0 </u>
	Line 10 +	<u> 0 </u>
	Investment Income =	<u> \$39 </u>

- Is your investment income more than \$2,550?

Yes. You cannot take the credit. **No.** *Continue* →
- Did a child live with you in 2002?

Yes. *Go to Step 3.* **No.** *Go to Step 4 on page 42.*

(Continued on page 42)

EARNED INCOME CREDIT

ANSWERS TO EXERCISES

LESSON 10

Exercise 3

Bell's Eligibility Questions, page 2

Continued from page 41

Step 3 Qualifying Child

A qualifying child is a child who is...

Your son, daughter, adopted child, stepchild, or grandchild

or

Your brother, sister, stepbrother, or stepsister, or a descendant of your brother, sister, etc. (for example, your niece or nephew), whom you cared for as your own child

or

A foster child (any child placed with you by an authorized placement agency whom you cared for as your own child)

If the child was married, see page 42.

AND

was at the end of 2002...

Under age 19

or

Under age 24 and a student (see page 44)

or

Any age and permanently and totally disabled (see page 44)

AND

who...

Lived with you in the United States for more than half of 2002. If the child did not live with you for the required time, see Exception to "Time Lived With You" Condition on page 44.

Note. If the child was married, see page 44.

1. Look at the qualifying child conditions above. Could you, or your spouse if filing a joint return, be a qualifying child of another person in 2002?

Yes.  You cannot take the credit. Put "No" to the left of the entry space for line 41.

No. Continue ↘

2. Do you have at least one child who meets the above conditions to be your qualifying child?

Yes. Continue ↘

No. Skip question 3; go to Step 4, question 2.

3. Does the child meet the conditions to be a qualifying child of any other person (other than your spouse if filing a joint return) for 2002?

Yes. See *Qualifying Child of More Than One Person* on page 44.

No. This child is your qualifying child. The child must have a social security number as defined on page 44 unless the child was born and died in 2002. Skip Step 4; go to Step 5 on page 43.

Step 4 Filers Without a Qualifying Child

1. Look at the qualifying child conditions in Step 3. Could you, or your spouse if filing a joint return, be a qualifying child of another person in 2002?

Yes.  You cannot take the credit. Put "No" to the left of the entry space for line 41.

No. Continue ↘

2. Can you, or your spouse if filing a joint return, be claimed as a dependent on someone else's 2002 tax return?

Yes.  You cannot take the credit.

No. Continue ↘

3. Were you, or your spouse if filing a joint return, at least age 25 but under age 65 at the end of 2002?

Yes. Continue ↘

No.  You cannot take the credit. Put "No" to the left of the entry space for line 41.

4. Was your home, and your spouse's if filing a joint return, in the United States for more than half of 2002? Members of the military stationed outside the United States, see page 44 before you answer.

Yes. Go to Step 5 on page 43.

No.  You cannot take the credit. Put "No" to the left of the entry space for line 41.

(Continued on page 41)

Exercise 3

Bell's Eligibility Questions, page 3

Continued from page 42

Step 5 Earned Income

1. Figure earned income:

Form 1040A, line 7 21,211

Subtract, if included on line 7, any:

- Taxable scholarship or fellowship grant not reported on a W-2 form
- Amount paid to an inmate in a penal institution for work (put "PRI" and the amount subtracted to the left of the entry space for line 7 of Form 1040A)
- Amount received as a pension or annuity from a nonqualified deferred compensation plan or a nongovernmental section 457 plan (put "DFC" and the amount subtracted to the left of the entry space for line 7 of Form 1040A). This amount may be shown in box 11 of your W-2 form. If you received such an amount but box 11 is blank, contact your employer for the amount received as a pension or annuity.

- 0

Taxable Earned Income = 21,211

Go to Step 6.

2. If you have:

- 2 or more qualifying children, is your earned income less than \$33,178 (\$34,178 if married filing jointly)?
- 1 qualifying child, is your earned income less than \$29,201 (\$30,201 if married filing jointly)?
- No qualifying children, is your earned income less than \$11,060 (\$12,060 if married filing jointly)?

Yes. Go to Step 6.

No. 

You cannot take the credit.

Step 6 How To Figure the Credit

1. Do you want the IRS to figure the credit for you?

Yes. See Credit
Figured by the IRS
below.

No. Go to the worksheet
on page 44.

Definitions and Special Rules (listed in alphabetical order)

Adopted Child. Any child placed with you by an authorized placement agency for legal adoption. An authorized placement agency includes any person authorized by state law to place children for legal adoption. The adoption does not have to be final.

Credit Figured by the IRS. To have the IRS figure the credit for you:

1. Put "EIC" to the left of the entry space for line 41 of Form 1040A.
2. If you have a qualifying child, complete and attach Schedule EIC. If your EIC for a year after 1996 was reduced or disallowed, see Form 8862, Who Must File, on page 44.

Exception to "Time Lived With You" Condition. A child is considered to have lived with you for all of 2002 if the child was born or died in 2002 and your home was this child's home for the entire time he or she was alive in 2002. Temporary absences, such as for school, vacation, medical care, or detention in a juvenile facility, count as time lived at home. If your child is presumed to have been kidnapped by someone who is not a family member, see Pub. 596 to find out if that child is a qualifying child for the EIC. To get Pub. 596, see page 9. If you were in the military stationed outside the United States, see Members of the Military below.

Form 8862, Who Must File. You must file Form 8862 if your EIC for a year after 1996 was reduced or disallowed for any reason other than a math or clerical error. But do not file Form 8862 if, after your EIC was reduced or disallowed in an earlier year:

- You filed Form 8862 (or other documents) and your EIC was then allowed and
- Your EIC has not been reduced or disallowed again for any reason other than a math or clerical error.

Also, do not file Form 8862 or take the credit if it was determined that your error was due to reckless or intentional disregard of the EIC rules or fraud.

(Continued on page 44)

EARNED INCOME CREDIT

ANSWERS TO EXERCISES

LESSON 10

Exercise 3

Bell's Form 1040A, page 2

dependent, see page 33. • All others: Single, \$4,700 Head of household, \$6,900 Married filing jointly or Qualifying widow(er), \$7,850 Married filing separately, \$3,925	28	Tax, including any alternative minimum tax (see page 33).		28	
	29	Credit for child and dependent care expenses. Attach Schedule 2.	29		
	30	Credit for the elderly or the disabled. Attach Schedule 3.	30		
	31	Education credits. Attach Form 8863.	31		
	32	Retirement savings contributions credit. Attach Form 8880.	32		
	33	Child tax credit (see page 36).	33		
	34	Adoption credit. Attach Form 8839.	34		
	35	Add lines 29 through 34. These are your total credits .		35	
	36	Subtract line 35 from line 28. If line 35 is more than line 28, enter -0-.		36	
	37	Advance earned income credit payments from Form(s) W-2.		37	
	38	Add lines 36 and 37. This is your total tax .		▶ 38	
	39	Federal income tax withheld from Forms W-2 and 1099.	39		
	40	2002 estimated tax payments and amount applied from 2001 return.	40		
If you have a qualifying child, attach Schedule EIC.	41	Earned income credit (EIC).	41	1,426	00
	42	Additional child tax credit. Attach Form 8812.	42		
	43	Add lines 39 through 42. These are your total payments .		▶ 43	

Exercise 4

- (A) See Kyle's completed steps and the EIC worksheet.
 (B) See Kyle's Schedule EIC .

EARNED INCOME CREDIT

ANSWERS TO EXERCISES

LESSON 10

Exercise 4 (D)

Kyle's EIC Eligibility Questions, page 1

Line 41— Earned Income Credit (EIC)

What Is the EIC?

The EIC is a credit for certain people who work. The credit may give you a refund even if you do not owe any tax.

To Take the EIC:

- Follow the steps below.
- Complete the worksheet that applies to you **or** let the IRS figure the credit for you.
- If you have a qualifying child, complete and attach Schedule EIC.



If you take the EIC even though you are not eligible and it is determined that your error is due to reckless or intentional disregard of the EIC rules, you will not be allowed to take the credit for 2 years even if you are otherwise eligible to do so. If you fraudulently take the EIC, you will not be allowed to take the credit for 10 years. You may also have to pay penalties.

Step 1 All Filers

1. If, in 2002:
 - 2 children lived with you, is the amount on Form 1040A, line 22, less than \$33,178 (or \$34,178 if married filing jointly)?
 - 1 child lived with you, is the amount on Form 1040A, line 22, less than \$29,201 (\$30,201 if married filing jointly)?
 - No children live with you, is the amount on Form 1040A, line 22, less than \$11,060 (or \$12,060 if married filing jointly)?

Yes. *Continue*  **No.**  You cannot take the credit.
2. Do you, and your spouse if filing a joint return, have a social security number that allows you to work or is valid for EIC purposes (see page 44)?

Yes. *Continue*  **No.**  You cannot take the credit.
Put "No" to the left of the entry space for line 41.
3. Is your filing status married filing separately?

Yes.  You cannot take the credit. **No.** *Continue* 
4. Were you a nonresident alien for any part of 2002?

Yes. *See Nonresident Aliens on page 44.* **No.** *Go to Step 2.*

Step 2 Investment Income

1. Add the amounts from	Line 8a	_____	0
Form 1040A:	Line 8b +	_____	0
	Line 9 +	_____	0
	Line 10 +	_____	0
	Investment Income =	<input type="text" value="0"/>	0

2. Is your investment income more than \$2,550?

Yes.  You cannot take the credit. **No.** *Continue* 
3. Did a child live with you in 2002?

Yes. *Go to Step 3.* **No.** *Go to Step 4 on page 42.*

(Continued on page 42)

EARNED INCOME CREDIT

ANSWERS TO EXERCISES

LESSON 10

Exercise 4 (D)

Kyle's EIC Eligibility Questions, page 2

Continued from page 41

Step 3 Qualifying Child

A qualifying child is a child who is...

Your son, daughter, adopted child, stepchild, or grandchild

or

Your brother, sister, stepbrother, or stepsister, or a descendant of your brother, sister, etc. (for example, your niece or nephew), whom you cared for as your own child

or

A foster child (any child placed with you by an authorized placement agency whom you cared for as your own child)

If the child was married, see page 42.

AND

was at the end of 2002...

Under age 19

or

Under age 24 and a student (see page 44)

or

Any age and permanently and totally disabled (see page 44)

AND

who...

Lived with you in the United States for more than half of 2002. If the child did not live with you for the required time, see Exception to "Time Lived With You" Condition on page 44.

Note. If the child was married, see page 44.

1. Look at the qualifying child conditions above. Could you, or your spouse if filing a joint return, be a qualifying child of another person in 2002?

Yes. 

You cannot take the credit. Put "No" to the left of the entry space for line 41.

No. *Continue* ↘

2. Do you have at least one child who meets the above conditions to be your qualifying child?

Yes. *Continue* ↘

No. *Skip question 3; go to Step 4, question 2.*

3. Does the child meet the conditions to be a qualifying child of any other person (other than your spouse if filing a joint return) for 2002?

Yes. *See Qualifying Child of More Than One Person on page 44.*

No. This child is your qualifying child. The child must have a social security number as defined on page 44 unless the child was born and died in 2002. *Skip Step 4; go to Step 5 on page 43.*

Step 4 Filers Without a Qualifying Child

1. Look at the qualifying child conditions in Step 3. Could you, or your spouse if filing a joint return, be a qualifying child of another person in 2002?

Yes. 

You cannot take the credit. Put "No" to the left of the entry space for line 41.

No. *Continue* ↘

2. Can you, or your spouse if filing a joint return, be claimed as a dependent on someone else's 2002 tax return?

Yes. 

You cannot take the credit.

No. *Continue* ↘

3. Were you, or your spouse if filing a joint return, at least age 25 but under age 65 at the end of 2002?

Yes. *Continue* ↘

No. 

You cannot take the credit. Put "No" to the left of the entry space for line 41.

4. Was your home, and your spouse's if filing a joint return, in the United States for more than half of 2002? Members of the military stationed outside the United States, see page 44 before you answer.

Yes. *Go to Step 5 on page 43.*

No. 

You cannot take the credit. Put "No" to the left of the entry space for line 41.

(Continued on page 41)

Exercise 4 (D)

Kyle's EIC Eligibility Questions, page 3

Continued from page 42

Step 5 Earned Income

1. Figure earned income:

Form 1040A, line 7 18,751

Subtract, if included on line 7, any:

- Taxable scholarship or fellowship grant not reported on a W-2 form
- Amount paid to an inmate in a penal institution for work (put "PRI" and the amount subtracted to the left of the entry space for line 7 of Form 1040A)
- Amount received as a pension or annuity from a nonqualified deferred compensation plan or a nongovernmental section 457 plan (put "DFC" and the amount subtracted to the left of the entry space for line 7 of Form 1040A). This amount may be shown in box 11 of your W-2 form. If you received such an amount but box 11 is blank, contact your employer for the amount received as a pension or annuity.

- 0

Taxable Earned Income = 18,751

Go to Step 6.

2. If you have:

- 2 or more qualifying children, is your earned income less than \$33,178 (\$34,178 if married filing jointly)?
- 1 qualifying child, is your earned income less than \$29,201 (\$30,201 if married filing jointly)?
- No qualifying children, is your earned income less than \$11,060 (\$12,060 if married filing jointly)?

Yes. Go to Step 6. **No.** You cannot take the credit.

Step 6 How To Figure the Credit

1. Do you want the IRS to figure the credit for you?

- Yes.** See Credit Figured by the IRS below. **No.** Go to the worksheet on page 44.

Definitions and Special Rules (listed in alphabetical order)

Adopted Child. Any child placed with you by an authorized placement agency for legal adoption. An authorized placement agency includes any person authorized by state law to place children for legal adoption. The adoption does not have to be final.

Credit Figured by the IRS. To have the IRS figure the credit for you:

1. Put "EIC" to the left of the entry space for line 41 of Form 1040A.
2. If you have a qualifying child, complete and attach Schedule EIC. If your EIC for a year after 1996 was reduced or disallowed, see Form 8862, Who Must File, on page 44.

Exception to "Time Lived With You" Condition. A child is considered to have lived with you for all of 2002 if the child was born or died in 2002 and your home was this child's home for the entire time he or she was alive in 2002. Temporary absences, such as for school, vacation, medical care, or detention in a juvenile facility, count as time lived at home. If your child is presumed to have been kidnapped by someone who is not a family member, see Pub. 596 to find out if that child is a qualifying child for the EIC. To get Pub. 596, see page 9. If you were in the military stationed outside the United States, see Members of the Military below.

Form 8862, Who Must File. You must file Form 8862 if your EIC for a year after 1996 was reduced or disallowed for any reason other than a math or clerical error. But do not file Form 8862 if, after your EIC was reduced or disallowed in an earlier year:

- You filed Form 8862 (or other documents) and your EIC was then allowed and
- Your EIC has not been reduced or disallowed again for any reason other than a math or clerical error.

Also, do not file Form 8862 or take the credit if it was determined that your error was due to reckless or intentional disregard of the EIC rules or fraud.

(Continued on page 44)

EARNED INCOME CREDIT

ANSWERS TO EXERCISES

LESSON 10

Exercise 4 (D)

Kyle's EIC Worksheet

Earned Income Credit (EIC) Worksheet—Line 41

Keep for Your Records



Part 1

All Filers

1. Enter your earned income from Step 5, on page 43.

1	18,751
---	--------

2. Look up the amount on line 1 above in the EIC Table on pages 46–51 to find the credit. Be sure you use the correct column for your filing status and the number of children you have. Enter the credit here.

2	1,666
---	-------

If line 2 is zero,  You cannot take the credit. Put "No" to the left of the entry space for line 41.

3. Enter the amount from Form 1040A, line 22.

3	19,223
---	--------

4. Are the amounts on lines 3 and 1 the same?

- Yes. Skip line 5; enter the amount from line 2 on line 6.
- No. Go to line 5.

Part 2

Filers Who Answered "No" on Line 4

5. If you have:
- No qualifying children, is the amount on line 3 less than \$6,150 (or \$7,150 if married filing jointly)?
 - 1 or more qualifying children, is the amount on line 3 less than \$13,520 (\$14,520 if married filing jointly)?

Yes. Leave line 5 blank; enter the amount from line 2 on line 6.

- No. Look up the amount on line 3 in the EIC Table on pages 46–51 to find the credit. Be sure you use the correct column for your filing status and the number of children you have. Enter the credit here.

5	1,594
---	-------

Look at the amounts on lines 5 and 2. Then, enter the **smaller** amount on line 6.

Part 3

Your Earned Income Credit

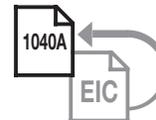
6. This is your earned income credit.

6	1,594
---	-------

Enter this amount on Form 1040A, line 41.

Reminder—

- ✓ If you have a qualifying child, complete and attach Schedule EIC.



If your EIC for a year after 1996 was reduced or disallowed, see page 44 to find out if you must file Form 8862 to take the credit for 2002.

EARNED INCOME CREDIT

ANSWERS TO EXERCISES

LESSON 10

Exercise 4 (E)

Kyle's Form 1040A, page 2

<p>SCHEDULE EIC (Form 1040A or 1040)</p> <p>Department of the Treasury Internal Revenue Service (99)</p> <p>Name(s) shown on return Kyle B. Evans</p>	<p>Earned Income Credit Qualifying Child Information</p> <p><i>Complete and attach to Form 1040A or 1040 only if you have a qualifying child.</i></p>	 <p>OMB No. 1545-0074</p> <p>2002</p> <p>Attachment Sequence No. 43</p>	<p>Your social security number 000 00 2442</p>
<p>Before you begin: See the instructions for Form 1040A, line 41, or Form 1040, line 64, to make sure that (a) you can take the EIC and (b) you have a qualifying child.</p>			
<p> If you take the EIC even though you are not eligible, you may not be allowed to take the credit for up to 10 years. See back of schedule for details.</p> <p>It will take us longer to process your return and issue your refund if you do not fill in all lines that apply for each qualifying child.</p> <p>Be sure the child's name on line 1 and social security number (SSN) on line 2 agree with the child's social security card. Otherwise, at the time we process your return, we may reduce or disallow your EIC. If the name or SSN on the child's social security card is not correct, call the Social Security Administration at 1-800-772-1213.</p>			
Qualifying Child Information			
	Child 1	Child 2	
1 Child's name <small>If you have more than two qualifying children, you only have to list two to get the maximum credit.</small>	First name Last name Julie Evans	First name Last name	Last name
2 Child's SSN <small>The child must have an SSN as defined on page 42 of the Form 1040A instructions or page 44 of the Form 1040 instructions unless the child was born and died in 2002. If your child was born and died in 2002 and did not have an SSN, enter "Died" on this line and attach a copy of the child's birth certificate.</small>	000 00 4104	: : : : :	: : : : :
3 Child's year of birth	Year <u>2 0 0 1</u> <small>If born after 1983, skip lines 4a and 4b; go to line 5.</small>	Year _____ <small>If born after 1983, skip lines 4a and 4b; go to line 5.</small>	_____
4 If the child was born before 1984—			
a Was the child under age 24 at the end of 2002 and a student?	<input type="checkbox"/> Yes. <i>Go to line 5.</i>	<input type="checkbox"/> No. <i>Continue</i>	<input type="checkbox"/> Yes. <i>Go to line 5.</i>
b Was the child permanently and totally disabled during any part of 2002?	<input type="checkbox"/> Yes. <i>Continue</i>	<input type="checkbox"/> No. <small>The child is not a qualifying child.</small>	<input type="checkbox"/> Yes. <i>Continue</i>
5 Child's relationship to you <small>(for example, son, daughter, grandchild, foster child, etc.)</small>	daughter		
6 Number of months child lived with you in the United States during 2002			
<ul style="list-style-type: none"> • If the child lived with you for more than half of 2002 but less than 7 months, enter "7". • If the child was born or died in 2002 and your home was the child's home for the entire time he or she was alive during 2002, enter "12". 	12 months <small>Do not enter more than 12 months.</small>	_____ months <small>Do not enter more than 12 months.</small>	
<p> You may also be able to take the additional child tax credit if your child (a) was under age 17 at the end of 2002, (b) is claimed as your dependent on line 6c of Form 1040A or Form 1040, and (c) is a U.S. citizen or resident alien. For more details, see the instructions for line 42 of Form 1040A or line 66 of Form 1040.</p>			
For Paperwork Reduction Act Notice, see Form 1040A or 1040 instructions.		Cat. No. 13339M	Schedule EIC (Form 1040A or 1040) 2002

▶▶ SUMMING UP THIS LESSON ◀◀

- ▶ The earned income credit can be claimed on Form 1040EZ, Form 1040A or Form 1040.
- ▶ Significant rules and qualifications for earned income credit were implemented beginning in January, 2002. They are:
 1. New definition for earned income.
 2. Elimination of modified adjusted gross income — now just adjusted gross income.
 3. New definition for foster child.
 4. New rules when more than one taxpayer has the same qualifying child.

STUDENT NOTES

INTRODUCTION AND OBJECTIVES

In this lesson you will learn about the child tax credit. This credit is unique because it can be both nonrefundable and refundable. This lesson will discuss who qualifies for the credit and how to calculate the credit.

After completing this lesson you should be able to:

- Calculate the child tax credit using the child tax credit worksheet.
- Calculate the additional child tax credit by using form 8812.

TAX TIPS

★★★★★★★★★★

If the taxpayer can claim the child tax credit on his or her income tax return, the taxpayer may want to consider having less tax withheld from his or her wages during the year. To check his or her withholding allowances for 2003, the taxpayer should fill out a 2003 Form W-4. If the taxpayer can claim more withholding allowances, he or she should file a new Form W-4 with his or her employer so that less income tax is withheld from his or her wages (See Lesson 7, *Finishing the Return*).

CHILD TAX CREDIT

A taxpayer can claim a child tax credit for each of the taxpayer's qualifying children. The maximum child tax credit is \$600 per child for 2002. The credit can be claimed on either Form 1040 or 1040A.

Qualifying child

To qualify, the child must be:

- Under age 17 at the end of 2002,
- A citizen or resident of the United States,
- The taxpayer's dependent, and
- The taxpayer's:
 - Son or daughter,
 - Stepson or stepdaughter, adopted child,
 - Grandchild, or
 - Eligible foster child

The taxpayer must provide the name and identification number (usually a social security number) of each qualifying child on his or her tax return.

Limits on credit

The amount of a taxpayer's child tax credit depends on the taxpayer's modified adjusted gross income (modified AGI) and the taxpayer's filing status.

Modified AGI

The credit begins to phase out if the taxpayer's modified AGI is above a certain amount (**Table 1**). For most taxpayers, modified AGI is generally the same as AGI. For 2002, AGI is shown on line 22 of Form 1040A and on line 36 of Form 1040.

**Table 1: *Child Tax Credit*
Threshold Modified AGI Amounts for
Claiming Child Tax Credit**

Filing Status	Amount
Married filing jointly	\$110,000
Qualifying widow(er)	75,000
Head of household	75,000
Single	75,000
Married filing separately	55,000

Before you can figure a taxpayer's credit amount for the year, you must have the taxpayer answer certain questions (Exhibit 1) to see if you must use the worksheet in Publication 972, *Child Tax Credit*. These questions are in the tax form instructions. If you do not need to use Publication 972, you can use the shorter *Child Tax Credit Worksheet* in the form instructions.

Example 1

Bill and Mary Allen have two dependent children under age 17. The children are qualifying children for purposes of claiming the child tax credit. Bill and Mary have modified AGI of \$34,000. Bill and Mary need to answer questions to determine if they must use Publication 972 (Exhibit 1). The completed Child Tax Credit Worksheet (Exhibit 2) shows that their credit is \$1,200. Their modified AGI is less than the phaseout amount for their filing status (\$110,000), so they are entitled to the full credit.

TAX TIPS

★★★★★★★★★
If the taxpayer's modified adjusted gross income exceeds the threshold limit, the taxpayer must use Publication 972 to compute his or her child tax credit.

TAX TIPS

★★★★★★★★★
A copy of a Child Tax Credit Worksheet can be found in the *Tax Forms Booklet Appendix*, which is part of your Publication 678 Package.

Line 33—Child Tax Credit

What Is the Child Tax Credit?

This credit is for people who have a qualifying child as defined in the instructions for line 6c, column (4), that begin on page 25. It is in addition to the credit for child and dependent care expenses on Form 1040A, line 33, and the earned income credit on Form 1040A, line 50.

Three Steps To Take the Child Tax Credit!

- Step 1.** Make sure you have a qualifying child for the child tax credit. See the instructions for line 6c, column (4), that begin on page 25.
- Step 2.** Make sure you checked the box in column (4) of line 6c on Form 1040A for each qualifying child.
- Step 3.** Answer the questions on this page to see if you may use the worksheet on page 39 to figure your credit or if you must use Pub. 972, Child Tax Credit. If you need Pub. 972, see page 9.

Questions

Who Must Use Pub. 972



- Is the amount on Form 1040A, line 22, more than the amount shown below for your filing status?
 - Married filing jointly –\$110,000
 - Single, head of household, or qualifying widow(er) – \$75,000
 - Married filing separately –\$55,000

No. *Continue*

Yes. You must use Pub. 972 to figure your credit.
- Are you claiming the adoption credit on Form 8839 (see the instructions for Form 1040A, line 34, on page 40)?
 - No.** Use the worksheet on page 39 to figure your child tax credit.
 - Yes.** You must use Pub. 972 to figure your child tax credit. You will also need Form 8839.

Child Tax Credit Worksheet—Line 33

Keep for Your Records



Do not use this worksheet if you answered “Yes” to question 1 or 2 on page 38. Instead, use Pub. 972.



1. Number of qualifying children: 2 × \$600. Enter the result.

1	1,200
---	-------

2. Enter the amount from Form 1040A, line 28.

2	1,526
---	-------

3. Add the amounts from Form 1040A:

Line 29 0

Line 30 + 0

Line 31 + 0

Line 32 + 0 Enter the total.

3	0
---	---

4. Are the amounts on lines 2 and 3 the same?

Yes.

You cannot take this credit because there is no tax to reduce. However, see the **TIP** below before completing the rest of your Form 1040A.

No. Subtract line 3 from line 2.

4	1,526
---	-------

5. Is the amount on line 1 more than the amount on line 4?

Yes. Enter the amount from line 4. Also, see the **TIP** below.

No. Enter the amount from line 1.

This is your child tax credit.

5	1,200
---	-------

Enter this amount on
Form 1040A, line 33.



You may be able to take the **additional child tax credit** on Form 1040A, line 42, if you answered “Yes” on line 4 or line 5 above.

- First, complete your Form 1040A through line 41.
- Then, use Form 8812 to figure any additional child tax credit.

TAX TIPS

★★★★★★★★★

Taxpayers who can claim the additional child tax credit should file a tax return even if they are not otherwise required to file because the additional child tax credit may give the taxpayer a refund even if he or she does not owe any tax.

TAX TIPS

★★★★★★★★★

The child tax credit *must* be figured, before the additional child tax credit can be figured.

ADDITIONAL CHILD TAX CREDIT

The child tax credit is a nonrefundable credit that gives eligible taxpayers \$600 for each qualifying child. If a taxpayer's tax liability is less than the allowable nonrefundable child tax credit, the taxpayer may be eligible to claim the **refundable additional child tax credit**.

Beginning in 2001, the additional child tax credit was expanded to include **all** taxpayers who have **earned income** regardless of the number of qualifying children. This extended the refundable part of the child tax credit to families who have less than three qualified children.

Before figuring additional child tax credit, figure the taxpayer's:

- Unused nonrefundable child tax credit amount,
- Total Social Security and Medicare taxes withheld (Form W-2, *Wage and Tax Statement*, boxes 4 and 6),
- Earned income credit amount,
- Total taxable earned income (back of Form 8812), and
- For 1040 filers, one-half of self-employment tax paid, Form 1040, line 29.

The taxpayer will need to seek the assistance of a paid professional tax preparer if he or she has:

- Excess social security and RRTA tax withheld (more than one employer and gross income in excess of \$84,900) or
- Social Security and Medicare tax on **unreported** tip income.

Taxpayers must use **Form 8812**, *Additional Child Tax Credit*, to claim the additional child tax credit. This credit is based on 10% of the taxpayer's taxable earned income in excess of \$10,350.

Form 8812 explains step-by-step how to compute the additional child tax credit. The form allows a taxpayer who can use both rules to claim the larger additional child tax credit. That is, taxpayers with three or more children can continue to claim a refundable additional tax credit, under the rules that applied in prior years, if that amount is greater than the refundable credit based on the taxpayer's earned income in excess of \$10,350.

Example 2

Maureen Langston is filing Form 1040A. Her filing status is head of household for 2002. She has five dependent children, all of whom are qualifying children for purposes of the child tax credit. Maureen's earned income (and adjusted gross income) is \$26,375, her tax is \$149, Social Security/Medicare taxes are \$2,018, and the earned income credit is \$1,433. Based on this information, Maureen's child tax credit is \$149 (Exhibit 4) and her additional child tax credit is \$1,603. Exhibits 5 and 6 illustrate how Maureen's additional child tax credit was figured.

POTENTIAL PITFALLS



When figuring the additional child tax credit, you *must* use the back of Form 8812 to determine taxable earned income (line 4).

Line 33—Child Tax Credit

What Is the Child Tax Credit?

This credit is for people who have a qualifying child as defined in the instructions for line 6c, column (4), that begin on page 25. It is in addition to the credit for child and dependent care expenses on Form 1040A, line 33, and the earned income credit on Form 1040A, line 50.

Three Steps To Take the Child Tax Credit!

- Step 1.** Make sure you have a qualifying child for the child tax credit. See the instructions for line 6c, column (4), that begin on page 25.
- Step 2.** Make sure you checked the box in column (4) of line 6c on Form 1040A for each qualifying child.
- Step 3.** Answer the questions on this page to see if you may use the worksheet on page 39 to figure your credit or if you must use Pub. 972, Child Tax Credit. If you need Pub. 972, see page 9.

Questions

Who Must Use Pub. 972



- Is the amount on Form 1040A, line 22, more than the amount shown below for your filing status?
 - Married filing jointly –\$110,000
 - Single, head of household, or qualifying widow(er) – \$75,000
 - Married filing separately –\$55,000

No. *Continue*
 Yes.
You must use Pub. 972 to figure your credit.
- Are you claiming the adoption credit on Form 8839 (see the instructions for Form 1040A, line 34, on page 40)?
 - No.** Use the worksheet on page 39 to figure your child tax credit.
 - Yes.** You must use Pub. 972 to figure your child tax credit. You will also need Form 8839.

Child Tax Credit Worksheet—Line 33

Keep for Your Records



Do not use this worksheet if you answered "Yes" to question 1 or 2 on page 38. Instead, use Pub. 972.



1. Number of qualifying children: 5 × \$600. Enter the result.

1	3,000
---	-------

2. Enter the amount from Form 1040A, line 28.

2	149
---	-----

3. Add the amounts from Form 1040A:

Line 29 0

Line 30 + 0

Line 31 + 0

Line 32 + 0 Enter the total.

3	0
---	---

4. Are the amounts on lines 2 and 3 the same?

Yes.

You cannot take this credit because there is no tax to reduce. However, see the **TIP** below before completing the rest of your Form 1040A.

No. Subtract line 3 from line 2.

4	149
---	-----

5. Is the amount on line 1 more than the amount on line 4?

Yes. Enter the amount from line 4. Also, see the **TIP** below.

No. Enter the amount from line 1.

This is your child tax credit.

5	149
---	-----

Enter this amount on Form 1040A, line 33.



You may be able to take the **additional child tax credit** on Form 1040A, line 42, if you answered "Yes" on line 4 or line 5 above.

- First, complete your Form 1040A through line 41.
- Then, use Form 8812 to figure any additional child tax credit.

Form 8812 Department of the Treasury Internal Revenue Service	<h2 style="margin:0;">Additional Child Tax Credit</h2> <p style="font-size: small; margin: 5px 0;">Complete and attach to Form 1040 or Form 1040A.</p>		OMB No. 1545-1620 <h1 style="margin:0;">2002</h1> Attachment Sequence No. 47
Name(s) shown on return Maureen Langston		Your social security number 000 00 9999	
Part I All Filers			
1 Enter the amount from line 1 of your Child Tax Credit Worksheet on page 38 of the Form 1040 instructions or page 37 of the Form 1040A instructions. If you used Pub. 972, enter the amount from line 8 of the worksheet on page 3 of the publication	1	3,000	00
2 Enter the amount from Form 1040, line 50, or Form 1040A, line 33	2	149	00
3 Subtract line 2 from line 1. If zero, stop ; you cannot take this credit	3	2,,851	00
4 Enter your total taxable earned income. See the instructions on back	4	26,375	00
5 Is the amount on line 4 more than \$10,350? <input type="checkbox"/> No. Leave line 5 blank and enter -0- on line 6. <input checked="" type="checkbox"/> Yes. Subtract \$10,350 from the amount on line 4. Enter the result	5	16,025	00
6 Multiply the amount on line 5 by 10% (.10) and enter the result Next. Do you have three or more qualifying children? <input type="checkbox"/> No. If line 6 is zero, stop ; you cannot take this credit. Otherwise, skip Part II and enter the smaller of line 3 or line 6 on line 13. <input checked="" type="checkbox"/> Yes. If line 6 is equal to or more than line 3, skip Part II and enter the amount from line 3 on line 13. Otherwise, go to line 7.	6	1,602	50
Part II Certain Filers Who Have Three or More Qualifying Children			
7 Enter the total of the withheld social security and Medicare taxes from Form(s) W-2, boxes 4 and 6. If married filing jointly, include your spouse's amounts with yours. If you worked for a railroad, see the instructions on back	7	2,018	00
8 1040 filers: Enter the total of the amounts from Form 1040, lines 29 and 57, plus any uncollected social security and Medicare or tier 1 RRTA taxes included on line 61. 1040A filers: Enter -0-.	8	0	00
9 Add lines 7 and 8	9	2,018	00
10 1040 filers: Enter the total of the amounts from Form 1040, lines 64 and 65. 1040A filers: Enter the total of the amount from Form 1040A, line 41, plus any excess social security and tier 1 RRTA taxes withheld that you entered to the left of line 43 (see the instructions on back).	10	1,433	00
11 Subtract line 10 from line 9. If zero or less, enter -0-	11	585	00
12 Enter the larger of line 6 or line 11 here Next, enter the smaller of line 3 or line 12 on line 13.	12	1,602	50
Part III Your Additional Child Tax Credit			
13 This is your additional child tax credit	13	1,602	50
		Enter this amount on Form 1040, line 66, or Form 1040A, line 42.	
For Paperwork Reduction Act Notice, see back of form.		Cat. No. 10644E	Form 8812 (2002)

Instructions

Purpose of Form

Use Form 8812 to figure your additional child tax credit.



The additional child tax credit may give you a refund even if you do not owe any tax.

Who Should Use Form 8812

First, complete the Child Tax Credit Worksheet that applies to you. See the instructions for Form 1040, line 50, or Form 1040A, line 33. If you meet the condition given in the **TIP** at the end of your Child Tax Credit Worksheet, use Form 8812 to see if you can take the additional child tax credit.

Effect of Credit on Welfare Benefits

Any refund you receive as a result of taking the additional child tax credit will not be used to determine if you are eligible for the following programs, or how much you can receive from them.

- Temporary Assistance for Needy Families (TANF).
- Medicaid and supplemental security income (SSI).
- Food stamps and low-income housing.

Taxable Earned Income

1. Did you, or your spouse if filing a joint return, have net earnings from self-employment and use either optional method to figure those net earnings?

- No.** Go to question 2.
- Yes.** Use Pub. 972 to figure the amount to enter on Form 8812, line 4.

2. Are you claiming the earned income credit (EIC) on Form 1040, line 64, or Form 1040A, line 41?

- Yes.** Use the following chart to find the amount to enter on Form 8812, line 4.

IF you are filing Form...	AND you completed...	THEN enter on Form 8812, line 4, the amount from...
1040	Worksheet B on page 46 of your 1040 instructions or on page XX of Pub. 596	Worksheet B, line 4b.*
	Step 6 on page 43 of your 1040 instructions (but not Worksheet B)	Step 6, Box A
	Worksheet 2 on page 22 of Pub. 596	Worksheet 2, line 8
1040A	Step 6 on page 41 of your 1040A instructions	Step 6, Box A
	Worksheet 2 on page 22 of Pub. 596	Worksheet 2, line 8

* If you were a minister, member of a religious order who has not taken a vow of poverty, or a Christian Science practitioner, subtract the following from the amount on line 4b: (a) the rental value of a home or the nontaxable portion of an allowance for a home furnished to you (including payments for utilities) and (b) the value of meals and lodging provided to you, your spouse, and your dependents for your employer's convenience.

- No. 1040 filers:** Go to question 3.
1040A filers: Skip question 3 and go to question 4.

3. Were you, or your spouse if filing a joint return, self-employed, or are you filing Schedule SE because you had church employee income, or are you filing Schedule C or C-EZ as a statutory employee?

- No.** Go to question 4.
- Yes.** Use Pub. 972 to figure the amount to enter on Form 8812, line 4.

4. Does the amount on line 7 of Form 1040 or Form 1040A include any of the following amounts?

- Scholarship or fellowship grants not reported on a W-2 form.
 - Amounts paid to an inmate in a penal institution for work (put "PRI" and the amount paid in the space next to line 7 of Form 1040 or 1040A).
 - Amounts received as a pension or annuity from a nonqualified deferred compensation plan or a nongovernmental section 457 plan (put "DFC" and the amount received in the space next to line 7 of Form 1040 or 1040A). This amount may be reported in box 11 of your W-2 form. If you received such an amount but box 11 is blank, contact your employer for the amount received as a pension or annuity.
 - Amounts from Form 2555, line 41, or Form 2555-EZ, line 18.
- No.** Enter the amount from line 7 of Form 1040 or Form 1040A on Form 8812, line 4.
- Yes.** Subtract the total of those amounts from the amount on line 7 of Form 1040 or Form 1040A. (If an amount is included in more than one of the above categories, include it only once in figuring the total amount to subtract.) Enter the result on Form 8812, line 4.

Railroad Employees

If you worked for a railroad, include the following taxes in the total on Form 8812, line 7.

- Tier 1 tax withheld from your pay. This tax should be shown in box 14 of your W-2 form(s) and identified as "Tier 1 tax."
- If you were an employee representative, 50% of the total tier 1 tax and tier 1 Medicare tax you paid for 2002.

1040A Filers

If you, or your spouse if filing a joint return, had more than one employer for 2002 and total wages of over \$84,900, figure any excess social security and tier 1 railroad retirement (RRTA) taxes withheld. See the instructions for Form 1040A, line 43. Include any excess on Form 8812, line 10.

Paperwork Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by Internal Revenue Code section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is: **Recordkeeping**, 6 min.; **Learning about the law or the form**, 5 min.; **Preparing the form**, 28 min.; **Copying, assembling, and sending the form to the IRS**, 20 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. See the Instructions for Form 1040 or Form 1040A.



Exercise 1

Emily and Victor (SSN-000-00-4410) Howard are married taxpayers with four children. They file married filing jointly for 2002 on Form 1040A. All of their children are qualifying for purposes of the child tax credit. Their adjusted gross income is \$31,467, of which \$18,467 is taxable earned income and \$13,000 is unemployment compensation. Taxable income is \$5,797, Social Security/Medicare taxes are \$1,413 and the earned income credit is 569. Based on the facts given, figure the Howards:

- A. Child tax credit
- B. Additional child tax credit.

Exhibit 7

Complete this form.

Line 33—Child Tax Credit

What Is the Child Tax Credit?

This credit is for people who have a qualifying child as defined in the instructions for line 6c, column (4), that begin on page 25. It is in addition to the credit for child and dependent care expenses on Form 1040A, line 33, and the earned income credit on Form 1040A, line 50.

Three Steps To Take the Child Tax Credit!

- Step 1.** Make sure you have a qualifying child for the child tax credit. See the instructions for line 6c, column (4), that begin on page 25.
- Step 2.** Make sure you checked the box in column (4) of line 6c on Form 1040A for each qualifying child.
- Step 3.** Answer the questions on this page to see if you may use the worksheet on page 39 to figure your credit or if you must use Pub. 972, Child Tax Credit. If you need Pub. 972, see page 9.

Questions

Who Must Use Pub. 972



1. Is the amount on Form 1040A, line 22, more than the amount shown below for your filing status?
 - Married filing jointly – \$110,000
 - Single, head of household, or qualifying widow(er) – \$75,000
 - Married filing separately – \$55,000

No. *Continue* ↘ **Yes.**  You must use Pub. 972 to figure your credit.
2. Are you claiming the adoption credit on Form 8839 (see the instructions for Form 1040A, line 34, on page 40)?

No. Use the worksheet on page 39 to figure your child tax credit. **Yes.** You must use Pub. 972 to figure your child tax credit. You will also need Form 8839.

Child Tax Credit Worksheet—Line 33

Keep for Your Records



Do not use this worksheet if you answered “Yes” to question 1 or 2 on page 38. Instead, use Pub. 972.



1. Number of qualifying children: _____ × \$600. Enter the result. 1

2. Enter the amount from Form 1040A, line 28. 2

3. Add the amounts from Form 1040A:

Line 29 _____

Line 30 + _____

Line 31 + _____

Line 32 + _____ Enter the total. 3

4. Are the amounts on lines 2 and 3 the same?

Yes.

You cannot take this credit because there is no tax to reduce. However, see the **TIP** below before completing the rest of your Form 1040A.

No. Subtract line 3 from line 2. 4

5. Is the amount on line 1 more than the amount on line 4?

Yes. Enter the amount from line 4. Also, see the **TIP** below.

No. Enter the amount from line 1.

This is your child tax credit.

5

Enter this amount on Form 1040A, line 33.



You may be able to take the **additional child tax credit** on Form 1040A, line 42, if you answered “Yes” on line 4 or line 5 above.

- First, complete your Form 1040A through line 41.
- Then, use Form 8812 to figure any additional child tax credit.

Form 8812 Department of the Treasury Internal Revenue Service	<h2 style="margin:0;">Additional Child Tax Credit</h2> <p style="font-size: small; margin-top: 10px;">Complete and attach to Form 1040 or Form 1040A.</p>		OMB No. 1545-1620 <h1 style="margin:0;">2002</h1> Attachment Sequence No. 47
Name(s) shown on return		Your social security number	
Part I All Filers			
1 Enter the amount from line 1 of your Child Tax Credit Worksheet on page 38 of the Form 1040 instructions or page 37 of the Form 1040A instructions. If you used Pub. 972, enter the amount from line 8 of the worksheet on page 3 of the publication	1		
2 Enter the amount from Form 1040, line 50, or Form 1040A, line 33	2		
3 Subtract line 2 from line 1. If zero, stop ; you cannot take this credit	3		
4 Enter your total taxable earned income. See the instructions on back	4		
5 Is the amount on line 4 more than \$10,350? <input type="checkbox"/> No. Leave line 5 blank and enter -0- on line 6. <input type="checkbox"/> Yes. Subtract \$10,350 from the amount on line 4. Enter the result	5		
6 Multiply the amount on line 5 by 10% (.10) and enter the result Next. Do you have three or more qualifying children? <input type="checkbox"/> No. If line 6 is zero, stop ; you cannot take this credit. Otherwise, skip Part II and enter the smaller of line 3 or line 6 on line 13. <input type="checkbox"/> Yes. If line 6 is equal to or more than line 3, skip Part II and enter the amount from line 3 on line 13. Otherwise, go to line 7.	6		
Part II Certain Filers Who Have Three or More Qualifying Children			
7 Enter the total of the withheld social security and Medicare taxes from Form(s) W-2, boxes 4 and 6. If married filing jointly, include your spouse's amounts with yours. If you worked for a railroad, see the instructions on back	7		
8 1040 filers: Enter the total of the amounts from Form 1040, lines 29 and 57, plus any uncollected social security and Medicare or tier 1 RRTA taxes included on line 61. 1040A filers: Enter -0-.	8		
9 Add lines 7 and 8	9		
10 1040 filers: Enter the total of the amounts from Form 1040, lines 64 and 65. 1040A filers: Enter the total of the amount from Form 1040A, line 41, plus any excess social security and tier 1 RRTA taxes withheld that you entered to the left of line 43 (see the instructions on back).	10		
11 Subtract line 10 from line 9. If zero or less, enter -0-	11		
12 Enter the larger of line 6 or line 11 here Next, enter the smaller of line 3 or line 12 on line 13.	12		
Part III Your Additional Child Tax Credit			
13 This is your additional child tax credit	13		
		Enter this amount on Form 1040, line 66, or Form 1040A, line 42.	
For Paperwork Reduction Act Notice, see back of form. Cat. No. 10644E Form 8812 (2002)			

Instructions

Purpose of Form

Use Form 8812 to figure your additional child tax credit.



The additional child tax credit may give you a refund even if you do not owe any tax.

Who Should Use Form 8812

First, complete the Child Tax Credit Worksheet that applies to you. See the instructions for Form 1040, line 50, or Form 1040A, line 33. If you meet the condition given in the **TIP** at the end of your Child Tax Credit Worksheet, use Form 8812 to see if you can take the additional child tax credit.

Effect of Credit on Welfare Benefits

Any refund you receive as a result of taking the additional child tax credit will not be used to determine if you are eligible for the following programs, or how much you can receive from them.

- Temporary Assistance for Needy Families (TANF).
- Medicaid and supplemental security income (SSI).
- Food stamps and low-income housing.

Taxable Earned Income

1. Did you, or your spouse if filing a joint return, have net earnings from self-employment and use either optional method to figure those net earnings?

- No.** Go to question 2.
- Yes.** Use Pub. 972 to figure the amount to enter on Form 8812, line 4.

2. Are you claiming the earned income credit (EIC) on Form 1040, line 64, or Form 1040A, line 41?

- Yes.** Use the following chart to find the amount to enter on Form 8812, line 4.

IF you are filing Form...	AND you completed...	THEN enter on Form 8812, line 4, the amount from...
1040	Worksheet B on page 46 of your 1040 instructions or on page XX of Pub. 596	Worksheet B, line 4b.*
	Step 6 on page 43 of your 1040 instructions (but not Worksheet B)	Step 6, Box A
	Worksheet 2 on page 22 of Pub. 596	Worksheet 2, line 8
1040A	Step 6 on page 41 of your 1040A instructions	Step 6, Box A
	Worksheet 2 on page 22 of Pub. 596	Worksheet 2, line 8

* If you were a minister, member of a religious order who has not taken a vow of poverty, or a Christian Science practitioner, subtract the following from the amount on line 4b: (a) the rental value of a home or the nontaxable portion of an allowance for a home furnished to you (including payments for utilities) and (b) the value of meals and lodging provided to you, your spouse, and your dependents for your employer's convenience.

- No. 1040 filers:** Go to question 3.
1040A filers: Skip question 3 and go to question 4.

3. Were you, or your spouse if filing a joint return, self-employed, or are you filing Schedule SE because you had church employee income, or are you filing Schedule C or C-EZ as a statutory employee?

- No.** Go to question 4.
- Yes.** Use Pub. 972 to figure the amount to enter on Form 8812, line 4.

4. Does the amount on line 7 of Form 1040 or Form 1040A include any of the following amounts?

- Scholarship or fellowship grants not reported on a W-2 form.
 - Amounts paid to an inmate in a penal institution for work (put "PRI" and the amount paid in the space next to line 7 of Form 1040 or 1040A).
 - Amounts received as a pension or annuity from a nonqualified deferred compensation plan or a nongovernmental section 457 plan (put "DFC" and the amount received in the space next to line 7 of Form 1040 or 1040A). This amount may be reported in box 11 of your W-2 form. If you received such an amount but box 11 is blank, contact your employer for the amount received as a pension or annuity.
 - Amounts from Form 2555, line 41, or Form 2555-EZ, line 18.
- No.** Enter the amount from line 7 of Form 1040 or Form 1040A on Form 8812, line 4.
- Yes.** Subtract the total of those amounts from the amount on line 7 of Form 1040 or Form 1040A. (If an amount is included in more than one of the above categories, include it only once in figuring the total amount to subtract.) Enter the result on Form 8812, line 4.

Railroad Employees

If you worked for a railroad, include the following taxes in the total on Form 8812, line 7.

- Tier 1 tax withheld from your pay. This tax should be shown in box 14 of your W-2 form(s) and identified as "Tier 1 tax."
- If you were an employee representative, 50% of the total tier 1 tax and tier 1 Medicare tax you paid for 2002.

1040A Filers

If you, or your spouse if filing a joint return, had more than one employer for 2002 and total wages of over \$84,900, figure any excess social security and tier 1 railroad retirement (RRTA) taxes withheld. See the instructions for Form 1040A, line 43. Include any excess on Form 8812, line 10.

Paperwork Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by Internal Revenue Code section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is: **Recordkeeping**, 6 min.; **Learning about the law or the form**, 5 min.; **Preparing the form**, 28 min.; **Copying, assembling, and sending the form to the IRS**, 20 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. See the Instructions for Form 1040 or Form 1040A.



CHILD TAX CREDIT

LESSON 11

ANSWERS TO EXERCISES

Exercise 1 (A)

The Howard's Child Tax Eligibility Questions

Line 33—Child Tax Credit

What Is the Child Tax Credit?

This credit is for people who have a qualifying child as defined in the instructions for line 6c, column (4), that begin on page 25. It is in addition to the credit for child and dependent care expenses on Form 1040A, line 33, and the earned income credit on Form 1040A, line 50.

Three Steps To Take the Child Tax Credit!

- Step 1.** Make sure you have a qualifying child for the child tax credit. See the instructions for line 6c, column (4), that begin on page 25.
- Step 2.** Make sure you checked the box in column (4) of line 6c on Form 1040A for each qualifying child.
- Step 3.** Answer the questions on this page to see if you may use the worksheet on page 39 to figure your credit or if you must use Pub. 972, Child Tax Credit. If you need Pub. 972, see page 9.

Questions

Who Must Use Pub. 972



1. Is the amount on Form 1040A, line 22, more than the amount shown below for your filing status?
- Married filing jointly – \$110,000
 - Single, head of household, or qualifying widow(er) – \$75,000
 - Married filing separately – \$55,000
- No.** Continue  **Yes.**  You must use Pub. 972 to figure your credit.
-
2. Are you claiming the adoption credit on Form 8839 (see the instructions for Form 1040A, line 34, on page 40)?
- No.** Use the worksheet on page 39 to figure your child tax credit. **Yes.** You must use Pub. 972 to figure your child tax credit. You will also need Form 8839.

CHILD TAX CREDIT

LESSON 11

ANSWERS TO EXERCISES

Exercise 1 (A)

The Howard's Child Tax Worksheet

Child Tax Credit Worksheet—Line 33

Keep for Your Records



Do not use this worksheet if you answered "Yes" to question 1 or 2 on page 38. Instead, use Pub. 972.



1. Number of qualifying children: 4 × \$600. Enter the result.

1	2,400
---	-------

2. Enter the amount from Form 1040A, line 28.

2	578
---	-----

3. Add the amounts from Form 1040A:

Line 29 0
 Line 30 + 0
 Line 31 + 0
 Line 32 + 0 Enter the total.

3	0
---	---

4. Are the amounts on lines 2 and 3 the same?

Yes.

You cannot take this credit because there is no tax to reduce. However, see the **TIP** below before completing the rest of your Form 1040A.

No. Subtract line 3 from line 2.

4	578
---	-----

5. Is the amount on line 1 more than the amount on line 4?

Yes. Enter the amount from line 4. Also, see the **TIP** below.

No. Enter the amount from line 1.

This is your child tax credit.

5	578
---	-----

Enter this amount on Form 1040A, line 33.



You may be able to take the **additional child tax credit** on Form 1040A, line 42, if you answered "Yes" on line 4 or line 5 above.

- First, complete your Form 1040A through line 41.
- Then, use Form 8812 to figure any additional child tax credit.

CHILD TAX CREDIT

ANSWERS TO EXERCISES

LESSON 11

Exercise 1 (B)

The Howard's Additional Child Tax Credit, page 1

Form 8812 Department of the Treasury Internal Revenue Service	<h2 style="margin: 0;">Additional Child Tax Credit</h2> <p style="font-size: small; margin: 5px 0;">Complete and attach to Form 1040 or Form 1040A.</p>		OMB No. 1545-1620 <h2 style="margin: 0;">2002</h2> Attachment Sequence No. 47
Name(s) shown on return Emily and Victor Howard		Your social security number 000 00 4410	
Part I All Filers			
1 Enter the amount from line 1 of your Child Tax Credit Worksheet on page 38 of the Form 1040 instructions or page 37 of the Form 1040A instructions. If you used Pub. 972, enter the amount from line 8 of the worksheet on page 3 of the publication	1	2,400	00
2 Enter the amount from Form 1040, line 50, or Form 1040A, line 33	2	578	00
3 Subtract line 2 from line 1. If zero, stop ; you cannot take this credit	3	1,822	00
4 Enter your total taxable earned income. See the instructions on back	4	18,467	00
5 Is the amount on line 4 more than \$10,350? <input type="checkbox"/> No. Leave line 5 blank and enter -0- on line 6. <input checked="" type="checkbox"/> Yes. Subtract \$10,350 from the amount on line 4. Enter the result	5	8,117	00
6 Multiply the amount on line 5 by 10% (.10) and enter the result Next. Do you have three or more qualifying children? <input type="checkbox"/> No. If line 6 is zero, stop ; you cannot take this credit. Otherwise, skip Part II and enter the smaller of line 3 or line 6 on line 13. <input checked="" type="checkbox"/> Yes. If line 6 is equal to or more than line 3, skip Part II and enter the amount from line 3 on line 13. Otherwise, go to line 7.	6	812	00
Part II Certain Filers Who Have Three or More Qualifying Children			
7 Enter the total of the withheld social security and Medicare taxes from Form(s) W-2, boxes 4 and 6. If married filing jointly, include your spouse's amounts with yours. If you worked for a railroad, see the instructions on back	7	1,413	00
8 1040 filers: Enter the total of the amounts from Form 1040, lines 29 and 57, plus any uncollected social security and Medicare or tier 1 RRTA taxes included on line 61. 1040A filers: Enter -0-.	8	0	00
9 Add lines 7 and 8	9	1,413	00
10 1040 filers: Enter the total of the amounts from Form 1040, lines 64 and 65. 1040A filers: Enter the total of the amount from Form 1040A, line 41, plus any excess social security and tier 1 RRTA taxes withheld that you entered to the left of line 43 (see the instructions on back).	10	569	00
11 Subtract line 10 from line 9. If zero or less, enter -0-	11	844	00
12 Enter the larger of line 6 or line 11 here Next, enter the smaller of line 3 or line 12 on line 13.	12	844	00
Part III Your Additional Child Tax Credit			
13 This is your additional child tax credit	13	844	00
		Enter this amount on Form 1040, line 66, or Form 1040A, line 42.	

For Paperwork Reduction Act Notice, see back of form.

Cat. No. 10644E

Form **8812** (2002)

WAGE EARNER COMPREHENSIVE PROBLEMS

INTRODUCTION

In this section, you will complete tax returns for several common wage earner scenarios often encountered at volunteer assistance sites. This will be valuable practice as you prepare to help taxpayers. Although answers to each of the problems are shown at the end of this section, you should try to complete the blank forms for each problem before referring to its answers.

After completing this section, you will be able to:

- accurately complete a basic tax return.

PROBLEM 1

Nathan Ramsey, a senior in high school, wants help with preparing his tax return. He tells you he will be 18 years old next week, lives with his parents, who claim him as a dependent, and two siblings. He has a Form W-2 showing wages of \$1,387 and Federal withholding of \$4. He also has a Form 1099-INT from his savings account for \$37. His social security number (SSN) is 123-00-0123. Nathan lives at 3497 Livingston St., N.E., Elgin, IL 60123. Nathan wants to contribute to the Presidential Election Campaign Fund. Any refund should be mailed to his home.

You are a volunteer at VITA Site 13B, on April 10, 2003.

WAGE EARNER COMPREHENSIVE PROBLEMS

Complete this form.

Form 1040EZ, front

<p>Form 1040EZ</p> <p>Label (See page 12.) Use the IRS label. Otherwise, please print or type.</p> <p>Presidential Election Campaign (page 12) ▶</p>	<p>Department of the Treasury-Internal Revenue Service</p> <p>Income Tax Return for Single and Joint Filers With No Dependents (99) 2002</p> <p>OMB No. 1545-0675</p>																			
<p>LABEL HERE</p>	<table border="1" style="width:100%; border-collapse: collapse;"> <tr> <td style="width:40%;">Your first name and initial</td> <td style="width:20%;">Last name</td> <td style="width:40%;">Your social security number</td> </tr> <tr> <td>If a joint return, spouse's first name and initial</td> <td>Last name</td> <td>Spouse's social security number</td> </tr> <tr> <td colspan="2">Home address (number and street). If you have a P.O. box, see page 12.</td> <td>Apt. no.</td> </tr> <tr> <td colspan="3">City, town or post office, state, and ZIP code. If you have a foreign address, see page 12.</td> </tr> </table>	Your first name and initial	Last name	Your social security number	If a joint return, spouse's first name and initial	Last name	Spouse's social security number	Home address (number and street). If you have a P.O. box, see page 12.		Apt. no.	City, town or post office, state, and ZIP code. If you have a foreign address, see page 12.			<p>▲ Important! ▲ You must enter your SSN(s) above.</p>						
Your first name and initial	Last name	Your social security number																		
If a joint return, spouse's first name and initial	Last name	Spouse's social security number																		
Home address (number and street). If you have a P.O. box, see page 12.		Apt. no.																		
City, town or post office, state, and ZIP code. If you have a foreign address, see page 12.																				
<p>Note. Checking "Yes" will not change your tax or reduce your refund. Do you, or your spouse if a joint return, want \$3 to go to this fund? ▶</p> <p style="text-align: right;">You Spouse <input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> Yes <input type="checkbox"/> No</p>																				
<p>Income Attach Form(s) W-2 here. Enclose, but do not attach, any payment.</p> <p>Note. You must check Yes or No. } Yes No</p>	<table border="1" style="width:100%; border-collapse: collapse;"> <tr> <td style="width:70%;">1 Total wages, salaries, and tips. This should be shown in box 1 of your W-2 form(s). Attach your W-2 form(s).</td> <td style="width:10%; text-align: center;">1</td> <td style="width:20%;"></td> </tr> <tr> <td>2 Taxable interest. If the total is over \$400, you cannot use Form 1040EZ.</td> <td style="text-align: center;">2</td> <td></td> </tr> <tr> <td>3 Unemployment compensation and Alaska Permanent Fund dividends (see page 14).</td> <td style="text-align: center;">3</td> <td></td> </tr> <tr> <td>4 Add lines 1, 2, and 3. This is your adjusted gross income.</td> <td style="text-align: center;">4</td> <td></td> </tr> <tr> <td>5 Can your parents (or someone else) claim you on their return? Yes. Enter amount from worksheet on back. <input type="checkbox"/> No. If single, enter \$7,700. If married, enter \$13,850. See back for explanation. <input type="checkbox"/></td> <td style="text-align: center;">5</td> <td></td> </tr> <tr> <td>6 Subtract line 5 from line 4. If line 5 is larger than line 4, enter -0-. This is your taxable income.</td> <td style="text-align: center;">▶ 6</td> <td></td> </tr> </table>	1 Total wages, salaries, and tips. This should be shown in box 1 of your W-2 form(s). Attach your W-2 form(s).	1		2 Taxable interest. If the total is over \$400, you cannot use Form 1040EZ.	2		3 Unemployment compensation and Alaska Permanent Fund dividends (see page 14).	3		4 Add lines 1, 2, and 3. This is your adjusted gross income .	4		5 Can your parents (or someone else) claim you on their return? Yes. Enter amount from worksheet on back. <input type="checkbox"/> No. If single , enter \$7,700. If married , enter \$13,850. See back for explanation. <input type="checkbox"/>	5		6 Subtract line 5 from line 4. If line 5 is larger than line 4, enter -0-. This is your taxable income .	▶ 6		
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<p>Payments and tax</p>	<table border="1" style="width:100%; border-collapse: collapse;"> <tr> <td style="width:70%;">7 Federal income tax withheld from box 2 of your W-2 form(s).</td> <td style="width:10%; text-align: center;">7</td> <td style="width:20%;"></td> </tr> <tr> <td>8 Earned income credit (EIC).</td> <td style="text-align: center;">8</td> <td></td> </tr> <tr> <td>9 Add lines 7 and 8. These are your total payments.</td> <td style="text-align: center;">▶ 9</td> <td></td> </tr> <tr> <td>10 Tax. Use the amount on line 6 above to find your tax in the tax table on pages 24-28 of the booklet. Then, enter the tax from the table on this line.</td> <td style="text-align: center;">10</td> <td></td> </tr> </table>	7 Federal income tax withheld from box 2 of your W-2 form(s).	7		8 Earned income credit (EIC).	8		9 Add lines 7 and 8. These are your total payments .	▶ 9		10 Tax. Use the amount on line 6 above to find your tax in the tax table on pages 24-28 of the booklet. Then, enter the tax from the table on this line.	10								
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10 Tax. Use the amount on line 6 above to find your tax in the tax table on pages 24-28 of the booklet. Then, enter the tax from the table on this line.	10																			
<p>Refund Have it directly deposited! See page 20 and fill in 11b, 11c, and 11d.</p>	<p>11a If line 9 is larger than line 10, subtract line 10 from line 9. This is your refund. ▶ 11a</p> <p>▶ b Routing number <input style="width:100px; height: 15px; border: 1px solid black;" type="text"/> ▶ c Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings</p> <p>▶ d Account number <input style="width:150px; height: 15px; border: 1px solid black;" type="text"/></p>																			
<p>Amount you owe</p>	<p>12 If line 10 is larger than line 9, subtract line 9 from line 10. This is the amount you owe. For details on how to pay, see page 21. ▶ 12</p>																			
<p>Third party designee</p>	<p>Do you want to allow another person to discuss this return with the IRS (see page 22)? <input type="checkbox"/> Yes. Complete the following. <input type="checkbox"/> No</p> <p>Designee's name ▶ _____ Phone no. ▶ () _____ Personal identification number (PIN) ▶ <input style="width:40px; height: 15px; border: 1px solid black;" type="text"/></p>																			
<p>Sign here Joint return? See page 11. Keep a copy for your records.</p>	<p>Under penalties of perjury, I declare that I have examined this return, and to the best of my knowledge and belief, it is true, correct, and accurately lists all amounts and sources of income I received during the tax year. Declaration of preparer (other than the taxpayer) is based on all information of which the preparer has any knowledge.</p> <table border="1" style="width:100%; border-collapse: collapse;"> <tr> <td style="width:40%;">Your signature</td> <td style="width:10%;">Date</td> <td style="width:20%;">Your occupation</td> <td style="width:30%;">Daytime phone number ()</td> </tr> <tr> <td>Spouse's signature. If a joint return, both must sign.</td> <td>Date</td> <td>Spouse's occupation</td> <td style="background-color: #cccccc;"></td> </tr> </table>	Your signature	Date	Your occupation	Daytime phone number ()	Spouse's signature. If a joint return, both must sign.	Date	Spouse's occupation												
Your signature	Date	Your occupation	Daytime phone number ()																	
Spouse's signature. If a joint return, both must sign.	Date	Spouse's occupation																		
<p>Paid preparer's use only</p>	<table border="1" style="width:100%; border-collapse: collapse;"> <tr> <td style="width:40%;">Preparer's signature ▶</td> <td style="width:10%;">Date</td> <td style="width:10%;">Check if self-employed <input type="checkbox"/></td> <td style="width:40%;">Preparer's SSN or PTIN</td> </tr> <tr> <td>Firm's name (or yours if self-employed), address, and ZIP code ▶</td> <td>EIN</td> <td>Phone no. ()</td> <td></td> </tr> </table>	Preparer's signature ▶	Date	Check if self-employed <input type="checkbox"/>	Preparer's SSN or PTIN	Firm's name (or yours if self-employed), address, and ZIP code ▶	EIN	Phone no. ()												
Preparer's signature ▶	Date	Check if self-employed <input type="checkbox"/>	Preparer's SSN or PTIN																	
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<p>For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see page 23. Cat. No. 11329W Form 1040EZ (2002)</p>																				

WAGE EARNER COMPREHENSIVE PROBLEMS

Complete this form.

Form 1040EZ, back

Form 1040EZ (2002)

Page **2**

Use this form if

- Your filing status is single or married filing jointly.
- You (and your spouse if married) were under 65 on January 1, 2003, and not blind at the end of 2002.
- You do not claim any dependents.
- Your taxable income (line 6) is less than \$50,000.
- You do not claim a deduction for educator expenses, student loan interest deduction, or tuition and fees deduction (see page 8).
- You do not claim an education credit.
- You had **only** wages, salaries, tips, taxable scholarship or fellowship grants, unemployment compensation, or Alaska Permanent Fund dividends, and your taxable interest was not over \$400. **But** if you earned tips, including allocated tips, that are not included in box 5 and box 7 of your W-2, you may not be able to use Form 1040EZ. See page 13. If you are planning to use Form 1040EZ for a child who received Alaska Permanent Fund dividends, see page 14.
- You did not receive any advance earned income credit payments.

If you are not sure about your filing status, see page 11. If you have questions about dependents, use TeleTax topic 354 (see page 6). If you **cannot use this form**, use TeleTax topic 352 (see page 6).

Filling in your return

For tips on how to avoid common mistakes, see page 30.

If you received a scholarship or fellowship grant or tax-exempt interest income, such as on municipal bonds, see the booklet before filling in the form. Also, see the booklet if you received a Form 1099-INT showing Federal income tax withheld or if Federal income tax was withheld from your unemployment compensation or Alaska Permanent Fund dividends.

Remember, you must report all wages, salaries, and tips even if you do not get a W-2 form from your employer. You must also report all your taxable interest, including interest from banks, savings and loans, credit unions, etc., even if you do not get a Form 1099-INT.

Worksheet for dependents who checked "Yes" on line 5

(keep a copy for your records)

Use this worksheet to figure the amount to enter on line 5 if someone can claim you (or your spouse if married) as a dependent, even if that person chooses not to do so. To find out if someone can claim you as a dependent, use TeleTax topic 354 (see page 6).

A. Amount, if any, from line 1 on front _____	+	250.00	Enter total ►	A. _____
B. Minimum standard deduction				B. <u>750.00</u>
C. Enter the larger of line A or line B here				C. _____
D. Maximum standard deduction. If single , enter \$4,700; if married , enter \$7,850				D. _____
E. Enter the smaller of line C or line D here. This is your standard deduction				E. _____
F. Exemption amount.				F. _____
• If single, enter -0-.				
• If married and— —both you and your spouse can be claimed as dependents, enter -0-. —only one of you can be claimed as a dependent, enter \$3,000.				
G. Add lines E and F. Enter the total here and on line 5 on the front				G. _____

If you checked "No" on line 5 because no one can claim you (or your spouse if married) as a dependent, enter on line 5 the amount shown below that applies to you.

- Single, enter \$7,700. This is the total of your standard deduction (\$4,700) and your exemption (\$3,000).
- Married, enter \$13,850. This is the total of your standard deduction (\$7,850), your exemption (\$3,000), and your spouse's exemption (\$3,000).

Mailing return

Mail your return by **April 15, 2003**. Use the envelope that came with your booklet. If you do not have that envelope or if you moved during the year, see the back cover for the address to use.



Form **1040EZ** (2002)

PROBLEM 2

Mary Duvall is 36 years old and single. Her social security number is 000-00-1234. Mary earned \$6,900 as a clerk before being laid off in October. Her income tax withholding from box 2 of her Form W-2 is \$800. For the remainder of 2002, she received \$950 in unemployment compensation. Mary had no other income. She lives at 46 Maple Lane, Atlanta, GA 30365. Mary does not want to contribute to the Presidential Election Campaign Fund. Any refund is to be directly deposited into her checking account at her bank. She shows you her check: the routing number is 250250025; the account number is 20202086.

Complete a tax return for Mary Duvall. You are a VITA volunteer at Site 123, on March 3, 2003.

WAGE EARNER COMPREHENSIVE PROBLEMS

Complete this form.

Form 1040EZ, front

Department of the Treasury—Internal Revenue Service		OMB No. 1545-0675	
Form 1040EZ	Income Tax Return for Single and Joint Filers With No Dependents (99) 2002		
Label (See page 12.) Use the IRS label. Otherwise, please print or type. Presidential Election Campaign (page 12)	<small>Your first name and initial</small>	<small>Last name</small>	
	<small>If a joint return, spouse's first name and initial</small>	<small>Last name</small>	
	<small>Home address (number and street). If you have a P.O. box, see page 12.</small>		<small>Apt. no.</small>
	<small>City, town or post office, state, and ZIP code. If you have a foreign address, see page 12.</small>		
		▲ Important! ▲ You must enter your SSN(s) above.	
		You	Spouse
		<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
Income Attach Form(s) W-2 here. Enclose, but do not attach, any payment.	1 Total wages, salaries, and tips. This should be shown in box 1 of your W-2 form(s). Attach your W-2 form(s).		1
	2 Taxable interest. If the total is over \$400, you cannot use Form 1040EZ.		2
	3 Unemployment compensation and Alaska Permanent Fund dividends (see page 14).		3
	4 Add lines 1, 2, and 3. This is your adjusted gross income .		4
Note. You must check Yes or No.	5 Can your parents (or someone else) claim you on their return? Yes. Enter amount from <input type="checkbox"/> worksheet on back. No. If single , enter \$7,700. If married , enter \$13,850. See back for explanation.		5
	6 Subtract line 5 from line 4. If line 5 is larger than line 4, enter -0-. This is your taxable income .		6
Payments and tax	7 Federal income tax withheld from box 2 of your W-2 form(s).		7
	8 Earned income credit (EIC).		8
	9 Add lines 7 and 8. These are your total payments .		9
	10 Tax. Use the amount on line 6 above to find your tax in the tax table on pages 24–28 of the booklet. Then, enter the tax from the table on this line.		10
Refund <small>Have it directly deposited! See page 20 and fill in 11b, 11c, and 11d.</small>	11a If line 9 is larger than line 10, subtract line 10 from line 9. This is your refund .		11a
	b Routing number <input type="text"/>	c Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings	
	d Account number <input type="text"/>		
Amount you owe	12 If line 10 is larger than line 9, subtract line 9 from line 10. This is the amount you owe . For details on how to pay, see page 21.		12
Third party designee	Do you want to allow another person to discuss this return with the IRS (see page 22)? <input type="checkbox"/> Yes . Complete the following. <input type="checkbox"/> No		
	Designee's name <input type="text"/>	Phone no. <input type="text"/> (<input type="text"/>)	Personal identification number (PIN) <input type="text"/>
Sign here <small>Joint return? See page 11. Keep a copy for your records.</small>	Under penalties of perjury, I declare that I have examined this return, and to the best of my knowledge and belief, it is true, correct, and accurately lists all amounts and sources of income I received during the tax year. Declaration of preparer (other than the taxpayer) is based on all information of which the preparer has any knowledge.		
	Your signature <input type="text"/>	Date <input type="text"/>	Your occupation <input type="text"/>
	Spouse's signature. If a joint return, both must sign. <input type="text"/>	Date <input type="text"/>	Spouse's occupation <input type="text"/>
Paid preparer's use only	Preparer's signature <input type="text"/>	Date <input type="text"/>	Check if self-employed <input type="checkbox"/>
	Firm's name (or yours if self-employed), address, and ZIP code <input type="text"/>	EIN <input type="text"/>	Preparer's SSN or PTIN <input type="text"/>
		Phone no. (<input type="text"/>)	
For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see page 23.		Cat. No. 11329W	Form 1040EZ (2002)

WAGE EARNER COMPREHENSIVE PROBLEMS

Complete this form.

2002 Form 1040EZ, page 2

Form 1040EZ (2002)

Page **2**

Use this form if

- Your filing status is single or married filing jointly.
- You (and your spouse if married) were under 65 on January 1, 2003, and not blind at the end of 2002.
- You do not claim any dependents.
- Your taxable income (line 6) is less than \$50,000.
- You do not claim a deduction for educator expenses, student loan interest deduction, or tuition and fees deduction (see page 8).
- You do not claim an education credit.
- You had **only** wages, salaries, tips, taxable scholarship or fellowship grants, unemployment compensation, or Alaska Permanent Fund dividends, and your taxable interest was not over \$400. **But** if you earned tips, including allocated tips, that are not included in box 5 and box 7 of your W-2, you may not be able to use Form 1040EZ. See page 13. If you are planning to use Form 1040EZ for a child who received Alaska Permanent Fund dividends, see page 14.
- You did not receive any advance earned income credit payments.

If you are not sure about your filing status, see page 11. If you have questions about dependents, use TeleTax topic 354 (see page 6). If you **cannot use this form**, use TeleTax topic 352 (see page 6).

Filling in your return

If you received a scholarship or fellowship grant or tax-exempt interest income, such as on municipal bonds, see the booklet before filling in the form. Also, see the booklet if you received a Form 1099-INT showing Federal income tax withheld or if Federal income tax was withheld from your unemployment compensation or Alaska Permanent Fund dividends.

For tips on how to avoid common mistakes, see page 30.

Remember, you must report all wages, salaries, and tips even if you do not get a W-2 form from your employer. You must also report all your taxable interest, including interest from banks, savings and loans, credit unions, etc., even if you do not get a Form 1099-INT.

Worksheet for dependents who checked "Yes" on line 5

(keep a copy for your records)

Use this worksheet to figure the amount to enter on line 5 if someone can claim you (or your spouse if married) as a dependent, even if that person chooses not to do so. To find out if someone can claim you as a dependent, use TeleTax topic 354 (see page 6).

- | | | | | |
|---|---|--------|---------------|------------------|
| A. Amount, if any, from line 1 on front _____ | + | 250.00 | Enter total ► | A. _____ |
| B. Minimum standard deduction | | | | B. <u>750.00</u> |
| C. Enter the larger of line A or line B here | | | | C. _____ |
| D. Maximum standard deduction. If single , enter \$4,700; if married , enter \$7,850 | | | | D. _____ |
| E. Enter the smaller of line C or line D here. This is your standard deduction | | | | E. _____ |
| F. Exemption amount. | | | | } F. _____ |
| • If single, enter -0-. | | | | |
| • If married and—
—both you and your spouse can be claimed as dependents, enter -0-.
—only one of you can be claimed as a dependent, enter \$3,000. | | | | |
| G. Add lines E and F. Enter the total here and on line 5 on the front | | | | G. _____ |

If you checked "No" on line 5 because no one can claim you (or your spouse if married) as a dependent, enter on line 5 the amount shown below that applies to you.

- Single, enter \$7,700. This is the total of your standard deduction (\$4,700) and your exemption (\$3,000).
- Married, enter \$13,850. This is the total of your standard deduction (\$7,850), your exemption (\$3,000), and your spouse's exemption (\$3,000).

Mailing return

Mail your return by **April 15, 2003**. Use the envelope that came with your booklet. If you do not have that envelope or if you moved during the year, see the back cover for the address to use.



Form **1040EZ** (2002)

WAGE EARNER COMPREHENSIVE PROBLEMS

Complete this form.

Line 8 Earned Income Credit (EIC)

What Is the EIC?

The EIC is a credit for certain people who work. The credit may give you a refund even if you do not owe any tax.



If you have a qualifying child (see the next column on this page), you may be able to take the credit, but you must use Schedule EIC and Form 1040A or 1040 to do so. For details, see Pub. 596.

To Take the EIC:

- Follow the steps below.
- Complete the worksheet on page 19 or let the IRS figure the credit for you.

You Will Need:



If you take the EIC even though you are not eligible and it is determined that your error is due to reckless or intentional disregard of the EIC rules, you will not be allowed to take the credit for 2 years even if you are otherwise eligible to do so. If you fraudulently take the EIC, you will not be allowed to take the credit for 10 years. You may also have to pay penalties.

Step 1 All Filers

1. Is the amount on Form 1040EZ, line 4, less than \$11,060 (or \$12,060 if married filing jointly)?

Yes. *Continue* → **No.** You cannot take the credit.

2. Do you, and your spouse if filing a joint return, have a social security number that allows you to work or is valid for EIC purposes (see page 18)?

Yes. *Continue* → **No.** You cannot take the credit.
Print "No" in the space to the left of line 8.

3. Can you, or your spouse if filing a joint return, be claimed as a dependent on someone else's 2002 tax return?

Yes. You cannot take the credit. **No.** *Continue* →

4. Were you, or your spouse if filing a joint return, at least age 25 but under age 65 at the end of 2002?

Yes. *Go to question 5.* **No.** You cannot take the credit.
Enter "No" in the space to the left of line 8.

5. Was your home, and your spouse's if filing a joint return, in the United States for more than half of 2002? Members of the military stationed outside the United States, see page 17 before you answer.

Yes. *Continue* → **No.** You cannot take the credit.
Enter "No" in the space to the left of line 8.

6. Look at the qualifying child conditions below. Could you, or your spouse if filing a joint return, be a qualifying child of another person in 2002?

Yes. You cannot take the credit. *Enter "No" in the space to the left of line 8.* **No.** *Go to Step 2 on page 18.* →

A qualifying child is a child who is—

Your son, daughter, adopted child, stepchild, or grandchild
or
Your brother, sister, stepbrother, stepsister or a descendant of your brother, sister, etc. (for example, your niece or nephew)
or
A foster child (any child placed with you by an authorized placement agency whom you cared for as your own child)

AND

was at the end of 2002...

Under age 19

or

Under age 24 and a student

or

Any age and permanently and totally disabled

AND

who...

Either lived with you in the United States for more than half of 2002 **or** was born or died in 2002 and your home was the child's home for the entire time he or she was alive in 2002.

Note. Special rules apply if the child was married or also meets the conditions to be a qualifying child of another person (other than your spouse if filing a joint return). For details, use TeleTax topic 601 (see page 8) or see Pub. 596.

(Continued on page 18)

WAGE EARNER COMPREHENSIVE PROBLEMS

Continued from page 17

Step 2 Earned Income

1. Figure earned income:

Form 1040EZ, line 1 _____

Subtract, if included on line 1, any:

- Taxable scholarship or fellowship grant not reported on a W-2 form
- Amount paid to an inmate in a penal institution for work (enter "PRI" in the space to the left of line 1 of Form 1040EZ)
- Amount received as a pension or annuity from a nonqualified deferred compensation plan or a section 457 plan (enter "DFC" in the space to the left of line 1 of Form 1040EZ). This amount may be shown in box 11 of your W-2 form. If you received such an amount but box 11 is blank, contact your employer for the amount received as a pension or annuity.

Earned Income =

Box C	
-------	--

2. Is Box A less than \$11,060 (or \$12,060 if married filing jointly)?

Yes. Go to Step 3.

No. 

You cannot take the credit.
Print "No" in the space to the left of line 8.

Step 3 How To Figure the Credit

1. Do you want the IRS to figure the credit for you?

Yes. See Credit Figured by the IRS on this page.

No. Go to the worksheet on page 19.

Definitions and Special Rules

(listed in alphabetical order)

Credit Figured by the IRS. To have the IRS figure the credit for you:

1. Enter "EIC" in the space to the left of line 8 of Form 1040EZ.
2. If your EIC for a year after 1996 was reduced or disallowed, see Form 8862, Who Must File, below.

Form 8862, Who Must File. You must file Form 8862 if your EIC for a year after 1996 was reduced or disallowed for any reason other than a math or clerical error. But do not file Form 8862 if, after your EIC was reduced or disallowed in an earlier year:

- You filed Form 8862 (or other documents) and your EIC was then allowed and
- Your EIC has not been reduced or disallowed again for any reason other than a math or clerical error.

Also, do not file Form 8862 or take the credit if it was determined that your error was due to reckless or intentional disregard of the EIC rules or fraud.

Members of the Military. If you were on extended active duty outside the United States, your home is considered to be in the United States during that duty period. Extended active duty is military duty ordered for an indefinite period or for a period of more than 90 days. Once you begin serving extended active duty, you are considered to be on extended active duty even if you serve fewer than 90 days.

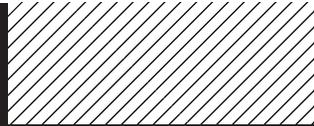
Social Security Number (SSN). For purposes of taking the EIC, a valid SSN is a number issued by the Social Security Administration unless "Not Valid for Employment" is printed on the social security card and the number was issued solely to apply for or receive a Federally funded benefit.

To find out how to get an SSN, see page 14. If you will not have an SSN by April 15, 2003, see What if You Cannot File on Time? on page 11.

Welfare Benefits, Effect of Credit on. Any refund you receive as a result of taking the EIC will not be used to determine if you are eligible for the following programs, or how much you can receive from them. But if the refund you receive because the EIC is not spent within a certain period of time, it may count as an asset (or resource) and affect your eligibility.

- Temporary Assistance for Needy Families (TANF).
- Medicaid and supplemental security income (SSI).
- Food stamps and low-income housing.

(Continued on page 19)



Earned Income Credit (EIC) Worksheet—Line 8

Keep for Your Records



Part 1

All Filers

1. Enter your total earned income from Step 2, Box A, on page 18. 1

2. Look up the amount on line 1 above in the EIC Table on page 20 to find the credit. Use the column for your filing status. Enter the credit here. 2

If line 2 is zero,  You cannot take the credit. Enter "No" in the space to the left of line 8.

3. Enter the amount from Form 1040EZ, line 4. 3

4. Are the amounts on lines 3 and 1 the same?
- Yes.** Skip line 5; enter the amount from line 2 on line 6.
- No.** Go to line 5.

Part 2

Filers Who Answered "No" on Line 4

5. Is the amount on line 3 less than \$6,150 (or \$7,150 if married filing jointly)?

Yes. Leave line 5 blank; enter the amount from line 2 on line 6.

No. Look up the amount on line 3 in the EIC Table on page 20 to find the credit. Use the column for your filing status. Enter the credit here. 5

Look at the amounts on lines 5 and 2. Then, enter the **smaller** amount on line 6.

Part 3

Your Earned Income Credit

6. This is your earned income credit. 6

Enter this amount on Form 1040EZ, line 8.



If your EIC for a year after 1996 was reduced or disallowed, see page 18 to find out if you must file Form 8862 to take the credit for 2002.

PROBLEM 3

Albert W. Rowan, SSN 000-00-7698 is 55. He lives at 1515 Kingston Court, Charlotte, NC 28215. He does not want to contribute \$3 to the Presidential Election Campaign Fund. Albert's grandson, Derek K. Rowan, SSN 000-00-6568, was born in 1994 and lived with Albert all of 2002. Albert provided all of his grandson's support.

Albert earned \$22,552 as a security officer for a local textile mill, and he had \$1,850 of taxes withheld from his wages. He had no other source of income. Albert received \$360 in advance earned income credit payments. While he worked, Albert paid Maude Lee Child Care Center, 551 Cower Street, Charlotte, NC 28215, EIN 10-9963246, to provide after school care for Derek. Albert paid \$1,500 for Derek's after school care. Albert wants a refund of any overpayment directly deposited by IRS into his checking account. When you ask him for the information for direct deposit, he shows you a check that has a routing number of 320360036 and an account number of 40403075.

You are a VITA volunteer at Site # 500. Prepare Albert's tax return. It is Jan. 24, 2003.

WAGE EARNER COMPREHENSIVE PROBLEMS

Complete this form.

Form 1040A, page 1

Form 1040A	Department of the Treasury—Internal Revenue Service U.S. Individual Income Tax Return (99) 2002	IRS Use Only—Do not write or staple in this space.																														
Label (See page 19.) Use the IRS label. Otherwise, please print or type.	<table border="1" style="width:100%; border-collapse: collapse;"> <tr> <td style="width:50%; height: 40px; vertical-align: top;">Your first name and initial</td> <td style="width:50%; height: 40px; vertical-align: top;">Last name</td> </tr> <tr> <td style="height: 40px; vertical-align: top;">If a joint return, spouse's first name and initial</td> <td style="height: 40px; vertical-align: top;">Last name</td> </tr> <tr> <td colspan="2" style="height: 40px; vertical-align: top;">Home address (number and street). If you have a P.O. box, see page 20.</td> </tr> <tr> <td colspan="2" style="height: 40px; vertical-align: top;">City, town or post office, state, and ZIP code. If you have a foreign address, see page 20.</td> </tr> </table>	Your first name and initial	Last name	If a joint return, spouse's first name and initial	Last name	Home address (number and street). If you have a P.O. box, see page 20.		City, town or post office, state, and ZIP code. If you have a foreign address, see page 20.		OMB No. 1545-0085 Your social security number Spouse's social security number ▲ Important! ▲ You must enter your SSN(s) above.																						
Your first name and initial	Last name																															
If a joint return, spouse's first name and initial	Last name																															
Home address (number and street). If you have a P.O. box, see page 20.																																
City, town or post office, state, and ZIP code. If you have a foreign address, see page 20.																																
Presidential Election Campaign (See page 20.)	Note. Checking "Yes" will not change your tax or reduce your refund. Do you, or your spouse if filing a joint return, want \$3 to go to this fund?	You Spouse <input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> Yes <input type="checkbox"/> No																														
Filing status Check only one box.	1 <input type="checkbox"/> Single 2 <input type="checkbox"/> Married filing jointly (even if only one had income) 3 <input type="checkbox"/> Married filing separately. Enter spouse's SSN above and full name here.	4 <input type="checkbox"/> Head of household (with qualifying person). (See page 21.) If the qualifying person is a child but not your dependent, enter this child's name here.																														
Exemptions If more than six dependents, see page 22.	6a <input type="checkbox"/> Yourself. If your parent (or someone else) can claim you as a dependent on his or her tax return, do not check box 6a. b <input type="checkbox"/> Spouse c Dependents: <table border="1" style="width:100%; border-collapse: collapse; margin-top: 5px;"> <thead> <tr> <th style="width:20%;">(1) First name</th> <th style="width:20%;">Last name</th> <th style="width:15%;">(2) Dependent's social security number</th> <th style="width:15%;">(3) Dependent's relationship to you</th> <th style="width:10%;">(4) <input checked="" type="checkbox"/> if qualifying child for child tax credit (see page 23)</th> </tr> </thead> <tbody> <tr><td> </td><td> </td><td> </td><td> </td><td><input type="checkbox"/></td></tr> </tbody> </table>	(1) First name	Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) <input checked="" type="checkbox"/> if qualifying child for child tax credit (see page 23)					<input type="checkbox"/>					<input type="checkbox"/>					<input type="checkbox"/>					<input type="checkbox"/>					<input type="checkbox"/>	No. of boxes checked on 6a and 6b No. of children on 6c who: • lived with you • did not live with you due to divorce or separation (see page 24) Dependents on 6c not entered above Add numbers on lines above
(1) First name	Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) <input checked="" type="checkbox"/> if qualifying child for child tax credit (see page 23)																												
				<input type="checkbox"/>																												
				<input type="checkbox"/>																												
				<input type="checkbox"/>																												
				<input type="checkbox"/>																												
				<input type="checkbox"/>																												
Income Attach Form(s) W-2 here. Also attach Form(s) 1099-R if tax was withheld. If you did not get a W-2, see page 25. Enclose, but do not attach, any payment.	7 Wages, salaries, tips, etc. Attach Form(s) W-2. 7 8a Taxable interest. Attach Schedule 1 if required. 8a b Tax-exempt interest. Do not include on line 8a. 8b 9 Ordinary dividends. Attach Schedule 1 if required. 9 10 Capital gain distributions (see page 25). 10 11a IRA distributions. 11a 11b Taxable amount (see page 25). 11b 12a Pensions and annuities. 12a 12b Taxable amount (see page 26). 12b 13 Unemployment compensation and Alaska Permanent Fund dividends. 13 14a Social security benefits. 14a 14b Taxable amount (see page 28). 14b 15 Add lines 7 through 14b (far right column). This is your total income . 15	16 Educator expenses (see page XX). 16 17 IRA deduction (see page 28). 17 18 Student loan interest deduction (see page 31). 18 19 Tuition and fees deduction (see page XX). 19 20 Add lines 16 through 19. These are your total adjustments . 20 21 Subtract line 20 from line 15. This is your adjusted gross income . 21																														
For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see page 53.																																
Cat. No. 11327A		Form 1040A (2002)																														

WAGE EARNER COMPREHENSIVE PROBLEMS

Complete this form.

Form 1040A, page 2

Form 1040A (2002) Page 2

Tax, credits, and payments	22	Enter the amount from line 21 (adjusted gross income).	22	
	23a	Check <input type="checkbox"/> You were 65 or older <input type="checkbox"/> Blind } Enter number of boxes checked ▶ 23a <input type="checkbox"/> if: <input type="checkbox"/> Spouse was 65 or older <input type="checkbox"/> Blind }		
	b	If you are married filing separately and your spouse itemizes deductions, see page 32 and check here ▶ 23b <input type="checkbox"/>		
	24	Enter your standard deduction (see left margin).	24	
	25	Subtract line 24 from line 22. If line 24 is more than line 22, enter -0-.	25	
	26	Multiply \$3,000 by the total number of exemptions claimed on line 6d.	26	
	27	Subtract line 26 from line 25. If line 26 is more than line 25, enter -0-. This is your taxable income . ▶ 27	27	
	28	Tax , including any alternative minimum tax (see page 33).	28	
	29	Credit for child and dependent care expenses. Attach Schedule 2.	29	
	30	Credit for the elderly or the disabled. Attach Schedule 3.	30	
	31	Education credits. Attach Form 8863.	31	
	32	Retirement savings contributions credit. Attach Form 8880.	32	
	33	Child tax credit (see page 36).	33	
	34	Adoption credit. Attach Form 8839.	34	
	35	Add lines 29 through 34. These are your total credits .	35	
	36	Subtract line 35 from line 28. If line 35 is more than line 28, enter -0-.	36	
	37	Advance earned income credit payments from Form(s) W-2.	37	
	38	Add lines 36 and 37. This is your total tax . ▶ 38	38	
	39	Federal income tax withheld from Forms W-2 and 1099.	39	
	40	2002 estimated tax payments and amount applied from 2001 return.	40	
	41	Earned income credit (EIC) .	41	
	42	Additional child tax credit. Attach Form 8812.	42	
	43	Add lines 39 through 42. These are your total payments . ▶ 43	43	
	Refund	44 If line 43 is more than line 38, subtract line 38 from line 43. This is the amount you overpaid .	44	
		45a Amount of line 44 you want refunded to you . ▶ 45a	45a	
		▶ b Routing number <input type="text"/> ▶ c Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings		
		▶ d Account number <input type="text"/>		
	46	Amount of line 44 you want applied to your 2003 estimated tax .	46	
	Amount you owe	47 Amount you owe . Subtract line 43 from line 38. For details on how to pay, see page 48. ▶ 47	47	
	48	Estimated tax penalty (see page 48).	48	

Third party designee Do you want to allow another person to discuss this return with the IRS (see page 49)? **Yes**. Complete the following. **No**

Designee's name ▶	Phone no. ▶ ()	Personal identification number (PIN) ▶ <input type="text"/>
-------------------	-----------------	---

Sign here Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and accurately list all amounts and sources of income I received during the tax year. Declaration of preparer (other than the taxpayer) is based on all information of which the preparer has any knowledge.

Your signature	Date	Your occupation	Daytime phone number ()
Spouse's signature. If a joint return, both must sign.	Date	Spouse's occupation	

Paid preparer's use only

Preparer's signature ▶	Date	Check if self-employed <input type="checkbox"/>	Preparer's SSN or PTIN
Firm's name (or yours if self-employed), address, and ZIP code ▶	EIN	Phone no. ()	

WAGE EARNER COMPREHENSIVE PROBLEMS

Complete this form.

Schedule 2, page 1

Schedule 2
(Form 1040A)

Department of the Treasury—Internal Revenue Service

Child and Dependent Care Expenses for Form 1040A Filers (99) **2002**

OMB No. 1545-0085

Name(s) shown on Form 1040A

Your social security number

Before you begin: You need to understand the following terms. See **Definitions** on page 1 of the separate instructions.

• **Dependent Care Benefits** • **Qualifying Person(s)** • **Qualified Expenses** • **Earned Income**

Part I

Persons or organizations who provided the care

1	(a) Care provider's name	(b) Address (number, street, apt. no., city, state, and ZIP code)	(c) Identifying number (SSN or EIN)	(d) Amount paid (see instructions)

(If you need more space, use the bottom of page 2.)

You must complete this part.

Did you receive dependent care benefits?	No	→ Complete only Part II below.
	Yes	→ Complete Part III on the back next.

Caution. If the care was provided in your home, you may owe employment taxes. If you do, you must use Form 1040. See **Schedule H** and its instructions for details.

Part II

Credit for child and dependent care expenses

2 Information about your **qualifying person(s)**. If you have more than two qualifying persons, see the instructions.

	(a) Qualifying person's name		(b) Qualifying person's social security number	(c) Qualified expenses you incurred and paid in 2002 for the person listed in column (a)
	First	Last		

3 Add the amounts in column (c) of line 2. **Do not** enter more than \$2,400 for one qualifying person or \$4,800 for two or more persons. If you completed Part III, enter the amount from line 26. 3

4 Enter your **earned income**. 4

5 If married filing a joint return, enter your spouse's earned income (if your spouse was a student or was disabled, see the instructions); **all others**, enter the amount from line 4. 5

6 Enter the **smallest** of line 3, 4, or 5. 6

7 Enter the amount from Form 1040A, line 22. 7

8 Enter on line 8 the decimal amount shown below that applies to the amount on line 7.

If line 7 is:			If line 7 is:		
Over	But not over	Decimal amount is	Over	But not over	Decimal amount is
\$0—10,000		.30	\$20,000—22,000		.24
10,000—12,000		.29	22,000—24,000		.23
12,000—14,000		.28	24,000—26,000		.22
14,000—16,000		.27	26,000—28,000		.21
16,000—18,000		.26	28,000—No limit		.20
18,000—20,000		.25			

9 Multiply **line 6** by the decimal amount on line 8. If you paid 2001 expenses in 2002, see the instructions. 9

10 Enter the amount from Form 1040A, line 28. 10

11 **Credit for child and dependent care expenses.** Enter the **smaller** of line 9 or line 10 here and on Form 1040A, line 29. 11

For Paperwork Reduction Act Notice, see Form 1040A instructions.

Cat. No. 10749I

Schedule 2 (Form 1040A) 2002

WAGE EARNER COMPREHENSIVE PROBLEMS

Complete this form.

Form 1040A Child Tax Credit Worksheet

Child Tax Credit Worksheet—Line 33

Keep for Your Records



Do not use this worksheet if you answered "Yes" to question 1 or 2 on page 38. Instead, use Pub. 972.



1. Number of qualifying children: _____ × \$600. Enter the result.

1	
---	--

2. Enter the amount from Form 1040A, line 28.

2	
---	--

3. Add the amounts from Form 1040A:

Line 29 _____

Line 30 + _____

Line 31 + _____

Line 32 + _____ Enter the total.

3	
---	--

4. Are the amounts on lines 2 and 3 the same?

Yes. 

You cannot take this credit because there is no tax to reduce. However, see the **TIP** below before completing the rest of your Form 1040A.

No. Subtract line 3 from line 2.

4	
---	--

5. Is the amount on line 1 more than the amount on line 4?

Yes. Enter the amount from line 4. Also, see the **TIP** below.

No. Enter the amount from line 1.

This is your child tax credit.

5	
---	--

Enter this amount on Form 1040A, line 33.



You may be able to take the **additional child tax credit** on Form 1040A, line 42, if you answered "Yes" on line 4 or line 5 above.

- First, complete your Form 1040A through line 41.
- Then, use Form 8812 to figure any additional child tax credit.

Complete this form.

Line 41— Earned Income Credit (EIC)

What Is the EIC?

The EIC is a credit for certain people who work. The credit may give you a refund even if you do not owe any tax.

To Take the EIC:

- Follow the steps below.
- Complete the worksheet that applies to you **or** let the IRS figure the credit for you.
- If you have a qualifying child, complete and attach Schedule EIC.



If you take the EIC even though you are not eligible and it is determined that your error is due to reckless or intentional disregard of the EIC rules, you will not be allowed to take the credit for 2 years even if you are otherwise eligible to do so. If you fraudulently take the EIC, you will not be allowed to take the credit for 10 years. You may also have to pay penalties.

Step 1 All Filers

- If, in 2002:
 - 2 children lived with you, is the amount on Form 1040A, line 22, less than \$33,178 (or \$34,178 if married filing jointly)?
 - 1 child lived with you, is the amount on Form 1040A, line 22, less than \$29,201 (\$30,201 if married filing jointly)?
 - No children live with you, is the amount on Form 1040A, line 22, less than \$11,060 (or \$12,060 if married filing jointly)?

Yes. *Continue* ↘ **No.**  You cannot take the credit.
- Do you, and your spouse if filing a joint return, have a social security number that allows you to work or is valid for EIC purposes (see page 44)?

Yes. *Continue* ↘ **No.**  You cannot take the credit.
 Put "No" to the left of the entry space for line 41.
- Is your filing status married filing separately?

Yes.  You cannot take the credit. **No.** *Continue* ↘
- Were you a nonresident alien for any part of 2002?

Yes. *See Nonresident Aliens on page 44.* **No.** *Go to Step 2.*

Step 2 Investment Income

- Add the amounts from Form 1040A:

Line 8a	_____			
Line 8b	+	_____		
Line 9	+	_____		
Line 10	+	_____		
Investment Income			=	

- Is your investment income more than \$2,550?

Yes.  You cannot take the credit. **No.** *Continue* ↘
- Did a child live with you in 2002?

Yes. *Go to Step 3.* **No.** *Go to Step 4 on page 42.*

(Continued on page 42)

WAGE EARNER COMPREHENSIVE PROBLEMS

Complete this form.

Form 1040A EIC Worksheet

Continued from page 41

Step 3 Qualifying Child

A qualifying child is a child who is...

Your son, daughter, adopted child, stepchild, or grandchild

or

Your brother, sister, stepbrother, or stepsister, or a descendant of your brother, sister, etc. (for example, your niece or nephew), whom you cared for as your own child

or

A foster child (any child placed with you by an authorized placement agency whom you cared for as your own child)

If the child was married, see page 42.

AND

was at the end of 2002...

Under age 19

or

Under age 24 and a student (see page 44)

or

Any age and permanently and totally disabled (see page 44)

AND

who...

Lived with you in the United States for more than half of 2002. If the child did not live with you for the required time, see Exception to "Time Lived With You" Condition on page 44.

Note. If the child was married, see page 44.

1. Look at the qualifying child conditions above. Could you, or your spouse if filing a joint return, be a qualifying child of another person in 2002?

Yes. 

You cannot take the credit. Put "No" to the left of the entry space for line 41.

No. *Continue* ↘

2. Do you have at least one child who meets the above conditions to be your qualifying child?

Yes. *Continue* ↘

No. *Skip question 3; go to Step 4, question 2.*

3. Does the child meet the conditions to be a qualifying child of any other person (other than your spouse if filing a joint return) for 2002?

Yes. *See Qualifying Child of More Than One Person on page 44.*

No. This child is your qualifying child. The child must have a social security number as defined on page 44 unless the child was born and died in 2002. *Skip Step 4; go to Step 5 on page 43.*

Step 4 Filers Without a Qualifying Child

1. Look at the qualifying child conditions in Step 3. Could you, or your spouse if filing a joint return, be a qualifying child of another person in 2002?

Yes.  You cannot take the credit. Put "No" to the left of the entry space for line 41.

No. *Continue* ↘

2. Can you, or your spouse if filing a joint return, be claimed as a dependent on someone else's 2002 tax return?

Yes.  You cannot take the credit.

No. *Continue* ↘

3. Were you, or your spouse if filing a joint return, at least age 25 but under age 65 at the end of 2002?

Yes. *Continue* ↘

No.  You cannot take the credit. Put "No" to the left of the entry space for line 41.

4. Was your home, and your spouse's if filing a joint return, in the United States for more than half of 2002? Members of the military stationed outside the United States, see page 44 before you answer.

Yes. *Go to Step 5 on page 43.*

No.  You cannot take the credit. Put "No" to the left of the entry space for line 41.

(Continued on page 41)

Continued from page 42

Step 5 Earned Income

1. Figure earned income:

Form 1040A, line 7 _____

Subtract, if included on line 7, any:

- Taxable scholarship or fellowship grant not reported on a W-2 form
- Amount paid to an inmate in a penal institution for work (put "PRI" and the amount subtracted to the left of the entry space for line 7 of Form 1040A)
- Amount received as a pension or annuity from a nonqualified deferred compensation plan or a nongovernmental section 457 plan (put "DFC" and the amount subtracted to the left of the entry space for line 7 of Form 1040A). This amount may be shown in box 11 of your W-2 form. If you received such an amount but box 11 is blank, contact your employer for the amount received as a pension or annuity.

Taxable Earned Income =

Go to Step 6.

2. If you have:

- 2 or more qualifying children, is your earned income less than \$33,178 (\$34,178 if married filing jointly)?
- 1 qualifying child, is your earned income less than \$29,201 (\$30,201 if married filing jointly)?
- No qualifying children, is your earned income less than \$11,060 (\$12,060 if married filing jointly)?

Yes. *Go to Step 6.* **No.**  You cannot take the credit.

Step 6 How To Figure the Credit

1. Do you want the IRS to figure the credit for you?

- Yes.** *See Credit Figured by the IRS below.* **No.** *Go to the worksheet on page 44.*

Definitions and Special Rules *(listed in alphabetical order)*

Adopted Child. Any child placed with you by an authorized placement agency for legal adoption. An authorized placement agency includes any person authorized by state law to place children for legal adoption. The adoption does not have to be final.

Credit Figured by the IRS. To have the IRS figure the credit for you:

1. Put "EIC" to the left of the entry space for line 41 of Form 1040A.
2. If you have a qualifying child, complete and attach Schedule EIC. If your EIC for a year after 1996 was reduced or disallowed, see Form 8862, Who Must File, on page 44.

Exception to "Time Lived With You" Condition. A child is considered to have lived with you for all of 2002 if the child was born or died in 2002 and your home was this child's home for the entire time he or she was alive in 2002. Temporary absences, such as for school, vacation, medical care, or detention in a juvenile facility, count as time lived at home. If your child is presumed to have been kidnapped by someone who is not a family member, see Pub. 596 to find out if that child is a qualifying child for the EIC. To get Pub. 596, see page 9. If you were in the military stationed outside the United States, see Members of the Military below.

Form 8862, Who Must File. You must file Form 8862 if your EIC for a year after 1996 was reduced or disallowed for any reason other than a math or clerical error. But do not file Form 8862 if, after your EIC was reduced or disallowed in an earlier year:

- You filed Form 8862 (or other documents) and your EIC was then allowed and
- Your EIC has not been reduced or disallowed again for any reason other than a math or clerical error.

Also, do not file Form 8862 or take the credit if it was determined that your error was due to reckless or intentional disregard of the EIC rules or fraud.

WAGE EARNER COMPREHENSIVE PROBLEMS

Complete this form.

Form 1040A EIC Worksheet

Earned Income Credit (EIC) Worksheet—Line 41

Keep for Your Records



Part 1

All Filers

1. Enter your earned income from Step 5, on page 43.

1	
---	--

2. Look up the amount on line 1 above in the EIC Table on pages 46–51 to find the credit. Be sure you use the correct column for your filing status and the number of children you have. Enter the credit here.

2	
---	--

If line 2 is zero,  You cannot take the credit. Put "No" to the left of the entry space for line 41.

3. Enter the amount from Form 1040A, line 22.

3	
---	--

4. Are the amounts on lines 3 and 1 the same?

- Yes.** Skip line 5; enter the amount from line 2 on line 6.
 No. Go to line 5.

Part 2

Filers Who Answered "No" on Line 4

5. If you have:

- No qualifying children, is the amount on line 3 less than \$6,150 (or \$7,150 if married filing jointly)?
 - 1 or more qualifying children, is the amount on line 3 less than \$13,520 (\$14,520 if married filing jointly)?
- Yes.** Leave line 5 blank; enter the amount from line 2 on line 6.

- No.** Look up the amount on line 3 in the EIC Table on pages 46–51 to find the credit. Be sure you use the correct column for your filing status and the number of children you have. Enter the credit here.

Look at the amounts on lines 5 and 2. Then, enter the **smaller** amount on line 6.

5	
---	--

Part 3

Your Earned Income Credit

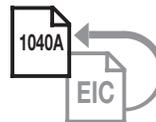
6. This is your earned income credit.

6	
---	--

Enter this amount on Form 1040A, line 41.

Reminder—

- ✓ If you have a qualifying child, complete and attach Schedule EIC.

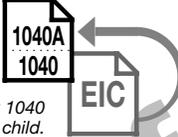


If your EIC for a year after 1996 was reduced or disallowed, see page 44 to find out if you must file Form 8862 to take the credit for 2002.

WAGE EARNER COMPREHENSIVE PROBLEMS

Complete this form.

2002 Schedule EIC

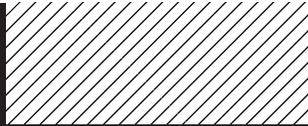
<p>SCHEDULE EIC (Form 1040A or 1040)</p> <p>Department of the Treasury Internal Revenue Service (99)</p> <p>Name(s) shown on return</p>	<p>Earned Income Credit Qualifying Child Information</p> <p><i>Complete and attach to Form 1040A or 1040 only if you have a qualifying child.</i></p> <div style="text-align: right;">  </div>	<p>OMB No. 1545-0074</p> <p style="font-size: 2em; font-weight: bold;">2002</p> <p>Attachment Sequence No. 43</p> <p>Your social security number</p>
<p>Before you begin: See the instructions for Form 1040A, line 41, or Form 1040, line 64, to make sure that (a) you can take the EIC and (b) you have a qualifying child.</p>		
<div style="display: flex; align-items: flex-start;"> <div style="margin-right: 10px;">  </div> <ul style="list-style-type: none"> If you take the EIC even though you are not eligible, you may not be allowed to take the credit for up to 10 years. See back of schedule for details. It will take us longer to process your return and issue your refund if you do not fill in all lines that apply for each qualifying child. Be sure the child's name on line 1 and social security number (SSN) on line 2 agree with the child's social security card. Otherwise, at the time we process your return, we may reduce or disallow your EIC. If the name or SSN on the child's social security card is not correct, call the Social Security Administration at 1-800-772-1213. </div>		
<p>Qualifying Child Information</p>		
	<p>Child 1</p>	<p>Child 2</p>
<p>1 Child's name If you have more than two qualifying children, you only have to list two to get the maximum credit.</p>	<p>First name Last name</p>	<p>First name Last name</p>
<p>2 Child's SSN The child must have an SSN as defined on page 42 of the Form 1040A instructions or page 44 of the Form 1040 instructions unless the child was born and died in 2002. If your child was born and died in 2002 and did not have an SSN, enter "Died" on this line and attach a copy of the child's birth certificate.</p>	<p>.....</p>	<p>.....</p>
<p>3 Child's year of birth</p>	<p>Year _____ <i>If born after 1983, skip lines 4a and 4b; go to line 5.</i></p>	<p>Year _____ <i>If born after 1983, skip lines 4a and 4b; go to line 5.</i></p>
<p>4 If the child was born before 1984— a Was the child under age 24 at the end of 2002 and a student?</p>	<p><input type="checkbox"/> Yes. <input type="checkbox"/> No. <i>Go to line 5. Continue</i></p>	<p><input type="checkbox"/> Yes. <input type="checkbox"/> No. <i>Go to line 5. Continue</i></p>
<p>b Was the child permanently and totally disabled during any part of 2002?</p>	<p><input type="checkbox"/> Yes. <input type="checkbox"/> No. <i>Continue The child is not a qualifying child.</i></p>	<p><input type="checkbox"/> Yes. <input type="checkbox"/> No. <i>Continue The child is not a qualifying child.</i></p>
<p>5 Child's relationship to you (for example, son, daughter, grandchild, foster child, etc.)</p>		
<p>6 Number of months child lived with you in the United States during 2002</p> <ul style="list-style-type: none"> If the child lived with you for more than half of 2002 but less than 7 months, enter "7". If the child was born or died in 2002 and your home was the child's home for the entire time he or she was alive during 2002, enter "12". 	<p>_____ months <i>Do not enter more than 12 months.</i></p>	<p>_____ months <i>Do not enter more than 12 months.</i></p>
<div style="display: flex; align-items: flex-start;"> <div style="margin-right: 10px;">  </div> <p>You may also be able to take the additional child tax credit if your child (a) was under age 17 at the end of 2002, (b) is claimed as your dependent on line 6c of Form 1040A or Form 1040, and (c) is a U.S. citizen or resident alien. For more details, see the instructions for line 42 of Form 1040A or line 66 of Form 1040.</p> </div>		
<p>For Paperwork Reduction Act Notice, see Form 1040A or 1040 instructions. Cat. No. 13339M Schedule EIC (Form 1040A or 1040) 2002</p>		

WAGE EARNER COMPREHENSIVE PROBLEMS ANSWERS TO PROBLEMS

Problem 1

Department of the Treasury—Internal Revenue Service		Income Tax Return for Single and Joint Filers With No Dependents (99) 2002		OMB No. 1545-0675																								
Form 1040EZ	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 30%; border-bottom: 1px solid black;">Your first name and initial Nathan</td> <td style="width: 30%; border-bottom: 1px solid black;">Last name Ramsey</td> <td style="width: 40%; border-bottom: 1px solid black;">Your social security number 123 : 00 : 0123</td> </tr> <tr> <td style="border-bottom: 1px solid black;">If a joint return, spouse's first name and initial</td> <td style="border-bottom: 1px solid black;">Last name</td> <td style="border-bottom: 1px solid black;">Spouse's social security number : : : : : : : : :</td> </tr> <tr> <td colspan="2" style="border-bottom: 1px solid black;">Home address (number and street). If you have a P.O. box, see page 12. 3497 Livingston St. N.E.</td> <td style="border-bottom: 1px solid black;">Apt. no.</td> </tr> <tr> <td colspan="3" style="border-bottom: 1px solid black;">City, town or post office, state, and ZIP code. If you have a foreign address, see page 12. Elgin, IL 60123</td> </tr> </table>			Your first name and initial Nathan	Last name Ramsey	Your social security number 123 : 00 : 0123	If a joint return, spouse's first name and initial	Last name	Spouse's social security number : : : : : : : : :	Home address (number and street). If you have a P.O. box, see page 12. 3497 Livingston St. N.E.		Apt. no.	City, town or post office, state, and ZIP code. If you have a foreign address, see page 12. Elgin, IL 60123															
Your first name and initial Nathan	Last name Ramsey	Your social security number 123 : 00 : 0123																										
If a joint return, spouse's first name and initial	Last name	Spouse's social security number : : : : : : : : :																										
Home address (number and street). If you have a P.O. box, see page 12. 3497 Livingston St. N.E.		Apt. no.																										
City, town or post office, state, and ZIP code. If you have a foreign address, see page 12. Elgin, IL 60123																												
<p>Label (See page 12.) Use the IRS label. Otherwise, please print or type.</p> <p>Presidential Election Campaign (page 12) ▶</p>	<p style="text-align: center;">▲ Important! ▲</p> <p style="text-align: center;">You must enter your SSN(s) above.</p>																											
	<p>Note. Checking "Yes" will not change your tax or reduce your refund. Do you, or your spouse if a joint return, want \$3 to go to this fund? ▶</p> <table style="width: 100%; border: none;"> <tr> <td style="text-align: center;">You</td> <td style="text-align: center;">Spouse</td> <td></td> </tr> <tr> <td style="text-align: center;"><input checked="" type="checkbox"/> Yes <input type="checkbox"/> No</td> <td style="text-align: center;"><input type="checkbox"/> Yes <input type="checkbox"/> No</td> <td></td> </tr> </table>			You	Spouse		<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No																				
You	Spouse																											
<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No																											
<p>Income Attach Form(s) W-2 here. Enclose, but do not attach, any payment.</p> <p>Note. You must check Yes or No. } Yes or No. }</p>	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 60%;">1 Total wages, salaries, and tips. This should be shown in box 1 of your W-2 form(s). Attach your W-2 form(s).</td> <td style="width: 10%; text-align: center;">1</td> <td style="width: 20%; text-align: right;">1,387</td> <td style="width: 10%; text-align: right;">00</td> </tr> <tr> <td>2 Taxable interest. If the total is over \$400, you cannot use Form 1040EZ.</td> <td style="text-align: center;">2</td> <td style="text-align: right;">37</td> <td style="text-align: right;">00</td> </tr> <tr> <td>3 Unemployment compensation and Alaska Permanent Fund dividends (see page 14).</td> <td style="text-align: center;">3</td> <td></td> <td></td> </tr> <tr> <td>4 Add lines 1, 2, and 3. This is your adjusted gross income.</td> <td style="text-align: center;">4</td> <td style="text-align: right;">1,424</td> <td style="text-align: right;">00</td> </tr> <tr> <td>5 Can your parents (or someone else) claim you on their return? Yes. Enter amount from worksheet on back. <input checked="" type="checkbox"/> No. If single, enter \$7,700. If married, enter \$13,850. See back for explanation. <input type="checkbox"/></td> <td style="text-align: center;">5</td> <td style="text-align: right;">1,637</td> <td style="text-align: right;">00</td> </tr> <tr> <td>6 Subtract line 5 from line 4. If line 5 is larger than line 4, enter -0-. This is your taxable income.</td> <td style="text-align: center;">6</td> <td style="text-align: right;">0</td> <td style="text-align: right;">00</td> </tr> </table>			1 Total wages, salaries, and tips. This should be shown in box 1 of your W-2 form(s). Attach your W-2 form(s).	1	1,387	00	2 Taxable interest. If the total is over \$400, you cannot use Form 1040EZ.	2	37	00	3 Unemployment compensation and Alaska Permanent Fund dividends (see page 14).	3			4 Add lines 1, 2, and 3. This is your adjusted gross income .	4	1,424	00	5 Can your parents (or someone else) claim you on their return? Yes. Enter amount from worksheet on back. <input checked="" type="checkbox"/> No. If single , enter \$7,700. If married , enter \$13,850. See back for explanation. <input type="checkbox"/>	5	1,637	00	6 Subtract line 5 from line 4. If line 5 is larger than line 4, enter -0-. This is your taxable income .	6	0	00	
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6 Subtract line 5 from line 4. If line 5 is larger than line 4, enter -0-. This is your taxable income .	6	0	00																									
<p>Payments and tax</p>	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 60%;">7 Federal income tax withheld from box 2 of your W-2 form(s).</td> <td style="width: 10%; text-align: center;">7</td> <td style="width: 20%; text-align: right;">4</td> <td style="width: 10%; text-align: right;">00</td> </tr> <tr> <td>8 Earned income credit (EIC).</td> <td style="text-align: center;">8</td> <td style="text-align: right;">0</td> <td style="text-align: right;">00</td> </tr> <tr> <td>9 Add lines 7 and 8. These are your total payments.</td> <td style="text-align: center;">9</td> <td style="text-align: right;">4</td> <td style="text-align: right;">00</td> </tr> <tr> <td>10 Tax. Use the amount on line 6 above to find your tax in the tax table on pages 24–28 of the booklet. Then, enter the tax from the table on this line.</td> <td style="text-align: center;">10</td> <td style="text-align: right;">0</td> <td style="text-align: right;">00</td> </tr> </table>			7 Federal income tax withheld from box 2 of your W-2 form(s).	7	4	00	8 Earned income credit (EIC).	8	0	00	9 Add lines 7 and 8. These are your total payments .	9	4	00	10 Tax. Use the amount on line 6 above to find your tax in the tax table on pages 24–28 of the booklet. Then, enter the tax from the table on this line.	10	0	00									
7 Federal income tax withheld from box 2 of your W-2 form(s).	7	4	00																									
8 Earned income credit (EIC).	8	0	00																									
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<p>Refund Have it directly deposited! See page 20 and fill in 11b, 11c, and 11d.</p>	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 60%;">11a If line 9 is larger than line 10, subtract line 10 from line 9. This is your refund.</td> <td style="width: 10%; text-align: center;">11a</td> <td style="width: 20%; text-align: right;">4</td> <td style="width: 10%; text-align: right;">00</td> </tr> <tr> <td colspan="4">▶ b Routing number <input style="width: 100px; height: 15px; border: 1px solid black;" type="text"/></td> </tr> <tr> <td colspan="4">▶ c Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings</td> </tr> <tr> <td colspan="4">▶ d Account number <input style="width: 100px; height: 15px; border: 1px solid black;" type="text"/></td> </tr> </table>			11a If line 9 is larger than line 10, subtract line 10 from line 9. This is your refund .	11a	4	00	▶ b Routing number <input style="width: 100px; height: 15px; border: 1px solid black;" type="text"/>				▶ c Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings				▶ d Account number <input style="width: 100px; height: 15px; border: 1px solid black;" type="text"/>												
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<p>Sign here Joint return? See page 11. Keep a copy for your records.</p>	<p>Under penalties of perjury, I declare that I have examined this return, and to the best of my knowledge and belief, it is true, correct, and accurately lists all amounts and sources of income I received during the tax year. Declaration of preparer (other than the taxpayer) is based on all information of which the preparer has any knowledge.</p> <table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 30%;">Your signature Nathan Ramsey</td> <td style="width: 10%;">Date 4/10/03</td> <td style="width: 30%;">Your occupation student</td> <td style="width: 30%;">Daytime phone number ()</td> </tr> <tr> <td colspan="2">Spouse's signature. If a joint return, both must sign.</td> <td>Spouse's occupation</td> <td style="background-color: #cccccc;"></td> </tr> </table>			Your signature Nathan Ramsey	Date 4/10/03	Your occupation student	Daytime phone number ()	Spouse's signature. If a joint return, both must sign.		Spouse's occupation																		
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<p>Paid preparer's use only</p>	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 40%;">Preparer's signature ▶ VITA Site 13B</td> <td style="width: 10%;">Date</td> <td style="width: 20%;">Check if self-employed <input type="checkbox"/></td> <td style="width: 30%;">Preparer's SSN or PTIN</td> </tr> <tr> <td>Firm's name (or yours if self-employed), address, and ZIP code ▶</td> <td>EIN</td> <td colspan="2">Phone no. ()</td> </tr> </table>			Preparer's signature ▶ VITA Site 13B	Date	Check if self-employed <input type="checkbox"/>	Preparer's SSN or PTIN	Firm's name (or yours if self-employed), address, and ZIP code ▶	EIN	Phone no. ()																		
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For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see page 23.		Cat. No. 11329W	Form 1040EZ (2002)																									

WAGE EARNER COMPREHENSIVE PROBLEMS ANSWERS TO PROBLEMS



Use this form if

- Your filing status is single or married filing jointly.
- You (and your spouse if married) were under 65 on January 1, 2003, and not blind at the end of 2002.
- You do not claim any dependents.
- Your taxable income (line 6) is less than \$50,000.
- You do not claim a deduction for educator expenses, student loan interest deduction, or tuition and fees deduction (see page 8).
- You do not claim an education credit.
- You had **only** wages, salaries, tips, taxable scholarship or fellowship grants, unemployment compensation, or Alaska Permanent Fund dividends, and your taxable interest was not over \$400. **But** if you earned tips, including allocated tips, that are not included in box 5 and box 7 of your W-2, you may not be able to use Form 1040EZ. See page 13. If you are planning to use Form 1040EZ for a child who received Alaska Permanent Fund dividends, see page 14.
- You did not receive any advance earned income credit payments.

If you are not sure about your filing status, see page 11. If you have questions about dependents, use TeleTax topic 354 (see page 6). If you **cannot use this form**, use TeleTax topic 352 (see page 6).

Filling in your return

For tips on how to avoid common mistakes, see page 30.

If you received a scholarship or fellowship grant or tax-exempt interest income, such as on municipal bonds, see the booklet before filling in the form. Also, see the booklet if you received a Form 1099-INT showing Federal income tax withheld or if Federal income tax was withheld from your unemployment compensation or Alaska Permanent Fund dividends.

Remember, you must report all wages, salaries, and tips even if you do not get a W-2 form from your employer. You must also report all your taxable interest, including interest from banks, savings and loans, credit unions, etc., even if you do not get a Form 1099-INT.

Worksheet for dependents who checked "Yes" on line 5

(keep a copy for your records)

Use this worksheet to figure the amount to enter on line 5 if someone can claim you (or your spouse if married) as a dependent, even if that person chooses not to do so. To find out if someone can claim you as a dependent, use TeleTax topic 354 (see page 6).

A. Amount, if any, from line 1 on front	1,387.00		
	+ 250.00	Enter total ▶	A. 1,637.00
B. Minimum standard deduction			B. 750.00
C. Enter the larger of line A or line B here			C. 1,637.00
D. Maximum standard deduction. If single , enter \$4,700; if married , enter \$7,850			D. 4,700.00
E. Enter the smaller of line C or line D here. This is your standard deduction			E. 1,637.00
F. Exemption amount.			F. _____
• If single, enter -0-.			
• If married and— —both you and your spouse can be claimed as dependents, enter -0-. —only one of you can be claimed as a dependent, enter \$3,000.			
G. Add lines E and F. Enter the total here and on line 5 on the front			G. 1,637.00

If you checked "No" on line 5 because no one can claim you (or your spouse if married) as a dependent, enter on line 5 the amount shown below that applies to you.

- Single, enter \$7,700. This is the total of your standard deduction (\$4,700) and your exemption (\$3,000).
- Married, enter \$13,850. This is the total of your standard deduction (\$7,850), your exemption (\$3,000), and your spouse's exemption (\$3,000).

Mailing return

Mail your return by **April 15, 2003**. Use the envelope that came with your booklet. If you do not have that envelope or if you moved during the year, see the back cover for the address to use.



WAGE EARNER COMPREHENSIVE PROBLEMS ANSWERS TO PROBLEMS

Problem 2

Form 1040EZ	Department of the Treasury—Internal Revenue Service Income Tax Return for Single and Joint Filers With No Dependents (99) 2002	OMB No. 1545-0675																								
Label (See page 12.) Use the IRS label. Otherwise, please print or type. Presidential Election Campaign (page 12)	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 30%; border-bottom: 1px solid black;">Your first name and initial Mary</td> <td style="width: 30%; border-bottom: 1px solid black;">Last name Duvall</td> <td style="width: 40%; border-bottom: 1px solid black;">Your social security number 000 00 1234</td> </tr> <tr> <td style="border-bottom: 1px solid black;">If a joint return, spouse's first name and initial</td> <td style="border-bottom: 1px solid black;">Last name</td> <td style="border-bottom: 1px solid black;">Spouse's social security number</td> </tr> <tr> <td colspan="2" style="border-bottom: 1px solid black;">Home address (number and street). If you have a P.O. box, see page 12. 46 Maple Lane</td> <td style="border-bottom: 1px solid black;">Apt. no.</td> </tr> <tr> <td colspan="3" style="border-bottom: 1px solid black;">City, town or post office, state, and ZIP code. If you have a foreign address, see page 12. Atlanta, GA 30365</td> </tr> </table>	Your first name and initial Mary	Last name Duvall	Your social security number 000 00 1234	If a joint return, spouse's first name and initial	Last name	Spouse's social security number	Home address (number and street). If you have a P.O. box, see page 12. 46 Maple Lane		Apt. no.	City, town or post office, state, and ZIP code. If you have a foreign address, see page 12. Atlanta, GA 30365			<p style="text-align: center;">▲ Important! ▲</p> <p style="text-align: center;">You must enter your SSN(s) above.</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 33%;"></td> <td style="width: 33%; text-align: center;">You</td> <td style="width: 33%; text-align: center;">Spouse</td> </tr> <tr> <td></td> <td style="text-align: center;"><input type="checkbox"/> Yes <input checked="" type="checkbox"/> No</td> <td style="text-align: center;"><input type="checkbox"/> Yes <input type="checkbox"/> No</td> </tr> </table>		You	Spouse		<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No						
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	You	Spouse																								
	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No																								
Income Attach Form(s) W-2 here. Enclose, but do not attach, any payment. Note. You must check Yes or No.	<p>Note. Checking "Yes" will not change your tax or reduce your refund. Do you, or your spouse if a joint return, want \$3 to go to this fund? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 60%; border-bottom: 1px solid black;">1 Total wages, salaries, and tips. This should be shown in box 1 of your W-2 form(s). Attach your W-2 form(s).</td> <td style="width: 10%; text-align: center; border-bottom: 1px solid black;">1</td> <td style="width: 20%; text-align: right; border-bottom: 1px solid black;">6,900</td> <td style="width: 10%; text-align: right; border-bottom: 1px solid black;">00</td> </tr> <tr> <td style="border-bottom: 1px solid black;">2 Taxable interest. If the total is over \$400, you cannot use Form 1040EZ.</td> <td style="text-align: center; border-bottom: 1px solid black;">2</td> <td style="border-bottom: 1px solid black;"></td> <td style="border-bottom: 1px solid black;"></td> </tr> <tr> <td style="border-bottom: 1px solid black;">3 Unemployment compensation and Alaska Permanent Fund dividends (see page 14).</td> <td style="text-align: center; border-bottom: 1px solid black;">3</td> <td style="text-align: right; border-bottom: 1px solid black;">950</td> <td style="text-align: right; border-bottom: 1px solid black;">00</td> </tr> <tr> <td style="border-bottom: 1px solid black;">4 Add lines 1, 2, and 3. This is your adjusted gross income.</td> <td style="text-align: center; border-bottom: 1px solid black;">4</td> <td style="text-align: right; border-bottom: 1px solid black;">7,850</td> <td style="text-align: right; border-bottom: 1px solid black;">00</td> </tr> <tr> <td style="border-bottom: 1px solid black;">5 Can your parents (or someone else) claim you on their return? Yes. Enter amount from worksheet on back. <input type="checkbox"/> No. If single, enter \$7,700. If married, enter \$13,850. See back for explanation. <input checked="" type="checkbox"/></td> <td style="text-align: center; border-bottom: 1px solid black;">5</td> <td style="text-align: right; border-bottom: 1px solid black;">7,700</td> <td style="text-align: right; border-bottom: 1px solid black;">00</td> </tr> <tr> <td style="border-bottom: 1px solid black;">6 Subtract line 5 from line 4. If line 5 is larger than line 4, enter -0-. This is your taxable income.</td> <td style="text-align: center; border-bottom: 1px solid black;">6</td> <td style="text-align: right; border-bottom: 1px solid black;">150</td> <td style="text-align: right; border-bottom: 1px solid black;">00</td> </tr> </table>	1 Total wages, salaries, and tips. This should be shown in box 1 of your W-2 form(s). Attach your W-2 form(s).	1	6,900	00	2 Taxable interest. If the total is over \$400, you cannot use Form 1040EZ.	2			3 Unemployment compensation and Alaska Permanent Fund dividends (see page 14).	3	950	00	4 Add lines 1, 2, and 3. This is your adjusted gross income .	4	7,850	00	5 Can your parents (or someone else) claim you on their return? Yes. Enter amount from worksheet on back. <input type="checkbox"/> No. If single , enter \$7,700. If married , enter \$13,850. See back for explanation. <input checked="" type="checkbox"/>	5	7,700	00	6 Subtract line 5 from line 4. If line 5 is larger than line 4, enter -0-. This is your taxable income .	6	150	00	
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Payments and tax	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 60%; border-bottom: 1px solid black;">7 Federal income tax withheld from box 2 of your W-2 form(s).</td> <td style="width: 10%; text-align: center; border-bottom: 1px solid black;">7</td> <td style="width: 20%; text-align: right; border-bottom: 1px solid black;">800</td> <td style="width: 10%; text-align: right; border-bottom: 1px solid black;">00</td> </tr> <tr> <td style="border-bottom: 1px solid black;">8 Earned income credit (EIC).</td> <td style="text-align: center; border-bottom: 1px solid black;">8</td> <td style="text-align: right; border-bottom: 1px solid black;">244</td> <td style="text-align: right; border-bottom: 1px solid black;">00</td> </tr> <tr> <td style="border-bottom: 1px solid black;">9 Add lines 7 and 8. These are your total payments.</td> <td style="text-align: center; border-bottom: 1px solid black;">9</td> <td style="text-align: right; border-bottom: 1px solid black;">1,044</td> <td style="text-align: right; border-bottom: 1px solid black;">00</td> </tr> <tr> <td style="border-bottom: 1px solid black;">10 Tax. Use the amount on line 6 above to find your tax in the tax table on pages 24–28 of the booklet. Then, enter the tax from the table on this line.</td> <td style="text-align: center; border-bottom: 1px solid black;">10</td> <td style="text-align: right; border-bottom: 1px solid black;">16</td> <td style="text-align: right; border-bottom: 1px solid black;">00</td> </tr> </table>	7 Federal income tax withheld from box 2 of your W-2 form(s).	7	800	00	8 Earned income credit (EIC).	8	244	00	9 Add lines 7 and 8. These are your total payments .	9	1,044	00	10 Tax. Use the amount on line 6 above to find your tax in the tax table on pages 24–28 of the booklet. Then, enter the tax from the table on this line.	10	16	00									
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Your signature Mary Duvall	Date 3/3/03	Your occupation Clerk	Daytime phone number ()																							
Spouse's signature. If a joint return, both must sign.	Date	Spouse's occupation	[Redacted]																							
Paid preparer's use only	Preparer's signature VITA Site 123	Date	Preparer's SSN or PTIN																							
Firm's name (or yours if self-employed), address, and ZIP code	EIN	Check if self-employed <input type="checkbox"/>	Phone no. ()																							

WAGE EARNER COMPREHENSIVE PROBLEMS

ANSWERS TO PROBLEMS

Complete this form.

Eligibility questions

Line 8 Earned Income Credit (EIC)

What Is the EIC?

The EIC is a credit for certain people who work. The credit may give you a refund even if you do not owe any tax.



If you have a qualifying child (see the next column on this page), you may be able to take the credit, but you must use Schedule EIC and Form 1040A or 1040 to do so. For details, see Pub. 596.

To Take the EIC:

- Follow the steps below.
- Complete the worksheet on page 19 or let the IRS figure the credit for you.

You Will Need:



If you take the EIC even though you are not eligible and it is determined that your error is due to reckless or intentional disregard of the EIC rules, you will not be allowed to take the credit for 2 years even if you are otherwise eligible to do so. If you fraudulently take the EIC, you will not be allowed to take the credit for 10 years. You may also have to pay penalties.

Step 1 All Filers

1. Is the amount on Form 1040EZ, line 4, less than \$11,060 (or \$12,060 if married filing jointly)?

Yes. *Continue* → **No.** You cannot take the credit.

2. Do you, and your spouse if filing a joint return, have a social security number that allows you to work or is valid for EIC purposes (see page 18)?

Yes. *Continue* → **No.** You cannot take the credit. Print "No" in the space to the left of line 8.

3. Can you, or your spouse if filing a joint return, be claimed as a dependent on someone else's 2002 tax return?

Yes. You cannot take the credit. **No.** *Continue* →

4. Were you, or your spouse if filing a joint return, at least age 25 but under age 65 at the end of 2002?

Yes. *Go to question 5.* **No.** You cannot take the credit. Enter "No" in the space to the left of line 8.

5. Was your home, and your spouse's if filing a joint return, in the United States for more than half of 2002? Members of the military stationed outside the United States, see page 17 before you answer.

Yes. *Continue* → **No.** You cannot take the credit. Enter "No" in the space to the left of line 8.

6. Look at the qualifying child conditions below. Could you, or your spouse if filing a joint return, be a qualifying child of another person in 2002?

Yes. You cannot take the credit. Enter "No" in the space to the left of line 8. **No.** *Go to Step 2 on page 18.* →

A qualifying child is a child who is—

Your son, daughter, adopted child, stepchild, or grandchild
or
Your brother, sister, stepbrother, stepsister or a descendant of your brother, sister, etc. (for example, your niece or nephew)
or

A foster child (any child placed with you by an authorized placement agency whom you cared for as your own child)

AND

was at the end of 2002...

Under age 19

or

Under age 24 and a student

or

Any age and permanently and totally disabled

AND

who...

Either lived with you in the United States for more than half of 2002 **or** was born or died in 2002 and your home was the child's home for the entire time he or she was alive in 2002.

Note. Special rules apply if the child was married or also meets the conditions to be a qualifying child of another person (other than your spouse if filing a joint return). For details, use TeleTax topic 601 (see page 8) or see Pub. 596.

(Continued on page 18)

WAGE EARNER COMPREHENSIVE PROBLEMS ANSWERS TO PROBLEMS

Complete this form.

Continued from page 17

Step 2 Earned Income

1. Figure earned income:
Form 1040EZ, line 1 6,900

Subtract, if included on line 1, any:

- Taxable scholarship or fellowship grant not reported on a W-2 form
- Amount paid to an inmate in a penal institution for work (enter "PRI" in the space to the left of line 1 of Form 1040EZ)
- Amount received as a pension or annuity from a nonqualified deferred compensation plan or a section 457 plan (enter "DFC" in the space to the left of line 1 of Form 1040EZ). This amount may be shown in box 11 of your W-2 form. If you received such an amount but box 11 is blank, contact your employer for the amount received as a pension or annuity.

0

Earned Income =

Box C	6,900
-------	-------

2. Is Box A less than \$11,060 (or \$12,060 if married filing jointly)?

Yes. Go to Step 3.

No.



You cannot take the credit.
Print "No" in the space to the left of line 8.

Step 3 How To Figure the Credit

1. Do you want the IRS to figure the credit for you?

Yes. See Credit Figured by the IRS on this page.

No. Go to the worksheet on page 19.

Definitions and Special Rules

(listed in alphabetical order)

Credit Figured by the IRS. To have the IRS figure the credit for you:

1. Enter "EIC" in the space to the left of line 8 of Form 1040EZ.
2. If your EIC for a year after 1996 was reduced or disallowed, see Form 8862, Who Must File, below.

Form 8862, Who Must File. You must file Form 8862 if your EIC for a year after 1996 was reduced or disallowed for any reason other than a math or clerical error. But do not file Form 8862 if, after your EIC was reduced or disallowed in an earlier year:

- You filed Form 8862 (or other documents) and your EIC was then allowed and
- Your EIC has not been reduced or disallowed again for any reason other than a math or clerical error.

Also, do not file Form 8862 or take the credit if it was determined that your error was due to reckless or intentional disregard of the EIC rules or fraud.

Members of the Military. If you were on extended active duty outside the United States, your home is considered to be in the United States during that duty period. Extended active duty is military duty ordered for an indefinite period or for a period of more than 90 days. Once you begin serving extended active duty, you are considered to be on extended active duty even if you serve fewer than 90 days.

Social Security Number (SSN). For purposes of taking the EIC, a valid SSN is a number issued by the Social Security Administration unless "Not Valid for Employment" is printed on the social security card and the number was issued solely to apply for or receive a Federally funded benefit.

To find out how to get an SSN, see page 14. If you will not have an SSN by April 15, 2003, see What if You Cannot File on Time? on page 11.

Welfare Benefits, Effect of Credit on. Any refund you receive as a result of taking the EIC will not be used to determine if you are eligible for the following programs, or how much you can receive from them. But if the refund you receive because the EIC is not spent within a certain period of time, it may count as an asset (or resource) and affect your eligibility.

- Temporary Assistance for Needy Families (TANF).
- Medicaid and supplemental security income (SSI).
- Food stamps and low-income housing.

(Continued on page 19)

WAGE EARNER COMPREHENSIVE PROBLEMS

ANSWERS TO PROBLEMS

Keep for Your Records



Earned Income Credit (EIC) Worksheet—Line 8

Part 1

All Filers

1. Enter your total earned income from Step 2, Box A, on page 18.

1	6,900
---	-------

2. Look up the amount on line 1 above in the EIC Table on page 20 to find the credit. Use the column for your filing status. Enter the credit here.

2	316
---	-----

If line 2 is zero,  You cannot take the credit. Enter "No" in the space to the left of line 8.

3. Enter the amount from Form 1040EZ, line 4.

3	7,850
---	-------

4. Are the amounts on lines 3 and 1 the same?

- Yes. Skip line 5; enter the amount from line 2 on line 6.
- No. Go to line 5.

Part 2

Filers Who Answered "No" on Line 4

5. Is the amount on line 3 less than \$6,150 (or \$7,150 if married filing jointly)?

- Yes. Leave line 5 blank; enter the amount from line 2 on line 6.
- No. Look up the amount on line 3 in the EIC Table on page 20 to find the credit. Use the column for your filing status. Enter the credit here.

5	244
---	-----

Look at the amounts on lines 5 and 2. Then, enter the **smaller** amount on line 6.

Part 3

Your Earned Income Credit

6. This is your earned income credit.

6	244
---	-----

Enter this amount on Form 1040EZ, line 8.



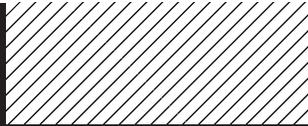
If your EIC for a year after 1996 was reduced or disallowed, see page 18 to find out if you must file Form 8862 to take the credit for 2002.

WAGE EARNER COMPREHENSIVE PROBLEMS ANSWERS TO PROBLEMS

Problem 3

Form 1040A	Department of the Treasury—Internal Revenue Service U.S. Individual Income Tax Return (99) 2002	IRS Use Only—Do not write or staple in this space.																																																												
Label (See page 19.) Use the IRS label. Otherwise, please print or type.	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 30%;"><small>Your first name and initial</small> Albert W.</td> <td style="width: 70%;"><small>Last name</small> Rowan</td> </tr> <tr> <td><small>If a joint return, spouse's first name and initial</small></td> <td><small>Last name</small></td> </tr> <tr> <td colspan="2"><small>Home address (number and street). If you have a P.O. box, see page 20.</small> 1515 Kingston Court</td> </tr> <tr> <td colspan="2"><small>City, town or post office, state, and ZIP code. If you have a foreign address, see page 20.</small> Charlotte, NC 28215</td> </tr> </table>	<small>Your first name and initial</small> Albert W.	<small>Last name</small> Rowan	<small>If a joint return, spouse's first name and initial</small>	<small>Last name</small>	<small>Home address (number and street). If you have a P.O. box, see page 20.</small> 1515 Kingston Court		<small>City, town or post office, state, and ZIP code. If you have a foreign address, see page 20.</small> Charlotte, NC 28215		<small>OMB No. 1545-0085</small> Your social security number 000 : 00 : 7698 Spouse's social security number ▲ Important! ▲ You must enter your SSN(s) above.																																																				
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Presidential Election Campaign (See page 20.)	Note. Checking "Yes" will not change your tax or reduce your refund. Do you, or your spouse if filing a joint return, want \$3 to go to this fund? . . .	<table style="width: 100%;"> <tr> <td style="width: 50%;">You</td> <td style="width: 50%;">Spouse</td> </tr> <tr> <td><input type="checkbox"/> Yes <input checked="" type="checkbox"/> No</td> <td><input type="checkbox"/> Yes <input type="checkbox"/> No</td> </tr> </table>	You	Spouse	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No																																																								
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Filing status <small>Check only one box.</small>	<table style="width: 100%;"> <tr> <td style="width: 50%; vertical-align: top;"> 1 <input type="checkbox"/> Single 2 <input type="checkbox"/> Married filing jointly (even if only one had income) 3 <input type="checkbox"/> Married filing separately. Enter spouse's SSN above and full name here. ▶ </td> <td style="width: 50%; vertical-align: top;"> 4 <input checked="" type="checkbox"/> Head of household (with qualifying person). (See page 21.) <small>If the qualifying person is a child but not your dependent, enter this child's name here. ▶</small> 5 <input type="checkbox"/> Qualifying widow(er) with dependent child (year spouse died ▶). (See page 22.) </td> </tr> </table>		1 <input type="checkbox"/> Single 2 <input type="checkbox"/> Married filing jointly (even if only one had income) 3 <input type="checkbox"/> Married filing separately. Enter spouse's SSN above and full name here. ▶	4 <input checked="" type="checkbox"/> Head of household (with qualifying person). (See page 21.) <small>If the qualifying person is a child but not your dependent, enter this child's name here. ▶</small> 5 <input type="checkbox"/> Qualifying widow(er) with dependent child (year spouse died ▶). (See page 22.)																																																										
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Exemptions <small>If more than six dependents, see page 22.</small>	<table style="width: 100%;"> <tr> <td style="width: 70%;"> 6a <input checked="" type="checkbox"/> Yourself. If your parent (or someone else) can claim you as a dependent on his or her tax return, do not check box 6a. </td> <td style="width: 30%; text-align: right;"> <small>No. of boxes checked on 6a and 6b</small> 1 </td> </tr> <tr> <td> b <input type="checkbox"/> Spouse </td> <td style="text-align: right;"> <small>No. of children on 6c who:</small> <input checked="" type="checkbox"/> lived with you <input type="checkbox"/> did not live with you due to divorce or separation (see page 24) </td> </tr> <tr> <td colspan="2"> c Dependents: </td> </tr> <tr> <td style="text-align: center;"> <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 20%;">(1) First name</th> <th style="width: 20%;">Last name</th> <th style="width: 20%;">(2) Dependent's social security number</th> <th style="width: 20%;">(3) Dependent's relationship to you</th> <th style="width: 20%;">(4) <input checked="" type="checkbox"/> if qualifying child for child tax credit (see page 23)</th> </tr> </thead> <tbody> <tr> <td>Derek K</td> <td>Rowan</td> <td>000 : 00 : 6568</td> <td>grandson</td> <td><input checked="" type="checkbox"/></td> </tr> <tr> <td> </td> <td> </td> <td> </td> <td> </td> <td><input type="checkbox"/></td> </tr> <tr> <td> </td> <td> </td> <td> </td> <td> </td> <td><input type="checkbox"/></td> </tr> <tr> <td> </td> <td> </td> <td> </td> <td> </td> <td><input type="checkbox"/></td> </tr> <tr> <td> </td> <td> </td> <td> </td> <td> </td> <td><input type="checkbox"/></td> </tr> </tbody> </table> </td> <td style="text-align: right;"> <small>Dependents on 6c not entered above</small> Add numbers on lines above </td> </tr> <tr> <td colspan="2" style="text-align: center;"> d Total number of exemptions claimed. </td> <td style="text-align: right; border: 1px solid black;"> <table style="width: 100%;"> <tr> <td style="border: 1px solid black; width: 80%;"></td> <td style="border: 1px solid black; text-align: center;">2</td> </tr> </table> </td> </tr> </table>		6a <input checked="" type="checkbox"/> Yourself. If your parent (or someone else) can claim you as a dependent on his or her tax return, do not check box 6a.	<small>No. of boxes checked on 6a and 6b</small> 1	b <input type="checkbox"/> Spouse	<small>No. of children on 6c who:</small> <input checked="" type="checkbox"/> lived with you <input type="checkbox"/> did not live with you due to divorce or separation (see page 24)	c Dependents:		<table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 20%;">(1) First name</th> <th style="width: 20%;">Last name</th> <th style="width: 20%;">(2) Dependent's social security number</th> <th style="width: 20%;">(3) Dependent's relationship to you</th> <th style="width: 20%;">(4) <input checked="" type="checkbox"/> if qualifying child for child tax credit (see page 23)</th> </tr> </thead> <tbody> <tr> <td>Derek K</td> <td>Rowan</td> <td>000 : 00 : 6568</td> <td>grandson</td> <td><input checked="" type="checkbox"/></td> </tr> <tr> <td> </td> <td> </td> <td> </td> <td> </td> <td><input type="checkbox"/></td> </tr> <tr> <td> </td> <td> </td> <td> </td> <td> </td> <td><input type="checkbox"/></td> </tr> <tr> <td> </td> <td> </td> <td> </td> <td> </td> <td><input type="checkbox"/></td> </tr> <tr> <td> </td> <td> </td> <td> </td> <td> </td> <td><input type="checkbox"/></td> </tr> </tbody> </table>	(1) First name	Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) <input checked="" type="checkbox"/> if qualifying child for child tax credit (see page 23)	Derek K	Rowan	000 : 00 : 6568	grandson	<input checked="" type="checkbox"/>					<input type="checkbox"/>					<input type="checkbox"/>					<input type="checkbox"/>					<input type="checkbox"/>	<small>Dependents on 6c not entered above</small> Add numbers on lines above	d Total number of exemptions claimed.		<table style="width: 100%;"> <tr> <td style="border: 1px solid black; width: 80%;"></td> <td style="border: 1px solid black; text-align: center;">2</td> </tr> </table>		2																	
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Income Attach Form(s) W-2 here. Also attach Form(s) 1099-R if tax was withheld. <small>If you did not get a W-2, see page 25.</small> <small>Enclose, but do not attach, any payment.</small>	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 60%;"> 7 Wages, salaries, tips, etc. Attach Form(s) W-2. </td> <td style="width: 20%; text-align: center;">7</td> <td style="width: 20%; text-align: right;">22,552 00</td> </tr> <tr> <td> 8a Taxable interest. Attach Schedule 1 if required. </td> <td style="text-align: center;">8a</td> <td></td> </tr> <tr> <td> b Tax-exempt interest. Do not include on line 8a. </td> <td style="text-align: center;">8b</td> <td></td> </tr> <tr> <td> 9 Ordinary dividends. Attach Schedule 1 if required. </td> <td style="text-align: center;">9</td> <td></td> </tr> <tr> <td> 10 Capital gain distributions (see page 25). </td> <td style="text-align: center;">10</td> <td></td> </tr> <tr> <td> 11a IRA distributions. </td> <td style="text-align: center;">11a</td> <td></td> </tr> <tr> <td> 11b Taxable amount (see page 25). </td> <td style="text-align: center;">11b</td> <td></td> </tr> <tr> <td> 12a Pensions and annuities. </td> <td style="text-align: center;">12a</td> <td></td> </tr> <tr> <td> 12b Taxable amount (see page 26). </td> <td style="text-align: center;">12b</td> <td></td> </tr> <tr> <td> 13 Unemployment compensation and Alaska Permanent Fund dividends. </td> <td style="text-align: center;">13</td> <td></td> </tr> <tr> <td> 14a Social security benefits. </td> <td style="text-align: center;">14a</td> <td></td> </tr> <tr> <td> 14b Taxable amount (see page 28). </td> <td style="text-align: center;">14b</td> <td></td> </tr> <tr> <td> 15 Add lines 7 through 14b (far right column). This is your total income. ▶ </td> <td style="text-align: center;">15</td> <td style="text-align: right;">22,552 00</td> </tr> <tr> <td> Adjusted gross income </td> <td></td> <td></td> </tr> <tr> <td> 16 Educator expenses (see page XX). </td> <td style="text-align: center;">16</td> <td></td> </tr> <tr> <td> 17 IRA deduction (see page 28). </td> <td style="text-align: center;">17</td> <td></td> </tr> <tr> <td> 18 Student loan interest deduction (see page 31). </td> <td style="text-align: center;">18</td> <td></td> </tr> <tr> <td> 19 Tuition and fees deduction (see page XX). </td> <td style="text-align: center;">19</td> <td></td> </tr> <tr> <td> 20 Add lines 16 through 19. These are your total adjustments. </td> <td style="text-align: center;">20</td> <td></td> </tr> <tr> <td> 21 Subtract line 20 from line 15. This is your adjusted gross income. ▶ </td> <td style="text-align: center;">21</td> <td style="text-align: right;">22,552 00</td> </tr> </table>		7 Wages, salaries, tips, etc. Attach Form(s) W-2.	7	22,552 00	8a Taxable interest. Attach Schedule 1 if required.	8a		b Tax-exempt interest. Do not include on line 8a.	8b		9 Ordinary dividends. Attach Schedule 1 if required.	9		10 Capital gain distributions (see page 25).	10		11a IRA distributions.	11a		11b Taxable amount (see page 25).	11b		12a Pensions and annuities.	12a		12b Taxable amount (see page 26).	12b		13 Unemployment compensation and Alaska Permanent Fund dividends.	13		14a Social security benefits.	14a		14b Taxable amount (see page 28).	14b		15 Add lines 7 through 14b (far right column). This is your total income . ▶	15	22,552 00	Adjusted gross income			16 Educator expenses (see page XX).	16		17 IRA deduction (see page 28).	17		18 Student loan interest deduction (see page 31).	18		19 Tuition and fees deduction (see page XX).	19		20 Add lines 16 through 19. These are your total adjustments .	20		21 Subtract line 20 from line 15. This is your adjusted gross income . ▶	21	22,552 00
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<small>Cat. No. 11327A</small>	<small>Form 1040A (2002)</small>																																																													

WAGE EARNER COMPREHENSIVE PROBLEMS ANSWERS TO PROBLEMS



Form 1040A (2002)

Page 2

Tax, credits, and payments	22 Enter the amount from line 21 (adjusted gross income).	22	22,552	00
	23a Check <input type="checkbox"/> You were 65 or older <input type="checkbox"/> Blind } Enter number of boxes checked ▶ 23a <input type="checkbox"/> if: <input type="checkbox"/> Spouse was 65 or older <input type="checkbox"/> Blind }			
	b If you are married filing separately and your spouse itemizes deductions, see page 32 and check here ▶ 23b <input type="checkbox"/>			
Standard Deduction for— • People who checked any box on line 23a or 23b or who can be claimed as a dependent, see page 33. • All others: Single, \$4,700 Head of household, \$6,900 Married filing jointly or Qualifying widow(er), \$7,850 Married filing separately, \$3,925	24 Enter your standard deduction (see left margin).	24	6,900	00
	25 Subtract line 24 from line 22. If line 24 is more than line 22, enter -0-.	25	15,652	00
	26 Multiply \$3,000 by the total number of exemptions claimed on line 6d.	26	6,000	00
	27 Subtract line 26 from line 25. If line 26 is more than line 25, enter -0-. This is your taxable income . ▶	27	9,652	00
	28 Tax, including any alternative minimum tax (see page 33).	28	968	00
	29 Credit for child and dependent care expenses. Attach Schedule 2.	29	345	00
	30 Credit for the elderly or the disabled. Attach Schedule 3.	30		
	31 Education credits. Attach Form 8863.	31		
	32 Retirement savings contributions credit. Attach Form 8880.	32		
	33 Child tax credit (see page 36).	33	600	00
	34 Adoption credit. Attach Form 8839.	34		
	35 Add lines 29 through 34. These are your total credits .	35	945	00
	36 Subtract line 35 from line 28. If line 35 is more than line 28, enter -0-.	36	23	00
	37 Advance earned income credit payments from Form(s) W-2.	37	360	00
	38 Add lines 36 and 37. This is your total tax . ▶	38	383	00
	39 Federal income tax withheld from Forms W-2 and 1099.	39	1,850	00
	40 2002 estimated tax payments and amount applied from 2001 return.	40		
	41 Earned income credit (EIC) .	41	1,059	00
	42 Additional child tax credit. Attach Form 8812.	42		
	43 Add lines 39 through 42. These are your total payments . ▶	43	2,909	00
	44 If line 43 is more than line 38, subtract line 38 from line 43. This is the amount you overpaid .	44	2,526	00
	45a Amount of line 44 you want refunded to you . ▶	45a	2,526	00
	b Routing number <input type="text" value="320360036"/> ▶ c Type: <input checked="" type="checkbox"/> Checking <input type="checkbox"/> Savings			
	d Account number <input type="text" value="40403075"/>			
	46 Amount of line 44 you want applied to your 2003 estimated tax .	46		
	47 Amount you owe . Subtract line 43 from line 38. For details on how to pay, see page 48. ▶	47		
	48 Estimated tax penalty (see page 48).	48		
	Do you want to allow another person to discuss this return with the IRS (see page 49)? <input type="checkbox"/> Yes . Complete the following. <input type="checkbox"/> No			
	Designee's name ▶	Phone no. ▶ ()	Personal identification number (PIN) ▶	
	Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and accurately list all amounts and sources of income I received during the tax year. Declaration of preparer (other than the taxpayer) is based on all information of which the preparer has any knowledge.			
	Your signature Albert W. Rowan	Date 1/24/2003	Your occupation Security Officer	Daytime phone number ()
	Spouse's signature. If a joint return, both must sign.		Date	Spouse's occupation
	Preparer's signature ▶ VITA Site #500		Date 1/24/03	Check if self-employed <input type="checkbox"/>
	Firm's name (or yours if self-employed), address, and ZIP code ▶		EIN	Preparer's SSN or PTIN
			Phone no. ()	

Printed on recycled paper

Form 1040A (2002)

WAGE EARNER COMPREHENSIVE PROBLEMS ANSWERS TO PROBLEMS

2002 Schedule 2

Schedule 2
(Form 1040A)

Department of the Treasury—Internal Revenue Service

Child and Dependent Care Expenses for Form 1040A Filers (99) **2002**

OMB No. 1545-0085

Name(s) shown on Form 1040A: Albert W. Rowan Your social security number: 000 : 00 : 7698

Before you begin: You need to understand the following terms. See **Definitions** on page 1 of the separate instructions.

- **Dependent Care Benefits** • **Qualifying Person(s)** • **Qualified Expenses** • **Earned Income**

Part I

Persons or organizations who provided the care

	(a) Care provider's name	(b) Address (number, street, apt. no., city, state, and ZIP code)	(c) Identifying number (SSN or EIN)	(d) Amount paid (see instructions)
1	Maude Lee Child Care Center	551 Cower St Charlotte, NC 28215	10-9963246	1,500 00

(If you need more space, use the bottom of page 2.)

You **must** complete this part.

<div style="border: 1px solid black; padding: 5px; display: inline-block;"> Did you receive dependent care benefits? </div>	No	→ Complete only Part II below.
	Yes	→ Complete Part III on the back next.

Caution. If the care was provided in your home, you may owe employment taxes. If you do, you must use Form 1040. See **Schedule H** and its instructions for details.

Part II

Credit for child and dependent care expenses

2 Information about your **qualifying person(s)**. If you have more than two qualifying persons, see the instructions.

	(a) Qualifying person's name		(b) Qualifying person's social security number	(c) Qualified expenses you incurred and paid in 2002 for the person listed in column (a)	
	First	Last			
3	Derek	Rowan	000 00 6568	1,500	00

3 Add the amounts in column (c) of line 2. **Do not** enter more than \$2,400 for one qualifying person or \$4,800 for two or more persons. If you completed Part III, enter the amount from line 26. 3 1,500 00

4 Enter your **earned income**. 4 22,552 00

5 If married filing a joint return, enter your spouse's earned income (if your spouse was a student or was disabled, see the instructions); **all others**, enter the amount from line 4. 5 22,552 00

6 Enter the **smallest** of line 3, 4, or 5. 6 1,500 00

7 Enter the amount from Form 1040A, line 22. 7 22,552 00

8 Enter on line 8 the decimal amount shown below that applies to the amount on line 7.

If line 7 is:			If line 7 is:		
Over	But not over	Decimal amount is	Over	But not over	Decimal amount is
\$0—10,000		.30	\$20,000—22,000		.24
10,000—12,000		.29	22,000—24,000		.23
12,000—14,000		.28	24,000—26,000		.22
14,000—16,000		.27	26,000—28,000		.21
16,000—18,000		.26	28,000—No limit		.20
18,000—20,000		.25			

8 × .23

9 Multiply **line 6** by the decimal amount on line 8. If you paid 2001 expenses in 2002, see the instructions. 9 345 00

10 Enter the amount from Form 1040A, line 28. 10 968 00

11 Credit for child and dependent care expenses. Enter the **smaller** of line 9 or line 10 here and on Form 1040A, line 29. 11 345 00

For Paperwork Reduction Act Notice, see Form 1040A instructions.

Cat. No. 10749I

Schedule 2 (Form 1040A) 2002

WAGE EARNER COMPREHENSIVE PROBLEMS

ANSWERS TO PROBLEMS

Form 1040A Child Tax Credit Worksheet

Child Tax Credit Worksheet—Line 33

Keep for Your Records



Do not use this worksheet if you answered “Yes” to question 1 or 2 on page 38. Instead, use Pub. 972.



1. Number of qualifying children: 1 × \$600. Enter the result.

1	600
---	-----

2. Enter the amount from Form 1040A, line 28.

2	968
---	-----

3. Add the amounts from Form 1040A:

Line 29 345

Line 30 + _____

Line 31 + _____

Line 32 + _____ Enter the total.

3	345
---	-----

4. Are the amounts on lines 2 and 3 the same?

Yes.

You cannot take this credit because there is no tax to reduce. However, see the **TIP** below before completing the rest of your Form 1040A.

No. Subtract line 3 from line 2.

4	623
---	-----

5. Is the amount on line 1 more than the amount on line 4?

Yes. Enter the amount from line 4. Also, see the **TIP** below.

No. Enter the amount from line 1.

This is your child tax credit.

5	600
---	-----

Enter this amount on Form 1040A, line 33.



You may be able to take the **additional child tax credit** on Form 1040A, line 42, if you answered “Yes” on line 4 or line 5 above.

- First, complete your Form 1040A through line 41.
- Then, use Form 8812 to figure any additional child tax credit.

WAGE EARNER COMPREHENSIVE PROBLEMS

ANSWERS TO PROBLEMS

Complete this form.

Form 1040A EIC Worksheet

Line 41— Earned Income Credit (EIC)

What Is the EIC?

The EIC is a credit for certain people who work. The credit may give you a refund even if you do not owe any tax.

To Take the EIC:

- Follow the steps below.
- Complete the worksheet that applies to you **or** let the IRS figure the credit for you.
- If you have a qualifying child, complete and attach Schedule EIC.



If you take the EIC even though you are not eligible and it is determined that your error is due to reckless or intentional disregard of the EIC rules, you will not be allowed to take the credit for 2 years even if you are otherwise eligible to do so. If you fraudulently take the EIC, you will not be allowed to take the credit for 10 years. You may also have to pay penalties.

Step 1 All Filers

- If, in 2002:
 - 2 children lived with you, is the amount on Form 1040A, line 22, less than \$33,178 (or \$34,178 if married filing jointly)?
 - 1 child lived with you, is the amount on Form 1040A, line 22, less than \$29,201 (\$30,201 if married filing jointly)?
 - No children live with you, is the amount on Form 1040A, line 22, less than \$11,060 (or \$12,060 if married filing jointly)?

Yes. *Continue* → **No.** You cannot take the credit.
- Do you, and your spouse if filing a joint return, have a social security number that allows you to work or is valid for EIC purposes (see page 44)?

Yes. *Continue* → **No.** You cannot take the credit.
Put "No" to the left of the entry space for line 41.
- Is your filing status married filing separately?

Yes. You cannot take the credit. **No.** *Continue* →
- Were you a nonresident alien for any part of 2002?

Yes. *See Nonresident Aliens on page 44.* **No.** *Go to Step 2.*

Step 2 Investment Income

- Add the amounts from Form 1040A:

Line 8a	_____	0	
Line 8b	+ _____	0	
Line 9	+ _____	0	
Line 10	+ _____	0	

Investment Income = 0

- Is your investment income more than \$2,550?

Yes. You cannot take the credit. **No.** *Continue* →
- Did a child live with you in 2002?

Yes. *Go to Step 3.* **No.** *Go to Step 4 on page 42.*

(Continued on page 42)

WAGE EARNER COMPREHENSIVE PROBLEMS ANSWERS TO PROBLEMS

Complete this form.

Form 1040A EIC Worksheet

Continued from page 41

Step 3 Qualifying Child

A qualifying child is a child who is...

Your son, daughter, adopted child, stepchild, or grandchild

or

Your brother, sister, stepbrother, or stepsister, or a descendant of your brother, sister, etc. (for example, your niece or nephew), whom you cared for as your own child

or

A foster child (any child placed with you by an authorized placement agency whom you cared for as your own child)

If the child was married, see page 42.

AND

was at the end of 2002...

Under age 19

or

Under age 24 and a student (see page 44)

or

Any age and permanently and totally disabled (see page 44)

AND

who...

Lived with you in the United States for more than half of 2002. If the child did not live with you for the required time, see Exception to "Time Lived With You" Condition on page 44.

Note. If the child was married, see page 44.

1. Look at the qualifying child conditions above. Could you, or your spouse if filing a joint return, be a qualifying child of another person in 2002?

Yes.  You cannot take the credit. Put "No" to the left of the entry space for line 41.

No. Continue →

2. Do you have at least one child who meets the above conditions to be your qualifying child?

Yes. Continue →

No. Skip question 3; go to Step 4, question 2.

3. Does the child meet the conditions to be a qualifying child of any other person (other than your spouse if filing a joint return) for 2002?

Yes. See *Qualifying Child of More Than One Person* on page 44.

No. This child is your qualifying child. The child must have a social security number as defined on page 44 unless the child was born and died in 2002. Skip Step 4; go to Step 5 on page 43.

Step 4 Filers Without a Qualifying Child

1. Look at the qualifying child conditions in Step 3. Could you, or your spouse if filing a joint return, be a qualifying child of another person in 2002?

Yes.  You cannot take the credit. Put "No" to the left of the entry space for line 41.

No. Continue →

2. Can you, or your spouse if filing a joint return, be claimed as a dependent on someone else's 2002 tax return?

Yes.  You cannot take the credit.

No. Continue →

3. Were you, or your spouse if filing a joint return, at least age 25 but under age 65 at the end of 2002?

Yes. Continue →

No.  You cannot take the credit. Put "No" to the left of the entry space for line 41.

4. Was your home, and your spouse's if filing a joint return, in the United States for more than half of 2002? Members of the military stationed outside the United States, see page 44 before you answer.

Yes. Go to Step 5 on page 43.

No.  You cannot take the credit. Put "No" to the left of the entry space for line 41.

(Continued on page 41)

WAGE EARNER COMPREHENSIVE PROBLEMS

ANSWERS TO PROBLEMS

Complete this form.

Form 1040A EIC Worksheet

Continued from page 42

Step 5 Earned Income

1. Figure earned income:

Form 1040A, line 7 \$22,552

Subtract, if included on line 7, any:

- Taxable scholarship or fellowship grant not reported on a W-2 form
- Amount paid to an inmate in a penal institution for work (put "PRI" and the amount subtracted to the left of the entry space for line 7 of Form 1040A)
- Amount received as a pension or annuity from a nonqualified deferred compensation plan or a nongovernmental section 457 plan (put "DFC" and the amount subtracted to the left of the entry space for line 7 of Form 1040A). This amount may be shown in box 11 of your W-2 form. If you received such an amount but box 11 is blank, contact your employer for the amount received as a pension or annuity.

— 0

Taxable Earned Income = **\$22,552**

Go to Step 6.

2. If you have:

- 2 or more qualifying children, is your earned income less than \$33,178 (\$34,178 if married filing jointly)?
- 1 qualifying child, is your earned income less than \$29,201 (\$30,201 if married filing jointly)?
- No qualifying children, is your earned income less than \$11,060 (\$12,060 if married filing jointly)?

Yes. *Go to Step 6.*

No.



You cannot take the credit.

Step 6 How To Figure the Credit

1. Do you want the IRS to figure the credit for you?

Yes. *See Credit Figured by the IRS below.*

No. *Go to the worksheet on page 44.*

Definitions and Special Rules (listed in alphabetical order)

Adopted Child. Any child placed with you by an authorized placement agency for legal adoption. An authorized placement agency includes any person authorized by state law to place children for legal adoption. The adoption does not have to be final.

Credit Figured by the IRS. To have the IRS figure the credit for you:

1. Put "EIC" to the left of the entry space for line 41 of Form 1040A.
2. If you have a qualifying child, complete and attach Schedule EIC. If your EIC for a year after 1996 was reduced or disallowed, see Form 8862, Who Must File, on page 44.

Exception to "Time Lived With You" Condition. A child is considered to have lived with you for all of 2002 if the child was born or died in 2002 and your home was this child's home for the entire time he or she was alive in 2002. Temporary absences, such as for school, vacation, medical care, or detention in a juvenile facility, count as time lived at home. If your child is presumed to have been kidnapped by someone who is not a family member, see Pub. 596 to find out if that child is a qualifying child for the EIC. To get Pub. 596, see page 9. If you were in the military stationed outside the United States, see Members of the Military below.

Form 8862, Who Must File. You must file Form 8862 if your EIC for a year after 1996 was reduced or disallowed for any reason other than a math or clerical error. But do not file Form 8862 if, after your EIC was reduced or disallowed in an earlier year:

- You filed Form 8862 (or other documents) and your EIC was then allowed and
- Your EIC has not been reduced or disallowed again for any reason other than a math or clerical error.

Also, do not file Form 8862 or take the credit if it was determined that your error was due to reckless or intentional disregard of the EIC rules or fraud.

WAGE EARNER COMPREHENSIVE PROBLEMS ANSWERS TO PROBLEMS

Earned Income Credit (EIC) Worksheet—Line 41

Keep for Your Records



Part 1

All Filers

1. Enter your earned income from Step 5, on page 43.

1	22,552
---	--------

2. Look up the amount on line 1 above in the EIC Table on pages 46–51 to find the credit. Be sure you use the correct column for your filing status and the number of children you have. Enter the credit here.

2	1,059
---	-------

If line 2 is zero, You cannot take the credit. Put "No" to the left of the entry space for line 41.

3. Enter the amount from Form 1040A, line 22.

3	22,552
---	--------

4. Are the amounts on lines 3 and 1 the same?

Yes. Skip line 5; enter the amount from line 2 on line 6.

No. Go to line 5.

Part 2

Filers Who Answered "No" on Line 4

5. If you have:

- No qualifying children, is the amount on line 3 less than \$6,150 (or \$7,150 if married filing jointly)?

- 1 or more qualifying children, is the amount on line 3 less than \$13,520 (\$14,520 if married filing jointly)?

Yes. Leave line 5 blank; enter the amount from line 2 on line 6.

No. Look up the amount on line 3 in the EIC Table on pages 46–51 to find the credit. Be sure you use the correct column for your filing status and the number of children you have. Enter the credit here.

Look at the amounts on lines 5 and 2. Then, enter the **smaller** amount on line 6.

5	
---	--

Part 3

Your Earned Income Credit

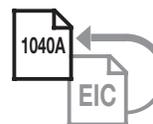
6. This is your earned income credit.

6	1,059
---	-------

Enter this amount on Form 1040A, line 41.

Reminder—

✓ If you have a qualifying child, complete and attach Schedule EIC.



If your EIC for a year after 1996 was reduced or disallowed, see page 44 to find out if you must file Form 8862 to take the credit for 2002.

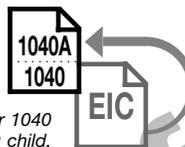
WAGE EARNER COMPREHENSIVE PROBLEMS ANSWERS TO PROBLEMS

2001 Schedule EIC

SCHEDULE EIC
(Form 1040A or 1040)

Earned Income Credit

Qualifying Child Information



OMB No. 1545-0074

2002

Attachment
Sequence No. **43**

Department of the Treasury
Internal Revenue Service (99)

Complete and attach to Form 1040A or 1040
only if you have a qualifying child.

Name(s) shown on return

Albert W. Rowan

Your social security number

000 00 7698

Before you begin: See the instructions for Form 1040A, line 41, or Form 1040, line 64, to make sure that
(a) you can take the EIC and (b) you have a qualifying child.



- If you take the EIC even though you are not eligible, you may not be allowed to take the credit for up to 10 years. See back of schedule for details.
- It will take us longer to process your return and issue your refund if you do not fill in all lines that apply for each qualifying child.
- Be sure the child's name on line 1 and social security number (SSN) on line 2 agree with the child's social security card. Otherwise, at the time we process your return, we may reduce or disallow your EIC. If the name or SSN on the child's social security card is not correct, call the Social Security Administration at 1-800-772-1213.

Qualifying Child Information

Child 1

Child 2

1 Child's name

If you have more than two qualifying children, you only have to list two to get the maximum credit.

First name	Last name	First name	Last name
Derek K.	Rowan		

2 Child's SSN

The child must have an SSN as defined on page 42 of the Form 1040A instructions or page 44 of the Form 1040 instructions unless the child was born and died in 2002. If your child was born and died in 2002 and did not have an SSN, enter "Died" on this line and attach a copy of the child's birth certificate.

000 00 6568

3 Child's year of birth

Year 1 9 9 4
If born after 1983, skip lines 4a and 4b; go to line 5.

Year _____
If born after 1983, skip lines 4a and 4b; go to line 5.

4 If the child was born before 1984—

a Was the child under age 24 at the end of 2002 and a student?

Yes. No.
Go to line 5. Continue

Yes. No.
Go to line 5. Continue

b Was the child permanently and totally disabled during any part of 2002?

Yes. No.
Continue The child is not a qualifying child.

Yes. No.
Continue The child is not a qualifying child.

5 Child's relationship to you

(for example, son, daughter, grandchild, foster child, etc.)

Grandson

6 Number of months child lived with you in the United States during 2002

- If the child lived with you for more than half of 2002 but less than 7 months, enter "7".
- If the child was born or died in 2002 and your home was the child's home for the entire time he or she was alive during 2002, enter "12".

12 months
Do not enter more than 12 months.

_____ months
Do not enter more than 12 months.



You may also be able to take the additional child tax credit if your child (a) was under age 17 at the end of 2002, (b) is claimed as your dependent on line 6c of Form 1040A or Form 1040, and (c) is a U.S. citizen or resident alien. For more details, see the instructions for line 42 of Form 1040A or line 66 of Form 1040.

For Paperwork Reduction Act Notice, see Form 1040A or 1040 instructions.

Cat. No. 13339M

Schedule EIC (Form 1040A or 1040) 2002

OBJECTIVES

After completing this lesson you should be able to:

- Identify the items that affect the basis of a stock.
- Determine if a stock's holding period is long term or short term.
- Determine when and how to report commissions from sale of stock on Schedule D.
- Calculate the amount of the qualified 5-year gain.
- Calculate the taxable gain or deductible loss using Schedule D.
- Calculate the tax liability using Part IV of Schedule D.
- Calculate the amount of capital loss carryover using the capital loss carryover worksheet.

What You Will Need

In order for you to complete Schedule D, the taxpayer will need to show you his or her records, including information returns he or she receives that are also forwarded to IRS.

- Form 1099-B, *Proceeds From Broker and Barter Exchange Transactions*, which the broker gives the taxpayer to report the sale price of stock.
- The taxpayer's records of his or her basis in the stock sold. Basis is explained in this lesson.
- The taxpayer's records of the date he or she originally acquired the stock.
- Form 1099-DIV, *Dividends and Distributions*, if the taxpayer received capital gain distributions (for example, from a mutual fund).
- The taxpayer's *Capital Loss Carryover Worksheet* from last year's Schedule D instructions if the taxpayer is carrying over a loss to 2002.

The taxpayer should not file these items with the return, but keep them with his or her records. The Internal Revenue Service (IRS) already receives copies of Form 1099-B from the broker and copies of Form 1099-DIV from the payer.

TAX TIPS

★★★★★★★★★★
If the taxpayer elected to recognize gain on an asset held on January 1, 2002 his or her basis in the asset is its closing market price or fair market value whichever applies, on the date of the deemed sale whether the deemed sale resulted in a gain or an unallowed loss. Taxpayers in this situation should use a paid professional preparer.

ALERT



Reporting capital gain distributions is simplified for 2002. Schedule D generally is not needed for taxpayers who received capital gain distributions from mutual funds but did not sell any shares of stock and do not have any Forms 1099-B as explained in Lesson 3, *Income*. Instead, report the total capital gain distribution on Form 1040, line 13, or on Form 1040A, line 10. If the taxpayer must file Form 1040, remember to check the box next to line 13 of Form 1040 to indicate that Schedule D is not required. If the taxpayer sold stocks, he or she must file Form 1040 and cannot report capital gain distributions on Form 1040A.

Capital Asset

A **capital asset** is any asset held either for personal use or for investment. Thus, all your items of personal property, such as your home and car, are capital assets. Property held for investment includes stocks and bonds. Property used in a trade or business, such as inventory or machinery, is not a capital asset.

In this lesson, corporate stock is the only capital asset discussed. **Capital gain distributions** are also discussed. They are recognized when the entity (such as a mutual fund) that owned a capital asset disposes of it and passes gain through to its shareholders. The discussion of capital gain distributions in this lesson supplements what you previously learned in Lesson 3.

Basis

The **basis** of property is usually its cost. Certain additional costs relating to its purchase are included in the basis of a capital asset. An example of an expense to include in the basis of stock is the commission or fee paid to a broker when stock is purchased.

If the taxpayer is not able to provide his or her basis in the property, the IRS will deem it to be zero. The taxpayer should make every effort to determine the basis. Refer taxpayers to their stockbroker or financial planner for assistance in determining basis. Once the taxpayer has the basis, volunteers may assist in preparing the tax return.

Adjusted Basis

Events after purchase can require adjustments to the basis of stock. The term **adjusted basis** refers to the basis after changes are made. For example, when a stock dividend or stock split is declared, the stockholder receives additional shares of stock. Some of the basis from the original stock is then allocated to the new stock. This change reduces the basis per share of the original shares.

Example 1

Fran paid \$1,100 for 100 shares of ABC, Inc. stock (including the broker's commission of \$25). Fran received 10 additional shares of ABC stock as a tax-free stock dividend. Her \$1,100 basis must be spread over 110 shares (100 original shares plus the 10-share stock dividend). Her basis per share decreases from \$11 to \$10 per share.

Holding Period

Long-term or short-term. Capital gains and losses are classified as either "long-term" or "short-term," depending on how long the taxpayer owned the stock. Stock held for more than one year (12 months) has a long-term holding period. Stock held for one year or less has a short-term holding period.

Example 2

Loretta bought stock on January 11, 2001 (trade date). Her holding period began the next day, January 12. If she sells that stock on January 11, 2002, she will not have owned them for more than a year. The holding period will be short-term. However, if she sells the stock on January 12, 2002, or later, the holding period will be long-term.

Blocks. Frequently, a taxpayer owns shares of stock that were bought on different dates or for different prices. That is, the individual owns more than one block of stock. Each block may differ from the others in its holding period (long-term or short-term), its basis (amount paid for the stock), or both.

In directing a broker to sell stock, the taxpayer may specify which block, or part of a block, to sell. Specification can make a difference in determining the holding period or basis of the stock sold, giving the taxpayer an element of control and versatility in handling an investment. To be valid, any such specification must be made before or at the time of sale. It cannot be made after the sale. If the taxpayer does not identify the specific block at the time of sale, shares sold are treated as coming from the earliest block purchased.

TAX TIPS

★★★★★★★★★
The adjusted basis of a stock is usually its cost plus any brokers' commissions. If you are not certain, ask the taxpayer about any commissions on the purchase.

TAX TIPS

★★★★★★★★★
To find out how long the taxpayer has held the stocks, begin counting on the day *after the day* he or she bought the shares of stock and include the day the shares are sold. This sale trade date is part of the holding period.

POTENTIAL PITFALLS



Stock splits and stock dividends do not occur often. However, do not assume that they never happen. Ask taxpayers if they received any additional shares from a stock split or stock dividend.

POTENTIAL PITFALLS



The specific selection of the block of stock must be made when the broker is directed to sell the stock, not after the fact.

POTENTIAL PITFALLS



Shares from a stock dividend may or may not have the same holding period as the original shares.

Example 3

In 1996, Tina bought 100 shares of Acme Corporation stock for \$2,000. In 1997 she bought another 100 shares of Acme for \$2,300. In 2002, Tina sold 100 shares of Acme for \$3,000.

The adjusted basis of the shares sold is \$2,000. However, if Tina had told her broker to sell the 100 shares bought in 1997, the adjusted basis of the shares sold would have been \$2,300, reducing her profit (and any taxable amount) on the sale.

Tax-free stock dividends and stock splits. Stock acquired in a tax-free stock dividend or stock split has the same holding period as the original stock owned. Thus, if the original stock has a long-term holding period, stock received in a tax-free stock dividend also has a long-term holding period. Similarly, if the original stock has a holding period of three months, the new stock immediately has a three-month holding period.

Example 4

On February 18, 1999, Wallace bought 500 shares of XYZ Corporation stock for \$1,500, including his broker's commission. XYZ distributed a two-percent stock dividend on April 6, 2002. On April 9, 2002, Wallace sold all his XYZ stock for \$2,030. He has a long-term capital gain of \$530 on the sale of his stock. Although he owned the 10 shares he received as a tax-free stock dividend for only three days, all the stock has a long-term holding period.

Taxable dividends. There are several types of taxable dividends, as discussed in Lesson 3. A taxpayer who participates in a dividend reinvestment plan (one type of taxable dividend) will use the dividends to purchase more shares of the stock. The stocks acquired (including fractional shares) through the dividend reinvestment plan are added to the taxpayer's basis at fair market value on the date of distribution. Thus, the new shares of stock do not always have the same holding period as the original stock. If the taxpayer does not know their basis refer them to their stockbroker or financial planner.

Demutualization

Some taxpayers have been informed by their insurance company that the company has been demutualized. When this happens the policy holder receives either a block of stock or the cash equivalent of company stock. The holding period for such stock is the length of time the policy has been in effect, usually many years. The basis for this stock is zero. The taxpayer must report all of the proceeds as a capital gain, usually long term. This gain will qualify for the qualified 5-year gain rate if the policy was held for more than 5 years.

Wash Sales

Generally, a **wash sale** occurs when stock is sold and, within 30 days before or after the sale, substantially identical stock is bought. A loss on a wash sale is not deductible, and special rules relate to the basis of the replacement stock. However, a gain on a wash sale must be reported. Any taxpayer with a wash sale should be referred to a paid professional tax preparer.

Sales Price, Form 1099-B, and Adjusted Basis

The stockbroker reports **sales price** to the Internal Revenue Service in box 2 of Form 1099-B, *Proceeds From Broker and Barter Exchange Transactions* (see Exhibit 1). Some brokers do not subtract commissions and fees; they report the **gross proceeds** as the sales price. Other brokers do subtract commissions and fees, reporting the **gross proceeds less commissions** (referred to as **net proceeds** in this lesson) as the sales price. The broker checks the appropriate square at the right of box 2 to indicate whether the gross or net proceeds were reported to IRS.

If Form 1099-B reports gross proceeds, add the sales broker's commissions and fees to the basis. If Form 1099-B reports net proceeds, the broker already subtracted the commissions and fees the seller paid. Do not adjust the basis further.

Exhibit 1

Form 1099-B

<input type="checkbox"/> CORRECTED (if checked)		OMB No. 1545-0715 2002 Form 1099-B		Proceeds From Broker and Barter Exchange Transactions
PAYER'S name, street address, city, state, ZIP code, and telephone no.		1a Date of sale	Reported } <input type="checkbox"/> Gross proceeds to IRS } <input type="checkbox"/> Gross proceeds less commissions and option premiums	
		1b CUSIP no.		
		2 Stocks, bonds, etc. \$		
PAYER'S Federal identification number	RECIPIENT'S identification number	3 Bartering \$	4 Federal income tax withheld \$	Copy B For Recipient This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.
RECIPIENT'S name Street address (including apt. no.) City, state, and ZIP code		5 Description		
		Regulated Futures Contracts		
Account number (optional)		6 Profit or (loss) realized in 2002 \$	7 Unrealized profit or (loss) on open contracts-4/31/2001 \$	
		8 Unrealized profit or (loss) on open contracts-4/31/2002 \$	9 Aggregate profit or (loss) \$	

Form **1099-B** (keep for your records) Department of the Treasury - Internal Revenue Service

Example 5

George sold stock for \$2,300. He paid his broker a commission of \$35 on the sale and received net proceeds of \$2,265. If his broker reported the gross proceeds, box 2 of Form 1099-B would show \$2,300, and the box next to gross proceeds would be checked. If his broker reported the net proceeds, box 2 of Form 1099-B would show \$2,265, and the box next to gross proceeds less commissions would be checked.

As a general rule, you will need the following information from Form 1099-B:

Information You Will Need From Form 1099-B	
IF Form 1099-B shows information in:	THEN report it on:
Box 1a , Date of sale	Schedule D, column (c), of either Part I, line 1, or Part II, line 8
Box 2 , Sales price reported to Internal Revenue Service (whether gross or net proceeds were reported)	Schedule D, column (d), of either Part I, line 1, or Part II, line 8
Box 4 , Federal income tax withheld	Form 1040, line 59
Box 5 , Description of the property sold	Schedule D, column (a) in either Part I, line 1, or Part II, line 8

If there are entries in box 3 or in boxes 6 through 9 of Form 1099-B, refer the taxpayer to a paid professional tax preparer.

Form 1099-B does **not** include the date the taxpayer bought the stock or what he or she paid for it. The taxpayer will need to provide you with this information.

Some brokers do not issue Forms 1099-B. Instead they issue a statement, sometimes titled “A 1099 Consolidated Statement,” which shows stock sales and other types of distributions such as dividends and interest. Exhibit 2 is an example of such a statement.

Exhibit 2

A 1099 Consolidated Statement

Payer		Account Number 77/64366		SS# 000-00-7026	
KING INVESTMENTS 555 CENTER STREET NEW YORK, NY 10022		Paul J. Birch Susan L. Birch 123 Green Street Claremont, VA 91711			
1099-INT Interest Income 2002					
Interest income not included in box 3	Early withdrawal penalty	US Savings Bonds and other US Treasury interest	Federal income tax withheld	Foreign tax paid	Foreign country or US possession
Box 1 \$378.00	Box 2	Box 3 \$100.00	Box 4	Box 5	Box 6
1099-DIV Dividends & Distributions 2002					
Ordinary dividends	Capital gain distributions	28% rate gain	Unrecaptured sec. 1250 gain	Section 1202 gain	Nontaxable distributions
Box 1 \$559.00	Box 2a \$179.00	Box 2b	Box 2c	Box 2d	Box 3
Investment expenses	Foreign tax paid	Foreign country or US possession	Liquidation distributions—cash	Liquidation distributions—non-cash	
Box 35	Box 6 \$25.00	Box 7	Box 8	Box 9	
1099-B Proceeds from Broker and Barter Exchange Transactions 2002					
Reference number	Trade date (Box 1a)	CUSIP number (Box 1b)	Quantity Description (Box 5)	Price	Gross proceeds less commissions (Box 2)
145367	7/17/02	765298	200 shrs ABC Corp.	\$16.75	\$3,299.90
239863	10/23/02	927651	300 shrs XYZ Markets, Inc.	\$83.65	\$25,000.20
Totals					\$28,300.10
1099-R Distributions from IRAs 2002					
Gross distribution (Box 1)	Taxable amount (Box 2a)	Taxable amount not determined	(Box 2b) Total Distribution	Federal Income tax withheld (Box 4)	Distribution Code (Box 7)
\$2,000	\$2,000			\$0.00	7-Normal Distribution
					IRA/SEP/SIMPLE Yes

Qualified 5-Year Gain

Qualified 5-year gain is a long-term capital gain from the sale of property held for more than 5 years. This qualified 5-year gain is taxed at 8% to the extent the gain would otherwise be taxed at 10%. The 8% tax rate does not apply to collectibles gain, gain on qualified small business stock, or unrecaptured section 1250 gain. The Qualified 5-Year Gain Worksheet – Line 29, Schedule D Instructions, must be completed to determine which gains are subject to the 8% tax rate. Schedule D, Part IV, includes the tax computation for the maximum capital gain rates.

Exercise 1

For the following situations, determine the adjusted basis of the stock sold, whether the holding period is long-term or short-term, and how the sales price is reported.

A. On May 11, 2000, Morris bought 1,000 shares of ZZZ Corporation stock for \$5,000, plus a \$100 commission. On February 14, 2002, he sold 500 shares for \$3,300 and paid a \$45 commission. The broker reported net proceeds on the sale.

1. What is the adjusted basis of the stock sold? _____

2. Is the holding period long term or short term? _____

3. What amount is reported to the Internal Revenue Service in box 2 of Form 1099-B? _____

B. In the case of Morris, above, assume that he bought 500 more shares of ZZZ stock on October 6, 2001, for \$3,500, plus a \$50 commission. At the time of the sale, he told the broker to sell the stock he had bought in 2001.

1. What is the adjusted basis of the stock sold? _____

2. Is the holding period long term or short term? _____

C. On November 30, 2000, Janice bought 100 shares of ABC Corporation stock for \$9,965, plus a \$35 commission. On January 5, 2002, the stock split two-for-one, and she then held a total of 200 shares. On March 6, 2002, she sold 100 shares for \$6,470 and paid a \$30 commission. Her broker reported net proceeds.

1. What is the adjusted basis of the stock sold? _____

2. Is the holding period long term or short term? _____

3. What amount is reported to the Internal Revenue Service in box 2 of Form 1099-B? _____

REPORTING GAIN OR LOSS ON SCHEDULE D

Use Schedule D (Form 1040), *Capital Gains and Losses*, to report gain or loss on the sale of stock. Figure gain or loss by subtracting the adjusted basis of stock sold from its sales price. If the sales price is greater, the taxpayer has gain on the sale. By contrast, if the adjusted basis is greater than the sales price, the taxpayer has a loss on the sale. To denote a loss, place the number in parentheses. The taxpayer should receive Form 1099-B, reporting each sale of stock.

Also use Schedule D to report capital gain distributions that the taxpayer has in addition to any sales of stock. Enter the capital gain distributions on Schedule D, Part II, line 13. They are reported to the taxpayer on Form 1099-DIV, *Dividends and Distributions*, box 2a.

Any distributions that are qualified 5-year gain will be reported to the taxpayer in box 2c and used to complete the Qualified 5-year gain Worksheet in the Schedule D instructions.

If the taxpayer had capital gain distributions, but did not sell stock, he or she may not have to use Schedule D. Instead, report the capital gain distributions as explained in Lesson 3, *Income*.

Schedule D is divided into four parts. They are:

- Part I, *Short-Term Capital Gains and Losses*. For assets held one year or less.
- Part II, *Long-Term Capital Gains and Losses*. For assets held more than one year. Part II shows all long-term gains and losses and identifies the part subject to the 28% tax rate. The 28% rate applies to section 1202 gain from the sale or exchange of qualified small business stock and to collectibles.

TAX TIPS

★★★★★★★★★
Schedule D (Form 1040) is included in the Tax Forms Booklet Appendix.

- Part III, *Taxable Gain or Deductible Loss*.
- Part IV, *Tax Computation Using Maximum Capital Gains Rates*. You should have no trouble with Part IV if you take your time and do as the form says for each line. Using Part IV, rather than the Tax Table or Tax Rate Schedules, may result in lower tax.

Parts I and II: Short-Term and Long-Term Capital Gains and Losses

Report transactions in Parts I and II as follows:

To Report Capital Gain or Loss in Part I or II, Schedule D		
	Short-Term	Long-Term
Show the first four sales on:	Part I, Line 1, Schedule D	Part II, line 8, Schedule D
For additional sales, use:	Part I, line 1, Schedule D-1	Part II, line 8, Schedule D-1
And transfer the total additional sales amount:	From Part I, line 2, Schedule D-1 Onto Part I, line 2, Schedule D	From Part II, line 9, Scheduled D-1 Onto Part II, line 9, Schedule D

Add the sales price amounts in column (d), lines 1 and 2 of Part I. Enter the result on line 3. Then add the amounts in column (d), lines 8 and 9 of Part II. Enter the result on line 10. The total of line 3 plus line 10 must equal the total from box 2 of all the taxpayer's Forms 1099-B. If they do not agree, the taxpayer should attach a statement to the return to explain the difference.

The Internal Revenue Service will compare the amounts reported on all of a taxpayer's Forms 1099-B with the sum of the amounts reported on lines 3 and 10 of Schedule D. If the numbers do not agree and the taxpayer did not explain the difference, IRS will contact the taxpayer.

Example 6

On November 13, 2001, Mary Lou bought 500 shares of XEN, Inc. stock for \$20 a share (\$10,000 total), plus a \$50 commission. On February 26, 2002, she sold the stock for \$8,090 and paid selling expenses of \$40. The Form 1099-B from her broker reported a sales price of \$8,090 (gross proceeds). Part I of Mary Lou's completed Schedule D appears in Exhibit 3.

Mary Lou has a short-term capital loss. Notice that Mary Lou shows the loss in column (f) of line 1. She completes Part I by entering the net short-term loss on line 7. This example shows that:

- Her broker reported gross proceeds on Form 1099-B. The amount shown in column (d) is \$8,090 (because selling expenses have not been subtracted), and
- She works those expenses into the computation—as an adjustment to basis, column (e)—and the result in column (f) reflects her true gain or loss.

Exhibit 3

Mary Lou's Schedule D, Part I

Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less						
(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-5 of the instructions)	(e) Cost or other basis (see page D-5 of the instructions)	(f) Gain or (loss) Subtract (e) from (d)	
1 500 sh. XEN	11/13/01	2/26/02	8,090 00	10,090 00	(2,000 00)	
2	Enter your short-term totals, if any, from Schedule D-1, line 2		2			
3	Total short-term sales price amounts. Add lines 1 and 2 in column (d)		3	8,090 00		
4	Short-term gain from Form 6252 and short-term gain or (loss) from Forms 4684, 6781, and 8824		4			
5	Net short-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1		5			
6	Short-term capital loss carryover. Enter the amount, if any, from line 8 of your 2000 Capital Loss Carryover Worksheet		6		()	
7	Net short-term capital gain or (loss). Combine lines 1 through 6 in column (f).		7		(2,000 00)	

Example 7

Exhibit 4 shows the three long-term transactions that Tess is reporting on Schedule D, Part II, for 2002. On August 21, 1999, she bought 200 shares of XYZ Company for \$1,500. On October 1, 2000, she bought 500 shares of TUV, Inc., for \$8,000, and on November 18, 2000, she bought 2,000 shares of QRS, Inc., for \$5,000. Each amount includes the commission.

On January 10, 2002, Tess sold the stock in XYZ and TUV. The Form 1099-B from her broker reported gross proceeds of \$1,875 for the XYZ stock, and \$6,000 for TUV. Tess paid commissions of \$35 for selling the XYZ shares, and \$40 for selling TUV. On March 27, 2002, Tess sold the QRS stock for \$10,000. She paid a \$50 commission. Her broker reported net proceeds of \$9,950 on Form 1099-B.

This example shows how to:

- Report basis when Form 1099-B shows gross proceeds (XYZ and TUV—basis includes commissions on the sale, as well as prior adjusted basis), in contrast to when it shows net proceeds (QRS—basis does not include commissions on the sale, but only the prior adjusted basis).
- Net gains and losses in column (f).

Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year							
(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-5 of the instructions)	(e) Cost or other basis (see page D-5 of the instructions)	(f) Gain or (loss) Subtract (e) from (d)	(g) 28% rate gain or (loss) * (see instr. below)	
8	200 sh. XYZ	8/21/99	1/10/02	1,875 00	1,535 00	340 00	
	500 sh. TUV	10/1/00	1/10/02	6,000 00	8,040 00	(2,040 00)	
	2,000 sh. QRS	11/18/00	3/27/02	9,950 00	5,000 00	4,950 00	
9	Enter your long-term totals, if any, from Schedule D-1, line 9		9				
10	Total long-term sales price amounts. Add lines 8 and 9 in column (d)		10	17,825 00			
11	Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and long-term gain or (loss) from Forms 4684, 6781, and 8824		11				
12	Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1		12				
13	Capital gain distributions. See page D-1 of the instructions		13				
14	Long-term capital loss carryover. Enter in both columns (f) and (g) the amount, if any, from line 13 of your 2001 Capital Loss Carryover Worksheet		14		()	()	
15	Combine lines 8 through 14 in column (g)		15				
16	Net long-term capital gain or (loss). Combine lines 8 through 14 in column (f) Next: Go to Part III on the back.		16		3,250 00		

* **28% rate gain or loss** includes all "collectibles gains and losses" (as defined on page D-6 of the instructions) and up to 50% of the eligible gain on qualified small business stock (see page D-4 of the instructions).

Exercise 2

For each of the following situations, figure the gain or loss on the sale of stock and indicate whether the gain or loss will be long term or short term.

A. On March 15, 2001, Bill bought 1,000 shares of stock for \$15,000, including commission. On March 15, 2002, he sold 600 shares of the stock for \$7,800, net proceeds on Form 1099-B.

1. Will Bill report a gain or a loss? _____
2. How much is the gain or loss? _____
3. Is the holding period long term or short term? _____

B. On January 7, 2001, Margo bought stock for \$1,500, plus a \$25 commission. On July 15, 2002, she sold the stock for \$2,000 and paid a \$25 commission. Her Form 1099-B shows the gross proceeds of \$2,000 as the sales price.

1. Will Margo report a gain or a loss? _____
2. How much is the gain or loss? _____
3. Is the holding period long term or short term? _____

Reporting Capital Gain Distributions From Form 1099-DIV on Schedule D

If the taxpayer received Form 1099-DIV, *Dividends and Distributions*, see whether an amount is shown in box 2a and box 2c.

- If capital gain distributions from Form 1099-DIV are the only capital gains or losses the taxpayer had for the year, the taxpayer may be able to report them directly on Form 1040A or Form 1040, as explained in Lesson 3, *Income*.
- If the taxpayer also sold stock reported on Form 1099-B, report the total capital gain distributions from Form 1099-DIV on line 13, column (f), of Schedule D.

Example 8

Alec received a Form 1099-DIV. Box 2a shows he received a total capital gain distribution of \$170. Alec also received a Form 1099-B that shows a net sales price of \$1,200 on the sale of 600 shares of ABC Group, Inc. He bought the stock on February 19, 2000, and sold it on August 25, 2002. His basis in ABC, including commission, is \$1,455. Alec's Form 1099-DIV, and Part II of his Schedule D, are shown in Exhibits 5 and 6. In this example, the capital gain distribution must be shown on Schedule D because Alec also sold stock in 2002 that must be reported on Schedule D.

Exhibit 5

Alec's Form 1099-DIV

<input type="checkbox"/> CORRECTED (if checked)		OMB No. 1545-0110 2002 Form 1099-DIV		Dividends and Distributions
PAYER'S name, street address, city, state, ZIP code, and telephone no. MIG, INC. 4321 Main Street Anytown, VA 00012		1 Ordinary dividends \$	Copy B For Recipient This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.	
PAYER'S Federal identification number 00 - 0000123		2a Total capital gain distr. \$ 170.		
		2b 28% rate gain \$		
RECIPIENT'S identification number 000 - 00 - 0128		2c Qualified 5-year gain \$	2d Unrecap. sec. 1250 gain \$	Copy B For Recipient This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.
RECIPIENT'S name Alec Green		2e Section 1202 gain \$	3 Nontaxable distributions \$	
Street address (including apt. no.) 1234 A Street		4 Federal income tax withheld \$	5 Investment expenses \$	
City, state, and ZIP code Anytown, VA 00013		6 Foreign tax paid \$	7 Foreign country or U.S. possession \$	
Account number (optional)		8 Cash liquidation distr. \$	9 Noncash liquidation distr. \$	
Form 1099-DIV		(keep for your records)		Department of the Treasury - Internal Revenue Service

Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year							
(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-5 of the instructions)	(e) Cost or other basis (see page D-5 of the instructions)	(f) Gain or (loss) Subtract (e) from (d)	(g) 28% rate gain or (loss) * (see instr. below)	
8 600 sh. ABC	2/19/00	8/25/02	1,200 00	1,455 00	(255 00)		
9 Enter your long-term totals, if any, from Schedule D-1, line 9			9				
10 Total long-term sales price amounts. Add lines 8 and 9 in column (d)			10 1,200 00				
11 Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and long-term gain or (loss) from Forms 4684, 6781, and 8824							
12 Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1							
13 Capital gain distributions. See page D-1 of the instructions					170 00		
14 Long-term capital loss carryover. Enter in both columns (f) and (g) the amount, if any, from line 13 of your 2001 Capital Loss Carryover Worksheet					()	()	
15 Combine lines 8 through 14 in column (g)							
16 Net long-term capital gain or (loss). Combine lines 8 through 14 in column (f) Next: Go to Part III on the back.					(85 00)		

* 28% rate gain or loss includes all "collectibles gains and losses" (as defined on page D-6 of the instructions) and up to 50% of the eligible gain on qualified small business stock (see page D-4 of the instructions).

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After Completing Parts I and II of Schedule D

Double-check your entries on Schedule D up to this point.

- Check that the sales price amount from each Form 1099-B agrees with the amount entered in column (d) of either line 1 or line 8.
- Check that all entries in column (d), lines 1 and 2, add up to the amount on line 3.
- Check that all entries in column (d), lines 8 and 9, add up to the amount on line 10.
- Check that line 3, added to line 10, agrees with the total sales price reported on all of the taxpayer's Forms 1099-B.
- Check that the amount on line 13, column (f), is the same as the total from all the taxpayer's Forms 1099-DIV, box 2a.

Exercise 3

This exercise will give you practice with Schedule D. Use the following information to complete Parts I and II of Jane's Schedule D.

Jane sold five stocks during 2002. Her broker reported net proceeds as sales price.

Stock	Purchase Date	Date Sold	Net Sales Price	Adjusted Basis
500 sh LSR	1/12/01	1/4/02	\$ 4,000	\$ 9,000
250 sh BGI	3/11/01	2/12/02	10,000	2,500
75 sh ABC	1/22/01	1/29/02	2,000	7,500
400 sh XYZ	12/3/99	3/6/02	15,000	10,000
100 sh DEF	4/2/99	1/16/02	1,200	2,000

Jane also owns shares in a mutual fund that sent her a Form 1099-DIV. It reported \$1,200 paid to her in total capital gain distributions for the year.

Exhibit 7

Complete Parts I and II of Jane's Schedule D.

Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less						
(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-5 of the instructions)	(e) Cost or other basis (see page D-5 of the instructions)	(f) Gain or (loss) Subtract (e) from (d)	
1						
2	Enter your short-term totals, if any, from Schedule D-1, line 2			2		
3	Total short-term sales price amounts. Add lines 1 and 2 in column (d)			3		
4	Short-term gain from Form 6252 and short-term gain or (loss) from Forms 4684, 6781, and 8824			4		
5	Net short-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1			5		
6	Short-term capital loss carryover. Enter the amount, if any, from line 8 of your 2001 Capital Loss Carryover Worksheet			6	()	
7	Net short-term capital gain or (loss). Combine lines 1 through 6 in column (f).			7		
Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year						
(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-5 of the instructions)	(e) Cost or other basis (see page D-5 of the instructions)	(f) Gain or (loss) Subtract (e) from (d)	(g) 28% rate gain or (loss) * (see instr. below)
8						
9	Enter your long-term totals, if any, from Schedule D-1, line 9			9		
10	Total long-term sales price amounts. Add lines 8 and 9 in column (d)			10		
11	Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and long-term gain or (loss) from Forms 4684, 6781, and 8824			11		
12	Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1			12		
13	Capital gain distributions. See page D-1 of the instructions			13		
14	Long-term capital loss carryover. Enter in both columns (f) and (g) the amount, if any, from line 13 of your 2001 Capital Loss Carryover Worksheet			14	()	()
15	Combine lines 8 through 14 in column (g)			15		
16	Net long-term capital gain or (loss). Combine lines 8 through 14 in column (f) Next: Go to Part III on the back.			16		

* **28% rate gain or loss** includes all "collectibles gains and losses" (as defined on page D-6 of the instructions) and up to 50% of the eligible gain on qualified small business stock (see page D-4 of the instructions).

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Part III: Summary of Parts I and II

Combine the amounts from line 7 (net short-term capital gain or loss) and line 16 (net long-term capital gain or loss). Enter the result on line 17 in Part III. This combined number may be a gain or a loss.

- If the line 17 amount is a gain, also enter it on line 13 of Form 1040.
- If the line 17 amount is a loss, complete line 18 of Schedule D. Line 18 ensures that no more than the maximum allowable capital loss is deducted on Form 1040. The line 18 amount is limited to the smaller of:
 - The loss from line 17 or
 - \$3,000 (\$1,500 for a married taxpayer filing separately).

Also enter this amount on line 13 of Form 1040. Because it is a loss, be sure to put parentheses around the number when you enter it on Form 1040; you will not need Part IV of Schedule D.

Part IV: Tax Computation Using the Maximum Capital Gains Rates

The law limits tax rates on net long-term capital gains. To obtain the lowest rate, taxpayers with long-term capital gains must go to Part IV of Schedule D to figure their tax. To determine whether you need Part IV, complete Form 1040 through line 41, Taxable Income. Then go to Part IV of Schedule D if:

- Both lines 16 and 17 of Schedule D are gains, and
- Form 1040, line 41, is more than zero.

Example 9

Edmund's tax return shows:

Filing status: Form 1040, line 1 box checked, single.

Amount from:	Form 1040, line 41:	\$65,001
	Schedule D, line 7:	(5,000)
	Schedule D, line 16:	16,000
	Schedule D, line 17:	11,000
	(Transferred to Form 1040, line 13.)	

There is capital gain on Schedule D, lines 16 and 17, and Form 1040, line 41, is more than zero.

Exhibits 8 and 9 show Edmund's Schedule D, Parts III and IV, and his Form 1040, lines 13 and 42. His tax is \$13,133. Without Schedule D, his tax from the Tax Table would be \$13,903. Using Schedule D saved Edmund \$770.

Part III Taxable Gain or Deductible Loss

17	Combine lines 7 and 16 and enter the result. If a loss, go to line 18. If a gain, enter the gain on Form 1040, line 13, and complete Form 1040 through line 41	17	11,000	00
	<p>Next:</p> <ul style="list-style-type: none"> • If both lines 16 and 17 are gains and Form 1040, line 41, is more than zero, complete Part IV below. • Otherwise, skip the rest of Schedule D and complete Form 1040. 			
18	If line 17 is a loss, enter here and on Form 1040, line 13, the smaller of (a) that loss or (b) (\$3,000) (or, if married filing separately, (\$1,500)). Then complete Form 1040 through line 39	18	()
	<p>Next:</p> <ul style="list-style-type: none"> • If the loss on line 17 is more than the loss on line 18 or if Form 1040, line 39, is less than zero, skip Part IV below and complete the Capital Loss Carryover Worksheet on page D-6 of the instructions before completing the rest of Form 1040. • Otherwise, skip Part IV below and complete the rest of Form 1040. 			

Part IV Tax Computation Using Maximum Capital Gains Rates

19	Enter your unrecaptured section 1250 gain, if any, from line 17 of the worksheet on page D-7 of the instructions	19		
	<p>If line 15 or line 19 is more than zero, complete the worksheet on page D-9 of the instructions to figure the amount to enter on lines 22, 29, and 40 below, and skip all other lines below. Otherwise, go to line 20.</p>			
20	Enter your taxable income from Form 1040, line 41	20	65,001	00
21	Enter the smaller of line 16 or line 17 of Schedule D	21	11,000	00
22	If you are deducting investment interest expense on Form 4952, enter the amount from Form 4952, line 4e. Otherwise, enter -0-	22	0	00
23	Subtract line 22 from line 21. If zero or less, enter -0-	23	11,000	00
24	Subtract line 23 from line 20. If zero or less, enter -0-	24	54,001	00
25	Figure the tax on the amount on line 24. Use the Tax Table or Tax Rate Schedules, whichever applies	25	10,933	00
26	Enter the smaller of: <ul style="list-style-type: none"> • The amount on line 20 or • \$46,700 if married filing jointly or qualifying widow(er); \$27,950 if single; \$37,450 if head of household; or \$23,350 if married filing separately 	26	27,950	00
	<p>If line 26 is greater than line 24, go to line 27. Otherwise, skip lines 27 through 33 and go to line 34.</p>			
27	Enter the amount from line 24	27		
28	Subtract line 27 from line 26. If zero or less, enter -0- and go to line 34	28		
29	Enter your qualified 5-year gain, if any, from line 7 of the worksheet on page D-8	29		
30	Enter the smaller of line 28 or line 29	30		
31	Multiply line 30 by 8% (.08)	31		
32	Subtract line 30 from line 28	32		
33	Multiply line 32 by 10% (.10)	33		
	<p>If the amounts on lines 23 and 28 are the same, skip lines 34 through 37 and go to line 38.</p>			
34	Enter the smaller of line 20 or line 23	34	11,000	00
35	Enter the amount from line 28 (if line 28 is blank, enter -0-)	35	0	00
36	Subtract line 35 from line 34	36	11,000	00
37	Multiply line 36 by 20% (.20)	37	2,200	00
38	Add lines 25, 31, 33, and 37	38	13,133	00
39	Figure the tax on the amount on line 20. Use the Tax Table or Tax Rate Schedules, whichever applies	39	13,903	00
40	Tax on all taxable income (including capital gains). Enter the smaller of line 38 or line 39 here and on Form 1040, line 42	40	13,133	00



Exhibit 9

Edmund's Form 1040, lines 13 and 40

12	Business income or (loss). Attach Schedule C or C-EZ	12		
13	Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/>	13	11,000	00
14	Other gains or (losses). Attach Form 4797	14		

41	Taxable income. Subtract line 40 from line 39. If line 40 is more than line 39, enter -0-	41		
42	Tax (see page 33). Check if any tax is from a <input type="checkbox"/> Form(s) 8814 b <input type="checkbox"/> Form 4972	42	13,133	00

Exercise 4

Melvin sold the following stocks during 2002. His broker reported net sales proceeds on Form 1099-B.

Stock	Purchase Date	Date Sold	Net Sales Price	Adjusted Basis
50 sh ABC	3/15/02	7/26/02	\$4,000	\$5,000
200 sh MLG	5/10/02	6/7/02	1,200	1,000
150 sh XYZ	4/17/00	3/8/02	5,500	6,000
300 sh MLS	1/13/98	6/19/02	6,000	3,000

Melvin also had shares in a mutual fund. The fund sent him a Form 1099-DIV that showed he received \$1,500 in total capital gain distributions. His taxable income (line 41, Form 1040) was \$67,001. His filing status is single.

Use the information given to complete Melvin's Schedule D. What amounts would be shown on his:

(A) 1. Form 1040, line 13? _____

2. Form 1040, line 42? _____

Exhibit 10

(B) Complete this form.

Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less						
(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-5 of the instructions)	(e) Cost or other basis (see page D-5 of the instructions)	(f) Gain or (loss) Subtract (e) from (d)	
1						
2	Enter your short-term totals, if any, from Schedule D-1, line 2			2		
3	Total short-term sales price amounts. Add lines 1 and 2 in column (d)			3		
4	Short-term gain from Form 6252 and short-term gain or (loss) from Forms 4684, 6781, and 8824				4	
5	Net short-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1				5	
6	Short-term capital loss carryover. Enter the amount, if any, from line 8 of your 2001 Capital Loss Carryover Worksheet				6	()
7	Net short-term capital gain or (loss). Combine lines 1 through 6 in column (f).				7	
Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year						
(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-5 of the instructions)	(e) Cost or other basis (see page D-5 of the instructions)	(f) Gain or (loss) Subtract (e) from (d)	(g) 28% rate gain or (loss) * (see instr. below)
8						
9	Enter your long-term totals, if any, from Schedule D-1, line 9			9		
10	Total long-term sales price amounts. Add lines 8 and 9 in column (d)			10		
11	Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and long-term gain or (loss) from Forms 4684, 6781, and 8824				11	
12	Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1				12	
13	Capital gain distributions. See page D-1 of the instructions				13	
14	Long-term capital loss carryover. Enter in both columns (f) and (g) the amount, if any, from line 13 of your 2001 Capital Loss Carryover Worksheet				14	() ()
15	Combine lines 8 through 14 in column (g)				15	
16	Net long-term capital gain or (loss). Combine lines 8 through 14 in column (f) Next: Go to Part III on the back.				16	

* 28% rate gain or loss includes all "collectibles gains and losses" (as defined on page D-6 of the instructions) and up to 50% of the eligible gain on qualified small business stock (see page D-4 of the instructions).

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Part III Taxable Gain or Deductible Loss

<p>17 Combine lines 7 and 16 and enter the result. If a loss, go to line 18. If a gain, enter the gain on Form 1040, line 13, and complete Form 1040 through line 41</p> <p>Next: • If both lines 16 and 17 are gains and Form 1040, line 41, is more than zero, complete Part IV below. • Otherwise, skip the rest of Schedule D and complete Form 1040.</p>	17			
<p>18 If line 17 is a loss, enter here and on Form 1040, line 13, the smaller of (a) that loss or (b) (\$3,000) (or, if married filing separately, (\$1,500)). Then complete Form 1040 through line 39</p> <p>Next: • If the loss on line 17 is more than the loss on line 18 or if Form 1040, line 39, is less than zero, skip Part IV below and complete the Capital Loss Carryover Worksheet on page D-6 of the instructions before completing the rest of Form 1040. • Otherwise, skip Part IV below and complete the rest of Form 1040.</p>	18 ()	

Part IV Tax Computation Using Maximum Capital Gains Rates

<p>19 Enter your unrecaptured section 1250 gain, if any, from line 17 of the worksheet on page D-7 of the instructions</p> <p>If line 15 or line 19 is more than zero, complete the worksheet on page D-9 of the instructions to figure the amount to enter on lines 22, 29, and 40 below, and skip all other lines below. Otherwise, go to line 20.</p>	19			
<p>20 Enter your taxable income from Form 1040, line 41</p>	20			
<p>21 Enter the smaller of line 16 or line 17 of Schedule D</p>	21			
<p>22 If you are deducting investment interest expense on Form 4952, enter the amount from Form 4952, line 4e. Otherwise, enter -0-</p>	22			
<p>23 Subtract line 22 from line 21. If zero or less, enter -0-</p>	23			
<p>24 Subtract line 23 from line 20. If zero or less, enter -0-</p>	24			
<p>25 Figure the tax on the amount on line 24. Use the Tax Table or Tax Rate Schedules, whichever applies</p>	25			
<p>26 Enter the smaller of:</p> <ul style="list-style-type: none"> • The amount on line 20 or • \$46,700 if married filing jointly or qualifying widow(er); <li style="padding-left: 20px;">\$27,950 if single; <li style="padding-left: 20px;">\$37,450 if head of household; or <li style="padding-left: 20px;">\$23,350 if married filing separately <p>If line 26 is greater than line 24, go to line 27. Otherwise, skip lines 27 through 33 and go to line 34.</p>	26			
<p>27 Enter the amount from line 24</p>	27			
<p>28 Subtract line 27 from line 26. If zero or less, enter -0- and go to line 34</p>	28			
<p>29 Enter your qualified 5-year gain, if any, from line 7 of the worksheet on page D-8</p>	29			
<p>30 Enter the smaller of line 28 or line 29</p>	30			
<p>31 Multiply line 30 by 8% (.08)</p>	31			
<p>32 Subtract line 30 from line 28</p>	32			
<p>33 Multiply line 32 by 10% (.10)</p> <p>If the amounts on lines 23 and 28 are the same, skip lines 34 through 37 and go to line 38.</p>	33			
<p>34 Enter the smaller of line 20 or line 23</p>	34			
<p>35 Enter the amount from line 28 (if line 28 is blank, enter -0-)</p>	35			
<p>36 Subtract line 35 from line 34</p>	36			
<p>37 Multiply line 36 by 20% (.20)</p>	37			
<p>38 Add lines 25, 31, 33, and 37</p>	38			
<p>39 Figure the tax on the amount on line 20. Use the Tax Table or Tax Rate Schedules, whichever applies</p>	39			
<p>40 Tax on all taxable income (including capital gains). Enter the smaller of line 38 or line 39 here and on Form 1040, line 42</p>	40			



Capital Loss Carryovers

Use the *Capital Loss Carryover Worksheet* in the Schedule D instructions to figure how much capital loss the taxpayer can carry from 2002 to 2003. As you learned earlier, a taxpayer cannot take net losses of more than \$3,000 (\$1,500 for married taxpayers filing separately) in figuring taxable income. The allowable loss for the year is also referred to as the deduction limit.

Unused losses are not gone forever. Rather, they are carried over to the next year. The carryover losses are combined with the gains and losses that actually occur in that next year. Unused losses are recycled this way, year after year, until they are all deducted. There is no limit on how many times a loss can be carried over during the taxpayer's life.

Unused losses keep their short-term or long-term classification when they are carried over. If the taxpayer has a short-term capital loss carryover from 2001, enter it on line 6, Part I, Schedule D. Enter it on line 14, Part II, if it is long-term.

Example 10

Andrew sold two stocks in 2002, as summarized here.

Stock	Purchase Date	Date Sold	Net Sales Price	Adjusted Basis
200 sh FFF	5/8/01	1/6/02	\$4,000	\$ 3,025
50 sh WWW	11/6/00	3/12/02	8,700	11,000

Andrew's 2001 return showed the following capital loss carryovers to 2002: a \$4,200 short-term loss (line 8 of the 2001 *Capital Loss Carryover Worksheet*) and a \$240 long-term loss (line 13 of the 2001 worksheet). His 2002 Form 1040, line 39, shows \$55,825.

Andrew's Schedule D, Parts I through III, his 2002 Form 1040, line 13, and his 2002 *Capital Loss Carryover Worksheet* appear below as Exhibits 12 through 15. This example shows how to:

- Report a capital loss carryover from 2001 and work it into the computation on Schedule D as if it had resulted from a 2002 sale. This example shows both a short-term loss (reported on Schedule D, Part I, line 6) and a long-term loss (reported on Schedule D, Part II, line 14).

TAX TIPS

★★★★★★★★★
It is easy to double check the carryover from 2002 to 2003. Take as much as possible of the \$3,000 (or \$1,500) deduction from short-term capital losses first. Then take any remaining amount of the \$3,000 (or \$1,500) from long-term capital losses. What is left is the carryover to 2003.

TAX TIPS

★★★★★★★★★
Capital Loss Carryover Worksheet is included in the *Tax Forms Booklet Appendix*.

POTENTIAL PITFALLS



In completing Schedule D, remember to include the amounts from lines 1 and 2, as well as from line 6, when you complete line 7 (Part I); and the amounts from lines 8 and 9, as well as from lines 13 and 14, when you complete line 16 (Part II).

- Combine a short-term capital loss and a long-term capital loss and apply the deduction limit (\$3,000 for Andrew). Andrew reports the combined long-term and short-term loss on Schedule D, Part III, line 17. Line 18 applies Andrew's deduction limit, his allowable loss for the year.
- Show the allowable loss for the year (\$3,000 for Andrew) in the Income section of Form 1040.
- Use the *Capital Loss Carryover Worksheet* to apply the \$3,000 deduction limit against the short-term loss first and figure the capital loss carryover to 2003. In this case, the carryover is a short-term loss of \$225 (line 8 of the worksheet) and a long-term loss of \$2,540 (line 13 of the worksheet).

Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less						
(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-5 of the instructions)	(e) Cost or other basis (see page D-5 of the instructions)	(f) Gain or (loss) Subtract (e) from (d)	
1 200 sh. FFF	5/8/01	1/6/02	4,000 00	3,025 00	975 00	
2 Enter your short-term totals, if any, from Schedule D-1, line 2			2			
3 Total short-term sales price amounts. Add lines 1 and 2 in column (d)			3	4,000 00		
4 Short-term gain from Form 6252 and short-term gain or (loss) from Forms 4684, 6781, and 8824					4	
5 Net short-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1					5	
6 Short-term capital loss carryover. Enter the amount, if any, from line 8 of your 2001 Capital Loss Carryover Worksheet					6	(4,200 00)
7 Net short-term capital gain or (loss). Combine lines 1 through 6 in column (f).					7	(3,225 00)

Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year						
(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-5 of the instructions)	(e) Cost or other basis (see page D-5 of the instructions)	(f) Gain or (loss) Subtract (e) from (d)	(g) 28% rate gain or (loss) * (see instr. below)
8 50 sh. WWW	11/6/00	3/12/02	8,700 00	11,000 00	(2,300 00)	
9 Enter your long-term totals, if any, from Schedule D-1, line 9			9			
10 Total long-term sales price amounts. Add lines 8 and 9 in column (d)			10	8,700 00		
11 Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and long-term gain or (loss) from Forms 4684, 6781, and 8824					11	
12 Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1					12	
13 Capital gain distributions. See page D-1 of the instructions					13	
14 Long-term capital loss carryover. Enter in both columns (f) and (g) the amount, if any, from line 13 of your 2001 Capital Loss Carryover Worksheet					14	(240 00) (240 00)
15 Combine lines 8 through 14 in column (g)					15	(240 00)
16 Net long-term capital gain or (loss). Combine lines 8 through 14 in column (f) Next: Go to Part III on the back.					16	(2,540 00)

* **28% rate gain or loss** includes all "collectibles gains and losses" (as defined on page D-6 of the instructions) and up to 50% of the eligible gain on qualified small business stock (see page D-4 of the instructions).

Exhibit 13

Andrew's Schedule D, Part III

Schedule D (Form 1040) 2002		Page 2
Part III Taxable Gain or Deductible Loss		
<p>17 Combine lines 7 and 16 and enter the result. If a loss, go to line 18. If a gain, enter the gain on Form 1040, line 13, and complete Form 1040 through line 41</p> <p>Next: • If both lines 16 and 17 are gains and Form 1040, line 41, is more than zero, complete Part IV below. • Otherwise, skip the rest of Schedule D and complete Form 1040.</p>	17	(5,765 00)
<p>18 If line 17 is a loss, enter here and on Form 1040, line 13, the smaller of (a) that loss or (b) (\$3,000) (or, if married filing separately, (\$1,500)). Then complete Form 1040 through line 39</p> <p>Next: • If the loss on line 17 is more than the loss on line 18 or if Form 1040, line 39, is less than zero, skip Part IV below and complete the Capital Loss Carryover Worksheet on page D-6 of the instructions before completing the rest of Form 1040. • Otherwise, skip Part IV below and complete the rest of Form 1040.</p>	18	(3,000 00)

Exhibit 14

Andrew's Form 1040, line 13

<p>13 Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/></p>	13	(3,000 00)
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Exhibit 15

Andrew's Capital Loss Carryover Worksheet

Capital Loss Carryover Worksheet—Line 18		<i>Keep for Your Records</i>	
Use this worksheet to figure your capital loss carryovers from 2002 to 2003 if Schedule D, line 18, is a loss and (a) that loss is a smaller loss than the loss on Schedule D, line 17, or (b) Form 1040, line 39, is a loss. Otherwise, you do not have any carryovers.			
1. Enter the amount from Form 1040, line 39. If a loss, enclose the amount in parentheses		1. <u>55,825. 00</u>	
2. Enter the loss from Schedule D, line 18, as a positive amount		2. <u>3,000. 00</u>	
3. Combine lines 1 and 2. If zero or less, enter -0-		3. <u>58,825. 00</u>	
4. Enter the smaller of line 2 or line 3		4. <u>3,000. 00</u>	
If line 7 of Schedule D is a loss, go to line 5; otherwise, enter -0- on line 5 and go to line 9.			
5. Enter the loss from Schedule D, line 7, as a positive amount		5. <u>3,225. 00</u>	
6. Enter any gain from Schedule D, line 16	6. <u>0. 00</u>		
7. Add lines 4 and 6		7. <u>3,000. 00</u>	
8. Short-term capital loss carryover to 2003. Subtract line 7 from line 5. If zero or less, enter -0-		8. <u>225. 00</u>	
If line 16 of Schedule D is a loss, go to line 9; otherwise, skip lines 9 through 13.			
9. Enter the loss from Schedule D, line 16, as a positive amount		9. <u>2,540. 00</u>	
10. Enter any gain from Schedule D, line 7	10. <u>0. 00</u>		
11. Subtract line 5 from line 4. If zero or less, enter -0-	11. <u>0. 00</u>		
12. Add lines 10 and 11		12. <u>0. 00</u>	
13. Long-term capital loss carryover to 2003. Subtract line 12 from line 9. If zero or less, enter -0-		13. <u>2,540. 00</u>	

Exercise 5

This exercise and the next one review the concepts covered in this lesson. They will measure your ability to apply what you have learned.

Matthew has a Form 1099-B from Broker One, who reported gross proceeds:

Stock	Date Sold	Sales Price
100 sh MNO	2/8/02	\$5,050
500 sh ZYX	8/7/02	5,250

Broker One reported sales commissions to Matthew separately. They were:

MNO: \$50 ZYX: \$200

Matthew also has a Form 1099-B from Broker Two, who reported net proceeds:

Stock	Date Sold	Sales Price
200 sh BCA	8/7/02	\$4,000
300 sh JKL	8/7/02	5,910

Matthew gave you the following information about the stocks he sold:

- He paid \$6,940, plus a \$60 commission, to buy the MNO stock on February 9, 2001.
- He bought the ZYX on March 11, 2000, for \$5,200, plus a \$100 commission.
- He paid \$3,900, plus a \$50 commission, to buy the BCA stock on January 29, 2002.
- He bought the JKL on June 26, 2001, for \$6,300, plus a \$30 commission.

Matthew's filing status is head of household. His Form 1040, line 39, shows \$55,282. When you look at Matthew's Form 1040 and Capital Loss Carryover Worksheet from 2001, you see that he has a \$450 short-term loss and a \$325 long-term loss that he can carry over to his 2002 return.

Use this information to complete Matthew's Schedule D, Parts I, II, and III, and his Form 1040, line 13, for 2002. Also complete the *Capital Loss Carryover Worksheet* to figure how much capital loss he can carry over to 2003.

(A) Complete this form.

<p>SCHEDULE D (Form 1040)</p> <p>Department of the Treasury Internal Revenue Service (99)</p>	<p>Capital Gains and Losses</p> <p>▶ Attach to Form 1040. ▶ See Instructions for Schedule D (Form 1040).</p> <p>▶ Use Schedule D-1 to list additional transactions for lines 1 and 8.</p>	<p>OMB No. 1545-0074</p> <p style="font-size: 2em; font-weight: bold;">2002</p> <p>Attachment Sequence No. 12</p>				
Name(s) shown on Form 1040		Your social security number				
Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less						
(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-5 of the instructions)	(e) Cost or other basis (see page D-5 of the instructions)	(f) Gain or (loss) Subtract (e) from (d)	
1						
2 Enter your short-term totals, if any, from Schedule D-1, line 2			2			
3 Total short-term sales price amounts. Add lines 1 and 2 in column (d)			3			
4 Short-term gain from Form 6252 and short-term gain or (loss) from Forms 4684, 6781, and 8824					4	
5 Net short-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1					5	
6 Short-term capital loss carryover. Enter the amount, if any, from line 8 of your 2001 Capital Loss Carryover Worksheet					6 ()	
7 Net short-term capital gain or (loss). Combine lines 1 through 6 in column (f).					7	
Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year						
(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-5 of the instructions)	(e) Cost or other basis (see page D-5 of the instructions)	(f) Gain or (loss) Subtract (e) from (d)	(g) 28% rate gain or (loss) * (see instr. below)
8						
9 Enter your long-term totals, if any, from Schedule D-1, line 9			9			
10 Total long-term sales price amounts. Add lines 8 and 9 in column (d)			10			
11 Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and long-term gain or (loss) from Forms 4684, 6781, and 8824					11	
12 Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1					12	
13 Capital gain distributions. See page D-1 of the instructions					13	
14 Long-term capital loss carryover. Enter in both columns (f) and (g) the amount, if any, from line 13 of your 2001 Capital Loss Carryover Worksheet					14 () ()	
15 Combine lines 8 through 14 in column (g)					15	
16 Net long-term capital gain or (loss). Combine lines 8 through 14 in column (f) Next: Go to Part III on the back.					16	

*28% rate gain or loss includes all "collectibles gains and losses" (as defined on page D-6 of the instructions) and up to 50% of the eligible gain on qualified small business stock (see page D-4 of the instructions).

Exercise 6

Katherine has two Forms 1099-B. They show:

From Broker No. 1 (gross proceeds reported):

Stock	Date Sold	Sales Price
100 sh LMN	4/20/02	\$3,000
50 sh PQR	4/12/02	2,600
500 sh OLE	4/17/02	7,800

Expenses for selling the stock through Broker No. 1 (reported to Katherine separately from Form 1099-B) were:

On the sale of: LMN stock: \$175 PQR stock: \$105 OLE: \$590

From Broker No. 2 (net proceeds reported):

Stock	Date Sold	Sales Price
75 sh ABC	1/24/02	\$2,500
125 sh XYZ	3/22/02	6,000

Katherine gave you the following information about these stocks:

- She bought 100 shares of LMN stock on March 6, 2000, for \$12.50 a share (\$1,250), plus a 10% broker's commission (\$125).
- She bought 200 shares of PQR stock on January 8, 2002, for \$14 a share (\$2,800), plus a 10% broker's commission (\$280).
- Katherine bought OLE stock on two dates. On November 27, 2000, she bought 800 shares for \$10 a share (\$8,000), plus 10% broker's commission (\$800). On March 6, 2002, she bought 600 more shares for \$18 a share (\$10,800), plus a 10% broker's commission (\$1,080). When Katherine sold 500 shares of OLE in 2002, she did not specify which block they came from.
- Katherine bought 100 shares of ABC on October 15, 1999, for \$72 a share (\$7,200), plus a 5% broker's commission (\$360). On May 8, 2000, the stock split two-for-one, so Katherine owned 200 shares after the split.
- She bought 125 shares of XYZ stock on October 26, 2001, for \$74 a share (\$9,250), plus a broker's commission of \$250.

Katherine also gave you a Form 1099-DIV from the Acme Mutual Fund. It showed \$1,050 in total capital gain distributions. From Katherine's tax return and worksheets for last year (2001), you found she has a \$150 long-term capital loss carryover from 2001 to 2002.

Complete Katherine's Schedule D, Parts I through IV, and her Form 1040, lines 13 and 42. She is single, and her taxable income shown on line 41 of her Form 1040 is \$61,221.

Exhibit 20

(A) Complete this form.

Schedule D, Parts I and II

Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less						
(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-5 of the instructions)	(e) Cost or other basis (see page D-5 of the instructions)	(f) Gain or (loss) Subtract (e) from (d)	
1						
2 Enter your short-term totals, if any, from Schedule D-1, line 2						
3 Total short-term sales price amounts. Add lines 1 and 2 in column (d)						
4 Short-term gain from Form 6252 and short-term gain or (loss) from Forms 4684, 6781, and 8824						
5 Net short-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1						
6 Short-term capital loss carryover. Enter the amount, if any, from line 8 of your 2001 Capital Loss Carryover Worksheet					()	
7 Net short-term capital gain or (loss). Combine lines 1 through 6 in column (f).						
Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year						
(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-5 of the instructions)	(e) Cost or other basis (see page D-5 of the instructions)	(f) Gain or (loss) Subtract (e) from (d)	(g) 28% rate gain or (loss) * (see instr. below)
8						
9 Enter your long-term totals, if any, from Schedule D-1, line 9						
10 Total long-term sales price amounts. Add lines 8 and 9 in column (d)						
11 Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and long-term gain or (loss) from Forms 4684, 6781, and 8824						
12 Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1						
13 Capital gain distributions. See page D-1 of the instructions						
14 Long-term capital loss carryover. Enter in both columns (f) and (g) the amount, if any, from line 13 of your 2001 Capital Loss Carryover Worksheet					()	()
15 Combine lines 8 through 14 in column (g)						
16 Net long-term capital gain or (loss). Combine lines 8 through 14 in column (f) Next: Go to Part III on the back.						

* **28% rate gain or loss** includes all "collectibles gains and losses" (as defined on page D-6 of the instructions) and up to 50% of the eligible gain on qualified small business stock (see page D-4 of the instructions).

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Part III Taxable Gain or Deductible Loss

17 Combine lines 7 and 16 and enter the result. If a loss, go to line 18. If a gain, enter the gain on Form 1040, line 13, and complete Form 1040 through line 41

- Next:**
- If both lines 16 and 17 are gains **and** Form 1040, line 41, is more than zero, complete Part IV below.
 - Otherwise, skip the rest of Schedule D and complete Form 1040.

18 If line 17 is a loss, enter here and on Form 1040, line 13, the **smaller** of (a) that loss or (b) (\$3,000) (or, if married filing separately, (\$1,500)). Then complete Form 1040 through line 39

- Next:**
- If the loss on line 17 is more than the loss on line 18 **or** if Form 1040, line 39, is less than zero, skip **Part IV** below and complete the **Capital Loss Carryover Worksheet** on page D-6 of the instructions before completing the rest of Form 1040.
 - Otherwise, skip **Part IV** below and complete the rest of Form 1040.

Part IV Tax Computation Using Maximum Capital Gains Rates

19 Enter your unrecaptured section 1250 gain, if any, from line 17 of the worksheet on page D-7 of the instructions

If line 15 or line 19 is more than zero, complete the worksheet on page D-9 of the instructions to figure the amount to enter on lines 22, 29, and 40 below, and skip all other lines below. Otherwise, go to line 20.

20 Enter your taxable income from Form 1040, line 41

21 Enter the **smaller** of line 16 or line 17 of Schedule D

22 If you are deducting investment interest expense on Form 4952, enter the amount from Form 4952, line 4e. Otherwise, enter -0-

23 Subtract line 22 from line 21. If zero or less, enter -0-

24 Subtract line 23 from line 20. If zero or less, enter -0-

25 Figure the tax on the amount on line 24. Use the Tax Table or Tax Rate Schedules, whichever applies

26 Enter the **smaller** of:

- The amount on line 20 **or**
- \$46,700 if married filing jointly or qualifying widow(er);
\$27,950 if single;
\$37,450 if head of household; or
\$23,350 if married filing separately

If line 26 is greater than line 24, go to line 27. Otherwise, skip lines 27 through 33 and go to line 34.

27 Enter the amount from line 24

28 Subtract line 27 from line 26. If zero or less, enter -0- and go to line 34

29 Enter your qualified 5-year gain, if any, from line 7 of the worksheet on page D-8

30 Enter the **smaller** of line 28 or line 29

31 Multiply line 30 by 8% (.08)

32 Subtract line 30 from line 28

33 Multiply line 32 by 10% (.10)

If the amounts on lines 23 and 28 are the same, skip lines 34 through 37 and go to line 38.

34 Enter the **smaller** of line 20 or line 23

35 Enter the amount from line 28 (if line 28 is blank, enter -0-)

36 Subtract line 35 from line 34

37 Multiply line 36 by 20% (.20)

38 Add lines 25, 31, 33, and 37

39 Figure the tax on the amount on line 20. Use the Tax Table or Tax Rate Schedules, whichever applies

40 Tax on all taxable income (including capital gains). Enter the **smaller** of line 38 or line 39 here and on Form 1040, line 42

17			
18	()	
19			
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Exhibit 22

(C) Complete these lines from Katherine's Form 1040.

Form 1040, lines 13 and 40

12	Business income or (loss). Attach Schedule C or C-EZ	12		
13	Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/>	13		
14	Other gains or (losses). Attach Form 4797	14		

41	Taxable income. Subtract line 40 from line 39. If line 40 is more than line 39, enter -0-	41		
42	Tax (see page 33). Check if any tax is from a <input type="checkbox"/> Form(s) 8814 b <input type="checkbox"/> Form 4972	42		
43	Alternative minimum tax (see page 34). Attach Form 6251	43		

▶▶ SUMMING UP THIS LESSON ◀◀

To figure and properly report a taxpayer's gain or loss on a sale of stock, you need to know:

1. Sales price (reported to the taxpayer and to the IRS on Form 1099-B),
2. Adjusted basis, and
3. Holding period.

To determine gain or loss, subtract adjusted basis from sales price. The holding period determines whether the gain or loss is long-term or short-term. Long-term capital gains are generally taxed at lower rates than short-term capital gains.

Use Schedule D, Parts I through IV, to figure capital gain or loss and the correct tax. Be sure the total sales price you report on line 3 plus line 10 of Schedule D is the same as the total sales price from all the taxpayer's Forms 1099-B, box 2.

Include capital gain distributions (reported to the taxpayer and to IRS on Form 1099-DIV) in the computation of long-term capital gains. Show them on Schedule D, Part II, line 13. Report capital gains distributions directly on Form 1040, line 13 (or on Form 1040A, line 10), if a Schedule D is not required to be completed for the gain or loss on a sale of stock.

A taxpayer can deduct up to \$3,000 (\$1,500 for a married taxpayer filing separately) in net capital loss for the year. The taxpayer can carry over any remaining loss to the next year. If the taxpayer has a carryover loss from 2001, include it on Schedule D, Part I, line 6, or Part II, line 14. The *Capital Loss Carryover Worksheet*, in the Schedule D instructions, can help you figure the carryover amount for 2003.

Report capital gain or loss on Form 1040, line 13.

Exercise 1

- A. 1. \$2,550. $[(\$5,000 + \$100) \div 1,000] \times 500 = \$2,550$
2. Long-term.
3. \$3,255. $\$3,300 - \$45 = \$3,255$
- B. 1. \$3,550. $\$3,500 + \$50 = \$3,550$
2. Short-term.
- C. 1. \$5,000. $[(\$9,965 + \$35) \div 200] \times 100 = \$5,000$
2. Long-term.
3. \$6,440. $\$6,470 - \$30 = \$6,440$

Exercise 2

- A. 1. Loss.
2. \$1,200. $\$7,800 - [(\$15,000 \div 1,000) \times 600] = (\$1,200)$
3. Short-term.
- B. 1. Gain.
2. \$450. $\$2,000 - (\$1,500 + \$25 + \$25) = \$450$
3. Long-term.

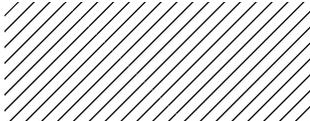
Exercise 3

Jane's Schedule D, Parts I and II

Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less						
(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-5 of the instructions)	(e) Cost or other basis (see page D-5 of the instructions)	(f) Gain or (loss) Subtract (e) from (d)	
1 500 sh. LSR	1/12/01	1/4/02	4,000.00	9,000.00	(5,000.00)	
250 sh. BGI	3/11/01	2/12/02	10,000.00	2,500.00	7,500.00	
2 Enter your short-term totals, if any, from Schedule D-1, line 2			2			
3 Total short-term sales price amounts. Add lines 1 and 2 in column (d)			3	14,000.00		
4 Short-term gain from Form 6252 and short-term gain or (loss) from Forms 4684, 6781, and 8824					4	
5 Net short-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1					5	
6 Short-term capital loss carryover. Enter the amount, if any, from line 8 of your 2001 Capital Loss Carryover Worksheet					6	()
7 Net short-term capital gain or (loss). Combine lines 1 through 6 in column (f).					7	2,500.00
Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year						
(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-5 of the instructions)	(e) Cost or other basis (see page D-5 of the instructions)	(f) Gain or (loss) Subtract (e) from (d)	(g) 28% rate gain or (loss) * (see instr. below)
8 75 sh. ABC	1/22/01	1/29/02	2,000.00	7,500.00	(5,500.00)	
400 sh. XYZ	12/3/99	3/6/02	15,000.00	10,000.00	5,000.00	
100 sh. DEF	4/2/99	1/16/02	1,200.00	2,000.00	(800.00)	
9 Enter your long-term totals, if any, from Schedule D-1, line 9			9			
10 Total long-term sales price amounts. Add lines 8 and 9 in column (d)			10	18,200.00		
11 Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and long-term gain or (loss) from Forms 4684, 6781, and 8824					11	
12 Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1					12	
13 Capital gain distributions. See page D-1 of the instructions					13	1,200.00
14 Long-term capital loss carryover. Enter in both columns (f) and (g) the amount, if any, from line 13 of your 2001 Capital Loss Carryover Worksheet					14	() ()
15 Combine lines 8 through 14 in column (g)					15	
16 Net long-term capital gain or (loss). Combine lines 8 through 14 in column (f) Next: Go to Part III on the back.					16	(100.00)

* 28% rate gain or loss includes all "collectibles gains and losses" (as defined on page D-6 of the instructions) and up to 50% of the eligible gain on qualified small business stock (see page D-4 of the instructions).

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SALE OF STOCK ANSWERS TO EXERCISES

LESSON 12

Exercise 4

- (A) 1. Form 1040, line 13: \$3,200
 2. Form 1040, line 42: \$14,219
- (B) Melvin's Schedule D, Page 1

Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less							
(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-5 of the instructions)	(e) Cost or other basis (see page D-5 of the instructions)	(f) Gain or (loss) Subtract (e) from (d)		
1 50 sh. ABC	3/15/02	7/26/02	4,000 00	5,000 00	(1,000 00)		
200 sh. MLG	5/10/02	6/7/02	1,200 00	1,000 00	200 00		
2 Enter your short-term totals, if any, from Schedule D-1, line 2			2				
3 Total short-term sales price amounts. Add lines 1 and 2 in column (d)			3	5,200 00			
4 Short-term gain from Form 6252 and short-term gain or (loss) from Forms 4684, 6781, and 8824					4		
5 Net short-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1					5		
6 Short-term capital loss carryover. Enter the amount, if any, from line 8 of your 2001 Capital Loss Carryover Worksheet					6	()	
7 Net short-term capital gain or (loss). Combine lines 1 through 6 in column (f).					7	(800 00)	
Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year							
(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-5 of the instructions)	(e) Cost or other basis (see page D-5 of the instructions)	(f) Gain or (loss) Subtract (e) from (d)	(g) 28% rate gain or (loss) * (see instr. below)	
8 150 sh. XYZ	4/17/00	3/8/02	5,500 00	6,000 00	(500 00)		
300 sh. MLS	1/13/98	6/19/02	6,000 00	3,000 00	3,000 00		
9 Enter your long-term totals, if any, from Schedule D-1, line 9			9				
10 Total long-term sales price amounts. Add lines 8 and 9 in column (d)			10	11,500 00			
11 Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and long-term gain or (loss) from Forms 4684, 6781, and 8824					11		
12 Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1					12		
13 Capital gain distributions. See page D-1 of the instructions					13	1,500 00	
14 Long-term capital loss carryover. Enter in both columns (f) and (g) the amount, if any, from line 13 of your 2001 Capital Loss Carryover Worksheet					14	() ()	
15 Combine lines 8 through 14 in column (g)					15		
16 Net long-term capital gain or (loss). Combine lines 8 through 14 in column (f) Next: Go to Part III on the back.					16	4,000 00	

* **28% rate gain or loss** includes all "collectibles gains and losses" (as defined on page D-6 of the instructions) and up to 50% of the eligible gain on qualified small business stock (see page D-4 of the instructions).

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(C) Melvin's Schedule D, Page 2

Schedule D (Form 1040) 2002

Page 2

Part III Taxable Gain or Deductible Loss

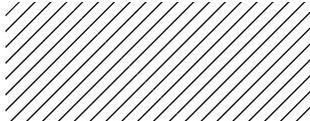
17	Combine lines 7 and 16 and enter the result. If a loss, go to line 18. If a gain, enter the gain on Form 1040, line 13, and complete Form 1040 through line 41	17	3,200	00
<p>Next:</p> <ul style="list-style-type: none"> • If both lines 16 and 17 are gains and Form 1040, line 41, is more than zero, complete Part IV below. • Otherwise, skip the rest of Schedule D and complete Form 1040. 				
18	If line 17 is a loss, enter here and on Form 1040, line 13, the smaller of (a) that loss or (b) (\$3,000) (or, if married filing separately, (\$1,500)). Then complete Form 1040 through line 39	18	()
<p>Next:</p> <ul style="list-style-type: none"> • If the loss on line 17 is more than the loss on line 18 or if Form 1040, line 39, is less than zero, skip Part IV below and complete the Capital Loss Carryover Worksheet on page D-6 of the instructions before completing the rest of Form 1040. • Otherwise, skip Part IV below and complete the rest of Form 1040. 				

Part IV Tax Computation Using Maximum Capital Gains Rates

19	Enter your unrecaptured section 1250 gain, if any, from line 17 of the worksheet on page D-7 of the instructions	19		
<p>If line 15 or line 19 is more than zero, complete the worksheet on page D-9 of the instructions to figure the amount to enter on lines 22, 29, and 40 below, and skip all other lines below. Otherwise, go to line 20.</p>				
20	Enter your taxable income from Form 1040, line 41	20	67,001	00
21	Enter the smaller of line 16 or line 17 of Schedule D	21	3,200	00
22	If you are deducting investment interest expense on Form 4952, enter the amount from Form 4952, line 4e. Otherwise, enter -0-	22	0	00
23	Subtract line 22 from line 21. If zero or less, enter -0-	23	3,200	00
24	Subtract line 23 from line 20. If zero or less, enter -0-	24	63,801	00
25	Figure the tax on the amount on line 24. Use the Tax Table or Tax Rate Schedules, whichever applies	25	13,579	00
26	Enter the smaller of: <ul style="list-style-type: none"> • The amount on line 20 or • \$46,700 if married filing jointly or qualifying widow(er); \$27,950 if single; \$37,450 if head of household; or \$23,350 if married filing separately 	26	27,950	00
<p>If line 26 is greater than line 24, go to line 27. Otherwise, skip lines 27 through 33 and go to line 34.</p>				
27	Enter the amount from line 24	27		
28	Subtract line 27 from line 26. If zero or less, enter -0- and go to line 34	28		
29	Enter your qualified 5-year gain, if any, from line 7 of the worksheet on page D-8	29		
30	Enter the smaller of line 28 or line 29	30		
31	Multiply line 30 by 8% (.08)	31		
32	Subtract line 30 from line 28	32		
33	Multiply line 32 by 10% (.10)	33		
<p>If the amounts on lines 23 and 28 are the same, skip lines 34 through 37 and go to line 38.</p>				
34	Enter the smaller of line 20 or line 23	34	3,200	00
35	Enter the amount from line 28 (if line 28 is blank, enter -0-)	35	0	00
36	Subtract line 35 from line 34	36	3,200	00
37	Multiply line 36 by 20% (.20)	37	640	00
38	Add lines 25, 31, 33, and 37	38	14,219	00
39	Figure the tax on the amount on line 20. Use the Tax Table or Tax Rate Schedules, whichever applies	39	14,443	00
40	Tax on all taxable income (including capital gains). Enter the smaller of line 38 or line 39 here and on Form 1040, line 42	40	14,219	00

Schedule D (Form 1040) 2002





SALE OF STOCK

ANSWERS TO EXERCISES

LESSON 12

Exercise 5

(A) Matthew's Schedule D, Parts I and II

Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less						
(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-5 of the instructions)	(e) Cost or other basis (see page D-5 of the instructions)	(f) Gain or (loss) Subtract (e) from (d)	
1	100 sh. MNO	2/9/01	2/8/02	5,050.00	7,050.00	(2,000.00)
	200 sh. BCA	1/29/02	8/7/02	4,000.00	3,950.00	50.00
2	Enter your short-term totals, if any, from Schedule D-1, line 2			2		
3	Total short-term sales price amounts. Add lines 1 and 2 in column (d)			3	9,050.00	
4	Short-term gain from Form 6252 and short-term gain or (loss) from Forms 4684, 6781, and 8824			4		
5	Net short-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1			5		
6	Short-term capital loss carryover. Enter the amount, if any, from line 8 of your 2001 Capital Loss Carryover Worksheet			6	(450.00)	
7	Net short-term capital gain or (loss). Combine lines 1 through 6 in column (f).			7	(2,400.00)	
Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year						
(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-5 of the instructions)	(e) Cost or other basis (see page D-5 of the instructions)	(f) Gain or (loss) Subtract (e) from (d)	(g) 28% rate gain or (loss) * (see instr. below)
8	500 sh. ZYX	3/11/00	8/7/02	5,250.00	5,500.00	(250.00)
	300 sh. JKL	6/26/01	8/7/02	5,910.00	6,330.00	(420.00)
9	Enter your long-term totals, if any, from Schedule D-1, line 9			9		
10	Total long-term sales price amounts. Add lines 8 and 9 in column (d)			10	11,160.00	
11	Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and long-term gain or (loss) from Forms 4684, 6781, and 8824			11		
12	Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1			12		
13	Capital gain distributions. See page D-1 of the instructions			13		
14	Long-term capital loss carryover. Enter in both columns (f) and (g) the amount, if any, from line 13 of your 2001 Capital Loss Carryover Worksheet			14	(325.00)	(325.00)
15	Combine lines 8 through 14 in column (g)			15		(325.00)
16	Net long-term capital gain or (loss). Combine lines 8 through 14 in column (f) Next: Go to Part III on the back.			16	(995.00)	

* 28% rate gain or loss includes all "collectibles gains and losses" (as defined on page D-6 of the instructions) and up to 50% of the eligible gain on qualified small business stock (see page D-4 of the instructions).

For Paperwork Reduction Act Notice, see Form 1040 instructions. Cat. No. 11338H Schedule D (Form 1040) 2002

(B) Matthew's Schedule D, Part III

Schedule D (Form 1040) 2002		Page 2
Part III Taxable Gain or Deductible Loss		
<p>17 Combine lines 7 and 16 and enter the result. If a loss, go to line 18. If a gain, enter the gain on Form 1040, line 13, and complete Form 1040 through line 41</p> <p>Next: • If both lines 16 and 17 are gains and Form 1040, line 41, is more than zero, complete Part IV below. • Otherwise, skip the rest of Schedule D and complete Form 1040.</p> <p>18 If line 17 is a loss, enter here and on Form 1040, line 13, the smaller of (a) that loss or (b) (\$3,000) (or, if married filing separately, (\$1,500)). Then complete Form 1040 through line 39</p> <p>Next: • If the loss on line 17 is more than the loss on line 18 or if Form 1040, line 39, is less than zero, skip Part IV below and complete the Capital Loss Carryover Worksheet on page D-6 of the instructions before completing the rest of Form 1040. • Otherwise, skip Part IV below and complete the rest of Form 1040.</p>	17	(3,395 00)
	18	(3,000 00)

(C) Matthew's Form 1040, Line 13

13 Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/>	13	(3,000 00)
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(D) Matthew's Capital Loss Carryover Worksheet

Capital Loss Carryover Worksheet—Line 18		<i>Keep for Your Records</i>	
Use this worksheet to figure your capital loss carryovers from 2002 to 2003 if Schedule D, line 18, is a loss and (a) that loss is a smaller loss than the loss on Schedule D, line 17, or (b) Form 1040, line 39, is a loss. Otherwise, you do not have any carryovers.			
1. Enter the amount from Form 1040, line 39. If a loss, enclose the amount in parentheses	1.	55,282 00	
2. Enter the loss from Schedule D, line 18, as a positive amount	2.	3,000 00	
3. Combine lines 1 and 2. If zero or less, enter -0-	3.	58,282 00	
4. Enter the smaller of line 2 or line 3	4.	3,000 00	
If line 7 of Schedule D is a loss, go to line 5; otherwise, enter -0- on line 5 and go to line 9.			
5. Enter the loss from Schedule D, line 7, as a positive amount	5.	2,400 00	
6. Enter any gain from Schedule D, line 16	6.	_____	
7. Add lines 4 and 6	7.	3,000 00	
8. Short-term capital loss carryover to 2003. Subtract line 7 from line 5. If zero or less, enter -0-	8.	0	
If line 16 of Schedule D is a loss, go to line 9; otherwise, skip lines 9 through 13.			
9. Enter the loss from Schedule D, line 16, as a positive amount	9.	995 00	
10. Enter any gain from Schedule D, line 7	10.	0	
11. Subtract line 5 from line 4. If zero or less, enter -0-	11.	600 00	
12. Add lines 10 and 11	12.	600 00	
13. Long-term capital loss carryover to 2003. Subtract line 12 from line 9. If zero or less, enter -0-	13.	395 00	

Exercise 6***Basis Computations:***LMN:

100 shares bought at \$12.50	=	\$1,250
Commission on purchase	=	125
Commission on sale	=	<u>+ 175</u>
Adjusted basis, LMN sold	=	<u>\$1,550</u>

PQR:

200 shares bought at \$14	=	\$2,800
Commission on purchase	=	<u>+ 280</u>
Total paid for purchase	=	3,080
Divided by number of shares bought		<u>÷ 200</u>
Per share basis after purchase	=	15.40
Times number of shares sold		<u>x 50</u>
	=	770
Commission on sale	=	<u>+ 105</u>
Adjusted basis, PQR sold	=	<u>\$ 875</u>

OLE: Katherine did not specify which block of stock to sell; the stocks sold are assumed to be from the block purchased first.

800 shares bought at \$10	=	\$8,000
Commission on purchase	=	<u>+ 800</u>
Total paid for purchase	=	8,800
Divided by number of shares bought		<u>÷ 800</u>
Per share basis after purchase	=	11
Times number of shares sold		<u>x 500</u>
	=	5,500
Commission on sale	=	<u>+ 590</u>
Adjusted basis, OLE sold	=	<u>\$6,090</u>

ABC:

100 shares bought at \$72	=	\$7,200
Commission on purchase	=	<u>+ 360</u>
Total paid for purchase	=	7,560
Divided by number of shares Katherine held after the two-for-one split		<u>÷ 200</u>
Per share basis after the split	=	37.80
Times number of shares sold	=	<u>x 75</u>
Adjusted basis, ABC sold	=	<u><u>\$2,835</u></u>

XYZ:

125 shares bought at \$74	=	\$9,250
Commission on purchase	=	<u>+ 250</u>
Adjusted basis, XYZ sold	=	<u><u>\$9,500</u></u>

Exercise 6

(A) Katherine's Schedule D, Parts I and II

Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less								
(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-5 of the instructions)	(e) Cost or other basis (see page D-5 of the instructions)	(f) Gain or (loss) Subtract (e) from (d)			
1 50 sh. PQR	1/8/02	4/12/02	2,600 00	875 00	1,725 00			
125 sh. XYZ	10/26/01	3/22/02	6,000 00	9,500 00	(3,500 00)			
2 Enter your short-term totals, if any, from Schedule D-1, line 2			2					
3 Total short-term sales price amounts. Add lines 1 and 2 in column (d)			3	8,600 00				
4 Short-term gain from Form 6252 and short-term gain or (loss) from Forms 4684, 6781, and 8824					4			
5 Net short-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1					5			
6 Short-term capital loss carryover. Enter the amount, if any, from line 8 of your 2001 Capital Loss Carryover Worksheet					6	()		
7 Net short-term capital gain or (loss). Combine lines 1 through 6 in column (f).					7	(1,775 00)		
Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year								
(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-5 of the instructions)	(e) Cost or other basis (see page D-5 of the instructions)	(f) Gain or (loss) Subtract (e) from (d)	(g) 28% rate gain or (loss) * (see instr. below)		
8 100 sh. LMN	3/6/00	4/20/02	3,000 00	1,550 00	1,450 00			
500 sh. OLE	11/27/00	4/17/02	7,800 00	6,090 00	1,710 00			
75 sh. ABC	10/15/99	1/24/02	2,500 00	2,835 00	(335 00)			
9 Enter your long-term totals, if any, from Schedule D-1, line 9			9					
10 Total long-term sales price amounts. Add lines 8 and 9 in column (d)			10	13,300 00				
11 Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and long-term gain or (loss) from Forms 4684, 6781, and 8824					11			
12 Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1					12			
13 Capital gain distributions. See page D-1 of the instructions					13	1,050 00		
14 Long-term capital loss carryover. Enter in both columns (f) and (g) the amount, if any, from line 13 of your 2001 Capital Loss Carryover Worksheet					14	(150 00)	(150 00)	
15 Combine lines 8 through 14 in column (g)					15		(150 00)	
16 Net long-term capital gain or (loss). Combine lines 8 through 14 in column (f) Next: Go to Part III on the back.					16	3,725 00		

*28% rate gain or loss includes all "collectibles gains and losses" (as defined on page D-6 of the instructions) and up to 50% of the eligible gain on qualified small business stock (see page D-4 of the instructions).

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(B) Katherine's Schedule D, Parts III and IV

Schedule D (Form 1040) 2002

Page **2**

Part III Taxable Gain or Deductible Loss

17	Combine lines 7 and 16 and enter the result. If a loss, go to line 18. If a gain, enter the gain on Form 1040, line 13, and complete Form 1040 through line 41	17	1,950	00
	Next: • If both lines 16 and 17 are gains and Form 1040, line 41, is more than zero, complete Part IV below. • Otherwise, skip the rest of Schedule D and complete Form 1040.			
18	If line 17 is a loss, enter here and on Form 1040, line 13, the smaller of (a) that loss or (b) (\$3,000) (or, if married filing separately, (\$1,500)). Then complete Form 1040 through line 39	18	()
	Next: • If the loss on line 17 is more than the loss on line 18 or if Form 1040, line 39, is less than zero, skip Part IV below and complete the Capital Loss Carryover Worksheet on page D-6 of the instructions before completing the rest of Form 1040. • Otherwise, skip Part IV below and complete the rest of Form 1040.			

Part IV Tax Computation Using Maximum Capital Gains Rates

19	Enter your unrecaptured section 1250 gain, if any, from line 17 of the worksheet on page D-7 of the instructions	19		
	If line 15 or line 19 is more than zero, complete the worksheet on page D-9 of the instructions to figure the amount to enter on lines 22, 29, and 40 below, and skip all other lines below. Otherwise, go to line 20.			
20	Enter your taxable income from Form 1040, line 41	20	61,221	00
21	Enter the smaller of line 16 or line 17 of Schedule D	21	1,950	00
22	If you are deducting investment interest expense on Form 4952, enter the amount from Form 4952, line 4e. Otherwise, enter -0-	22	0	
23	Subtract line 22 from line 21. If zero or less, enter -0-	23	1,950	00
24	Subtract line 23 from line 20. If zero or less, enter -0-	24	59,271	00
25	Figure the tax on the amount on line 24. Use the Tax Table or Tax Rate Schedules, whichever applies	25	12,350	00
26	Enter the smaller of: • The amount on line 20 or • \$46,700 if married filing jointly or qualifying widow(er); \$27,950 if single; \$37,450 if head of household; or \$23,350 if married filing separately	26	27,950	00
	If line 26 is greater than line 24, go to line 27. Otherwise, skip lines 27 through 33 and go to line 34.			
27	Enter the amount from line 24	27		
28	Subtract line 27 from line 26. If zero or less, enter -0- and go to line 34	28		
29	Enter your qualified 5-year gain, if any, from line 7 of the worksheet on page D-8	29		
30	Enter the smaller of line 28 or line 29	30		
31	Multiply line 30 by 8% (.08)	31		
32	Subtract line 30 from line 28	32		
33	Multiply line 32 by 10% (.10)	33		
	If the amounts on lines 23 and 28 are the same, skip lines 34 through 37 and go to line 38.			
34	Enter the smaller of line 20 or line 23	34	1,950	00
35	Enter the amount from line 28 (if line 28 is blank, enter -0-)	35	0	
36	Subtract line 35 from line 34	36	1,950	00
37	Multiply line 36 by 20% (.20)	37	390	00
38	Add lines 25, 31, 33, and 37	38	12,740	00
39	Figure the tax on the amount on line 20. Use the Tax Table or Tax Rate Schedules, whichever applies	39	12,877	00
40	Tax on all taxable income (including capital gains). Enter the smaller of line 38 or line 39 here and on Form 1040, line 42	40	12,740	00

Schedule D (Form 1040) 2002





(C) Katherine's Form 1040, lines 13 and 42

12	Business income or (loss). Attach Schedule C or C-EZ	12		
13	Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/> 13		1,950	00
14	Other gains or (losses). Attach Form 4797	14		

41	Taxable income. Subtract line 40 from line 39. If line 40 is more than line 39, enter -0-	41		
42	Tax (see page 33). Check if any tax is from a <input type="checkbox"/> Form(s) 8814 b <input type="checkbox"/> Form 4972	42	12,740	00
43	Alternative minimum tax (see page 34). Attach Form 6251	43		

INTRODUCTION AND OBJECTIVES

Introduction

This lesson generally discusses the tax rules that apply when a taxpayer sells his or her **main home** in 2002. The taxpayer's main home is the one in which he or she lives most of the time.

A taxpayer does not need to report the sale of his or her main home on his or her tax return if the gain on the sale is less than or equal to an **exclusion amount** (discussed later). Generally, if the taxpayer meets the **ownership and use tests** (discussed later), he or she can exclude any gain from income up to \$250,000 (\$500,000, if married filing jointly).

This lesson does not cover the sale of a main home used as rental property or partially for business. However, see sidebar on this page.

Objective

At the end of this lesson you will be able to determine the amount of gain a taxpayer may exclude if a primary residence is sold.

MAIN HOME

Only the gain from the sale of the taxpayer's main home is eligible for the rules discussed in this lesson. If a home that is not the taxpayer's main home is sold during the year, the gain generally will have to be reported as income. Any gain that must be reported as income is taxable gain and is reported on Schedule D (Form 1040), *Capital Gains and Losses*. Therefore, a clear understanding of what is, and what is not, an individual's main home is very important.

A **main home** is where the taxpayer lives most of the time. The home does not necessarily have to be a house. A houseboat, a mobile home, a cooperative apartment, or a condominium (house or apartment) may also qualify as a main home.

TAX TIPS

★★★★★★★★★
If a taxpayer sold a main home in 2002 that was used as rental property or partly for business, he or she must report the taxable gain on the sale of the home on his or her tax return. A taxpayer in this situation should be referred to a paid professional tax preparer. The taxpayer can also get Publication 523, *Selling Your Home*, for more information.

POTENTIAL PITFALLS



A taxpayer's main home is not necessarily a home that is owned by the taxpayer. A rental home may be a main home.

TAX TIPS

★★★★★★★★★★

Taxpayers cannot choose which home to designate as their main home. Facts and circumstances determine which home is the main home.

If a taxpayer has more than one home, it is necessary to determine which home he or she lives in most of the time.

In many, if not most cases, the taxpayer owns a single home in which he or she lives all the time. It may seem easy to evaluate this situation, since it is not necessary to determine which home is the main home. However, you must be sure that the owner of a single home also meets the requirement of living in the home most of the time. If not, it cannot be considered the main home.

Never assume that the house sold during the year was the taxpayer's main home, even if the house was the only one owned by the taxpayer. Be sure to check that the house was, in fact, the individual's main home.

Example 1

Lucille owns a home in a Colorado ski area (the ski home). She stays at the ski home most weekends and spends the entire months of December, January, and February there. When she is not at the ski home, she lives in a four-room apartment that she rents in Denver. For over half the year, she lives in Denver. Lucille's main home is her rental apartment in Denver, because she lives there most of the time. This is so even though she does not own the apartment in Denver.

POTENTIAL PITFALLS



If there is a loss on the sale of a taxpayer's main home, the taxpayer cannot deduct it on his or her tax return.

GAIN ON SALE OF MAIN HOME

To figure the gain (or loss) on the sale of the taxpayer's main home, you must know the **selling price**, the **amount realized**, and the **adjusted basis**.

Selling price

The selling price is the total amount the taxpayer (seller) received for his or her main home. It includes money, all notes, mortgages, or other debts taken over by the buyer as part of the sale, and the fair market value of any other property or services that the seller received.

Form 1099-S

If the taxpayer received Form 1099-S, *Proceeds From Real Estate Transactions*, box 1 shows the date of sale (closing) and box 2 shows the **gross proceeds** received from the sale of his or her main home. (Exhibit 1 shows a blank Form 1099-S.) If the taxpayer can exclude the entire gain from a sale in 2002, the person responsible for closing the sale (for example, a real estate broker or settlement agent) generally will not have to report it on Form 1099-S.

<input type="checkbox"/> CORRECTED (if checked)		OMB No. 1545-0997	
FILER'S name, street address, city, state, ZIP code, and telephone no.		1 Date of closing	<div style="font-size: 2em; font-weight: bold;">2002</div> <div style="font-weight: bold;">Form 1099-S</div>
		2 Gross proceeds	
FILER'S Federal identification number		3 Address or legal description	
TRANSFEROR'S identification number		<div style="font-weight: bold;">Copy B</div> <div style="font-weight: bold;">For Transferor</div> <small>This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this item is required to be reported and the IRS determines that it has not been reported.</small>	
TRANSFEROR'S name			
Street address (including apt. no.)			
City, state, and ZIP code		4 Transferor received or will receive property or services as part of the consideration (if checked) . . . ▶ <input type="checkbox"/>	
Account number (optional)		5 Buyer's part of real estate tax	
		\$	

Form **1099-S** (keep for your records) Department of the Treasury - Internal Revenue Service

TAX TIPS
 ★★★★★★★★
Jointly owned home
 If a taxpayer and his or her spouse sell their jointly owned home and file a joint return, they figure their gain or loss as one taxpayer.

Separate returns
 If married taxpayers file separate returns, each of the spouses must figure his or her gain or loss according to his or her ownership interests in the main home. Each spouse's ownership interest is determined by state law.

Joint owners not married
 If a taxpayer and a joint owner (other than his or her spouse) sell a jointly owned home, each of them must figure his or her own gain or loss according to his or her ownership interest in the home. Each of them applies the rules discussed in this lesson and in Publication 523 on an individual basis.

Amount realized

The amount realized is the selling price minus **selling expenses**.

Selling expenses

Selling expenses include commissions, advertising fees, legal fees, and loan charges paid by the seller, such as points (points were discussed in lesson 5).

Adjusted basis

While the taxpayer owned his or her main home, he or she may have made adjustments (increases or decreases) to the **basis**. This adjusted basis is used to figure gain or loss on the sale of the taxpayer's main home. For information on how to figure the home's adjusted basis, see *Basis* in Publication 523.

Amount of gain (or loss)

When you know the amount realized and the home's adjusted basis, you can figure the taxpayer's **gain or loss**. If the amount realized is more than the adjusted basis, the difference is a gain and the taxpayer may be able to exclude all or part of it. If the amount realized is less than the adjusted basis, the difference is a loss. **A loss on the sale of the taxpayer's main home cannot be deducted.**

POTENTIAL PITFALLS



A taxpayer cannot exclude the part of any gain that is equal to any depreciation allowed or allowable for the business use of his or her home.

Refer a taxpayer who used his or her main home for business to a paid professional tax preparer.

AMOUNT OF EXCLUSION

A single homeowner can generally exclude up to \$250,000 of gain from the sale of a main home. A married couple can exclude up to \$500,000 if they meet all of the following conditions.

1. They filed a joint return.
2. Either spouse or both meet the ownership test.
3. Both individuals meet the use test.
4. Neither individual excluded gain in the 2 years before the current sale of the home (not counting any sales before May 7, 1997).

For married individuals filing jointly who do not qualify for the \$500,000 exclusion of gain on the sale of a home because they do not satisfy the two-year ownership test, two-year use test, and the prohibition on any other sale or exchange of a residence within the last two years, the limit on the amount of excludable gain should be calculated separately for each spouse. In that case, the maximum exclusion for the couple is equal to the sum of the exclusions to which the spouses would otherwise be entitled if they had not been married.

OWNERSHIP AND USE TESTS

The **exclusion** is allowed each time a taxpayer sells or exchanges his or her main home, but generally no more than once every 2 years. To be eligible, the property must have been:

1. Owned by the taxpayer for a combined period of at least 2 years out of a 5-year period ending on the date of sale (the ownership test).
2. Lived in as the taxpayer's main home for at least 2 years of that 5-year period (the use test).

Period of ownership and use

The required 2 years of ownership and use do not have to be continuous. The taxpayer meets the tests if the taxpayer can show that he or she owned and lived in the property as his or her main home for either 24 full months or 730 days during the 5-year period. Short temporary absences, even if the property is rented during those absences, are counted as periods of use.

Ownership and use tests can be met during different 2-year periods. However, a taxpayer must meet both tests during the 5-year period ending on the date of the sale.

Example 2

In 1994, Helen Jones lived in a rented apartment. The apartment building was later changed to a condominium, and she bought her apartment on December 1, 1999. In 2000, Helen became ill and on April 14 of that year she moved in to her daughter's home. On July 10, 2002, while still living in her daughter's home, she sold her apartment.

Helen can exclude all the gain on the sale of her apartment because she met the ownership and use tests. Her 5-year period is from July 11, 1997, to July 10, 2002, the date she sold the apartment. She owned her apartment from December 1, 1999, to July 10, 2002 (over 2 years). She lived in the apartment from July 11, 1997 (the beginning of the 5-year period), to April 14, 2000 (over 2 years).

Reduced Exclusion

If the property was owned and used as a main home for less than 2 years, a taxpayer may be able to claim a reduced exclusion. If this situation applies to a taxpayer, use the worksheet in Publication 523 to figure how to claim the reduced exclusion.

Example 3

Amanda, who is single, bought her first home in August 2000. In December 2001, the company she worked for notified her that she would be transferred to another town by the end of 2002. She continued to live in the home until June 2002, when she sold it at a gain and moved to the new town. Amanda owned and lived in the home less than 2 years, so she does not meet the ownership and use tests. However, she qualifies to exclude the gain because she sold the home due to a change in place of employment.

Exercise 1

John is single and sold his home in July 2002, for \$300,000. The amount he realized from the sale was \$297,500. His adjusted basis in the home was \$255,500. Assuming he meets the ownership and use tests,

- a. What is the amount of the gain?
- b. What is his exclusion amount?

Exercise 2

Tim owns two homes. One residence is located in St. Louis where he works and the other is located in a resort area approximately 100 miles away. Tim lives in his St. Louis home during the week (Monday through Friday) and travels to his weekend home for Saturday and Sunday. His office allows him to work from home so approximately 5 months of the year he works from his weekend home. Which home is his main home?

TAXWISE HINTS

If a gain on the sale of a main home must be reported on the taxpayer's Form 1040. Link to a Schedule D, enter the description of property, and complete the remaining entries annotated in red. The software will calculate the gain and carry the calculation to the Form 1040.

Exercise 1a. \$42,000 (\$297,500 minus \$255,500)
1b. \$42,000

Exercise 2. His main home is the St. Louis residence

▶▶ SUMMING UP THIS LESSON ◀◀

In this lesson you have learned about the simplified rules that apply to homeowners who sell or exchange their principal residence. For more information on the tax rules that apply on the sale of a main home, see Publication 523.

INTRODUCTION AND OBJECTIVES

In this lesson, you will learn about *Pensions*.

After completing this lesson, you should be able to:

- **Figure** and **report** any taxable pension benefits.
- **Determine** if any part of retirement income is nontaxable.
- **List** the methods used to determine the tax-free portion of an annuity payment.
- **Compute** the taxable portion of a pension using the Simplified Method.
- **List** options for handling lump-sum distributions.
- **Explain** minimum distribution rules.
- **Distinguish** between taxable and nontaxable social security benefits.
- **Determine** if estimated tax payments are required.

Disability pension income. Generally, a taxpayer who retires on disability must report his or her pension or annuity as income.

A taxpayer who is 65 or older at the end of the tax year, or a taxpayer who is under 65, retired on permanent and total disability, and who received taxable disability income, may be able to claim the credit for the elderly or the disabled. The taxpayer must be a U.S. citizen or a resident to claim the credit.

Do not treat the following payments as disability income:

1. Any payment received from a retirement plan that does not provide for disability retirement.
2. Any lump-sum payment for accrued annual leave paid to a taxpayer who retires on disability. Treat these payments as salary.

SPECIAL POPULATIONS



Some taxpayers with retirement income may be eligible for the credit for the elderly or the disabled. See Lesson 15 for more information.

TAX TIPS

★★★★★★★★★★

Form W-2 and Form 1099-R are included in the Tax Forms Booklet Appendix.

PERSON

TO

PERSON

Many taxpayers become upset because they do not understand the pension tax rules. Be considerate when probing for the information you need to complete the return. If the taxpayer cannot provide the required information, suggest that the former employer or annuity administrator be contacted. You may want to give the taxpayer a written list of questions that should be answered by the employer.

Reporting disability pension income. For reporting the taxpayer's disability pension income, disability payments are taxed as wages until the taxpayer reaches the *minimum retirement age* set by the employer. After the taxpayer reaches the minimum retirement age, disability payments are treated as pension income. Minimum retirement age is generally the earliest age at which the taxpayer may receive a pension whether or not disabled.

An employer may report disability income on Form W-2, *Wage and Tax Statement*. However, an employer may also report disability income on Form 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.* Enter disability income reported on Form W-2 on line 7 of either Form 1040 or Form 1040A.

If the employer reports disability income on Form 1099-R, Box 2a shows the taxable amount. Check to see if Box 7 (Distribution Code) shows the code number 3 (Disability). If Box 7 indicates that the taxpayer is receiving disability payments, then determine if the taxpayer has reached the minimum retirement age.

1. Until the taxpayer reaches the minimum retirement age, report the disability income as wages on line 7 of Form 1040 or Form 1040A.
2. After the taxpayer has reached the minimum retirement age, report the disability income as a taxable pension. If the disability payments are partially taxable, use lines 16a and 16b (Form 1040) or lines 12a and 12b (Form 1040A). If the payments are fully taxable, enter the taxable amount on line 16b or line 12b; do not make an entry on line 16a or line 12a.

PENSIONS AND ANNUITIES

Pensions and annuities provide cash payments, usually after a person has retired. The payments may be for life or for a fixed period of time. They may begin at retirement or at a specific age.

- A **pension** is generally a series of definitely determinable payments made to an employee or survivor (the beneficiary of a deceased employee's pension) after the employee retires from work. Payments are made regularly and are for past services with an employer.
- An **annuity** is a series of payments under a contract from an insurance company, a trust company, or an individual. Annuity payments are made at regular intervals over a period of more than one full year.

A pension is fully or partially taxable depending on whether the employee contributed to the pension plan. Employee contributions are "after-tax" amounts that the employee paid into the pension fund. The employer usually deducts the contributions

from wages and deposits them into the pension fund on behalf of the employee. Each year, the employee pays tax on the amount that he or she contributed that year. The employee's contributions are included in his or her Form W-2. Employee contributions are often referred to as the **cost** of the pension or as the **investment** in the annuity contract. For pensions discussed here, the employer will also have contributed to the pension fund.

Fully Taxable Pensions

Generally, if the taxpayer did not contribute to the cost of the pension plan, the pension benefits received are fully taxable. Military pensions are noncontributory and, therefore, fully taxable.

Partially Taxable Pensions and Annuities

If a taxpayer contributed to a pension plan while employed, part of the pension received is a return of the amounts contributed in earlier years and, therefore, is nontaxable. If the taxpayer has paid tax on the contribution (it was included in wages), the amount contributed is not taxed again when the pension is received.

If the taxpayer's annuity starting date is after November 18, 1996, he or she generally must use the Simplified Method to determine the taxable portion of his or her pension income.

The General Rule

Most taxpayers who are covered by a qualified retirement plan will no longer be eligible to use the General Rule for annuity payments received from the plan. However, if a taxpayer is 75 or over and his or her annuity starting date is after November 18, 1996, use the General Rule if the payments are guaranteed for at least 5 years. Use the Simplified Method if the payments are guaranteed for less than 5 years.

Using the General Rule, each pension payment from a nonqualified plan consists of two parts: (1) a tax-free return of the taxpayer's contribution and (2) the remaining taxable part. For each taxpayer, an **exclusion percentage** is figured. The exclusion percentage is the taxpayer's contribution to the pension plan divided by the taxpayer's expected total pension income. The annual pension income, before deductions for insurance premiums or income taxes, is multiplied by the exclusion percentage. The result is the tax-free part of the pension. The remaining amount of pension income is taxable. For a full explanation and the tables you need, get Publication 939, *General Rule for Pensions and Annuities*.

Once the tax-free amount is figured using the General Rule, it remains the same in future years, even if payments become larger. All increases in the installment payments, including cost of living increases, are fully taxable.

TAX TIPS

★★★★★★★★★
Most taxpayers who retire in 2002 can no longer use the General Rule. Unless the exception applies, retirees must use the Simplified Method for annuity payments from a qualified plan.

TAX TIPS

★★★★★★★★★
If the taxpayer must use the General Rule for annuity payments received from a nonqualified plan (including a commercial annuity), tell the taxpayer to consult a paid professional tax preparer or get Publication 939. However, if the exclusion percentage has already been calculated for the taxpayer it can be used for all future returns.

If the annuity starting date was before 1987, the taxpayer will exclude from the taxable income the tax-free amount until the pension income ceases.

If the annuity starting date of an eligible taxpayer is during or after 1987, the tax-free amount is excluded from taxable income until the pension cost is recovered. Once the pension cost is recovered, all of the pension income is taxable. If the taxpayer (or the last annuitant) dies before recovering all of the pension cost, a miscellaneous itemized deduction on Schedule A (Form 1040) is allowed (not subject to the 2-percent-of-adjusted-gross-income limitation) for the unrecovered cost on his or her final income tax return filed for the year of death.

TAX TIPS

★★★★★★★★★

The annuity starting date is either the first day of the first period for which the taxpayer receives payment under the contract, or the date upon which the obligation under the contract becomes fixed, whichever comes later.

TAX TIPS

★★★★★★★★★

Total pension received, line 1 of the Simplified Method Worksheet, should be the pension income before deductions such as insurance premiums and income tax.

TAX TIPS

★★★★★★★★★

On line 3 of the Simplified Method Worksheet, enter the number that applies from either Table 1 or Table 2.

The Simplified Method

If the taxpayer's annuity starting date is after November 18, 1996, he or she must use the Simplified Method to figure the taxable portion of his or her pension if he or she participated in a qualified plan.

The Simplified Method must be used only if:

- The annuity starting date is after July 1, 1986,
- The annuity payments are for either (a) the duration of the taxpayer's life, or (b) the duration of the lives of the taxpayer and his or her beneficiary,
- The pension or annuity payments are from a qualified employee plan, a qualified employee annuity, or a tax-sheltered annuity, **and**
- At the time the pension or annuity payments began, the taxpayer was under the age of 75 **or** was entitled to less than 5 years of guaranteed payments.

For pensions starting after December 31, 1986, the taxpayer will exclude the nontaxable pension amount until the pension cost is recovered. Once the pension cost is recovered, the entire pension income is taxable.

The method shown in Table 2 of the Simplified Method Worksheet is used to figure the tax-free portion of joint and survivor annuity payments from a qualified plan. Under this recovery method, you must combine the ages of the annuitants at the birthdays preceding the annuity starting date. Example 1 shows how the Simplified Method applies if the annuity is payable over the lives of more than one annuitant after 1997.

Example 1

Peter, age 65, receives retirement benefits under a joint and survivor annuity, to be paid over the joint lives of Peter and his wife, Mary, age 62. Peter's annuity starting date is January 1, 2002. He contributed \$31,000 to a qualified plan and did not receive any distributions before the annuity starting date. Peter receives monthly payments of \$1,200 and his tax-free

monthly amount is \$100. Mary will receive monthly survivor benefits of \$600 upon her husband's death. See Exhibit 1 for a completed Simplified Method Worksheet for Peter.

Use the Simplified Method for Peter because his annuity starting date is after November 18, 1996, and the payments are from a qualified plan. In addition, because his annuity starting date is after December 31, 1997, and his annuity is payable over the lives of more than one annuitant, you must combine his age with his wife's age in completing line 3 of the worksheet. Complete the worksheet as follows:

TAX TIPS

★★★★★★★★★★
Once figured, the monthly exclusion amount remains the same even when the pension income increases.

Exhibit 1

Simplified Method Worksheet

Simplified Method Worksheet—Lines 16a and 16b		Keep for Your Records
Before you begin:	<input checked="" type="checkbox"/> If you are the beneficiary of a deceased employee or former employee who died before August 21, 1996, see Pub. 939 to find out if you are entitled to a death benefit exclusion of up to \$5,000. If you are, include the exclusion in the amount entered on line 2 below.	
Note. If you had more than one partially taxable pension or annuity, figure the taxable part of each separately. Enter the total of the taxable parts on Form 1040, line 16b. Enter the total pension or annuity payments received in 2002 on Form 1040, line 16a.		
1. Enter the total pension or annuity payments received in 2002. Also, enter this amount on Form 1040, line 16a	2. Enter your cost in the plan at the annuity starting date	1. <u>14,400</u>
2. 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	3. Divide line 2 by the number on line 3	2. <u>31,000</u>
3. Multiply line 4 by the number of months for which this year's payments were made. If your annuity starting date was before 1987, skip lines 6 and 7 and enter this amount on line 8. Otherwise, go to line 6	4. Enter the amount, if any, recovered tax free in years after 1986	3. <u>310</u>
4. Enter the amount, if any, recovered tax free in years after 1986	5. Subtract line 6 from line 2	4. <u>100</u>
5. Enter the smaller of line 5 or line 7.	6. Taxable amount. Subtract line 8 from line 1. Enter the result, but not less than zero. Also, enter this amount on Form 1040, line 16b. If your Form 1099-R shows a larger amount, use the amount on this line instead of the amount from Form 1099-R	5. <u>1,200</u>
		6. <u>0</u>
		7. <u>31,000</u>
		8. <u>1,200</u>
		9. <u>13,200</u>
Table 1 for Line 3 Above		
AND your annuity starting date was—		
IF the age at annuity starting date (see page 25) 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		
IF the combined ages at annuity starting date (see page 25) were . . .	THEN enter on line 3 . . .	
110 or under	410	
111-120	360	
121-130	310	
131-140	260	
141 or older	210	
<i>Need more information or forms? See page 7.</i>		
- 24 -		

TAX TIPS

★★★★★★★★★★
Line 6 of the Simplified Method Worksheet can be more complicated than in Example 1. Line 6 is the total tax-free pension income recovered in previous years. It includes amounts excluded from taxable income after 1986. Get Pub. 17, Chapter 11, and Pub. 575 for more information and additional examples.

After Peter excludes \$31,000 from taxable income this year and in future years, the rest of his retirement benefits will be fully taxable. Because this is a joint and survivor annuity, if Peter dies before recovering all of the pension cost, his wife will also exclude \$100 from her \$600 monthly payment until the pension cost is fully recovered. If she dies before recovering all of the pension cost, the remaining unrecovered cost will be deducted on her final income tax return as a miscellaneous itemized deduction on Schedule A (Form 1040) (not subject to the 2-percent-of-adjusted-gross-income limitation).

If the taxpayer's annuity starting date was before November 19, 1996, (and he or she received payments in prior years), you do not need to recompute the tax-free monthly amount. Enter the monthly exclusion computed in prior years on line 4 of the worksheet. If the taxpayer did not keep a copy of the completed worksheet for 2001, use the recovery rates from Table 1 (line 3) of the Simplified Method Worksheet.

Note: The Simplified Method Worksheet is part of the 1099R input screen in the Taxwise® software. Scroll to the bottom of the input screen to see the worksheet.

Form 1099-R

Pension income is reported on Form 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.* Generally, the taxpayer's after-tax contributions to a profit-sharing or retirement plan that was recovered tax-free, this year, is shown in box 5 of Form 1099-R. A copy of Form 1099-R should be attached to Form 1040 or Form 1040A, if there is an entry in box 4 (Federal income tax withheld).

Reporting Pension Income

Total pension income is entered on either Form 1040, line 16a, or Form 1040A, line 12a. The taxable part is entered on Form 1040, line 16b, or on Form 1040A, line 12b. If the pension is fully taxable, enter it on Form 1040, line 16b, or Form 1040A, line 12b and leave Form 1040, line 16a, or Form 1040A, line 12a, blank. If the taxpayer has more than one pension or annuity that is not fully taxable, figure the taxable part of each separately. Enter only totals on the proper lines of Form 1040 and Form 1040A.

TAX TIPS

★★★★★★★★★
When the taxpayer has more than one pension or annuity, use a separate piece of paper as a worksheet to group together detailed information. Only the summary information is entered on Form 1040 or Form 1040A. The worksheet should be kept for future reference.

POTENTIAL PITFALLS



Be sure to add the amounts shown on all Forms 1099-R as federal income tax withheld and enter the total on Form 1040, line 62, or on Form 1040A, line 39. The omission of pension withholding is a frequent error that results in an incorrect amount owed or refunded (and an unhappy taxpayer).

Exercise 1

George, age 65, began receiving pension income under a joint and survivor annuity. George's annuity starting date is January 1, 2002. George had contributed \$26,000 to a qualified plan and had received no distribution before 2002. George is to receive a monthly retirement benefit of \$1,000 and his wife, age 66, is to receive a monthly survivor benefit of \$500 upon George's death. Using the 2002 Form 1099-R for George, complete the Simplified Method Worksheet and Form 1040A, lines 12a and 12b.

Exhibit 2

George's Form 1099-R

<input type="checkbox"/> CORRECTED (if checked)		OMB No. 1545-0119		2002 Form 1099-R	Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.
PAYER'S name, street address, city, state, and ZIP code ABC, Inc. 1042 West 1st Street Dayton, OH 45102		1 Gross distribution \$ 12,000	2a Taxable amount \$		
PAYER'S Federal identification number 10-5432102		3 Capital gain (included in box 2a) \$		4 Federal income tax withheld \$ -0-	
RECIPIENT'S identification number 000-00-6218		5 Employee contributions or insurance premiums \$ 26,000		6 Net unrealized appreciation in employer's securities \$	
RECIPIENT'S name George E. Lopez Street address (including apt. no.) 89 East Forest Avenue City, state, and ZIP code Dayton, OH 45440		7 Distribution code 7	IRA/SEP/SIMPLE <input type="checkbox"/>	8 Other \$ %	
Account number (optional)		9a Your percentage of total distribution %		9b Total employee contributions \$	
State tax withheld \$ \$		10 State tax withheld \$ \$		11 State/Payer's state no. \$ \$	
Local tax withheld \$ \$		13 Local tax withheld \$ \$		14 Name of locality \$ \$	
State distribution \$ \$		12 State distribution \$ \$		15 Local distribution \$ \$	

Form **1099-R** Department of the Treasury - Internal Revenue Service

A. Complete this form.

12a Pensions and annuities. 12a	12b Taxable amount (see page 26). 12b	
--	--	--

Simplified Method Worksheet

Simplified Method Worksheet—Lines 12a and 12b

Keep for Your Records

Before you begin: If you are the beneficiary of a deceased employee or former employee who died **before** August 21, 1996, see Pub. 939 to find out if you are entitled to a death benefit exclusion of up to \$5,000. If you are, include the exclusion in the amount entered on line 2 below. 

Note. If you had more than one partially taxable pension or annuity, figure the taxable part of each separately. Enter the total of the taxable parts on Form 1040A, line 12b. Enter the total pension or annuity payments received in 2002 on Form 1040A, line 12a.

1. Enter the total pension or annuity payments received in 2002. Also, enter this amount on Form 1040A, line 12a . . . 1.
2. Enter your cost in the plan at the annuity starting date 2.
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 3.
4. Divide line 2 by the number on line 3 4.
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, skip lines 6 and 7 and enter this amount on line 8. Otherwise, go to line 6 5.
6. Enter the amount, if any, recovered tax free in years after 1986 6.
7. Subtract line 6 from line 2 7.
8. Enter the **smaller** of line 5 or line 7 8.
9. **Taxable amount.** Subtract line 8 from line 1. Enter the result, but not less than zero. Also, enter this amount on Form 1040A, line 12b. If your Form 1099-R shows a larger amount, use the amount on this line instead of the amount from Form 1099-R. 9.

Table 1 for Line 3 Above

IF the age at annuity starting date (see page 28) 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

IF the combined ages at annuity starting date (see page 28) were . . .	THEN enter on line 3 . . .
110 or under	410
111–120	360
121–130	310
131–140	260
141 or older	210

Lump-sum Distributions

A **lump-sum distribution** is the distribution or payment within one tax year of an employee's entire balance (less deductible voluntary employee contributions and certain amounts forfeited or subject to forfeiture) from all qualified pension, stock bonus, or profit-sharing plans that the employer maintains. To qualify as a lump-sum distribution, the payment must have been made:

- Because the plan participant died, or
- After the participant reached age 59 1/2, or
- Because the participant (not including a self-employed individual) separated from service with the employer, or
- After the participant, if a self-employed individual, becomes totally and permanently disabled.

Lump-sum distributions are reported on Form 1099-R like any other pension distribution. Some lump-sum distributions qualify for special tax treatments. Code A in box 7 of the 1099-R indicates that it is a lump-sum distribution and it qualifies for special tax treatments such as:

- Distributions allocable to pre-1974 participation being taxed at a special rate (there will be an amount in box 3 of Form 1099-R) (The part after 1973 is ordinary income)
- Ten-year tax option of the distributions
- Tax-free rollover of the distribution into an Individual Retirement Arrangement (IRA).

Minimum Distributions

Taxpayers are required to receive **minimum distributions** from qualified employee retirement plans, qualified annuity plans, deferred compensation plans, tax-sheltered annuity plans and Individual Retirement Arrangements (IRAs) other than Roth IRAs.

Distributions must begin by April 1 of the calendar year that follows the calendar year in which the taxpayer reaches age 70 1/2 or retires, if later. (For IRAs, it does not matter whether the taxpayer is employed. Distributions must begin by April 1 of the year following the calendar year in which the taxpayer reaches age 70 1/2.) Required distributions for later years must be made by December 31 of that year.

SPECIAL POPULATIONS



Taxpayers may be subject to an additional tax when a distribution from certain pensions is taken before age 59 1/2. However, if all distributions received are rolled over, the 10% early distribution tax will not apply.

For example, people who are laid off may take a lump-sum distribution and be liable for a tax of 10% in addition to any income tax on the amount distributed.

Taxpayers in this situation should be referred to a paid professional tax preparer.

A minimum distribution is:

- The entire amount in the pension plan, or
- Regular periodic distributions in an amount large enough to use up the entire amount in the pension plan over:
 1. The taxpayer's life expectancy,
 2. The joint life expectancies of the taxpayer and a designated surviving beneficiary, or
 3. A shorter period of time than these life expectancies.

IMPORTANT! If the taxpayer does not receive the minimum distribution, an excise tax may be imposed. The tax is 50 percent of the difference between the minimum distribution and the amount actually distributed for the tax year.

TAXABLE SOCIAL SECURITY AND RAILROAD RETIREMENT BENEFITS

Part of the social security benefits or Part of the social security equivalent portion of tier 1 railroad retirement benefits a taxpayer receives may be taxable. The taxable amount, if any, depends upon the rest of the taxpayer's income and filing status. Many taxpayers that you assist will not have enough income for any of their benefits to be taxable.

Taxable Benefits

The taxable amount of benefits received is figured using the worksheet provided in the instruction booklets for Forms 1040 and 1040A.

The computation to figure the taxable amount is the same for both types of benefits.

1. Social Security Monthly Benefits

Social security benefits are payments made under Title II of the Social Security Act. They include old-age, survivors', disability, insurance, and some workers' compensation benefits.

Social security benefits are reported to the taxpayer on Form SSA-1099, *Social Security Benefit Statement* (see Exhibit 3.) The amount in box 5, *Net benefits for 2002*, is entered on a worksheet to figure if any of the benefits are taxable. Net benefits are the gross benefits less any repayments made by the taxpayer in the tax year. Make sure you enter only the amount from box 5 of Form SSA-1099 on line 1 of the worksheet.

PERSON

TO

PERSON

Taxpayers may become upset when you question them about their social security benefits. They may insist that benefits are tax free. Use your effective communication skills to calm them. Explain that some benefits could be taxable, but you must do the calculations before that can be determined.

Neither Form SSA-1099 nor the worksheet is attached to the income tax return. They are kept with the taxpayer's other personal records.

2. Railroad Retirement Benefits

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

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" and is treated for tax purposes like social security benefits. It is shown on the blue part of the Form RRB-1099, *Payments by the Railroad Retirement Board*. Use the amount from box 5 of Form RRB-1099 to complete the worksheet.

The **second category** contains the rest of the tier 1 benefits, called the "non-social security equivalent benefit," any tier 2 benefits, vested dual benefits, and supplemental annuity benefits. This category of benefits, shown on the green part of the Form RRB-1099-R, *Annuities or Pensions by the Railroad Retirement Board*, is treated as an amount received from a qualified employer plan. Vested dual benefits and supplemental annuity benefits are fully taxable pensions. Publication 575, *Pension and Annuity Income* explains the items shown on the form.

Who Should Report?

Benefits, if taxable, are included in the income of the person with the legal right to receive them. Forms SSA-1099 and RRB-1099 will show this person's name. If a child receives benefits, the check may be in the parent's name. The benefits actually belong to the child, however, and are not reported on the parent's tax return.

COMMON QUERIES

If the taxpayer's only income was social security benefits, none of the benefits are taxable.

SPECIAL POPULATIONS



The *Social Security Benefits Worksheet* is not used for taxpayers who are nonresident aliens. Special tax rules apply to their benefits, and they should consult a paid professional tax preparer.

TAX TIPS

★★★★★★★★★★
A copy of a *Social Security Benefits Worksheet for Form 1040* is included in the *IRS Volunteer Quick Reference Guide*, which is part of your Publication 678 Package.

Example 2

Anne and her son, Tony, both receive survivor social security benefits. Anne receives a benefit check for \$400 each month. A portion of these benefits belongs to Tony. He was sent a Form SSA-1099, which showed \$1,800 of net benefits received. Tony also had \$4,000 income from a summer job and some interest income. When you prepare his tax return, you would complete a *Social Security Benefits Worksheet* for Tony to figure if any of his social security benefits are taxable.

When you complete Anne's tax return, you would include only the \$3,000 of her social security benefits on her worksheet to figure if any of her benefits are taxable.

If the taxpayer files a joint return, you must combine the income and benefits of both spouses when completing the worksheet.

Even if the spouse received no social security benefits, include the spouse's other income when completing the worksheet. If both spouses received benefits, combine both their benefits and income, and complete only one worksheet.

Example 3

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

Using the Social Security Benefits Worksheet

The *Social Security Benefits Worksheet* is found in the instruction booklets for Forms 1040 and 1040A. The worksheet is used to figure the taxable portion of benefits received.

Some of the benefits received are taxable if total income, plus one-half of the benefits received, is more than certain **base amounts**. The current base income amounts are:

- \$32,000 if married and filing a joint return
- \$25,000 if taxpayer is filing as single, head of household, or qualifying widow(er) with dependent child
- \$25,000 if married but filing separately, and the taxpayer **did not** live with his or her spouse at any time during 2002
- \$0 if married filing separately, and the taxpayer **did** live with his or her spouse at any time during 2002

Report taxable social security benefits on Form 1040, line 20b, or Form 1040A, line 14b. Complete the other income and adjustment items on page 1 of Form 1040 or Form 1040A before you use the *Social Security Benefits Worksheet*. Then complete the other lines of the worksheet to figure if any of the benefits are taxable.

If the worksheet shows that no benefits are taxable, leave the line blank for social security benefits on Form 1040 or Form 1040A. Then total page 1 and complete the remainder of the tax return.

If you determine that any benefits are taxable, complete line 20 of Form 1040 or line 14 of Form 1040A. Enter the social security benefits received on Form 1040, line 20a, and enter the taxable portion (from line 18 of the worksheet) on line 20b. On Form 1040A, enter the benefits received on line 14a, and enter the taxable portion of benefits on line 14b.

The taxable portion of social security benefits is never more than 85 percent of the net benefits the taxpayer has received. In many cases, the taxable portion is less than 50 percent.

Example 4

Ray and Susan are married and file a joint Form 1040. Ray is retired and receives a fully taxable pension of \$12,000 (Form 1040, line 16b). Ray received a \$3,000 short-term capital gain from the sale of stock. He must file a Schedule D to report the gain. Ray also receives social security benefits. His Form SSA-1099 is shown in Exhibit 3. Susan worked and earned wages of \$21,500 (Form 1040, line 7) in 2002. She also contributed \$560 to her traditional IRA (Form 1040, line 23). Susan is not covered at work by a pension plan. Ray and Susan's completed *Social Security Benefits Worksheet* is shown in Exhibit 4.

Exhibit 5 shows Ray and Susan's Form 1040 for 2002. The amount from line 1 of the worksheet is entered on line 20a of Form 1040. Then the taxable benefits (\$3,050) from line 18 of the worksheet is entered on line 20b.

TAX TIPS

★★★★★★★★★★

When completing line 1 of the worksheet, be sure to use the amount from box 5, *Net Benefits*, on Form SSA-1099 or Form RRB-1099. Do not enter the amount from box 3.

SPECIAL POPULATIONS



Certain taxpayers may have to include up to 85% of their total net benefits from social security and equivalent railroad retirement in taxable income.

FORM SSA-1099 – SOCIAL SECURITY BENEFIT STATEMENT

2002 • PART OF YOUR SOCIAL SECURITY BENEFITS SHOWN IN BOX 5 MAY BE TAXABLE INCOME.
 • SEE THE REVERSE FOR MORE INFORMATION.

Box 1. Name Ray Hess		Box 2. Beneficiary's Social Security Number 000-00-6735
Box 3. Benefits Paid in 2002 6,100.00	Box 4. Benefits Repaid to SSA in 2002	Box 5. Net Benefits for 2002 (Box 3 minus Box 4) 6,100.00
DESCRIPTION OF AMOUNT IN BOX 3		DESCRIPTION OF AMOUNT IN BOX 4
<p style="font-size: 2em; opacity: 0.5; transform: rotate(-30deg); position: absolute; top: 50%; left: 50%;">Draft as of 7/31/2002</p>		Box 6. Voluntary Federal Income Tax Withholding
		Box 7. Address 1234 Main St. Wilton, FL 10123
		Box 8. Claim Number (Use this number if you need to contact SSA.)

Form SSA-1099-SM (1-2002)

DO NOT RETURN THIS FORM TO SSA OR IRS

Social Security Benefits Worksheet—Lines 20a and 20b

Keep for Your Records

Before you begin:

- ✓ Complete Form 1040, lines 21, 23, 24, and 27 through 33a, if they apply to you.
- ✓ Figure any amount to be entered on the dotted line next to line 34 (see page 30).
- ✓ If you are married filing separately and you **lived apart** from your spouse for all of 2002, enter "D" to the right of the word "benefits" on line 20a.
- ✓ Be sure you have read the **Exception** on page 25 to see if you can use this worksheet instead of a publication to find out if any of your benefits are taxable.



<p>1. Enter the total amount from box 5 of all your Forms SSA-1099 and RRB-1099</p> <p>2. Enter one-half of line 1</p> <p>3. Add the amounts on Form 1040, lines 7, 8a, 9 through 14, 15b, 16b, 17 through 19, and 21. Do not include amounts from box 5 of Forms SSA-1099 or RRB-1099</p> <p>4. Enter the amount, if any, from Form 1040, line 8b</p> <p>5. Add lines 2, 3, and 4</p> <p>6. Add the amounts on Form 1040, lines 23, 24, and 27 through 33a, and any amount you entered on the dotted line next to line 34</p> <p>7. Is the amount on line 6 less than the amount on line 5? <input type="checkbox"/> No. None of your social security benefits are taxable. <input checked="" type="checkbox"/> Yes. Subtract line 6 from line 5</p> <p>8. Enter: \$25,000 if single, head of household, qualifying widow(er), or married filing separately and you lived apart from your spouse for all of 2002; \$32,000 if married filing jointly; -0- if married filing separately and you lived with your spouse at any time in 2002.</p> <p>9. Is the amount on line 8 less than the amount on line 7? <input type="checkbox"/> No. None of your social security benefits are taxable. You do not have to enter any amounts on lines 20a or 20b of Form 1040. But if you are married filing separately and you lived apart from your spouse for all of 2002, enter -0- on line 20b. Be sure you entered "D" to the right of the word "benefits" on line 20a. <input checked="" type="checkbox"/> Yes. Subtract line 8 from line 7</p> <p>10. Enter: \$9,000 if single, head of household, qualifying widow(er), or married filing separately and you lived apart from your spouse for all of 2002; \$12,000 if married filing jointly; -0- if married filing separately and you lived with your spouse at any time in 2002.</p> <p>11. Subtract line 10 from line 9. If zero or less, enter -0-</p> <p>12. Enter the smaller of line 9 or line 10.</p> <p>13. Enter one-half of line 12</p> <p>14. Enter the smaller of line 2 or line 13.</p> <p>15. Multiply line 11 by 85% (.85). If line 11 is zero, enter -0-</p> <p>16. Add lines 14 and 15</p> <p>17. Multiply line 1 by 85% (.85).</p> <p>18. Taxable social security benefits. Enter the smaller of line 16 or line 17 <ul style="list-style-type: none"> • Enter the amount from line 1 above on Form 1040, line 20a. • Enter the amount from line 18 above on Form 1040, line 20b. </p>	<p>1. <u>6,100</u></p> <p>2. <u>3,050</u></p> <p>3. <u>36,500</u></p> <p>4. <u>- 0 -</u></p> <p>5. <u>39,550</u></p> <p>6. <u>560</u></p> <p>7. <u>38,990</u></p> <p>8. <u>32,000</u></p> <p>9. <u>6,990</u></p> <p>10. <u>12,000</u></p> <p>11. <u>- 0 -</u></p> <p>12. <u>6,990</u></p> <p>13. <u>3,495</u></p> <p>14. <u>3,050</u></p> <p>15. <u>- 0 -</u></p> <p>16. <u>3,050</u></p> <p>17. <u>5,185</u></p> <p>18. <u>3,050</u></p>
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If part of your benefits are taxable for 2002 **and** they include benefits paid in 2002 that were for an earlier year, you may be able to reduce the taxable amount. See Pub. 915 for details.

<p>Income</p> <p>Attach Forms W-2 and W-2G here. Also attach Form(s) 1099-R if tax was withheld.</p> <p>If you did not get a W-2, see page 21.</p> <p>Enclose, but do not attach, any payment. Also, please use Form 1040-V.</p>	7	Wages, salaries, tips, etc. Attach Form(s) W-2	7			
	8a	Taxable interest. Attach Schedule B if required	8a			
	b	Tax-exempt interest. Do not include on line 8a	8b			
	9	Ordinary dividends. Attach Schedule B if required	9			
	10	Taxable refunds, credits, or offsets of state and local income taxes (see page 22)	10			
	11	Alimony received	11			
	12	Business income or (loss). Attach Schedule C or C-EZ	12			
	13	Capital gain or (loss). Attach Schedule D if required. If not required, check here ► <input type="checkbox"/>	13			
	14	Other gains or (losses). Attach Form 4797	14			
	15a	IRA distributions	15a			
	b	Taxable amount (see page 23)	15b			
	16a	Pensions and annuities	16a			
	b	Taxable amount (see page 23)	16b			
	17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E	17			
	18	Farm income or (loss). Attach Schedule F	18			
	19	Unemployment compensation	19			
	20a	Social security benefits	20a	6,100 00		
	b	Taxable amount (see page 25)	20b		3,050 00	
	21	Other income. List type and amount (see page 27)	21			
	22	Add the amounts in the far right column for lines 7 through 21. This is your total income ►	22			
	<p>Adjusted Gross Income</p>	23	Educator expenses (see page xx)	23		
		24	IRA deduction (see page 27)	24		
25		Student loan interest deduction (see page 28)	25			
26		Tuition and fees deduction (see page XX)	26			
27		Archer MSA deduction. Attach Form 8853	27			
28		Moving expenses. Attach Form 3903	28			
29		One-half of self-employment tax. Attach Schedule SE	29			
30		Self-employed health insurance deduction (see page 30)	30			
31		Self-employed SEP, SIMPLE, and qualified plans	31			
32		Penalty on early withdrawal of savings	32			
33a	Alimony paid b Recipient's SSN ►	33a				
34	Add lines 23 through 33a	34				
35	Subtract line 34 from line 22. This is your adjusted gross income ►	35				

Exercise 2

Steve Ransom and his wife separated in July and Steve moved into an apartment. They are still legally married, but they are filing separate returns. Steve's Form 1040A shows income of \$18,975 (wages) before considering his social security benefits. He has no tax-exempt interest income and no adjustments to income. Steve's Form SSA-1099 is shown in Exhibit 6.

- A. Complete Steve's *Social Security Benefits Worksheet*, Exhibit 7.
- B. Complete lines 7 through 18 of Steve's Form 1040A, Exhibit 8.

FORM SSA-1099 – SOCIAL SECURITY BENEFIT STATEMENT

2002 • PART OF YOUR SOCIAL SECURITY BENEFITS SHOWN IN BOX 5 MAY BE TAXABLE INCOME.
 • SEE THE REVERSE FOR MORE INFORMATION.

Box 1. Name Steve Ransom		Box 2. Beneficiary's Social Security Number 000-00-4356	
Box 3. Benefits Paid in 2002 8,250.00	Box 4. Benefits Repaid to SSA in 2002	Box 5. Net Benefits for 2002 (Box 3 minus Box 4) 8,250.00	
DESCRIPTION OF AMOUNT IN BOX 3		DESCRIPTION OF AMOUNT IN BOX 4	
		Box 6. Voluntary Federal Income Tax Withholding	
		Box 7. Address 1234 Main St. Wilton, FL 10123	
		Box 8. Claim Number (Use this number if you need to contact SSA.)	

Draft as of 7/31/2002

Social Security Benefits Worksheet—Lines 14a and 14b

Keep for Your Records

Before you begin:

- ✓ Complete Form 1040A, lines 16 and 17, if it applies to you.
- ✓ If you are married filing separately and you **lived apart** from your spouse for all of 2002, enter "D" to the right of the word "benefits" on line 14a.
- ✓ Be sure you have read the **Exception** on page 30 to see if you can use this worksheet instead of a publication to find out if any of your benefits are taxable.



1. Enter the total amount from box 5 of all your Forms SSA-1099 and Forms RRB-1099 1.	1. <input style="width: 80px;" type="text"/>
2. Is the amount on line 1 more than zero?	
<input type="checkbox"/> No. None of your social security benefits are taxable.	
<input type="checkbox"/> Yes. Enter one-half of line 1 2.	2. <input style="width: 80px;" type="text"/>
3. Add the amounts on Form 1040A, lines 7, 8a, 9, 10, 11b, 12b, and 13. Do not include amounts from box 5 of Forms SSA-1099 or RRB-1099 3.	3. <input style="width: 80px;" type="text"/>
4. Enter the amount, if any, from Form 1040A, line 8b 4.	4. <input style="width: 80px;" type="text"/>
5. Add lines 2, 3, and 4 5.	5. <input style="width: 80px;" type="text"/>
6. Add the amounts on Form 1040A, lines 16 and 17 6.	6. <input style="width: 80px;" type="text"/>
7. Is the amount on line 6 less than the amount on line 5?	
<input type="checkbox"/> No. None of your social security benefits are taxable.	
<input type="checkbox"/> Yes. Subtract line 6 from line 5 7.	7. <input style="width: 80px;" type="text"/>
8. Enter: \$25,000 if single, head of household, qualifying widow(er), or married filing separately and you lived apart from your spouse for all of 2002; \$32,000 if married filing jointly; -0- if married filing separately and you lived with your spouse at any time in 2002 8.	8. <input style="width: 80px;" type="text"/>
9. Is the amount on line 8 less than the amount on line 7?	
<input type="checkbox"/> No. None of your social security benefits are taxable. You do not have to enter any amount on line 14a or 14b of Form 1040A. But if you are married filing separately and you lived apart from your spouse for all of 2002, enter -0- on line 14b. Be sure you entered "D" to the right of the word "benefits" on line 14a.	
<input type="checkbox"/> Yes. Subtract line 8 from line 7 9.	9. <input style="width: 80px;" type="text"/>
10. Enter: \$9,000 if single, head of household, qualifying widow(er), or married filing separately and you lived apart from your spouse for all of 2002; \$12,000 if married filing jointly; -0- if married filing separately and you lived with your spouse at any time in 2002 10.	10. <input style="width: 80px;" type="text"/>
11. Subtract line 10 from line 9. If zero or less, enter -0- 11.	11. <input style="width: 80px;" type="text"/>
12. Enter the smaller of line 9 or line 10 12.	12. <input style="width: 80px;" type="text"/>
13. Enter one-half of line 12 13.	13. <input style="width: 80px;" type="text"/>
14. Enter the smaller of line 2 or line 13 14.	14. <input style="width: 80px;" type="text"/>
15. Multiply line 11 by 85% (.85). If line 11 is zero, enter -0- 15.	15. <input style="width: 80px;" type="text"/>
16. Add lines 14 and 15 16.	16. <input style="width: 80px;" type="text"/>
17. Multiply line 1 by 85% (.85) 17.	17. <input style="width: 80px;" type="text"/>
18. Taxable social security benefits. Enter the smaller of line 16 or line 17 18.	18. <input style="width: 80px;" type="text"/>
<ul style="list-style-type: none"> • Enter the amount from line 1 above on Form 1040A, line 14a. • Enter the amount from line 18 above on Form 1040A, line 14b. 	



If part of your benefits are taxable for 2002 **and** they include benefits paid in 2002 that were for an earlier year, you may be able to reduce the taxable amount. See Pub. 915 for details.

Exhibit 8
Complete this form.

Income Attach Form(s) W-2 here. Also attach Form(s) 1099-R if tax was withheld. <small>If you did not get a W-2, see page 25.</small> <small>Enclose, but do not attach, any payment.</small>	7	Wages, salaries, tips, etc. Attach Form(s) W-2.	7		
	8a	Taxable interest. Attach Schedule 1 if required.	8a		
	b	Tax-exempt interest. Do not include on line 8a.	8b		
	9	Ordinary dividends. Attach Schedule 1 if required.	9		
	10	Capital gain distributions (see page 25).	10		
	11a	IRA distributions.	11a		
			11b Taxable amount (see page 25).	11b	
	12a	Pensions and annuities.	12a		
			12b Taxable amount (see page 26).	12b	
	13	Unemployment compensation and Alaska Permanent Fund dividends.	13		
	14a	Social security benefits.	14a		
			14b Taxable amount (see page 28).	14b	
	15	Add lines 7 through 14b (far right column). This is your total income .	▶ 15		
	Adjusted gross income	16	Educator expenses (see page XX).	16	
		17	IRA deduction (see page 28).	17	
18		Student loan interest deduction (see page 31).	18		
19		Tuition and fees deduction (see page XX).	19		
20		Add lines 16 through 19. These are your total adjustments .	20		
21	Subtract line 20 from line 15. This is your adjusted gross income .	▶ 21			

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see page 53.

Cat. No. 11327A

Form **1040A** (2002)

POTENTIAL PITFALLS 

Taxable social security benefits cannot be reported on Form 1040EZ.

Taxable social security benefits cannot be reported on Form 1040EZ. The taxpayer must use Form 1040 or Form 1040A if any benefits are taxable. If the completed worksheet shows that no benefits are taxable, the taxpayer may be able to use the shorter Form 1040EZ. There are, however, some situations that prevent taxpayers who do not have any taxable social security benefits from using the shorter Form 1040EZ.

POTENTIAL PITFALLS 

A lump-sum death benefit is not subject to tax.

Lump-Sum Benefit Payments

Some taxpayers may have received a **lump-sum benefit payment** in 2002. This payment could be for both the current tax year and the prior tax year. The lump-sum payment will be included in box 3 of the Form SSA-1099 or Form RRB-1099 that the taxpayer receives. The form will also show the year, or years, of the payment.

When figuring the taxable portion of social security benefits, two options are available for lump-sum benefit payments. The first option allows the taxpayer to report the whole payment in 2002, the year it was received. When the taxpayer chooses this option, complete the *Social Security Benefits Worksheet* as usual by including the entire lump-sum payment on line 1.

The taxpayer also has the option of treating the payment as received in the earlier year or years. This is done by figuring whether any part of these benefits is taxable, based on the earlier year's income. Any part that is taxable is then added to any taxable benefits for the current year (2002) and included on Form 1040, line 20b.

If the taxpayer chooses to spread the payments back to earlier years, only 2002 income will be adjusted. The taxpayer does not file amended returns for the earlier years. However, a special procedure **must** be used to figure the taxable portion of the benefits assigned to the earlier years. If the taxpayer wants to use this option, refer him or her to a paid professional tax preparer or to IRS Publication 915, *Social Security and Equivalent Railroad Retirement Benefits*.

DISTRIBUTIONS FROM INDIVIDUAL RETIREMENT ARRANGEMENTS

A taxpayer establishes an **individual retirement arrangement (IRA)** and makes **contributions** to it through a bank, credit union, brokerage, or other entity approved by the IRS. Earnings and gains generally accumulate tax free until they are withdrawn as either taxable, non-taxable or partly taxable **distributions**. There are four kinds of IRAs, each of which offer tax advantages.

As a volunteer, you will be able to complete the return of a taxpayer who received a distribution from an IRA only if the whole distribution is either tax free or taxable as a normal distribution. If part is taxable and part is tax free, refer the taxpayer to a paid professional tax preparer.

For further information about IRAs, see Publication 590, *Individual Retirement Arrangements (IRAs)*.

Traditional IRA. If the taxpayer made nondeductible contributions into the IRA, he or she need not pay income tax on those contributions again when receiving them later as part of a distribution from the traditional IRA. The taxpayer does have to pay tax on the part of traditional IRA distributions that represent either earnings that accumulated tax free in the traditional IRA or contributions that were deducted when the taxpayer paid them into the traditional IRA.

The taxpayer cannot withdraw only nondeductible contributions from a traditional IRA; if there have been any earnings or gains on contributions or deductible contributions have been made to any traditional IRA, part of each distribution will be taxable.

Example 5

Tyrone contributed \$500 a year to a traditional IRA. Each year he deducted his traditional IRA contribution from his income. This year he received his first distribution from the traditional IRA. It is fully taxable. Tyrone will pay income tax on the distributions he receives which represent the contributions he made and deducted as well as the money the contributions have earned over the years.

Example 6

Dorothy contributed \$750 a year to a traditional IRA. She did not qualify to deduct her contributions from her income. This year she received her first distribution from the traditional IRA. She will pay income tax only on the part of the distribution from the traditional IRA that represents earnings on the contributions.

Savings Incentive Match Plans for Employees (SIMPLE) IRA. Some employers offer their employees, including a self-employed individual, the chance to contribute part of their pay to an IRA as part of a SIMPLE plan. The employer is also generally required to make contributions on behalf of eligible employees. The employee is not currently taxed on his or her contributions when they are paid into the IRA. Distributions from a SIMPLE IRA are generally fully taxable.

Simplified Employee Pension (SEP) IRA. Some employers offer their employees the chance to take part in a SEP. Self-employed people also can establish a SEP-IRA for themselves. Generally, SEP-IRA contributions are not included in an employee's income when paid into the IRA. Distributions are generally fully taxable when the employee receives them in later years.

Roth IRA. Contributions to a Roth IRA are not deductible. Distributions from a Roth IRA are tax free if they meet certain conditions, even if they represent earnings that accumulated in the Roth IRA.

Reporting IRA Distributions

IRA distributions are reported on Form 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.*

Traditional IRA, SIMPLE IRA, or SEP-IRA: Box 7 of Form 1099-R shows "7" as the distribution code for a normal distribution, and the box "IRA/SEP/SIMPLE" is checked. Ask the taxpayer whether he or she deducted all traditional IRA contributions from income in the year they were made. If so, the entire distribution is taxable. Report it on Form 1040A, lines 11a and 11b, or on Form 1040, lines 15a and 15b. Distributions from a SIMPLE IRA and from a SEP-IRA are generally fully taxable.

POTENTIAL PITFALLS



Not all taxpayers know how much of their IRA distribution is taxable. Form 1099-R may show the same amount in box 1, *Gross distribution*, and box 2a, *Taxable amount*, even if part of the distribution is non-taxable. Or box 2a, may be blank with a check mark in box 2b, *Taxable amount not determined*. If you cannot tell that all of a distribution is taxable, or that all of it is tax free, refer the taxpayer to a paid professional tax preparer.

Refer the taxpayer to a paid professional tax preparer if the taxpayer either:

- Cannot tell you whether all traditional IRA contributions were deducted or excluded from income in the year they were made, or
- Did not deduct all traditional IRA contributions from income in the year they were made, and they were not otherwise excluded from income that year. Only part of the distribution is taxable now. The taxable part must be computed.

Note: A traditional IRA is any IRA that is not a ROTH, or SIMPLE IRA.

Roth IRA. Form 1099-R shows “J” in box 7. The taxable and tax-free amounts must be computed. Refer the taxpayer to a paid professional tax preparer.

Withdrawal of Excess Contributions

If the taxpayer withdraws excess contributions and any earnings by the due date of the return, he or she will not be subject to an additional 6% tax on the excess contribution. The withdrawal must be completed by the due date of the tax return for that year, including extensions.

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

- 1) No deduction was allowed for the excess contribution.
- 2) All interest or other income earned on the excess contribution is withdrawn.

However, the taxpayer must include in his or her gross income the interest or other income that was earned on the excess contribution. Report it on the return for the year in which the excess contribution was made. The withdrawal of interest or other income may be subject to an additional 10% tax on early withdrawals.

Taxpayers will receive Form 1099-R indicating the amount of the withdrawal. If the excess contribution was made in a previous tax year, the form will indicate the year in which the earnings are taxable.

In general, a taxpayer must include all withdrawals from his or her traditional IRA in gross income. However, if the total contributions to an IRA (other than rollover contributions for the year) are \$3,000 or less (\$3,500 or less if taxpayer is age 50 or older), and there are no employer contributions for the year, the taxpayer can withdraw any excess contribution after the due date for filing the tax return for that year, including extensions, and not include the amount withdrawn in his or her gross

TAX TIPS

★★★★★★★★★★

There is a 10% additional tax on premature distributions (early withdrawals) from a traditional IRA. However, this additional tax will not apply to distributions up to the amount taxpayers pay for unreimbursed medical expenses that exceed 7.5% of their adjusted gross income.

Under certain conditions, the 10% additional tax will also not apply to distributions up to the amount paid for medical insurance for the taxpayer, his or her spouse and his or her dependents. The 10% additional tax also does not apply to distributions from a traditional IRA used to pay qualified higher education expenses or to buy, build, or rebuild a main home. For more information, see Publication 590.

income. ***This applies only to the part of the excess for which the taxpayer did not take a deduction.*** For more information on excess contributions, see Publication 590.

Pension Withholding and Estimated Tax Payments

Income tax is normally withheld from the taxable part of a pension or annuity. At the taxpayer's request, the payer of the pension or annuity can adjust the withholding amount or stop the withholding completely. However, an exemption from withholding generally may not be permitted for payments made outside the United States or its possessions.

A taxpayer who chooses not to have tax withheld may have to pay estimated tax. For more information about estimated tax or withholding, see Lesson 7 and Publication 505, *Tax Withholding and Estimated Tax*.

COMMON QUERIES

Use Form W-4P, *Withholding Certificate for Pension or Annuity Payments*, to change the amount of income tax to be withheld.

▶▶ SUMMING UP THIS LESSON ◀◀

- ▶ Pensions or annuities may have a tax-free portion if the taxpayer made after-tax contributions to the plan.
- ▶ To determine the taxable portion of the annuity payments of a taxpayer, use:
 - a. The Simplified Method if the taxpayer's annuity starting date is after November 18, 1996, and annuity payments are from a qualified plan. For annuity starting dates after 1997, use the annuitant's age (or combined ages if more than one annuitant) at the annuity starting date of the taxpayer(s).
 - b. The General Rule for annuity payments from a nonqualified plan and for certain retirees age 75 or older.
- ▶ Total pension or annuity income and taxable pension or annuity income are entered on Form 1040, lines 16a and 16b, or Form 1040A, lines 12a and 12b.
- ▶ Social security – Nontaxable or taxable
To determine taxable portion of social security payments received by a taxpayer, use: Social Security Benefits Worksheet.
- ▶ Total social security income and taxable portion are entered on Form 1040, lines 20a and 20b, or Form 1040A, lines 14a and 14b.
- ▶ Federal income tax on pension, annuity and social security income can be withheld by the payer, or the taxpayer may choose to pay estimated tax.

Exercise 1

George's Worksheet

Simplified Method Worksheet—Lines 12a and 12b

Keep for Your Records

Before you begin: If you are the beneficiary of a deceased employee or former employee who died **before** August 21, 1996, see Pub. 939 to find out if you are entitled to a death benefit exclusion of up to \$5,000. If you are, include the exclusion in the amount entered on line 2 below.



Note. If you had more than one partially taxable pension or annuity, figure the taxable part of each separately. Enter the total of the taxable parts on Form 1040A, line 12b. Enter the total pension or annuity payments received in 2002 on Form 1040A, line 12a.

1. Enter the total pension or annuity payments received in 2002. Also, enter this amount on Form 1040A, line 12a 1. 12,000.00
2. Enter your cost in the plan at the annuity starting date 2. 26,000.00
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 3. 260.00
4. Divide line 2 by the number on line 3 4. 100.00
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, skip lines 6 and 7 and enter this amount on line 8. Otherwise, go to line 6 5. 1,200.00
6. Enter the amount, if any, recovered tax free in years after 1986 6. 0
7. Subtract line 6 from line 2 7. 26,000.00
8. Enter the **smaller** of line 5 or line 7 8. 1,200.00
9. **Taxable amount.** Subtract line 8 from line 1. Enter the result, but not less than zero. Also, enter this amount on Form 1040A, line 12b. If your Form 1099-R shows a larger amount, use the amount on this line instead of the amount from Form 1099-R. 9. 10,800.00

Table 1 for Line 3 Above

IF the age at annuity starting date (see page 28) 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

IF the combined ages at annuity starting date (see page 28) were . . .	THEN enter on line 3 . . .
110 or under	410
111–120	360
121–130	310
131–140	260
141 or older	210

George's Form 1040A

12a Pensions and annuities.	12a	12,000	12b Taxable amount (see page 26).	12b	10,800
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Social Security Benefits Worksheet—Lines 14a and 14b

Keep for Your Records

Before you begin:

- ✓ Complete Form 1040A, lines 16 and 17, if it applies to you.
- ✓ If you are married filing separately and you **lived apart** from your spouse for all of 2002, enter "D" to the right of the word "benefits" on line 14a.
- ✓ Be sure you have read the **Exception** on page 30 to see if you can use this worksheet instead of a publication to find out if any of your benefits are taxable.



1.	Enter the total amount from box 5 of all your Forms SSA-1099 and Forms RRB-1099 1.	8,250.00
2.	Is the amount on line 1 more than zero?	
	<input type="checkbox"/> No. None of your social security benefits are taxable.	
	<input checked="" type="checkbox"/> Yes. Enter one-half of line 1 2.	4,125.00
3.	Add the amounts on Form 1040A, lines 7, 8a, 9, 10, 11b, 12b, and 13. Do not include amounts from box 5 of Forms SSA-1099 or RRB-1099 3.	18,975.00
4.	Enter the amount, if any, from Form 1040A, line 8b 4.	
5.	Add lines 2, 3, and 4 5.	23,100.00
6.	Add the amounts on Form 1040A, lines 16 and 17 6.	0
7.	Is the amount on line 6 less than the amount on line 5?	
	<input type="checkbox"/> No. None of your social security benefits are taxable.	
	<input checked="" type="checkbox"/> Yes. Subtract line 6 from line 5 7.	23,100.00
8.	Enter: \$25,000 if single, head of household, qualifying widow(er), or married filing separately and you lived apart from your spouse for all of 2002; \$32,000 if married filing jointly; -0- if married filing separately and you lived with your spouse at any time in 2002 8.	0
9.	Is the amount on line 8 less than the amount on line 7?	
	<input type="checkbox"/> No. None of your social security benefits are taxable. You do not have to enter any amount on line 14a or 14b of Form 1040A. But if you are married filing separately and you lived apart from your spouse for all of 2002, enter -0- on line 14b. Be sure you entered "D" to the right of the word "benefits" on line 14a.	
	<input checked="" type="checkbox"/> Yes. Subtract line 8 from line 7 9.	23,100.00
10.	Enter: \$9,000 if single, head of household, qualifying widow(er), or married filing separately and you lived apart from your spouse for all of 2002; \$12,000 if married filing jointly; -0- if married filing separately and you lived with your spouse at any time in 2002 10.	0
11.	Subtract line 10 from line 9. If zero or less, enter -0- 11.	23,100.00
12.	Enter the smaller of line 9 or line 10 12.	0
13.	Enter one-half of line 12 13.	0
14.	Enter the smaller of line 2 or line 13 14.	0
15.	Multiply line 11 by 85% (.85). If line 11 is zero, enter -0- 15.	19,635.00
16.	Add lines 14 and 15 16.	19,635.00
17.	Multiply line 1 by 85% (.85) 17.	7,013.00
18.	Taxable social security benefits. Enter the smaller of line 16 or line 17 18.	7,013.00

- Enter the amount from line 1 above on Form 1040A, line 14a.
- Enter the amount from line 18 above on Form 1040A, line 14b.



If part of your benefits are taxable for 2002 **and** they include benefits paid in 2002 that were for an earlier year, you may be able to reduce the taxable amount. See Pub. 915 for details.

Exercise 2
(B)

Steve's Form 1040A

<p>Income</p> <p>Attach Form(s) W-2 here. Also attach Form(s) 1099-R if tax was withheld.</p> <p>If you did not get a W-2, see page 25.</p> <p>Enclose, but do not attach, any payment.</p>	7	Wages, salaries, tips, etc. Attach Form(s) W-2.	7	18,975	00	
	8a	Taxable interest. Attach Schedule 1 if required.	8a			
	b	Tax-exempt interest. Do not include on line 8a.	8b			
	9	Ordinary dividends. Attach Schedule 1 if required.	9			
	10	Capital gain distributions (see page 25).	10			
	11a	IRA distributions.	11a			
	11b	Taxable amount (see page 25).	11b			
	12a	Pensions and annuities.	12a			
	12b	Taxable amount (see page 26).	12b			
	13	Unemployment compensation and Alaska Permanent Fund dividends.	13			
	14a	Social security benefits.	14a	8,250	00	
	14b	Taxable amount (see page 28).	14b	7,013	00	
	15	Add lines 7 through 14b (far right column). This is your total income .	▶ 15	25,988	00	
	<p>Adjusted gross income</p>	16	Educator expenses (see page XX).	16		
		17	IRA deduction (see page 28).	17		
18		Student loan interest deduction (see page 31).	18			
19		Tuition and fees deduction (see page XX).	19			
20		Add lines 16 through 19. These are your total adjustments .	20			
21	Subtract line 20 from line 15. This is your adjusted gross income .	▶ 21	25,988	00		
<p>For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see page 53. Cat. No. 11327A Form 1040A (2002)</p>						

STUDENT NOTES

CREDIT FOR THE ELDERLY OR THE DISABLED

LESSON 15

INTRODUCTION AND OBJECTIVES

In this lesson, you will learn about the credit for the elderly or the disabled.

After completing this lesson you should be able to:

- **Figure** and **claim** the credit for the elderly of the disabled using Schedule R, Form 1040 or Schedule 3, Form 1040A.

TAX TIPS

★★★★★★★★★
Schedule R (Form 1040) is included in the *Tax Forms Booklet Appendix*.

SPECIAL POPULATIONS



Certain work offered at qualified locations to persons with disabilities or with mental retardation is considered sheltered employment. Because a person has accepted sheltered employment is not proof of the person's ability to engage in substantial gainful activity.

ALERT



Although physician statements are no longer required to be attached to the return, they must be completed and kept with the taxpayer's records.

CREDIT FOR THE ELDERLY OR THE DISABLED

Elderly individuals and individuals who are permanently and totally disabled may be able to claim a special credit on their tax returns if they are a U.S. citizen or resident. To be eligible for the credit, an individual must be:

- At least 65 years old by the end of the year, or
- Under age 65, retired on permanent and total disability by the end of the year and did not reach mandatory retirement age before this year. They must also have received taxable disability income for this year.

Many elderly taxpayers are not eligible for this credit because of the income limitations. Here, we will cover the basics of determining who is eligible.

Exhibit 1 helps to determine if the taxpayer is a qualified individual for this credit. Also, taxpayers cannot exceed the income limits for their filing status (see **Exhibit 2**).

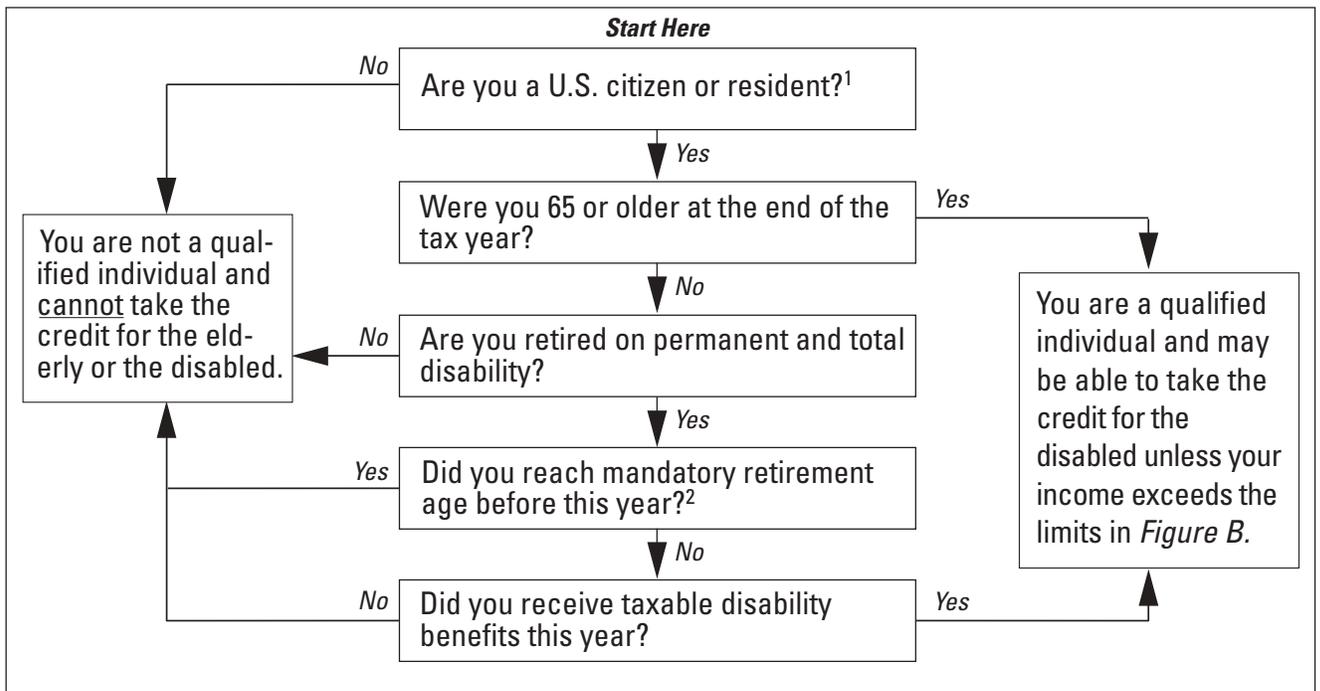
If the taxpayer is a qualified individual and meets the income limits, complete a Schedule 3 for 1040A filers or a Schedule R for 1040 filers. Schedule R (Form 1040) and Schedule 3 (Form 1040A) are almost identical. The instructions for completing Schedule 3 can be used to complete Schedule R.

Example 1

Carlos (000-00-9850) and Lucinda Fernandez are married and file a joint return. Their respective ages are 66 and 68. They received nontaxable social security benefits of \$4,500 in 2002. They had adjusted gross income (line 35, Form 1040) of \$13,000. Parts I and III of the Schedule R will be completed and the schedule attached to their Form 1040 for 2002. (Part II need not be completed since both are age 65 or older.) See Exhibits 3 and 4.

For additional information on the credit for the elderly, refer to the instructions for the schedules or Publication 524, *Credit for the Elderly or the Disabled*.

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 both choose to be treated as U.S. residents, 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**

Even if you qualify (see Figure A), you CANNOT take the credit if:		
Your filing status is	AND your adjusted gross income (AGI)* is equal to or more than	OR your nontaxable social security or 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 <i>Figure A</i>	\$25,000	\$7,500
Married filing a joint return and only one spouse qualifies in <i>Figure A</i>	\$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 20, or Form 1040, line 34.

**Schedule R
(Form 1040)**

Department of the Treasury
Internal Revenue Service (99)

Credit for the Elderly or the Disabled

OMB No. 1545-0074

2002

Attachment
Sequence No. **16**

▶ **Attach to Form 1040.** ▶ **See Instructions for Schedule R (Form 1040).**

Name(s) shown on Form 1040

Carlos and Lucinda Fernandez

Your social security number

000 00 9850

You may be able to take this credit and reduce your tax if by the end of 2002:

- You were age 65 or older **or**
- You were under age 65, you retired on **permanent and total** disability, and you received taxable disability income.

But you must also meet other tests. See page R-1.

TIP In most cases, the IRS can figure the credit for you. See page R-1.

Part I Check the Box for Your Filing Status and Age

If your filing status is: And by the end of 2002: Check only one box:

Single,
Head of household, or
Qualifying widow(er)
with dependent child

1 You were 65 or older **1**

2 You were under 65 and you retired on permanent and total disability **2**

3 Both spouses were 65 or older **3**

4 Both spouses were under 65, but only one spouse retired on permanent and total disability **4**

Married filing jointly

5 Both spouses were under 65, and both retired on permanent and total disability **5**

6 One spouse was 65 or older, and the other spouse was under 65 and retired on permanent and total disability **6**

7 One spouse was 65 or older, and the other spouse was under 65 and **not** retired on permanent and total disability **7**

Married filing separately

8 You were 65 or older and you lived apart from your spouse for all of 2002 **8**

9 You were under 65, you retired on permanent and total disability, and you lived apart from your spouse for all of 2002 **9**

Did you check box 1, 3, 7, or 8?

Yes —▶ Skip Part II and complete Part III on back.

No —▶ Complete Parts II and III.

Part II Statement of Permanent and Total Disability (Complete **only** if you checked box 2, 4, 5, 6, or 9 above.)

If: 1 You filed a physician's statement for this disability for 1983 or an earlier year, or you filed or got a statement for tax years after 1983 and your physician signed line B on the statement, **and**

2 Due to your continued disabled condition, you were unable to engage in any substantial gainful activity in 2002, check this box

- If you checked this box, you do not have to get another statement for 2002.
- If you **did not** check this box, have your physician complete the statement on page R-4. You **must** keep the statement for your records.

Part III Figure Your Credit

10 If you checked (in Part I):		Enter:			
Box 1, 2, 4, or 7		\$5,000	}	10	7,500 00
Box 3, 5, or 6		\$7,500			
Box 8 or 9		\$3,750			
Did you check box 2, 4, 5, 6, or 9 in Part I?		Yes →	You must complete line 11.		
		No →	Enter the amount from line 10 on line 12 and go to line 13.		
11 If you checked (in Part I):				11	
<ul style="list-style-type: none"> Box 6, add \$5,000 to the taxable disability income of the spouse who was under age 65. Enter the total. Box 2, 4, or 9, enter your taxable disability income. Box 5, add your taxable disability income to your spouse's taxable disability income. Enter the total. 					
TIP For more details on what to include on line 11, see page R-3.					
12 If you completed line 11, enter the smaller of line 10 or line 11; all others , enter the amount from line 10				12	7,500 00
13 Enter the following pensions, annuities, or disability income that you (and your spouse if filing a joint return) received in 2002.					
a Nontaxable part of social security benefits and Nontaxable part of railroad retirement benefits treated as social security. See page R-3.			13a	4,500	00
b Nontaxable veterans' pensions and Any other pension, annuity, or disability benefit that is excluded from income under any other provision of law. See page R-3.			13b		
c Add lines 13a and 13b. (Even though these income items are not taxable, they must be included here to figure your credit.) If you did not receive any of the types of nontaxable income listed on line 13a or 13b, enter -0- on line 13c			13c	4,500	00
14 Enter the amount from Form 1040, line 36		14		13,000	00
15 If you checked (in Part I):		Enter:			
Box 1 or 2		\$7,500	}	15	10,000 00
Box 3, 4, 5, 6, or 7		\$10,000			
Box 8 or 9		\$5,000			
16 Subtract line 15 from line 14. If zero or less, enter -0-			16	3,000	00
17 Enter one-half of line 16			17	1,500	00
18 Add lines 13c and 17			18	6,000	00
19 Subtract line 18 from line 12. If zero or less, stop ; you cannot take the credit. Otherwise, go to line 20			19	1,500	00
20 Multiply line 19 by 15% (.15)			20	225	00
21 Enter the amount from Form 1040, line 44			21		
22 Add the amounts from Form 1040, lines 45 and 46, and enter the total			22		
23 Subtract line 22 from line 21			23	0	00
24 Credit for the elderly or the disabled. Enter the smaller of line 20 or line 23 here and on Form 1040, line 47			24	225	00



STUDENT NOTES

PENSION EARNER COMPREHENSIVE PROBLEMS

INTRODUCTION

In this section, you will complete tax returns for several common pension earner scenarios often encountered at volunteer assistance sites. This will be valuable practice as you prepare to help taxpayers. Although answers to each of the problems are shown at the end of this section, you should try to complete the blank forms for each problem before referring to its answers.

After completing this section, you will be able to:

- accurately complete a basic tax return with some advanced topics.

PROBLEM 1

Kirk J. Evergreen, SSN 000-00-2345, lives at 2610 Yellowstone Street, Missoula, MT 59810. He is 68 and retired. He files a joint return with his wife, Mary, age 55, whose social security number (SSN) is 000-00-5678. They do not wish to contribute to the Presidential Election Campaign Fund. They would like any overpayment mailed to their home.

They have \$36 of tax-exempt interest; they have a Form 1099-INT indicating \$287 of interest. Kirk indicates that he received a Form SSA-1099 showing that he was paid \$7,200 in social security benefits. He also received a small taxable pension of \$4,500. He provides documentation substantiating these amounts.

Mary has a part-time job as a clerk, and her Form W-2 indicates that she earned \$12,637 with \$619 of Federal tax withheld. Mary plans to make a \$900 payment to her traditional IRA account; she will make her contribution by the due date of the return.

Kirk and Mary visit TCE Site #101, on 3/16/2003.

PENSION EARNER COMPREHENSIVE PROBLEMS

Complete this form.

Form 1040A, page 1

Form 1040A	Department of the Treasury—Internal Revenue Service U.S. Individual Income Tax Return (99) 2002	IRS Use Only—Do not write or staple in this space.																																																									
Label (See page 19.) Use the IRS label. Otherwise, please print or type.	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 50%; padding: 2px;">Your first name and initial</td> <td style="width: 50%; padding: 2px;">Last name</td> </tr> <tr> <td style="padding: 2px;">If a joint return, spouse's first name and initial</td> <td style="padding: 2px;">Last name</td> </tr> </table>	Your first name and initial	Last name	If a joint return, spouse's first name and initial	Last name	OMB No. 1545-0085 Your social security number Spouse's social security number																																																					
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	Home address (number and street). If you have a P.O. box, see page 20.	Apt. no.	▲ Important! ▲ You must enter your SSN(s) above.																																																								
City, town or post office, state, and ZIP code. If you have a foreign address, see page 20.																																																											
Presidential Election Campaign (See page 20.) <table style="width: 100%; border: none;"> <tr> <td style="border: none;"> Note. Checking "Yes" will not change your tax or reduce your refund. Do you, or your spouse if filing a joint return, want \$3 to go to this fund? . . . </td> <td style="border: none; text-align: right;"> You Spouse <input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> Yes <input type="checkbox"/> No </td> </tr> </table>			Note. Checking "Yes" will not change your tax or reduce your refund. Do you, or your spouse if filing a joint return, want \$3 to go to this fund? . . .	You Spouse <input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> Yes <input type="checkbox"/> No																																																							
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For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see page 53.

Cat. No. 11327A

Form 1040A (2002)

PENSION EARNER COMPREHENSIVE PROBLEMS

Complete this form.

Social Security Benefits Worksheet

Social Security Benefits Worksheet—Lines 14a and 14b

Keep for Your Records

Before you begin:

- ✓ Complete Form 1040A, lines 16 and 17, if it applies to you.
- ✓ If you are married filing separately and you **lived apart** from your spouse for all of 2002, enter 'D' to the right of the word "benefits" on line 14a.
- ✓ Be sure you have read the **Exception** on page 30 to see if you can use this worksheet instead of a publication to find out if any of your benefits are taxable.



1. Enter the total amount from box 5 of all your Forms SSA-1099 and Forms RRB-1099	1.	
2. Is the amount on line 1 more than zero?		
<input type="checkbox"/> No. None of your social security benefits are taxable.		
<input type="checkbox"/> Yes. Enter one-half of line 1	2.	
3. Add the amounts on Form 1040A, lines 7, 8a, 9, 10, 11b, 12b, and 13. Do not include amounts from box 5 of Forms SSA-1099 or RRB-1099	3.	
4. Enter the amount, if any, from Form 1040A, line 8b	4.	
5. Add lines 2, 3, and 4	5.	
6. Add the amounts on Form 1040A, lines 16 and 17	6.	
7. Is the amount on line 6 less than the amount on line 5?		
<input type="checkbox"/> No. None of your social security benefits are taxable.		
<input type="checkbox"/> Yes. Subtract line 6 from line 5	7.	
8. Enter: \$25,000 if single, head of household, qualifying widow(er), or married filing separately and you lived apart from your spouse for all of 2002; \$32,000 if married filing jointly; -0- if married filing separately and you lived with your spouse at any time in 2002	8.	
9. Is the amount on line 8 less than the amount on line 7?		
<input type="checkbox"/> No. None of your social security benefits are taxable. You do not have to enter any amount on line 14a or 14b of Form 1040A. But if you are married filing separately and you lived apart from your spouse for all of 2002, enter -0- on line 14b. Be sure you entered 'D' to the right of the word "benefits" on line 14a.		
<input type="checkbox"/> Yes. Subtract line 8 from line 7	9.	
10. Enter: \$9,000 if single, head of household, qualifying widow(er), or married filing separately and you lived apart from your spouse for all of 2002; \$12,000 if married filing jointly; -0- if married filing separately and you lived with your spouse at any time in 2002	10.	
11. Subtract line 10 from line 9. If zero or less, enter -0-	11.	
12. Enter the smaller of line 9 or line 10	12.	
13. Enter one-half of line 12	13.	
14. Enter the smaller of line 2 or line 13	14.	
15. Multiply line 11 by 85% (.85). If line 11 is zero, enter -0-	15.	
16. Add lines 14 and 15	16.	
17. Multiply line 1 by 85% (.85)	17.	
18. Taxable social security benefits. Enter the smaller of line 16 or line 17	18.	

- Enter the amount from line 1 above on Form 1040A, line 14a.
- Enter the amount from line 18 above on Form 1040A, line 14b.



If part of your benefits are taxable for 2002 **and** they include benefits paid in 2002 that were for an earlier year, you may be able to reduce the taxable amount. See Pub. 915 for details.

PROBLEM 2

Paul and Mary Birch are married and file a joint return.

They live at 123 Green Street, Claremont, CA 91711.

Paul's SSN is 000-00-4321 and Mary's is 000-00-2221. They both want to contribute to the Presidential Election Campaign Fund. They have no dependents.

Paul's wages for 2002 were \$28,542. He works as a computer technician. Mary was self-employed, earning \$7,800 teaching craft classes. Her only expense was \$450 for materials and supplies. Her principal business code is 812990. Paul had \$4,575 of federal taxes withheld from his wages. Mary paid estimated taxes of \$1,625 in 2002.

Paul and Mary received \$478 interest income from their savings account with Main Street Bank. Dividend income was \$242 ordinary dividends from ABC Corporation, and \$317 ordinary dividends, plus \$179 capital gain distributions from XYZ Corporation. On July 9, 2002, Mary sold 200 shares of stock in ABC Corporation. The Form 1099-B reports a net sales price of \$3,300. She had purchased this stock on November 21, 1998, at a cost of \$18.45 per share plus a broker's commission of \$87. In addition, on October 23, 2002, she sold 500 shares of XYZ Markets, Inc., which she purchased on February 18, 2000, at a cost of \$35.00 per share, including broker's commissions. The Form 1099-B reports a net sales price of \$25,000. They have no foreign accounts or trusts.

Paul and Mary are taking a standard deduction. Neither is 65 or more, or blind. You are helping them at TCE Site #33 on Feb. 14, 2003. They want any refund mailed to their home.

PENSION EARNER COMPREHENSIVE PROBLEMS

Complete this form.

Form 1040, page 1

Form **1040** Department of the Treasury—Internal Revenue Service **2002** (99) IRS Use Only—Do not write or staple in this space.

Label

(See instructions on page 19.)

Use the IRS label. Otherwise, please print or type.

L
A
B
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For the year Jan. 1–Dec. 31, 2002, or other tax year beginning _____, 2002, ending _____, 20		OMB No. 1545-0074
Your first name and initial	Last name	Your social security number
If a joint return, spouse's first name and initial	Last name	Spouse's social security number
Home address (number and street). If you have a P.O. box, see page 19.		Apt. no.
City, town or post office, state, and ZIP code. If you have a foreign address, see page 19.		

▲ Important! ▲
You **must** enter your SSN(s) above.

Presidential Election Campaign

(See page 19.)

Note. Checking "Yes" will not change your tax or reduce your refund.
Do you, or your spouse if filing a joint return, want \$3 to go to this fund? Yes No Yes No

Filing Status

Check only one box.

- 1 Single
- 2 Married filing jointly (even if only one had income)
- 3 Married filing separately. Enter spouse's SSN above and full name here. ▶
- 4 Head of household (with qualifying person). (See page 19.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶
- 5 Qualifying widow(er) with dependent child (year spouse died ▶). (See page 19.)

Exemptions

6a <input type="checkbox"/> Yourself. If your parent (or someone else) can claim you as a dependent on his or her tax return, do not check box 6a	No. of boxes checked on 6a and 6b																									
b <input type="checkbox"/> Spouse	No. of children on 6c who:																									
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Dependents on 6c not entered above																										
Add numbers on lines above ▶ <input style="width: 50px; height: 20px;" type="text"/>																										
d Total number of exemptions claimed																										

Income

Attach Forms W-2 and W-2G here. Also attach Form(s) 1099-R if tax was withheld.

If you did not get a W-2, see page 21.

Enclose, but do not attach, any payment. Also, please use **Form 1040-V.**

7 Wages, salaries, tips, etc. Attach Form(s) W-2	7	
8a Taxable interest. Attach Schedule B if required	8a	
b Tax-exempt interest. Do not include on line 8a	8b	
9 Ordinary dividends. Attach Schedule B if required	9	
10 Taxable refunds, credits, or offsets of state and local income taxes (see page 22)	10	
11 Alimony received	11	
12 Business income or (loss). Attach Schedule C or C-EZ	12	
13 Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ <input type="checkbox"/>	13	
14 Other gains or (losses). Attach Form 4797	14	
15a IRA distributions	15a	b Taxable amount (see page 23)
16a Pensions and annuities	16a	b Taxable amount (see page 23)
17 Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E	17	
18 Farm income or (loss). Attach Schedule F	18	
19 Unemployment compensation	19	
20a Social security benefits	20a	b Taxable amount (see page 25)
21 Other income. List type and amount (see page 27)	21	
22 Add the amounts in the far right column for lines 7 through 21. This is your total income ▶	22	

Adjusted Gross Income

23 Educator expenses (see page xx)	23	
24 IRA deduction (see page 27)	24	
25 Student loan interest deduction (see page 28)	25	
26 Tuition and fees deduction (see page XX)	26	
27 Archer MSA deduction. Attach Form 8853	27	
28 Moving expenses. Attach Form 3903	28	
29 One-half of self-employment tax. Attach Schedule SE	29	
30 Self-employed health insurance deduction (see page 30)	30	
31 Self-employed SEP, SIMPLE, and qualified plans	31	
32 Penalty on early withdrawal of savings	32	
33a Alimony paid b Recipient's SSN ▶	33a	
34 Add lines 23 through 33a	34	
35 Subtract line 34 from line 22. This is your adjusted gross income ▶	35	

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see page 72. Cat. No. 11320B Form **1040** (2002)

PENSION EARNER COMPREHENSIVE PROBLEMS

Complete this form.

Form 1040, page 2

Form 1040 (2002)

Page **2**

Tax and Credits

Standard Deduction for—

• People who checked any box on line 37a or 37b or who can be claimed as a dependent, see page 31.

• All others:

Single, \$4,700

Head of household, \$6,900

Married filing jointly or Qualifying widow(er), \$7,850

Married filing separately, \$3,925

36	Amount from line 35 (adjusted gross income)		36	
37a	Check if: <input type="checkbox"/> You were 65 or older, <input type="checkbox"/> Blind; <input type="checkbox"/> Spouse was 65 or older, <input type="checkbox"/> Blind. Add the number of boxes checked above and enter the total here			
b	If you are married filing separately and your spouse itemizes deductions, or you were a dual-status alien, see page 31 and check here			
38	Itemized deductions (from Schedule A) or your standard deduction (see left margin)		38	
39	Subtract line 38 from line 36		39	
40	If line 36 is \$103,000 or less, multiply \$3,000 by the total number of exemptions claimed on line 6d. If line 36 is over \$103,000, see the worksheet on page 32		40	
41	Taxable income. Subtract line 40 from line 39. If line 40 is more than line 39, enter -0-		41	
42	Tax (see page 33). Check if any tax is from a <input type="checkbox"/> Form(s) 8814 b <input type="checkbox"/> Form 4972		42	
43	Alternative minimum tax (see page 34). Attach Form 6251		43	
44	Add lines 42 and 43		44	
45	Foreign tax credit. Attach Form 1116 if required	45		
46	Credit for child and dependent care expenses. Attach Form 2441	46		
47	Credit for the elderly or the disabled. Attach Schedule R	47		
48	Education credits. Attach Form 8863	48		
49	Retirement savings contributions credit. Attach Form 8880	49		
50	Child tax credit (see page XX)	50		
51	Adoption credit. Attach Form 8839	51		
52	Credits from: a <input type="checkbox"/> Form 8396 b <input type="checkbox"/> Form 8859	52		
53	Other credits. Check applicable box(es): a <input type="checkbox"/> Form 3800 b <input type="checkbox"/> Form 8801 c <input type="checkbox"/> Specify	53		
54	Add lines 45 through 53. These are your total credits		54	
55	Subtract line 54 from line 44. If line 54 is more than line 44, enter -0-		55	

Other Taxes

56	Self-employment tax. Attach Schedule SE		56	
57	Social security and Medicare tax on tip income not reported to employer. Attach Form 4137		57	
58	Tax on qualified plans, including IRAs, and other tax-favored accounts. Attach Form 5329 if required		58	
59	Advance earned income credit payments from Form(s) W-2		59	
60	Household employment taxes. Attach Schedule H		60	
61	Add lines 55 through 60. This is your total tax		61	

Payments

If you have a qualifying child, attach Schedule EIC.

62	Federal income tax withheld from Forms W-2 and 1099	62		
63	2002 estimated tax payments and amount applied from 2001 return	63		
64	Earned income credit (EIC)	64		
65	Excess social security and tier 1 RRTA tax withheld (see page 51)	65		
66	Additional child tax credit. Attach Form 8812	66		
67	Amount paid with request for extension to file (see page 51)	67		
68	Other payments from: a <input type="checkbox"/> Form 2439 b <input type="checkbox"/> Form 4136	68		
69	Add lines 62 through 68. These are your total payments		69	

Refund

Direct deposit? See page 51 and fill in 71b, 71c, and 71d.

70	If line 69 is more than line 61, subtract line 61 from line 69. This is the amount you overpaid		70	
71a	Amount of line 70 you want refunded to you		71a	
b	Routing number	c Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings		
d	Account number			
72	Amount of line 70 you want applied to your 2003 estimated tax	72		

Amount You Owe

73	Amount you owe. Subtract line 69 from line 61. For details on how to pay, see page 52	73		
74	Estimated tax penalty (see page 52)	74		

Third Party Designee

Do you want to allow another person to discuss this return with the IRS (see page 53)? Yes. Complete the following. No

Designee's name	Phone no.	Personal identification number (PIN)
-----------------	-----------	--------------------------------------

Sign Here

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Joint return? See page 19. Keep a copy for your records.	Your signature	Date	Your occupation	Daytime phone number
	Spouse's signature. If a joint return, both must sign.	Date	Spouse's occupation	

Paid Preparer's Use Only

Preparer's signature	Date	Check if self-employed <input type="checkbox"/>	Preparer's SSN or PTIN
Firm's name (or yours if self-employed), address, and ZIP code	EIN	Phone no.	

Form **1040** (2002)

Comprehensive Problems

CP-7

PENSION EARNER

PENSION EARNER COMPREHENSIVE PROBLEMS

Complete this form.

2002 Schedule B

Schedules A&B (Form 1040) 2002

OMB No. 1545-0074 Page **2**

Name(s) shown on Form 1040. Do not enter name and social security number if shown on other side.

Your social security number

Schedule B—Interest and Ordinary Dividends

Attachment
Sequence No. **08**

Part I Interest

(See page B-1 and the instructions for Form 1040, line 8a.)

- 1** List name of payer. If any interest is from a seller-financed mortgage and the buyer used the property as a personal residence, see page B-1 and list this interest first. Also, show that buyer's social security number and address ▶

Note. If you received a Form 1099-INT, Form 1099-OID, or substitute statement from a brokerage firm, list the firm's name as the payer and enter the total interest shown on that form.

- 2** Add the amounts on line 1
- 3** Excludable interest on series EE and I U.S. savings bonds issued after 1989 from Form 8815, line 14. You **must** attach Form 8815
- 4** Subtract line 3 from line 2. Enter the result here and on Form 1040, line 8a ▶

Note. If line 4 is over \$400, you must complete Part III.

Amount

1		
2		
3		
4		

Part II Ordinary Dividends

(See page B-1 and the instructions for Form 1040, line 9.)

- 5** List name of payer. Include only ordinary dividends. If you received any capital gain distributions, see the instructions for Form 1040, line 13 ▶

Note. If you received a Form 1099-DIV or substitute statement from a brokerage firm, list the firm's name as the payer and enter the ordinary dividends shown on that form.

- 6** Add the amounts on line 5. Enter the total here and on Form 1040, line 9 ▶

Note. If line 6 is over \$400, you must complete Part III.

Amount

5		
6		

Part III Foreign Accounts and Trusts

(See page B-2.)

You must complete this part if you **(a)** had over \$400 of taxable interest or ordinary dividends; **(b)** had a foreign account; or **(c)** received a distribution from, or were a grantor of, or a transferor to, a foreign trust.

- 7a** At any time during 2002, did you have an interest in or a signature or other authority over a financial account in a foreign country, such as a bank account, securities account, or other financial account? See page B-2 for exceptions and filing requirements for Form TD F 90-22.1
- b** If "Yes," enter the name of the foreign country ▶
- 8** During 2002, did you receive a distribution from, or were you the grantor of, or transferor to, a foreign trust? If "Yes," you may have to file Form 3520. See page B-2

		Yes	No
7a		/	/
b		/	/
8		/	/

For Paperwork Reduction Act Notice, see Form 1040 instructions.

Schedule B (Form 1040) 2002



PENSION EARNER COMPREHENSIVE PROBLEMS

Complete this form.

Schedule C-EZ

SCHEDULE C-EZ (Form 1040) <small>Department of the Treasury Internal Revenue Service (99)</small>	Net Profit From Business (Sole Proprietorship) ▶ Partnerships, joint ventures, etc., must file Form 1065 or 1065-B. ▶ Attach to Form 1040 or 1041. ▶ See instructions on back.	<small>OMB No. 1545-0074</small> <div style="font-size: 2em; font-weight: bold; text-align: center;">2002</div> Attachment Sequence No. 09A
Name of proprietor _____		Social security number (SSN) _____
Part I General Information		
You May Use Schedule C-EZ Instead of Schedule C Only If You:	<ul style="list-style-type: none"> • Had business expenses of \$2,500 or less. • Use the cash method of accounting. • Did not have an inventory at any time during the year. • Did not have a net loss from your business. • Had only one business as a sole proprietor. 	And You: <ul style="list-style-type: none"> • Had no employees during the year. • Are not required to file Form 4562, Depreciation and Amortization, for this business. See the instructions for Schedule C, line 13, on page C-3 to find out if you must file. • Do not deduct expenses for business use of your home. • Do not have prior year unallowed passive activity losses from this business.
A Principal business or profession, including product or service _____		B Enter code from pages C-7 & 8 ▶
C Business name. If no separate business name, leave blank. _____		D Employer ID number (EIN), if any
E Business address (including suite or room no.). Address not required if same as on Form 1040, page 1. _____ City, town or post office, state, and ZIP code _____		
Part II Figure Your Net Profit		
1 Gross receipts. Caution. If this income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked, see Statutory Employees in the instructions for Schedule C, line 1, on page C-2 and check here ▶ <input type="checkbox"/>	1	
2 Total expenses. If more than \$2,500, you must use Schedule C (see instructions)	2	
3 Net profit. Subtract line 2 from line 1. If less than zero, you must use Schedule C. Enter on Form 1040, line 12 , and also on Schedule SE, line 2 . (Statutory employees do not report this amount on Schedule SE, line 2. Estates and trusts, enter on Form 1041, line 3.)	3	
Part III Information on Your Vehicle. Complete this part only if you are claiming car or truck expenses on line 2.		
4 When did you place your vehicle in service for business purposes? (month, day, year) ▶/...../.....		
5 Of the total number of miles you drove your vehicle during 2002, enter the number of miles you used your vehicle for:		
a Business b Commuting c Other		
6 Do you (or your spouse) have another vehicle available for personal use? <input type="checkbox"/> Yes <input type="checkbox"/> No		
7 Was your vehicle available for personal use during off-duty hours? <input type="checkbox"/> Yes <input type="checkbox"/> No		
8a Do you have evidence to support your deduction? <input type="checkbox"/> Yes <input type="checkbox"/> No		
b If "Yes," is the evidence written? <input type="checkbox"/> Yes <input type="checkbox"/> No		
For Paperwork Reduction Act Notice, see Form 1040 instructions. Cat. No. 14374D Schedule C-EZ (Form 1040) 2002		

PENSION EARNER COMPREHENSIVE PROBLEMS

Complete this form.

Schedule SE

SCHEDULE SE (Form 1040) Department of the Treasury Internal Revenue Service (99)	Self-Employment Tax ▶ Attach to Form 1040. ▶ See Instructions for Schedule SE (Form 1040).	OMB No. 1545-0074 2002 Attachment Sequence No. 17
Name of person with self-employment income (as shown on Form 1040)		Social security number of person with self-employment income ▶

Who Must File Schedule SE

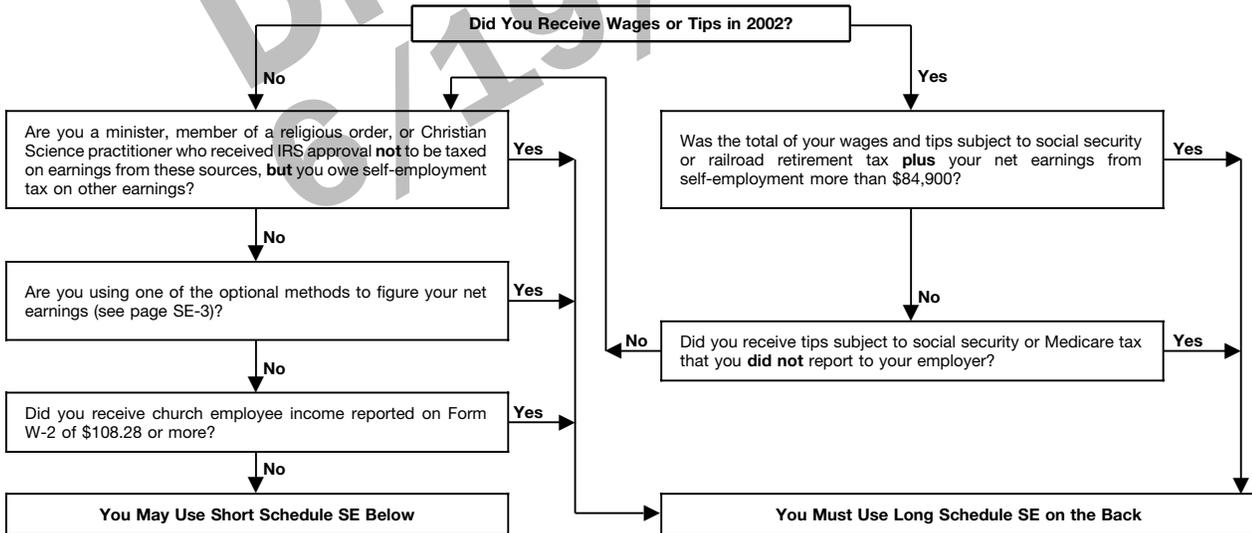
You must file Schedule SE if:

- You had net earnings from self-employment from **other than** church employee income (line 4 of Short Schedule SE or line 4c of Long Schedule SE) of \$400 or more **or**
- You had church employee income of \$108.28 or more. Income from services you performed as a minister or a member of a religious order **is not** church employee income. See page SE-1.

Note. Even if you had a loss or a small amount of income from self-employment, it may be to your benefit to file Schedule SE and use either "optional method" in Part II of Long Schedule SE. See page SE-3.

Exception. If your only self-employment income was from earnings as a minister, member of a religious order, or Christian Science practitioner **and** you filed Form 4361 and received IRS approval not to be taxed on those earnings, **do not** file Schedule SE. Instead, write "Exempt-Form 4361" on Form 1040, line 56.

May I Use Short Schedule SE or Must I Use Long Schedule SE?



Section A—Short Schedule SE. Caution. Read above to see if you can use Short Schedule SE.

1 Net farm profit or (loss) from Schedule F, line 36, and farm partnerships, Schedule K-1 (Form 1065), line 15a	1		
2 Net profit or (loss) from Schedule C, line 31; Schedule C-EZ, line 3; Schedule K-1 (Form 1065), line 15a (other than farming); and Schedule K-1 (Form 1065-B), box 9. Ministers and members of religious orders, see page SE-1 for amounts to report on this line. See page SE-2 for other income to report	2		
3 Combine lines 1 and 2	3		
4 Net earnings from self-employment. Multiply line 3 by 92.35% (.9235). If less than \$400, do not file this schedule; you do not owe self-employment tax	4		
5 Self-employment tax. If the amount on line 4 is: <ul style="list-style-type: none"> • \$84,900 or less, multiply line 4 by 15.3% (.153). Enter the result here and on Form 1040, line 56. • More than \$84,900, multiply line 4 by 2.9% (.029). Then, add \$10,527.60 to the result. Enter the total here and on Form 1040, line 56. 	5		
6 Deduction for one-half of self-employment tax. Multiply line 5 by 50% (.5). Enter the result here and on Form 1040, line 29	6		

For Paperwork Reduction Act Notice, see Form 1040 instructions.

Cat. No. 11358Z

Schedule SE (Form 1040) 2002

PENSION EARNER COMPREHENSIVE PROBLEMS

Complete this form.

2002 Schedule D, page 1

SCHEDULE D (Form 1040) <small>Department of the Treasury Internal Revenue Service (99)</small> Name(s) shown on Form 1040	Capital Gains and Losses ▶ Attach to Form 1040. ▶ See Instructions for Schedule D (Form 1040). ▶ Use Schedule D-1 to list additional transactions for lines 1 and 8.	OMB No. 1545-0074 <div style="font-size: 2em; font-weight: bold; margin-bottom: 5px;">2002</div> Attachment Sequence No. 12 Your social security number
--	--	--

Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less						
(a) Description of property <small>(Example: 100 sh. XYZ Co.)</small>	(b) Date acquired <small>(Mo., day, yr.)</small>	(c) Date sold <small>(Mo., day, yr.)</small>	(d) Sales price <small>(see page D-5 of the instructions)</small>	(e) Cost or other basis <small>(see page D-5 of the instructions)</small>	(f) Gain or (loss) <small>Subtract (e) from (d)</small>	
1						
2	Enter your short-term totals, if any, from Schedule D-1, line 2					
3	Total short-term sales price amounts. Add lines 1 and 2 in column (d)					
4	Short-term gain from Form 6252 and short-term gain or (loss) from Forms 4684, 6781, and 8824					
5	Net short-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1					
6	Short-term capital loss carryover. Enter the amount, if any, from line 8 of your 2001 Capital Loss Carryover Worksheet				()	
7	Net short-term capital gain or (loss). Combine lines 1 through 6 in column (f).					

Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year						
(a) Description of property <small>(Example: 100 sh. XYZ Co.)</small>	(b) Date acquired <small>(Mo., day, yr.)</small>	(c) Date sold <small>(Mo., day, yr.)</small>	(d) Sales price <small>(see page D-5 of the instructions)</small>	(e) Cost or other basis <small>(see page D-5 of the instructions)</small>	(f) Gain or (loss) <small>Subtract (e) from (d)</small>	(g) 28% rate gain or (loss) * <small>(see instr. below)</small>
8						
9	Enter your long-term totals, if any, from Schedule D-1, line 9					
10	Total long-term sales price amounts. Add lines 8 and 9 in column (d)					
11	Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and long-term gain or (loss) from Forms 4684, 6781, and 8824					
12	Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1					
13	Capital gain distributions. See page D-1 of the instructions					
14	Long-term capital loss carryover. Enter in both columns (f) and (g) the amount, if any, from line 13 of your 2001 Capital Loss Carryover Worksheet				()	()
15	Combine lines 8 through 14 in column (g)					
16	Net long-term capital gain or (loss). Combine lines 8 through 14 in column (f) Next: Go to Part III on the back.					

* 28% rate gain or loss includes all "collectibles gains and losses" (as defined on page D-6 of the instructions) and up to 50% of the eligible gain on qualified small business stock (see page D-4 of the instructions).

For Paperwork Reduction Act Notice, see Form 1040 instructions.

Cat. No. 11338H

Schedule D (Form 1040) 2002

PENSION EARNER COMPREHENSIVE PROBLEMS

Schedule D (Form 1040) 2002

Page **2**

Part III Taxable Gain or Deductible Loss

<p>17 Combine lines 7 and 16 and enter the result. If a loss, go to line 18. If a gain, enter the gain on Form 1040, line 13, and complete Form 1040 through line 41</p> <p>Next: • If both lines 16 and 17 are gains and Form 1040, line 41, is more than zero, complete Part IV below. • Otherwise, skip the rest of Schedule D and complete Form 1040.</p>	17			
<p>18 If line 17 is a loss, enter here and on Form 1040, line 13, the smaller of (a) that loss or (b) (\$3,000) (or, if married filing separately, (\$1,500)). Then complete Form 1040 through line 39</p> <p>Next: • If the loss on line 17 is more than the loss on line 18 or if Form 1040, line 39, is less than zero, skip Part IV below and complete the Capital Loss Carryover Worksheet on page D-6 of the instructions before completing the rest of Form 1040. • Otherwise, skip Part IV below and complete the rest of Form 1040.</p>	18 ()			

Part IV Tax Computation Using Maximum Capital Gains Rates

<p>19 Enter your unrecaptured section 1250 gain, if any, from line 17 of the worksheet on page D-7 of the instructions</p> <p>If line 15 or line 19 is more than zero, complete the worksheet on page D-9 of the instructions to figure the amount to enter on lines 22, 29, and 40 below, and skip all other lines below. Otherwise, go to line 20.</p>	19			
<p>20 Enter your taxable income from Form 1040, line 41</p>	20			
<p>21 Enter the smaller of line 16 or line 17 of Schedule D</p>	21			
<p>22 If you are deducting investment interest expense on Form 4952, enter the amount from Form 4952, line 4e. Otherwise, enter -0-</p>	22			
<p>23 Subtract line 22 from line 21. If zero or less, enter -0-</p>	23			
<p>24 Subtract line 23 from line 20. If zero or less, enter -0-</p>	24			
<p>25 Figure the tax on the amount on line 24. Use the Tax Table or Tax Rate Schedules, whichever applies</p>	25			
<p>26 Enter the smaller of:</p> <ul style="list-style-type: none"> • The amount on line 20 or • \$46,700 if married filing jointly or qualifying widow(er); \$27,950 if single; \$37,450 if head of household; or \$23,350 if married filing separately <p>If line 26 is greater than line 24, go to line 27. Otherwise, skip lines 27 through 33 and go to line 34.</p>	26			
<p>27 Enter the amount from line 24</p>	27			
<p>28 Subtract line 27 from line 26. If zero or less, enter -0- and go to line 34</p>	28			
<p>29 Enter your qualified 5-year gain, if any, from line 7 of the worksheet on page D-8</p>	29			
<p>30 Enter the smaller of line 28 or line 29</p>	30			
<p>31 Multiply line 30 by 8% (.08)</p>	31			
<p>32 Subtract line 30 from line 28</p>	32			
<p>33 Multiply line 32 by 10% (.10)</p> <p>If the amounts on lines 23 and 28 are the same, skip lines 34 through 37 and go to line 38.</p>	33			
<p>34 Enter the smaller of line 20 or line 23</p>	34			
<p>35 Enter the amount from line 28 (if line 28 is blank, enter -0-)</p>	35			
<p>36 Subtract line 35 from line 34</p>	36			
<p>37 Multiply line 36 by 20% (.20)</p>	37			
<p>38 Add lines 25, 31, 33, and 37</p>	38			
<p>39 Figure the tax on the amount on line 20. Use the Tax Table or Tax Rate Schedules, whichever applies</p>	39			
<p>40 Tax on all taxable income (including capital gains). Enter the smaller of line 38 or line 39 here and on Form 1040, line 42</p>	40			



PENSION EARNER COMPREHENSIVE PROBLEMS

ANSWERS TO PROBLEMS

Problem 1

Form 1040A, page 1

Form 1040A Department of the Treasury—Internal Revenue Service U.S. Individual Income Tax Return (99) 2002 IRS Use Only—Do not write or staple in this space.

Label
(See page 19.)

Use the IRS label.

Otherwise, please print or type.

L A B E L H E R E	Your first name and initial Kirk J.	Last name Evergreen
	If a joint return, spouse's first name and initial Mary	Last name Evergreen
	Home address (number and street). If you have a P.O. box, see page 20. 2610 Yellowstone St.	
	City, town or post office, state, and ZIP code. If you have a foreign address, see page 20. Missoula, MT 59810	

OMB No. 1545-0085
Your social security number
000 : 00 : 2345
Spouse's social security number
000 : 00 : 5678

▲ Important! ▲
You **must** enter your SSN(s) above.

Presidential Election Campaign
(See page 20.)

Note. Checking "Yes" will not change your tax or reduce your refund.
Do you, or your spouse if filing a joint return, want \$3 to go to this fund? . . .

You Yes No **Spouse** Yes No

Filing status

- 1 Single
2 Married filing jointly (even if only one had income)
3 Married filing separately. Enter spouse's SSN above and full name here. ▶
4 Head of household (with qualifying person). (See page 21.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶
5 Qualifying widow(er) with dependent child (year spouse died ▶). (See page 22.)

Check only one box.

Exemptions

6a **Yourself.** If your parent (or someone else) can claim you as a dependent on his or her tax return, **do not** check box 6a.

b **Spouse**

c **Dependents:**

(1) First name	Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) <input checked="" type="checkbox"/> if qualifying child for child tax credit (see page 23)
				<input type="checkbox"/>

d Total number of exemptions claimed. Add numbers on lines above **2**

Income

Attach Form(s) W-2 here. Also attach Form(s) 1099-R if tax was withheld.

If you did not get a W-2, see page 25.

Enclose, but do not attach, any payment.

7 Wages, salaries, tips, etc. Attach Form(s) W-2.	7	12,637	00
8a Taxable interest. Attach Schedule 1 if required.	8a	287	00
b Tax-exempt interest. Do not include on line 8a.	8b	36	00
9 Ordinary dividends. Attach Schedule 1 if required.	9		
10 Capital gain distributions (see page 25).	10		
11a IRA distributions.	11a		
11b Taxable amount (see page 25).	11b		
12a Pensions and annuities.	12a		
12b Taxable amount (see page 26).	12b	4,500	00
13 Unemployment compensation and Alaska Permanent Fund dividends.	13		
14a Social security benefits.	14a		
14b Taxable amount (see page 28).	14b		
15 Add lines 7 through 14b (far right column). This is your total income .	15	17,424	00
16 Educator expenses (see page XX).	16		
17 IRA deduction (see page 28).	17	900	00
18 Student loan interest deduction (see page 31).	18		
19 Tuition and fees deduction (see page XX).	19		
20 Add lines 16 through 19. These are your total adjustments .	20	900	00
21 Subtract line 20 from line 15. This is your adjusted gross income .	21	16,524	00

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see page 53.

Cat. No. 11327A

Form 1040A (2002)

Comprehensive Problems

CP-13

PENSION EARNER

PENSION EARNER COMPREHENSIVE PROBLEMS ANSWERS TO PROBLEMS

Form 1040A, page 2

Form 1040A (2002)

Page **2**

Tax, credits, and payments	22	Enter the amount from line 21 (adjusted gross income).	22	16,524	00
	23a	Check if: <input checked="" type="checkbox"/> You were 65 or older <input type="checkbox"/> Blind <input type="checkbox"/> Spouse was 65 or older <input type="checkbox"/> Blind Enter number of boxes checked ▶ 23a			1
	b	If you are married filing separately and your spouse itemizes deductions, see page 32 and check here ▶ 23b			<input type="checkbox"/>
	24	Enter your standard deduction (see left margin).	24	8,750	00
	25	Subtract line 24 from line 22. If line 24 is more than line 22, enter -0-.	25	7,774	00
	26	Multiply \$3,000 by the total number of exemptions claimed on line 6d.	26	6,000	00
	27	Subtract line 26 from line 25. If line 26 is more than line 25, enter -0-. This is your taxable income .	▶ 27	1,774	00
	28	Tax , including any alternative minimum tax (see page 33).	28	176	00
	29	Credit for child and dependent care expenses. Attach Schedule 2.	29		
	30	Credit for the elderly or the disabled. Attach Schedule 3.	30		
	31	Education credits. Attach Form 8863.	31		
	32	Retirement savings contributions credit. Attach Form 8880.	32		
	33	Child tax credit (see page 36).	33		
	34	Adoption credit. Attach Form 8839.	34		
	35	Add lines 29 through 34. These are your total credits .	35	0	00
	36	Subtract line 35 from line 28. If line 35 is more than line 28, enter -0-.	36	176	00
	37	Advance earned income credit payments from Form(s) W-2.	37		
	38	Add lines 36 and 37. This is your total tax .	▶ 38	176	00
	39	Federal income tax withheld from Forms W-2 and 1099.	39	619	00
	40	2002 estimated tax payments and amount applied from 2001 return.	40		
	41	Earned income credit (EIC) .	41		
	42	Additional child tax credit. Attach Form 8812.	42		
	43	Add lines 39 through 42. These are your total payments .	▶ 43	619	00
	44	If line 43 is more than line 38, subtract line 38 from line 43. This is the amount you overpaid .	44	443	00
	45a	Amount of line 44 you want refunded to you .	▶ 45a	443	00
	b	Routing number <input style="width: 100px;" type="text"/> ▶ c Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings			
	d	Account number <input style="width: 100px;" type="text"/>			
	46	Amount of line 44 you want applied to your 2003 estimated tax .	46		
	47	Amount you owe . Subtract line 43 from line 38. For details on how to pay, see page 48.	▶ 47		
	48	Estimated tax penalty (see page 48).	48		

Standard Deduction for—

- People who checked any box on line 23a or 23b or who can be claimed as a dependent, see page 33.
- All others:
- Single, \$4,700
- Head of household, \$6,900
- Married filing jointly or Qualifying widow(er), \$7,850
- Married filing separately, \$3,925

If you have a qualifying child, attach Schedule EIC.

Refund

Direct deposit? See page 47 and fill in 45b, 45c, and 45d.

Third party designee

Do you want to allow another person to discuss this return with the IRS (see page 49)? **Yes**. Complete the following. **No**

Designee's name ▶	Phone no. ▶ ()	Personal identification number (PIN) ▶ <input style="width: 40px;" type="text"/>
-------------------	-----------------	--

Sign here

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and accurately list all amounts and sources of income I received during the tax year. Declaration of preparer (other than the taxpayer) is based on all information of which the preparer has any knowledge.

Your signature	Date	Your occupation	Daytime phone number
<u>Kirk J. Evergreen</u>	3/16/03	Retired	()
Spouse's signature. If a joint return, both must sign.	Date	Spouse's occupation	
<u>Mary Evergreen</u>	3/16/03	Clerk	

Paid preparer's use only

Preparer's signature ▶	Date	Check if self-employed <input type="checkbox"/>	Preparer's SSN or PTIN
Firm's name (or yours if self-employed), address, and ZIP code ▶	TCE Site #101	EIN	Phone no. ()



Form **1040A** (2002)

PENSION EARNER COMPREHENSIVE PROBLEMS

ANSWERS TO PROBLEMS

Social Security Benefits Worksheet—Lines 14a and 14b

Keep for Your Records

Before you begin:

- ✓ Complete Form 1040A, lines 16 and 17, if it applies to you.
- ✓ If you are married filing separately and you **lived apart** from your spouse for all of 2002, enter “D” to the right of the word “benefits” on line 14a.
- ✓ Be sure you have read the **Exception** on page 30 to see if you can use this worksheet instead of a publication to find out if any of your benefits are taxable.



1.	Enter the total amount from box 5 of all your Forms SSA-1099 and Forms RRB-1099	1.	7,200
2.	Is the amount on line 1 more than zero?		
	<input type="checkbox"/> No. None of your social security benefits are taxable.		
	<input checked="" type="checkbox"/> Yes. Enter one-half of line 1	2.	3,600
3.	Add the amounts on Form 1040A, lines 7, 8a, 9, 10, 11b, 12b, and 13. Do not include amounts from box 5 of Forms SSA-1099 or RRB-1099	3.	17,424
4.	Enter the amount, if any, from Form 1040A, line 8b	4.	36
5.	Add lines 2, 3, and 4	5.	21,060
6.	Add the amounts on Form 1040A, lines 16 and 17	6.	900
7.	Is the amount on line 6 less than the amount on line 5?		
	<input type="checkbox"/> No. None of your social security benefits are taxable.		
	<input checked="" type="checkbox"/> Yes. Subtract line 6 from line 5	7.	20,160
8.	Enter: \$25,000 if single, head of household, qualifying widow(er), or married filing separately and you lived apart from your spouse for all of 2002; \$32,000 if married filing jointly; -0- if married filing separately and you lived with your spouse at any time in 2002	8.	32,000
9.	Is the amount on line 8 less than the amount on line 7?		
	<input checked="" type="checkbox"/> No. None of your social security benefits are taxable. You do not have to enter any amount on line 14a or 14b of Form 1040A. But if you are married filing separately and you lived apart from your spouse for all of 2002, enter -0- on line 14b. Be sure you entered “D” to the right of the word “benefits” on line 14a.		
	<input type="checkbox"/> Yes. Subtract line 8 from line 7	9.	
10.	Enter: \$9,000 if single, head of household, qualifying widow(er), or married filing separately and you lived apart from your spouse for all of 2002; \$12,000 if married filing jointly; -0- if married filing separately and you lived with your spouse at any time in 2002	10.	
11.	Subtract line 10 from line 9. If zero or less, enter -0-	11.	
12.	Enter the smaller of line 9 or line 10	12.	
13.	Enter one-half of line 12	13.	
14.	Enter the smaller of line 2 or line 13	14.	
15.	Multiply line 11 by 85% (.85). If line 11 is zero, enter -0-	15.	
16.	Add lines 14 and 15	16.	
17.	Multiply line 1 by 85% (.85)	17.	
18.	Taxable social security benefits. Enter the smaller of line 16 or line 17	18.	

TIP If part of your benefits are taxable for 2002 **and** they include benefits paid in 2002 that were for an earlier year, you may be able to reduce the taxable amount. See Pub. 915 for details.

PENSION EARNER COMPREHENSIVE PROBLEMS ANSWERS TO PROBLEMS

Problem 2

Form	1040	Department of the Treasury—Internal Revenue Service U.S. Individual Income Tax Return 2002	(99)	IRS Use Only—Do not write or staple in this space.																																																																																
		For the year Jan. 1—Dec. 31, 2002, or other tax year beginning _____, 2002, ending _____, 20		OMB No. 1545-0074																																																																																
Label (See instructions on page 19.) Use the IRS label. Otherwise, please print or type. Presidential Election Campaign (See page 19.)	L A B E L H E R E	Your first name and initial Paul	Last name Birch	Your social security number 000 00 4321																																																																																
		If a joint return, spouse's first name and initial Mary	Last name Birch	Spouse's social security number 000 00 2221																																																																																
		Home address (number and street). If you have a P.O. box, see page 19. 123 Green Street		Apt. no.	▲ Important! ▲ You must enter your SSN(s) above.																																																																															
		City, town or post office, state, and ZIP code. If you have a foreign address, see page 19. Claremont, CA 91711																																																																																		
Filing Status		Note. Checking "Yes" will not change your tax or reduce your refund.																																																																																		
Check only one box.		Do you, or your spouse if filing a joint return, want \$3 to go to this fund? <input type="checkbox"/> Yes <input type="checkbox"/> No <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No																																																																																		
1 <input type="checkbox"/> Single		4 <input type="checkbox"/> Head of household (with qualifying person). (See page 19.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶																																																																																		
2 <input checked="" type="checkbox"/> Married filing jointly (even if only one had income)		5 <input type="checkbox"/> Qualifying widow(er) with dependent child (year spouse died ▶). (See page 19.)																																																																																		
3 <input type="checkbox"/> Married filing separately. Enter spouse's SSN above and full name here. ▶																																																																																				
Exemptions		<table border="0" style="width: 100%;"> <tr> <td style="width: 70%;">6a <input checked="" type="checkbox"/> Yourself. If your parent (or someone else) can claim you as a dependent on his or her tax return, do not check box 6a</td> <td style="width: 5%; text-align: center;">}</td> <td style="width: 25%;">No. of boxes checked on 6a and 6b</td> <td style="width: 10%; text-align: center;">2</td> </tr> <tr> <td>6b <input checked="" type="checkbox"/> Spouse</td> <td></td> <td>No. of children on 6c who:</td> <td></td> </tr> <tr> <td colspan="2">6c Dependents:</td> <td colspan="2">• lived with you</td> </tr> <tr> <td>(1) First name</td> <td>Last name</td> <td>(2) Dependent's social security number</td> <td>(3) Dependent's relationship to you</td> </tr> <tr> <td></td> <td></td> <td></td> <td>(4) <input checked="" type="checkbox"/> if qualifying child for child tax credit (see page 20)</td> </tr> <tr> <td></td> <td></td> <td></td> <td><input type="checkbox"/></td> </tr> <tr> <td colspan="2">d Total number of exemptions claimed</td> <td colspan="2" style="text-align: center;">2</td> </tr> </table>			6a <input checked="" type="checkbox"/> Yourself. If your parent (or someone else) can claim you as a dependent on his or her tax return, do not check box 6a	}	No. of boxes checked on 6a and 6b	2	6b <input checked="" type="checkbox"/> Spouse		No. of children on 6c who:		6c Dependents:		• lived with you		(1) First name	Last name	(2) Dependent's social security number	(3) Dependent's relationship to you				(4) <input checked="" type="checkbox"/> if qualifying child for child tax credit (see page 20)				<input type="checkbox"/>				<input type="checkbox"/>				<input type="checkbox"/>				<input type="checkbox"/>	d Total number of exemptions claimed		2																																									
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For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see page 72.

Cat. No. 11320B

Form **1040** (2002)

PENSION EARNER COMPREHENSIVE PROBLEMS

ANSWERS TO PROBLEMS

Form 1040 (2002)

Page **2**

Tax and Credits

Standard Deduction for—

- People who checked any box on line 37a or 37b or who can be claimed as a dependent, see page 31.

- All others:
 - Single, \$4,700
 - Head of household, \$6,900
 - Married filing jointly or Qualifying widow(er), \$7,850
 - Married filing separately, \$3,925

36	Amount from line 35 (adjusted gross income)		36	43,611	00
37a	Check if: <input type="checkbox"/> You were 65 or older, <input type="checkbox"/> Blind; <input type="checkbox"/> Spouse was 65 or older, <input type="checkbox"/> Blind. Add the number of boxes checked above and enter the total here ▶ 37a				
b	If you are married filing separately and your spouse itemizes deductions, or you were a dual-status alien, see page 31 and check here ▶ 37b <input type="checkbox"/>				
38	Itemized deductions (from Schedule A) or your standard deduction (see left margin)		38	7,850	00
39	Subtract line 38 from line 36		39	35,761	00
40	If line 36 is \$103,000 or less, multiply \$3,000 by the total number of exemptions claimed on line 6d. If line 36 is over \$103,000, see the worksheet on page 32		40	6,000	00
41	Taxable income. Subtract line 40 from line 39. If line 40 is more than line 39, enter -0-		41	29,761	00
42	Tax (see page 33). Check if any tax is from a <input type="checkbox"/> Form(s) 8814 b <input type="checkbox"/> Form 4972		42	3,506	00
43	Alternative minimum tax (see page 34). Attach Form 6251		43	0	00
44	Add lines 42 and 43 ▶		44	3,506	00
45	Foreign tax credit. Attach Form 1116 if required	45			
46	Credit for child and dependent care expenses. Attach Form 2441	46			
47	Credit for the elderly or the disabled. Attach Schedule R	47			
48	Education credits. Attach Form 8863	48			
49	Retirement savings contributions credit. Attach Form 8880	49			
50	Child tax credit (see page XX)	50			
51	Adoption credit. Attach Form 8839	51			
52	Credits from: a <input type="checkbox"/> Form 8396 b <input type="checkbox"/> Form 8859	52			
53	Other credits. Check applicable box(es): a <input type="checkbox"/> Form 3800 b <input type="checkbox"/> Form 8801 c <input type="checkbox"/> Specify	53			
54	Add lines 45 through 53. These are your total credits		54		
55	Subtract line 54 from line 44. If line 54 is more than line 44, enter -0- ▶		55	3,506	00

Other Taxes

56	Self-employment tax. Attach Schedule SE		56	1,039	00
57	Social security and Medicare tax on tip income not reported to employer. Attach Form 4137		57		
58	Tax on qualified plans, including IRAs, and other tax-favored accounts. Attach Form 5329 if required		58		
59	Advance earned income credit payments from Form(s) W-2		59		
60	Household employment taxes. Attach Schedule H		60		
61	Add lines 55 through 60. This is your total tax ▶		61	4,545	00

Payments

If you have a qualifying child, attach Schedule EIC.

62	Federal income tax withheld from Forms W-2 and 1099	62	4,575	00
63	2002 estimated tax payments and amount applied from 2001 return	63	1,625	00
64	Earned income credit (EIC)	64		
65	Excess social security and tier 1 RRTA tax withheld (see page 51)	65		
66	Additional child tax credit. Attach Form 8812	66		
67	Amount paid with request for extension to file (see page 51)	67		
68	Other payments from: a <input type="checkbox"/> Form 2439 b <input type="checkbox"/> Form 4136	68		
69	Add lines 62 through 68. These are your total payments ▶	69	6,200	00

Refund

Direct deposit? See page 51 and fill in 71b, 71c, and 71d.

70	If line 69 is more than line 61, subtract line 61 from line 69. This is the amount you overpaid		70	1,655	00
71a	Amount of line 70 you want refunded to you ▶		71a	1,655	00
b	Routing number <input type="text"/>	c	Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings		
d	Account number <input type="text"/>				
72	Amount of line 70 you want applied to your 2003 estimated tax ▶	72			

Amount You Owe

73	Amount you owe. Subtract line 69 from line 61. For details on how to pay, see page 52 ▶	73		
74	Estimated tax penalty (see page 52)	74		

Third Party Designee

Do you want to allow another person to discuss this return with the IRS (see page 53)? Yes. Complete the following. No

Designee's name ▶ Phone no. ▶ () Personal identification number (PIN) ▶

Sign Here

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Joint return? See page 19. Keep a copy for your records. ▶	Your signature	Date	Your occupation	Daytime phone number
	Paul Birch	2/14/03	Computer Tech	()
	Spouse's signature. If a joint return, both must sign.	Date	Spouse's occupation	
	Mary Birch	2/14/03	Self-employed	

Preparer's Use Only

Preparer's signature ▶ TCE Site #33	Date	Check if self-employed <input type="checkbox"/>	Preparer's SSN or PTIN
Firm's name (or yours if self-employed), address, and ZIP code ▶	EIN	Phone no. ()	

PENSION EARNER COMPREHENSIVE PROBLEMS

ANSWERS TO PROBLEMS

2002 Schedule B

Schedules A&B (Form 1040) 2002

OMB No. 1545-0074 Page **2**

Name(s) shown on Form 1040. Do not enter name and social security number if shown on other side.

Your social security number

Paul and Mary Birch

000 : 00 : 4321

Schedule B—Interest and Ordinary Dividends

Attachment Sequence No. **08**

Part I Interest

(See page B-1 and the instructions for Form 1040, line 8a.)

- 1** List name of payer. If any interest is from a seller-financed mortgage and the buyer used the property as a personal residence, see page B-1 and list this interest first. Also, show that buyer's social security number and address ▶

Main Street Bank

Amount

478 00

1

Note. If you received a Form 1099-INT, Form 1099-OID, or substitute statement from a brokerage firm, list the firm's name as the payer and enter the total interest shown on that form.

- 2** Add the amounts on line 1
- 3** Excludable interest on series EE and I U.S. savings bonds issued after 1989 from Form 8815, line 14. You **must** attach Form 8815
- 4** Subtract line 3 from line 2. Enter the result here and on Form 1040, line 8a ▶

478 00

478 00

Note. If line 4 is over \$400, you must complete Part III.

Part II Ordinary Dividends

(See page B-1 and the instructions for Form 1040, line 9.)

- 5** List name of payer. Include only ordinary dividends. If you received any capital gain distributions, see the instructions for Form 1040, line 13 ▶

ABC Corporation

XYZ Corporation

Amount

242 00

317 00

5

Note. If you received a Form 1099-DIV or substitute statement from a brokerage firm, list the firm's name as the payer and enter the ordinary dividends shown on that form.

- 6** Add the amounts on line 5. Enter the total here and on Form 1040, line 9 . ▶

559 00

Note. If line 6 is over \$400, you must complete Part III.

Part III Foreign Accounts and Trusts

(See page B-2.)

You must complete this part if you **(a)** had over \$400 of taxable interest or ordinary dividends; **(b)** had a foreign account; or **(c)** received a distribution from, or were a grantor of, or a transferor to, a foreign trust.

- 7a** At any time during 2002, did you have an interest in or a signature or other authority over a financial account in a foreign country, such as a bank account, securities account, or other financial account? See page B-2 for exceptions and filing requirements for Form TD F 90-22.1
- b** If "Yes," enter the name of the foreign country ▶
- 8** During 2002, did you receive a distribution from, or were you the grantor of, or transferor to, a foreign trust? If "Yes," you may have to file Form 3520. See page B-2

	Yes	No
7a	<input type="checkbox"/>	<input checked="" type="checkbox"/>
b	<input type="checkbox"/>	<input type="checkbox"/>
8	<input type="checkbox"/>	<input checked="" type="checkbox"/>

For Paperwork Reduction Act Notice, see Form 1040 instructions.

Schedule B (Form 1040) 2002



PENSION EARNER COMPREHENSIVE PROBLEMS

ANSWERS TO PROBLEMS

Schedule C-EZ

SCHEDULE C-EZ (Form 1040)

Department of the Treasury
Internal Revenue Service (99)

Net Profit From Business

(Sole Proprietorship)

▶ Partnerships, joint ventures, etc., must file Form 1065 or 1065-B.
▶ Attach to Form 1040 or 1041. ▶ See instructions on back.

OMB No. 1545-0074

2002

Attachment Sequence No. **09A**

Name of proprietor

Mary Birch

Social security number (SSN)

000 00 2221

Part I General Information

You May Use Schedule C-EZ Instead of Schedule C Only If You:

- Had business expenses of \$2,500 or less.
- Use the cash method of accounting.
- Did not have an inventory at any time during the year.
- Did not have a net loss from your business.
- Had only one business as a sole proprietor.

And You:

- Had no employees during the year.
- Are not required to file **Form 4562**, Depreciation and Amortization, for this business. See the instructions for Schedule C, line 13, on page C-3 to find out if you must file.
- Do not deduct expenses for business use of your home.
- Do not have prior year unallowed passive activity losses from this business.

A Principal business or profession, including product or service
Crafts Instructor

B Enter code from pages C-7 & 8

8 1 2 9 9 0

C Business name. If no separate business name, leave blank.

D Employer ID number (EIN), if any

E Business address (including suite or room no.). Address not required if same as on Form 1040, page 1.

City, town or post office, state, and ZIP code

Part II Figure Your Net Profit

1	Gross receipts. Caution. If this income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked, see Statutory Employees in the instructions for Schedule C, line 1, on page C-2 and check here <input type="checkbox"/>	1	7,800	00
2	Total expenses. If more than \$2,500, you must use Schedule C (see instructions)	2	450	00
3	Net profit. Subtract line 2 from line 1. If less than zero, you must use Schedule C. Enter on Form 1040, line 12 , and also on Schedule SE, line 2 . (Statutory employees do not report this amount on Schedule SE, line 2. Estates and trusts, enter on Form 1041, line 3.)	3	7,350	00

Part III Information on Your Vehicle. Complete this part **only** if you are claiming car or truck expenses on line 2.

- 4** When did you place your vehicle in service for business purposes? (month, day, year) ▶/...../.....
- 5** Of the total number of miles you drove your vehicle during 2002, enter the number of miles you used your vehicle for:
- a** Business **b** Commuting **c** Other
- 6** Do you (or your spouse) have another vehicle available for personal use? **Yes** **No**
- 7** Was your vehicle available for personal use during off-duty hours? **Yes** **No**
- 8a** Do you have evidence to support your deduction? **Yes** **No**
- b** If "Yes," is the evidence written? **Yes** **No**

For Paperwork Reduction Act Notice, see Form 1040 instructions.

Cat. No. 14374D

Schedule C-EZ (Form 1040) 2002

PENSION EARNER COMPREHENSIVE PROBLEMS ANSWERS TO PROBLEMS

2002 Schedule SE

SCHEDULE SE
(Form 1040)

Self-Employment Tax

OMB No. 1545-0074

2002

Attachment
Sequence No. **17**

Department of the Treasury
Internal Revenue Service (99)

▶ **Attach to Form 1040.** ▶ **See Instructions for Schedule SE (Form 1040).**

Name of person with **self-employment** income (as shown on Form 1040)

Mary Birch

Social security number of person
with **self-employment** income ▶

000 | 00 | 2221

Who Must File Schedule SE

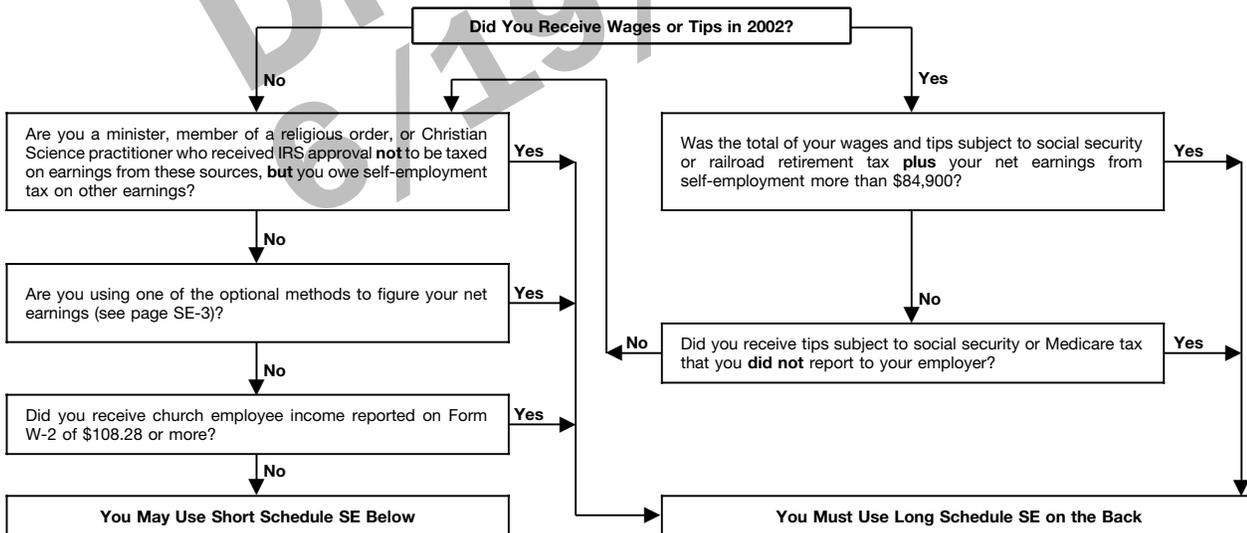
You must file Schedule SE if:

- You had net earnings from self-employment from **other than** church employee income (line 4 of Short Schedule SE or line 4c of Long Schedule SE) of \$400 or more **or**
- You had church employee income of \$108.28 or more. Income from services you performed as a minister or a member of a religious order **is not** church employee income. See page SE-1.

Note. Even if you had a loss or a small amount of income from self-employment, it may be to your benefit to file Schedule SE and use either "optional method" in Part II of Long Schedule SE. See page SE-3.

Exception. If your only self-employment income was from earnings as a minister, member of a religious order, or Christian Science practitioner **and** you filed Form 4361 and received IRS approval not to be taxed on those earnings, **do not** file Schedule SE. Instead, write "Exempt-Form 4361" on Form 1040, line 56.

May I Use Short Schedule SE or Must I Use Long Schedule SE?



Section A—Short Schedule SE. Caution. Read above to see if you can use Short Schedule SE.

1	Net farm profit or (loss) from Schedule F, line 36, and farm partnerships, Schedule K-1 (Form 1065), line 15a	1		
2	Net profit or (loss) from Schedule C, line 31; Schedule C-EZ, line 3; Schedule K-1 (Form 1065), line 15a (other than farming); and Schedule K-1 (Form 1065-B), box 9. Ministers and members of religious orders, see page SE-1 for amounts to report on this line. See page SE-2 for other income to report	2	7,350	00
3	Combine lines 1 and 2	3	7,350	00
4	Net earnings from self-employment. Multiply line 3 by 92.35% (.9235). If less than \$400, do not file this schedule; you do not owe self-employment tax	4	6,788	00
5	Self-employment tax. If the amount on line 4 is: <ul style="list-style-type: none"> • \$84,900 or less, multiply line 4 by 15.3% (.153). Enter the result here and on Form 1040, line 56. • More than \$84,900, multiply line 4 by 2.9% (.029). Then, add \$10,527.60 to the result. Enter the total here and on Form 1040, line 56. 	5	1,039	00
6	Deduction for one-half of self-employment tax. Multiply line 5 by 50% (.5). Enter the result here and on Form 1040, line 29	6	520	00

For Paperwork Reduction Act Notice, see Form 1040 instructions.

Cat. No. 11358Z

Schedule SE (Form 1040) 2002

PENSION EARNER COMPREHENSIVE PROBLEMS

ANSWERS TO PROBLEMS

2002 Schedule D, page 1

**SCHEDULE D
(Form 1040)**

Department of the Treasury
Internal Revenue Service (99)

Capital Gains and Losses

▶ Attach to Form 1040. ▶ See Instructions for Schedule D (Form 1040).
▶ Use Schedule D-1 to list additional transactions for lines 1 and 8.

OMB No. 1545-0074

2002

Attachment
Sequence No. **12**

Name(s) shown on Form 1040

Paul and Mary Birch

Your social security number

000 00 4321

Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less

(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-5 of the instructions)	(e) Cost or other basis (see page D-5 of the instructions)	(f) Gain or (loss) Subtract (e) from (d)
1					
2 Enter your short-term totals, if any, from Schedule D-1, line 2					
3 Total short-term sales price amounts. Add lines 1 and 2 in column (d)					
4 Short-term gain from Form 6252 and short-term gain or (loss) from Forms 4684, 6781, and 8824					
5 Net short-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1					
6 Short-term capital loss carryover. Enter the amount, if any, from line 8 of your 2001 Capital Loss Carryover Worksheet					()
7 Net short-term capital gain or (loss). Combine lines 1 through 6 in column (f).					

Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year

(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-5 of the instructions)	(e) Cost or other basis (see page D-5 of the instructions)	(f) Gain or (loss) Subtract (e) from (d)	(g) 28% rate gain or (loss) * (see instr. below)
8 200 sh. ABC Corp	11/21/98	7/9/02	3,300 00	3,777 00	(477 00)	
500 sh. XYZ Corp	2/18/00	10/23/02	25,000 00	17,500 00	7,500 00	
9 Enter your long-term totals, if any, from Schedule D-1, line 9						
10 Total long-term sales price amounts. Add lines 8 and 9 in column (d)			28,300 00			
11 Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and long-term gain or (loss) from Forms 4684, 6781, and 8824						
12 Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1						
13 Capital gain distributions. See page D-1 of the instructions					179 00	
14 Long-term capital loss carryover. Enter in both columns (f) and (g) the amount, if any, from line 13 of your 2001 Capital Loss Carryover Worksheet					()	()
15 Combine lines 8 through 14 in column (g)						
16 Net long-term capital gain or (loss). Combine lines 8 through 14 in column (f) Next: Go to Part III on the back.					7,202 00	

* 28% rate gain or loss includes all "collectibles gains and losses" (as defined on page D-6 of the instructions) and up to 50% of the eligible gain on qualified small business stock (see page D-4 of the instructions).

PENSION EARNER COMPREHENSIVE PROBLEMS ANSWERS TO PROBLEMS

Schedule D (Form 1040) 2002

Page **2**

Part III Taxable Gain or Deductible Loss

17	Combine lines 7 and 16 and enter the result. If a loss, go to line 18. If a gain, enter the gain on Form 1040, line 13, and complete Form 1040 through line 41	17	7,202	00
	Next: • If both lines 16 and 17 are gains and Form 1040, line 41, is more than zero, complete Part IV below. • Otherwise, skip the rest of Schedule D and complete Form 1040.			
18	If line 17 is a loss, enter here and on Form 1040, line 13, the smaller of (a) that loss or (b) (\$3,000) (or, if married filing separately, (\$1,500)). Then complete Form 1040 through line 39	18		
	Next: • If the loss on line 17 is more than the loss on line 18 or if Form 1040, line 39, is less than zero, skip Part IV below and complete the Capital Loss Carryover Worksheet on page D-6 of the instructions before completing the rest of Form 1040. • Otherwise, skip Part IV below and complete the rest of Form 1040.			

Part IV Tax Computation Using Maximum Capital Gains Rates

19	Enter your unrecaptured section 1250 gain, if any, from line 17 of the worksheet on page D-7 of the instructions	19		
	If line 15 or line 19 is more than zero, complete the worksheet on page D-9 of the instructions to figure the amount to enter on lines 22, 29, and 40 below, and skip all other lines below. Otherwise, go to line 20.			
20	Enter your taxable income from Form 1040, line 41	20	29,761	00
21	Enter the smaller of line 16 or line 17 of Schedule D	21	7,202	00
22	If you are deducting investment interest expense on Form 4952, enter the amount from Form 4952, line 4e. Otherwise, enter -0-	22	0	00
23	Subtract line 22 from line 21. If zero or less, enter -0-	23	7,202	00
24	Subtract line 23 from line 20. If zero or less, enter -0-	24	22,559	00
25	Figure the tax on the amount on line 24. Use the Tax Table or Tax Rate Schedules, whichever applies	25	2,786	00
26	Enter the smaller of: • The amount on line 20 or • \$46,700 if married filing jointly or qualifying widow(er); \$27,950 if single; \$37,450 if head of household; or \$23,350 if married filing separately	26	29,761	00
	If line 26 is greater than line 24, go to line 27. Otherwise, skip lines 27 through 33 and go to line 34.			
27	Enter the amount from line 24	27	22,559	00
28	Subtract line 27 from line 26. If zero or less, enter -0- and go to line 34	28	7,202	00
29	Enter your qualified 5-year gain, if any, from line 7 of the worksheet on page D-8	29		
30	Enter the smaller of line 28 or line 29	30		
31	Multiply line 30 by 8% (.08)	31		
32	Subtract line 30 from line 28	32	7,202	00
33	Multiply line 32 by 10% (.10)	33	720	00
	If the amounts on lines 23 and 28 are the same, skip lines 34 through 37 and go to line 38.			
34	Enter the smaller of line 20 or line 23	34		
35	Enter the amount from line 28 (if line 28 is blank, enter -0-)	35		
36	Subtract line 35 from line 34	36		
37	Multiply line 36 by 20% (.20)	37		
38	Add lines 25, 31, 33, and 37	38	3,506	00
39	Figure the tax on the amount on line 20. Use the Tax Table or Tax Rate Schedules, whichever applies	39	3,866	00
40	Tax on all taxable income (including capital gains). Enter the smaller of line 38 or line 39 here and on Form 1040, line 42	40	3,506	00

Schedule D (Form 1040) 2002



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**Help Us To
Picture Them Home**

Beatriz Ambrosio



**Female, Age Now: 18
Ht:5'3 Wt:110 lbs.
Black eyes, Black hair**

Age Progression By NCMEC

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